MDC HOLDINGS INC
Form 10-Q
November 03, 2011
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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, 2011

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 **80237**

Denver, Colorado **(Zip code)**

(Address of principal executive offices)

(303) 773-1100

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes 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 x **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, 2011, 47,474,000 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, 2011

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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, 2011	December 31, 2010
Assets		
Cash and cash equivalents	$ 567,501	$ 572,225
Marketable securities	535,494	968,729
Restricted cash	682	420
Receivables		
Home sales receivables	11,160	8,530
Income taxes receivable	-	2,048
Other receivables	8,254	9,432
Mortgage loans held-for-sale, net	42,301	65,114
Inventories, net		
Housing completed or under construction	333,350	372,422
Land and land under development	517,337	415,237
Property and equipment, net	37,400	40,826
Deferred tax asset, net of valuation allowance of $274,380 and $231,379 at September 30, 2011 and December 31, 2010, respectively	-	-
Related party assets	7,393	7,393
Prepaid expenses and other assets, net	54,097	85,393
Total Assets	$ 2,114,969	$ 2,547,769
Liabilities		
Accounts payable	$ 27,295	$ 35,018
Accrued liabilities	189,161	260,729
Income taxes payable	869	-
Related party liabilities	70	90
Mortgage repurchase facility	10,708	25,434
Senior notes, net	1,006,656	1,242,815
Total Liabilities	1,234,759	1,564,086
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; 47,530,000 and 47,474,000 issued and outstanding, respectively, at September 30, 2011 and 47,198,000 and 47,142,000 issued and outstanding, respectively, at December 31, 2010	475	472
Additional paid-in-capital	850,795	820,237
Retained earnings	43,620	158,749
Accumulated other comprehensive (loss) income	(14,021)	4,884
Treasury stock, at cost; 56,000 shares at September 30, 2011 and December 31, 2010	(659)	(659)
Total Stockholders Equity	880,210	983,683

Total Liabilities and Stockholders Equity	$ 2,114,969	$ 2,547,769

The accompanying Notes are an integral part of these 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, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue				
Home sales revenue	$ 204,886	$ 216,501	$ 574,432	$ 668,720
Land sales revenue	730	904	3,499	6,618
Other revenue	5,744	8,276	18,861	23,751
Total revenue	211,360	225,681	596,792	699,089
Costs and expenses				
Home cost of sales	170,443	171,199	490,521	535,651
Land cost of sales	724	818	2,482	5,983
Asset impairments	4,692	3,718	14,090	3,718
Marketing expenses	10,002	11,191	29,732	29,726
Commission expenses	7,476	8,078	20,699	24,818
General and administrative expenses	35,580	39,269	108,569	124,060
Other operating expenses	2,390	817	3,287	1,837
Related party expenses	24	-	56	9
Total operating costs and expenses	231,331	235,090	669,436	725,802
Loss from operations	(19,971)	(9,409)	(72,644)	(26,713)
Other income (expense)				
Interest income	6,745	7,544	21,943	19,513
Interest expense	(3,695)	(9,000)	(19,819)	(28,810)
Extinguishment of senior notes and other	(17,268)	271	(17,176)	475
Loss before income taxes	(34,189)	(10,594)	(87,696)	(35,535)
Benefit from income taxes, net	2,479	355	8,127	739
Net loss	$ (31,710)	$ (10,239)	$ (79,569)	$ (34,796)
Loss per share				
Basic	$ (0.68)	$ (0.22)	$ (1.72)	$ (0.75)
Diluted	$ (0.68)	$ (0.22)	$ (1.72)	$ (0.75)
Dividends declared per share	$ 0.25	$ 0.25	$ 0.75	$ 0.75

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

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M.D.C. HOLDINGS, INC.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2011	2010
Operating Activities		
Net loss	$ (79,569)	$ (34,796)
Adjustments to reconcile net loss to net cash used in operating activities		
Loss on extinguishment of senior notes	18,559	-
Asset impairments	14,090	3,718
Stock-based compensation expense	12,092	12,421
Amortization of deferred marketing costs	7,385	7,922
Write-offs of land option deposits and pre-acquisition costs	5,201	1,794
Depreciation and amortization of long-lived assets	4,713	3,884
Other non-cash expenses	619	1,680
Net changes in assets and liabilities:		
Restricted cash	(262)	(28)
Home sales and other receivables	(1,452)	(9,356)
Income taxes receivable	17,566	144,502
Mortgage loans held-for-sale	22,813	14,154
Housing completed or under construction	53,737	(158,304)
Land and land under development	(104,201)	(103,029)
Prepaid expenses and other assets	(11,419)	(21,850)
Accounts payable	(7,723)	14,683
Accrued liabilities and related party liabilities	(32,892)	(14,986)
Net cash used in operating activities	(80,743)	(137,591)
Investing Activities		
Purchase of marketable securities	(431,011)	(796,334)
Maturity of marketable securities	553,071	129,519
Sales of marketable securities	290,819	77,340
Purchase of property and equipment and other	(31,717)	(7,651)
Net cash provided by (used in) investing activities	381,162	(597,126)
Financing Activities		
Extinguishment of senior notes	(254,903)	-
Payments on mortgage repurchase facility	(56,454)	(131,142)
Advances on mortgage repurchase facility	41,728	113,182
Dividend payments	(35,560)	(35,355)
Proceeds from issuance of senior notes	-	242,288
Proceeds from exercise of stock options	46	53
Net cash (used in) provided by financing activities	(305,143)	189,026
Net decrease in cash and cash equivalents	(4,724)	(545,691)
Cash and cash equivalents		
Beginning of period	572,225	1,234,252

End of period	$ 567,501	$ 688,561

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

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

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. 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, 2011 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, 2010, filed with the SEC on February 11, 2011.

The Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 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, 2010 Annual Report on Form 10-K.

2. Fair Value Measurements

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

The following 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 s marketable securities consist of fixed rate and floating rate interest earning securities, primarily: (1) debt securities, which may include, among others, United States government and government agency debt and corporate debt; (2) holdings in mutual fund equity securities and (3) deposit securities, which may include, among others, certificates of deposit and time deposits. As of September 30, 2011 all of the Company s marketable securities are treated as available-for-sale investments and, as such, the Company has recorded all of its marketable securities at fair value with changes in fair value recorded as a component of accumulated other comprehensive (loss) income.

As of December 31, 2010, the Company classified certain marketable securities as held-to-maturity as it had, at the time of purchase, the intent and ability to hold those securities until maturity. In July 2011, the Company sold $100 million of held-to-maturity marketable securities prior to their maturity and, as a result, the Company now classifies its debt securities, which were previously accounted for as held-to-maturity, as available-for-sale.

The following table sets forth the Company s amortized cost and fair values of marketable securities which were re-classified from held-to-maturity to available-for-sale (in thousands) during 2011. The fair values of the Company s marketable securities are based upon Level 1 and Level 2 fair value inputs.

	September 30, 2011		December 31, 2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Debt securities - maturity less than 1 year	$ 65,690	$ 65,534	$ 469,318	$ 469,956
Debt securities - maturity 1 to 5 years	20,341	20,284	120,078	121,406

Total	$ 86,031	$ 85,818	$ 589,396	$ 591,362

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

The following table sets forth the amortized cost and estimated fair value of the Company s other available-for-sale marketable securities (in thousands).

	September 30, 2011		December 31, 2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Equity securities	$ 166,460	$ 155,266	$ 103,189	$ 105,304
Debt securities	297,024	294,410	271,260	274,029
Total	$ 463,484	$ 449,676	$ 374,449	$ 379,333

As of September 30, 2011, the Company s marketable securities were in an unrealized loss position of $14.0 million including three mutual fund securities that have a combined unrealized loss of $11.2 million and various debt securities that are in an unrealized position of $2.8 million as of September 30, 2011. These debt and equity securities have been in this unrealized loss position for less than 12 months. The Company has evaluated the decline in the market value in the debt and equity securities in order to determine if this decline is other than temporary. Based upon this evaluation, the Company does not believe the decline in value is permanent and, as such, an other-than-temporary impairment has not been recorded.

Mortgage Loans Held-for-Sale, Net. As of September 30, 2011, 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, 2011 and December 31, 2010, the Company had $39.9 million and $56.9 million, respectively, of 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, 2011 and December 31, 2010, the Company had $2.4 million and $8.2 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 records its homebuilding inventory (housing completed or under construction and land and land under development) at fair value only when the estimated fair value of a subdivision is less than its carrying value. The Company determines the estimated fair value of each impaired subdivision either by: (1) calculating the present value of the estimated future cash flows at discount rates that are commensurate with the risk of the subdivision under evaluation; or (2) assessing what the market value of the land is in its current condition by considering the estimated price a willing buyer would pay for the land (other than in a forced liquidation), and recent land purchase transactions that the Company believes are indicators of fair value. These estimates are dependent on specific market or sub-market conditions for each subdivision. Local market-specific conditions that may impact these estimates for a subdivision include, among other things: (1) forecasted base selling prices and home sales incentives; (2) estimated land development costs and home cost of construction; (3) the current sales pace for active subdivisions; (4) changes by management in the sales strategy of a given subdivision; and (5) the level of competition within a market or sub-market, including publicly available home sales prices and home sales incentives offered by our competitors. The estimated fair values of impaired subdivisions are based upon Level 3 inputs. The fair value of the Company s inventory that was impaired at September 30, 2011 is as follows (in thousands).

	Land and Land Under Development	Housing Completed or Under Construction	Total Fair Value of Impaired Inventory
West	$ 9,115	$ 4,437	13,552
Mountain	808	1,500	2,308
East	-	-	-

Other Homebuilding	1,238	1,466	2,704
Consolidated	$ 11,161	$ 7,403	$ 18,564

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Related Party Assets. The Company s related party assets are debt security bonds that it acquired from a quasi-municipal corporation in the state of Colorado. The Company has estimated the fair value of the related party assets based upon discounted cash flows as the Company does not believe there is a readily available market for such assets. The estimated cash flows from the bonds are ultimately based upon the Company s estimated cash flows associated with the building, selling and closing of homes in one of its Colorado subdivisions. The estimated fair values of these assets are based upon Level 3 cash flow inputs. Based upon this evaluation, the estimated fair value of the related party assets approximates its carrying value.

Mortgage Repurchase Facility. The Company s Mortgage Repurchase Facility (as defined below) is 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 following table states the estimated fair values of the Company s senior notes (in thousands).

	September 30, 2011		December 31, 2010	
	Recorded Amount	Estimated Fair Value	Recorded Amount	Estimated Fair Value
7% Senior Notes due 2012	$ 86,110	$ 92,347	$ 149,650	$ 160,493
5 1/2% Senior Notes due 2013	176,615	189,782	349,748	362,198
5 3/8% Medium Term Senior Notes due 2014	249,394	265,000	249,266	255,683
5 3/8% Medium Term Senior Notes due 2015	249,848	261,675	249,821	251,450
5 5/8% Senior Notes due 2020	244,689	221,675	244,330	244,400
Total	$ 1,006,656	$ 1,030,479	$ 1,242,815	$ 1,274,224

On July 7, 2011, the Company completed a debt tender offer extinguishing $63.7 million of its 7% Senior Notes due 2012 and $173.3 million of its 5 1/2% Senior Notes due 2013. The Company paid $254.9 million for the acquired notes.

As further described in Note 16, in October 2011, the Company redeemed the remaining $86.1 million of its outstanding 7% Senior Notes due 2012 and announced that it will redeem the remaining $176.6 million outstanding balance of its 5 1/2% Senior Notes due 2013 in November 2011.

The estimated fair value of the 7% Senior Notes due 2012 and 5 1/2% Senior Notes due 2013 are based upon the amounts paid and expected to be paid up redemption in October and November, respectively. The estimated fair value of the remaining senior notes is based on Level 2 fair value inputs, including market prices of bonds in the homebuilding sector.

3. Inventory Impairments

The following table sets forth, by reportable segment, the asset impairments recorded during the three and nine months ended September 30, 2011 (in thousands).

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

	Three Months Ended September 30,		Nine Months Ended September 30,	
Land and Land Under Development	**2011**	**2010**	**2011**	**2010**
West	$ 1,193	$ 2,490	$ 7,112	$ 2,490
Mountain	550	-	1,786	-
East	-	-	285	-
Other Homebuilding	1,519	-	1,519	-
Subtotal	3,262	2,490	10,702	2,490
Housing Completed or Under Construction				
West	484	1,143	1,438	1,143
Mountain	210	-	449	-
East	-	-	-	-
Other Homebuilding	93	-	93	-
Subtotal	787	1,143	1,980	1,143
Other Assets	643	85	1,408	85
Consolidated Asset Impairments	$ 4,692	$ 3,718	$ 14,090	$ 3,718

The Company recorded $4.7 million and $14.1 million of asset impairments during the three and nine months ended September 30, 2011, which resulted from a decline in the market value of land and homes in certain subdivisions of the West, Mountain and Other Homebuilding segments. The Company recorded $3.7 million of asset impairments during the three and nine months ended September 30, 2010 which resulted from a decline in the market value of land and homes in several subdivisions of our West segment.

4. 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, 2011, the Company had $89.1 million in interest rate lock commitments and $38.0 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, 2011 and 2010.

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

5. Balance Sheet Components

The following table sets forth information relating to prepaid expenses and other assets, net (in thousands).

	September 30, 2011	December 31, 2010
Deferred marketing costs	$ 22,444	$ 22,736
Land option deposits	9,192	11,606
Goodwill	6,458	-
Deferred debt issue costs, net	3,850	5,021
Prepaid expenses	5,771	5,935
IRS deposit (See Note 13)	-	35,562
Other	6,382	4,533
Total	$ 54,097	$ 85,393

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

	September 30, 2011	December 31, 2010
Accrued liabilities		
Insurance reserves	$ 51,575	$ 52,901
Warranty reserves	28,803	34,704
Accrued executive deferred compensation	23,301	20,956
Accrued interest payable	16,264	17,822
Accrued compensation and related expenses	13,966	22,659
Legal accruals	12,673	14,230
Land development and home construction accruals	8,376	12,450
Mortgage loan loss reserves	6,961	6,881
Customer and escrow deposits	6,678	4,523
Liability for unrecognized tax benefits	3,505	55,850
Other accrued liabilities	17,059	17,753
Total accrued liabilities	$ 189,161	$ 260,729

6. Loss Per Share

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

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Basic and Diluted Loss Per Common Share				
Net loss	$ (31,710)	$ (10,239)	$ (79,569)	$ (34,796)
Less: distributed and undistributed earnings allocated to participating securities	(215)	(135)	(580)	(394)
Net loss attributable to common stockholders	$ (31,925)	$ (10,374)	$ (80,149)	$ (35,190)
Basic and diluted weighted-average shares outstanding	46,737	46,625	46,717	46,619
Basic Loss Per Common Share	$ (0.68)	$ (0.22)	$ (1.72)	$ (0.75)
Dilutive Loss Per Common Share	$ (0.68)	$ (0.22)	$ (1.72)	$ (0.75)

Diluted EPS includes the dilutive effect of common stock equivalents and is computed using the weighted-average number of common stock and common stock equivalents outstanding during the reporting period. Common stock equivalents include stock options and unvested restricted stock. Diluted EPS for the three and nine months ending September 30, 2011 and 2010 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 0.2 million and 0.4 million shares during the three and nine months ended September 30, 2011, respectively, and 0.4 million shares during the three and nine months ended September 30, 2010.

7. Interest Activity

The Company capitalizes interest on its senior notes associated with its qualifying assets, which includes land and land under development that is actively being developed and homes under construction through the completion of construction. When construction of 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 expensed $3.7 million and $9.0 million of interest primarily associated with interest incurred on its senior notes during the three months ended September 30, 2011 and 2010, respectively, and $19.8 million and $28.8 million during the nine months ended September 30, 2011 and 2010, respectively, that could not be capitalized.

Interest activity is shown below (in thousands).

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Total Interest Incurred				
Corporate	$ 14,474	$ 18,187	$ 50,744	$ 53,276
Financial Services and Other	54	183	177	389
Total interest incurred	$ 14,528	$ 18,370	$ 50,921	$ 53,665
Total Interest Capitalized				
Interest capitalized, beginning of period	$ 49,058	$ 32,420	$ 38,446	$ 28,339
Interest capitalized	10,833	9,370	31,102	24,855

Previously capitalized interest included in home cost of sales	(5,140)	(5,581)	(14,797)	(16,985)
Interest capitalized, end of period	$ 54,751	$ 36,209	$ 54,751	$ 36,209

8. Warranty Reserves

The Company records expenses and warranty reserves for general and structural warranty claims, as well as reserves for known, unusual warranty-related expenditures. The establishment of warranty reserves is primarily

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

based on an actuarial based analysis that includes known facts and interpretations of circumstances, including, among other things, the Company s trends in historical warranty payment levels and warranty payments for claims not considered to be normal and recurring. Warranty payments incurred for an individual house may differ from the related reserve established for the home at the time it was closed. The actual disbursements for warranty claims are evaluated in the aggregate to determine if an adjustment to the historical warranty reserve should be recorded.

The following table summarizes the warranty reserve activity for the three and nine months ended September 30, 2011 and 2010 (in thousands).

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Balance at beginning of period	$ 31,200	$ 51,986	$ 34,704	$ 59,022
Expense provisions	1,265	1,403	3,140	4,613
Cash payments	(2,707)	(2,944)	(5,823)	(7,584)
Adjustments	(955)	(7,197)	(3,218)	(12,803)
Balance at end of period	$ 28,803	$ 43,248	$ 28,803	$ 43,248

The favorable warranty adjustments that were recorded as a reduction to home cost of sales in the Consolidated Statements of Operations during the three and nine months ended September 30, 2011 and 2010 were primarily the result of favorable experience in the amount of warranty payments incurred on previously closed homes.

9. Insurance Reserves

The Company records expenses and liabilities for losses and loss adjustment expenses for claims associated with: (1) insurance policies with Allegiant Insurance Company, Inc., A Risk Retention Group (Allegiant) and re-insurance agreements issued by StarAmerican Insurance Ltd. (StarAmerican); (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 the Company s experience with similar cases and historical trends involving claim payment patterns, pending levels of unpaid claims, product mix or concentration, claim severity, frequency patterns such as those caused by natural disasters, fires, or accidents, depending on the business conducted, and changing regulatory and legal environments.

The following table summarizes the insurance reserve activity for the three and nine months ended September 30, 2011 and 2010 (in thousands).

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Balance at beginning of period	$ 52,310	$ 48,312	$ 52,901	$ 51,606
Expense provisions	645	841	1,712	2,655
Cash payments	(1,380)	(212)	(3,386)	(5,320)
Adjustments	-	-	348	-
Balance at end of period	$ 51,575	$ 48,941	$ 51,575	$ 48,941

10. 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 two key executives the Chief Executive Officer and the Chief Operating 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

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

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

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 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,	
	2011	2010	2011	2010
Homebuilding				
West	$ 71,292	$ 66,233	$ 183,176	$ 246,563
Mountain	82,637	89,111	232,463	245,905
East	36,610	58,304	130,778	162,466
Other Homebuilding	16,678	7,344	37,486	33,137
Total Homebuilding	207,217	220,992	583,903	688,071
Financial Services and Other	5,540	7,932	17,974	22,696
Corporate	-	-	-	-
Intercompany adjustments	(1,397)	(3,243)	(5,085)	(11,678)
Consolidated	$ 211,360	$ 225,681	$ 596,792	$ 699,089

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.

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Homebuilding				
West	$ (2,584)	$ 4,900	$ (18,981)	$ 13,611
Mountain	2,988	520	552	6,652
East	(2,518)	2,021	(6,819)	1,957
Other Homebuilding	(1,514)	(1,673)	(3,206)	(1,897)
Total Homebuilding	(3,628)	5,768	(28,454)	20,323
Financial Services and Other	(450)	4,326	4,419	10,261
Corporate	(30,111)	(20,688)	(63,661)	(66,119)
Consolidated	$ (34,189)	$ (10,594)	$ (87,696)	$ (35,535)

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, 2011	December 31, 2010
Homebuilding		
West	$ 365,759	$ 300,652
Mountain	289,828	311,833
East	224,497	188,693
Other Homebuilding	30,331	40,554
Total Homebuilding	910,415	841,732
Financial Services and Other	115,176	135,286
Corporate	1,093,523	1,573,408
Intercompany adjustments	(4,145)	(2,657)
Consolidated	$ 2,114,969	$ 2,547,769

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,	
	2011	2010	2011	2010
Homebuilding				
West	$ 1,102	$ 1,189	$ 3,223	$ 4,474
Mountain	857	941	2,618	2,495

East	393	454	1,439	1,405
Other Homebuilding	290	97	689	495
Total Homebuilding	2,642	2,681	7,969	8,869
Financial Services and Other	156	169	486	508
Corporate	1,233	855	3,643	2,429
Consolidated	$ 4,031	$ 3,705	$ 12,098	$ 11,806

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Notes to Unaudited Consolidated Financial Statements (Continued)

11. Commitments and Contingencies

The Company often is 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, 2011 the Company had issued and outstanding performance bonds and letters of credit totaling $70.6 million and $21.5 million, respectively, including $7.8 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.

Mortgage Loan Loss Reserves. In the normal course of business, the Company establishes reserves for potential losses associated with HomeAmerican s sale of mortgage loans to third-parties. These reserves are created to address repurchase and indemnity claims by third-party purchasers of the mortgage loans, which claims arise primarily out of allegations of homebuyer fraud at the time of origination of the loan. These reserves are based upon, among other 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; and (3) historical loss experience. During 2011, HomeAmerican reached settlements associated with claims and potential claims to repurchase certain previously sold mortgage loans. Primarily as a result of these settlements, coupled with an increase in the volume of mortgage loans that may be subject to repurchase, the Company increased its estimated mortgage loan loss reserve by $3.0 million and $4.3 million during the three and nine months ended September 30, 2011, respectively. 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.

The following table summarizes the mortgage loan loss reserve activity for the three and nine months ended September 30, 2011 and 2010 (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	$ 4,100	$ 8,069	$ 6,881	$ 9,641
Expense provisions	-	-	-	-
Cash payments	(174)	(563)	(4,252)	(2,135)
Adjustments	3,035	-	4,332	-
Balance at end of period	$ 6,961	$ 7,506	$ 6,961	$ 7,506

Legal Accruals. Litigation has been filed by homeowners in West Virginia against MDC, its subsidiary Richmond American Homes of West Virginia, Inc. (RAH West Virginia) and various subcontractors alleging a failure to install functional passive radon mitigation systems in their homes. The plaintiffs seek compensatory and punitive damages and medical monitoring costs for alleged negligent construction, failure to warn, breach of warranty or contract, breach of implied warranty of habitability, fraud, and intentional and negligent infliction of emotional distress based upon alleged exposure to radon gas. The litigation includes the following actions:

Joy, et al. v. Richmond American Homes of West Virginia, Inc., et al., No. 08-C-204, Circuit Court of Jefferson County, West Virginia (*Joy*). This action was filed on May 16, 2008, by sixty-six plaintiffs from fifteen households. The Company and RAH West Virginia have answered and asserted cross-claims against the subcontractors for contractual and implied indemnity and contribution.

Bauer, et al. v. Richmond American Homes of West Virginia, Inc., et al., No. 08-C-431, Circuit Court of Jefferson County, West Virginia (*Bauer*). This action was filed on October 24, 2008, by eighty-six plaintiffs from twenty-one households. This action has been consolidated for discovery and pre-trial proceedings with the Joy action.

Saliba, et al. v. Richmond American Homes of West Virginia, Inc., et al., No. 08-C-447, Circuit Court, Jefferson County, West Virginia (*Saliba*). This action was filed on November 7, 2008, by thirty-five plaintiffs from nine households. This action has been consolidated for discovery and pre-trial proceedings with the Joy action.

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Notes to Unaudited Consolidated Financial Statements (Continued)

By orders dated November 4 and 18, 2009, the trial court struck the answers filed by the Company and RAH West Virginia and entered judgment by default in favor of the plaintiffs on liability, with damages to be determined in a subsequent jury trial. On December 7, 2009, the Company and RAH West Virginia filed with the West Virginia Supreme Court of Appeals a motion seeking to stay the proceedings and a petition for writ of prohibition to vacate the default judgment. On June 16, 2010, the West Virginia Supreme Court of Appeals granted the Company and RAH West Virginia a writ of prohibition and vacated the trial court s sanctions orders.

On July 29, 2010, the plaintiffs filed a renewed motion for sanctions based on substantially the same alleged misconduct. On January 14, 2011 the trial court again entered an order striking the answers filed by the Company and RAH West Virginia and imposing judgment by default upon them on the claims asserted in plaintiffs complaints (exclusive of the claim for punitive damages). As stated in the January 14, 2011 order, the cross-claims made by the Company and RAH West Virginia remain in effect.

On March 31, 2011 the West Virginia Supreme Court of Appeals declined to enter a writ of prohibition with respect to the trial court s re-entry of its judgment of default stating that the issues presented are more properly presented on appeal after full development of the record in the lower court.

Separately, additional claims have been filed by homeowners in West Virginia against the Company, RAH West Virginia and individual superintendants who had worked for RAH West Virginia. The new litigation consists of the following:

Thorin, et al. v. Richmond American Homes of West Virginia, Inc., et al., No. 10-C-154, Circuit Court of Jefferson County, West Virginia (*Thorin*). This litigation was filed on May 12, 2010, by forty plaintiffs from eleven households in Jefferson and Berkeley Counties. To date, this action has not been consolidated for any purposes with the prior three actions. The claims asserted and the relief sought in the Thorin case are substantially similar to the Joy, Bauer and Saliba cases.

MDC and RAH West Virginia believe that they have meritorious defenses to each of the lawsuits and intend to vigorously defend the actions.

Additionally, in the normal course of business, the Company is a defendant in claims primarily relating to construction defects, product liability and personal injury claims. These claims seek relief from the Company under various theories, including breach of implied and express warranty, negligence, strict liability, misrepresentation and violation of consumer protection statutes.

The Company has accrued for losses that may be incurred with respect to legal claims based upon information provided to it by its legal counsel, including counsels on-going evaluation of the merits of the claims and defenses. Due to uncertainties in the estimation and legal process, actual results could significantly vary from those accruals. The Company had legal accruals of $12.7 million and $14.2 million at September 30, 2011 and December 31, 2010, respectively.

12. Line of Credit and Total Debt Obligations

Mortgage Lending. HomeAmerican has a Master Repurchase Agreement, which was amended in September 2011 and extended until September 27, 2012 (the Mortgage Repurchase Facility), with U.S. Bank National Association (USBNA). The Mortgage Repurchase Facility provides liquidity to HomeAmerican by providing for the sale of eligible mortgage loans to USBNA with an agreement by HomeAmerican to repurchase the mortgage loans at a future date. Until such mortgage loans are transferred back to HomeAmerican, the documents relating to such loans are held by USBNA, as custodian, pursuant to the Custody Agreement (Custody Agreement), dated as of November 12, 2008, by and between HomeAmerican and USBNA. As of September 30, 2011, the Mortgage Repurchase Facility has a maximum aggregate commitment of $50 million, reduced from $70 million through the fourth amendment in September 2011. At September 30, 2011 and December 31, 2010, the Company had $10.7 million and $25.4 million, respectively, of mortgage loans that the Company was obligated to repurchase under its Mortgage Repurchase Facility. Mortgage loans that the Company is obligated to repurchase under the Mortgage Repurchase Facility are accounted for as a

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Notes to Unaudited Consolidated Financial Statements (Continued)

debt financing arrangement and are reported as mortgage repurchase facility on the Consolidated Balance Sheets. Advances under the Mortgage Repurchase Facility carry a Pricing Rate equal to the greater of (i) the LIBOR Rate (as defined in the Mortgage Repurchase Facility) plus 2.5%, or (ii) 3.75%. At HomeAmerican s option the Balance Funded Rate (equal to 3.75%) may be applied to advances under the Mortgage Repurchase Facility provided the applicable Buyer is holding sufficient Qualifying Balances. The foregoing terms are defined in the Mortgage Repurchase Facility.

The Company s senior notes are not secured and, while the senior note indentures contain some restrictions on secured debt and other transactions, they do not contain financial covenants. 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, 2011 and December 31, 2010 are as follows (in thousands):

	September 30, 2011	December 31, 2010
7% Senior Notes due 2012	$ 86,110	$ 149,650
5 1/2% Senior Notes due 2013	176,615	349,748
5 3/8% Medium-Term Senior Notes due 2014	249,394	249,266
5 3/8% Medium-Term Senior Notes due 2015	249,848	249,821
5 5/8% Senior Notes due 2020	244,689	244,330
Total Senior Notes, net	1,006,656	1,242,815
Mortgage repurchase facility	10,708	25,434
Total Debt	$ 1,017,364	$ 1,268,249

On July 7, 2011, the Company completed a debt tender offer extinguishing $63.7 million of its 7% Senior Notes due 2012 and $173.3 million of its 5 1/2% Senior Notes due 2013. The Company paid $254.9 million for the acquired notes and, as a result of the tender, the Company recorded an $18.6 million charge during the 2011 third quarter.

As further described in Note 16, in October 2011, the Company redeemed the remaining $86.1 million of its outstanding 7% Senior Notes due 2012 and announced that it will redeem the remaining $176.6 million outstanding balance of its 5 1/2% Senior Notes due 2013 in November 2011.

13. 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. Due to the effects of the deferred tax valuation allowance and changes in unrecognized tax benefits, the Company s effective tax rates in 2011 and 2010 are not meaningful as the income tax benefit is not directly correlated to the amount of pretax loss. The income tax benefits of $2.5 million and $8.1 million during the three and nine months ended September 30, 2011, respectively, resulted primarily from our 2011 second and third quarter settlement of various state income tax matters and our 2011 first quarter settlement with the IRS on its audit of the 2004 and 2005 federal income tax returns. The Company s income tax benefits during the three and nine months ended September 30, 2010 were not material to our results of operations.

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. The Company s liability for unrecognized tax benefits was $3.5 million and $55.9 million at September 30, 2011 and December 31, 2010, respectively. This decrease resulted primarily from the Company s settlement with the IRS on the audit of its 2004 and 2005 federal income tax returns and settlement of various state income tax matters.

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, 2011 (per the table below) resulted primarily from an increase in the Company s net operating loss carry forwards.

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

A valuation allowance is recorded against a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not (a likelihood of more than 50%) that some portion, or all, of the deferred tax asset will not be realized. At September 30, 2011 and December 31, 2010, the Company had a full valuation allowance recorded against its net deferred tax assets. 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. The Company will continue analyzing, in subsequent reporting periods, the positive and negative evidence in determining the expected realization of its deferred tax assets.

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

	September 30, 2011	December 31, 2010
Deferred tax assets		
Federal net operating loss carryforward	$ 118,716	$ 73,189
State net operating loss carryforward	51,286	47,041
Asset impairment charges	35,794	46,118
Stock-based compensation expense	26,041	22,777
Warranty, litigation and other reserves	23,304	27,635
Accrued liabilities	10,450	9,789
Alternative minimum tax and other tax credit carryforwards	10,296	10,296
Unrealized loss on marketable securities	5,398	-
Inventory, additional costs capitalized for tax purposes	3,264	5,368
Other	1,228	3,037
Total deferred tax assets	285,777	245,250
Valuation allowance	(274,380)	(231,379)
Total deferred tax assets, net of valuation allowance	11,397	13,871
Deferred tax liabilities		
Deferred revenue	5,591	6,401
Unrealized gain	-	1,880
Inventory, additional costs capitalized for financial statement purposes	546	604
Accrued liabilities	383	713
Other, net	4,877	4,273
Total deferred tax liabilities	11,397	13,871
Net deferred tax asset	$ -	$ -

14. Variable Interest Entities

In the normal course of business, the Company enters into lot option purchase contracts (Option Contracts), generally through a deposit of cash or letter of credit, for the right to purchase land or lots at a future point in time with predetermined terms. The use of such land option and other contracts generally allows the Company to reduce the risks associated with direct land ownership and development, reduces the Company s capital and financial commitments, including interest and other carrying costs, and minimizes the amount of the Company s land inventories on its consolidated balance sheets. The Company s obligation with respect to Option Contracts generally is limited to forfeiture of the related cash deposits and/or letters of credit. At September 30, 2011 the Company had cash deposits and letters of credit of $8.9 million and $5.1 million, respectively, at risk associated with 2,385 lots under Option Contracts.

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

15. Other Comprehensive Loss

Total other comprehensive loss includes net loss and unrealized holding gains or losses on the Company s available-for-sale marketable securities. The following table sets forth the Company s other comprehensive loss during the three and nine months ended September 30, 2011 and 2010 (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss	$ (31,710)	$ (10,239)	$ (79,569)	$ (34,796)
Unrealized holding (loss) gain	(20,237)	5,917	(18,905)	4,623
Total other comprehensive loss	$ (51,947)	$ (4,322)	$ (98,474)	$ (30,173)

16. Subsequent Events

On October 19, 2011, the Company redeemed the remaining $86.1 million of its outstanding 7% Senior Notes due 2012. The Company paid $94.6 million as a result of this redemption pursuant to the terms of the 7% Senior Notes and will record a loss on redemption of $8.6 million during the 2011 fourth quarter. Additionally, the Company announced its intent to redeem the remaining $176.7 million outstanding balance of its 5 $^{1}/2$% Senior Notes due 2013 in November 2011. The Company anticipates recording a loss on redemption of these 5 $^{1}/2$% Senior Notes of approximately $13.2 million pursuant to the terms of the 5 $^{1}/2$% Senior Notes during the 2011 fourth quarter.

17. Supplemental Guarantor Information

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

M.D.C. Land Corporation
RAH of Florida, Inc.
Richmond American Construction, Inc.
Richmond American Homes of Arizona, Inc.
Richmond American Homes of Colorado, Inc.
Richmond American Homes of Delaware, Inc.
Richmond American Homes of Florida, LP
Richmond American Homes of Illinois, Inc.
Richmond American Homes of Maryland, Inc.
Richmond American Homes of Nevada, Inc.
Richmond American Homes of New Jersey, Inc.
Richmond American Homes of Pennsylvania, Inc.
Richmond American Homes of Utah, Inc.
Richmond American Homes of Virginia, Inc.

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

American Home Insurance
American Home Title
HomeAmerican
StarAmerican
Allegiant
Richmond American Homes of West Virginia, Inc.
Richmond American Homes of Washington, Inc.

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

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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Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Balance Sheet

September 30, 2011

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Assets					
Cash and cash equivalents	$ 532,302	$ 2,845	$ 32,354	$ -	$ 567,501
Marketable securities	503,828	-	31,666	-	535,494
Restricted cash	-	682	-	-	682
Receivables	4,645	12,499	4,709	(2,439)	19,414
Mortgage loans held-for-sale, net	-	-	42,301	-	42,301
Inventories, net					
Housing completed or under construction	-	318,737	14,613	-	333,350
Land and land under development	-	498,830	18,507	-	517,337
Investment in subsidiaries	123,615	-	-	(123,615)	-
Other assets, net	48,619	38,722	12,390	(841)	98,890
Total Assets	$ 1,213,009	$ 872,315	$ 156,540	$ (126,895)	$ 2,114,969
Liabilities					
Accounts payable and related party liabilities	$ 2,804	$ 24,731	$ 2,492	$ (2,662)	$ 27,365
Accrued liabilities	69,904	54,611	66,133	(618)	190,030
Advances and notes payable to parent and subsidiaries	(746,565)	732,473	14,092	-	- -
Mortgage repurchase facility	-	-	10,708	-	10,708
Senior notes, net	1,006,656	-	-	-	1,006,656
Total Liabilities	332,799	811,815	93,425	(3,280)	1,234,759
Stockholders Equity	880,210	60,500	63,115	(123,615)	880,210
Total Liabilities and Stockholders Equity	$ 1,213,009	$ 872,315	$ 156,540	$ (126,895)	$ 2,114,969

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Balance Sheet

December 31, 2010

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Assets					
Cash and cash equivalents	$ 535,035	$ 4,287	$ 32,903	$ -	$ 572,225
Marketable securities	938,471	-	30,258	-	968,729
Restricted cash	-	420	-	-	420
Receivables	14,402	8,071	194	(2,657)	20,010
Mortgage loans held-for-sale, net	-	-	65,114	-	65,114
Inventories, net					
Housing completed or under construction	-	372,422	-	-	372,422
Land and land under development	-	415,237	-	-	415,237
Investment in subsidiaries	110,065	-	-	(110,065)	-
Other assets, net	88,267	42,288	3,057	-	133,612
Total Assets	$ 1,686,240	$ 842,725	$ 131,526	$ (112,722)	$ 2,547,769
Liabilities					
Accounts payable and related party liabilities	$ 2,747	$ 34,553	$ 465	$ (2,657)	$ 35,108
Accrued liabilities	130,960	65,622	64,147	-	260,729
Advances and notes payable to parent and subsidiaries	(673,965)	671,190	2,775	-	-
Mortgage repurchase facility	-	-	25,434	-	25,434
Senior notes, net	1,242,815	-	-	-	1,242,815
Total Liabilities	702,557	771,365	92,821	(2,657)	1,564,086
Stockholders Equity	983,683	71,360	38,705	(110,065)	983,683
Total Liabilities and Stockholders Equity	$ 1,686,240	$ 842,725	$ 131,526	$ (112,722)	$ 2,547,769

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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, 2011

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Revenue					
Home sales revenue	$ -	$ 193,128	$ 13,154	$ (1,396)	$ 204,886
Land sales and other revenue	-	923	5,551	-	6,474
Equity in (loss) income of subsidiaries	(4,022)	-	-	4,022	-
Total revenue	(4,022)	194,051	18,705	2,626	211,360
Costs and Expenses					
Home cost of sales	-	161,027	10,812	(1,396)	170,443
Asset impairments	-	4,692	-	-	4,692
Marketing and commission expenses	-	16,559	919	-	17,478
General and administrative and other expenses	15,120	15,191	8,407	-	38,718
Total operating costs and expenses	15,120	197,469	20,138	(1,396)	231,331
Loss from operations	(19,142)	(3,418)	(1,433)	4,022	(19,971)
Other (expense) income	(14,987)	35	734	-	(14,218)
Loss before income taxes	(34,129)	(3,383)	(699)	4,022	(34,189)
Benefit from (provision for) income taxes	2,419	(1)	61	-	2,479
Net loss	$ (31,710)	$ (3,384)	$ (638)	$ 4,022	$ (31,710)

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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, 2010

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Revenue					
Home sales revenue	$ -	$ 219,743	$ -	$ (3,242)	$ 216,501
Land sales and other revenue	-	1,249	7,931	-	9,180
Equity in (loss) income of subsidiaries	9,066	-	-	(9,066)	-
Total revenue	9,066	220,992	7,931	(12,308)	225,681
Costs and Expenses					
Home cost of sales	-	173,963	478	(3,242)	171,199
Asset impairments	-	3,718	-	-	3,718
Marketing and commission expenses	-	19,269	-	-	19,269
General and administrative and other expenses	18,530	13,078	9,296	-	40,904
Total operating costs and expenses	18,530	210,028	9,774	(3,242)	235,090
(Loss) income from operations	(9,464)	10,964	(1,843)	(9,066)	(9,409)
Other (expense) income	(2,169)	50	934	-	(1,185)
(Loss) income before income taxes	(11,633)	11,014	(909)	(9,066)	(10,594)
Benefit from (provision for) income taxes	1,394	753	(1,792)	-	355
Net (loss) income	$ (10,239)	$ 11,767	$ (2,701)	$ (9,066)	$ (10,239)

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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, 2011

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Revenue					
Home sales revenue	$ -	$ 552,579	$ 26,937	$ (5,084)	$ 574,432
Land sales and other revenue	-	4,314	18,046	-	22,360
Equity in (loss) income of subsidiaries	(23,295)	-	-	23,295	-
Total revenue	(23,295)	556,893	44,983	18,211	596,792
Costs and Expenses					
Home cost of sales	-	472,522	23,083	(5,084)	490,521
Asset impairments	-	14,090	-	-	14,090
Marketing and commission expenses	-	48,646	1,785	-	50,431
General and administrative and other expenses	46,139	49,620	18,635	-	114,394
Total operating costs and expenses	46,139	584,878	43,503	(5,084)	669,436
(Loss) income from operations	(69,434)	(27,985)	1,480	23,295	(72,644)
Other (expense) income	(17,515)	118	2,345	-	(15,052)
(Loss) income before income taxes	(86,949)	(27,867)	3,825	23,295	(87,696)
Benefit from (provision for) income taxes	7,380	2,583	(1,836)	-	8,127
Net (loss) income	$ (79,569)	$ (25,284)	$ 1,989	$ 23,295	$ (79,569)

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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, 2010

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Revenue					
Home sales revenue	$ -	$ 680,398	$ -	$ (11,678)	$ 668,720
Land sales and other revenue	-	7,673	22,696	-	30,369
Equity in (loss) income of subsidiaries	26,727	-	-	(26,727)	-
Total revenue	26,727	688,071	22,696	(38,405)	699,089
Costs and Expenses					
Home cost of sales	-	546,888	441	(11,678)	535,651
Asset impairments	-	3,718	-	-	3,718
Marketing and commission expenses	-	54,544	-	-	54,544
General and administrative and other expenses	55,319	57,529	19,041	-	131,889
Total operating costs and expenses	55,319	662,679	19,482	(11,678)	725,802
(Loss) income from operations	(28,592)	25,392	3,214	(26,727)	(26,713)
Other (expense) income	(10,799)	126	1,851	-	(8,822)
(Loss) income before income taxes	(39,391)	25,518	5,065	(26,727)	(35,535)
Benefit from (provision for) income taxes	4,595	530	(4,386)	-	739
Net (loss) income	$ (34,796)	$ 26,048	$ 679	$ (26,727)	$ (34,796)

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Statements of Cash Flows

Nine Months Ended September 30, 2011

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Net cash (used in) provided by operating activities	$ (39,482)	$ (77,129)	$ 12,567	$ 23,301	$ (80,743)
Net cash provided by (used in) investing activities	413,999	(20)	(32,817)	-	381,162
Financing activities					
(Advances to) payments from subsidiaries	(86,833)	75,707	34,427	(23,301)	-
Extinguishment of senior notes	(254,903)	-	-	-	(254,903)
Mortgage repurchase facility, net	-	-	(14,726)	-	(14,726)
Dividend payments	(35,560)	-	-	-	(35,560)
Proceeds from exercise of stock options	46	-	-	-	46
Net cash (used in) provided by financing activities	(377,250)	75,707	19,701	(23,301)	(305,143)
Net decrease in cash and cash equivalents	(2,733)	(1,442)	(549)	-	(4,724)
Cash and cash equivalents					
Beginning of period	535,035	4,287	32,903	-	572,225
End of period	$ 532,302	$ 2,845	$ 32,354	$ -	$ 567,501

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Statements of Cash Flows

Nine Months Ended September 30, 2010

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Net cash provided by (used in) operating activities	$ 70,017	$ (235,638)	$ 11,456	$ 16,574	$ (137,591)
Net cash used in investing activities	(566,995)	(1,029)	(29,102)	-	(597,126)
Financing activities					
(Advances to) payments from subsidiaries	(269,877)	238,312	48,139	(16,574)	-
Proceeds from issuance of senior notes, net	242,288	-	-	-	242,288
Mortgage repurchase facility, net	-	-	(17,960)	-	(17,960)
Dividend payments	(35,355)	-	-	-	(35,355)
Proceeds from exercise of stock options	53	-	-	-	53
Net cash (used in) provided by financing activities	(62,891)	238,312	30,179	(16,574)	189,026
Net (decrease) increase in cash and cash equivalents	(559,869)	1,645	12,533	-	(545,691)
Cash and cash equivalents					
Beginning of period	1,210,123	3,258	20,871	-	1,234,252
End of period	$ 650,254	$ 4,903	$ 33,404	$ -	$ 688,561

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Unaudited Consolidated Financial Statements and Notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This item contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those indicated in such forward-looking statements. Factors that may cause such a difference include, but are not limited to, those discussed in Item 1A: Risk Factors Relating to our Business of our Annual Report on Form 10-K for the year ended December 31, 2010 and this Quarterly Report on Form 10-Q.

INTRODUCTION

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

Our Financial Services and Other segment consists of HomeAmerican Mortgage Corporation (HomeAmerican), which originates mortgage loans, primarily for our homebuyers, American Home Insurance Agency, Inc. (American Home Insurance), which offers third-party insurance products to our homebuyers, and American Home Title and Escrow Company (American Home Title), which provides title agency services to the Company and our homebuyers in Colorado, Florida, Maryland, Nevada and Virginia. This segment also includes Allegiant Insurance Company, Inc., A Risk Retention Group (Allegiant), which provides insurance coverage primarily to our homebuilding subsidiaries and certain subcontractors for homes sold by our homebuilding subsidiaries and for work performed in completed subdivisions, and StarAmerican Insurance Ltd. (StarAmerican), a Hawaii corporation and a wholly-owned subsidiary of MDC, which is a re-insurer of Allegiant claims.

EXECUTIVE SUMMARY

Overview and Outlook:

The Company s goal is to return to profitability, even if overall market conditions do not improve. Through the second quarter of 2011, our main strategy to accomplish the goal of profitability was to increase our community count, which we expected would give us the opportunity to capture additional market share and drive higher revenues. This effort resulted in a 23% increase in our active subdivisions at September 30, 2011 from December 31, 2010, through (1) growth in existing markets and (2) our expansion into the Seattle market through an asset acquisition in April 2011. However, as our economy continues to display considerable weakness, including continued low consumer confidence and high unemployment, it has become difficult to justify a significant number of additional land acquisitions in the near-term. Therefore, while our existing subdivision count provides us with an opportunity for revenue growth, we do not believe it is enough to achieve our goal and, as such, we are now focusing on other strategies to drive profitability. In particular, we are focused on: (1) reducing our general and administrative expenses; (2) evaluating and improving our sales process; and (3) aligning our debt structure with our operating needs. See **Forward-Looking Statements** below.

Since 2009, we have maintained a general and administrative structure designed to open new communities, implement a new enterprise resource planning system, and position ourselves for expected market improvement. However, given that market conditions have remained depressed, we have taken additional steps to reduce general and administrative expenses. Since the beginning of 2011, we have reduced our general and administrative headcount by approximately 33% from September 30, 2010, the most significant reductions coming during the 2011 second and third quarters.

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As we look at the communities we already own, we have closely analyzed our sales process. Over the past eighteen months, we have relied on large promotions as a critical component of our sales strategy. While these promotions were successful in producing a high level of urgency for our sales personnel and customers, we have also experienced increased volatility in sales absorptions and Cancellation Rates (as defined below), which created inefficiencies on the operational and back-office side of our business. As a result, we are modifying our sales and marketing strategies to rely less on these large promotions in the future, and have made management changes in these departments, with the goal of increasing absorptions and home gross margins. Furthermore, during the 2011 third quarter, we changed our approach to the production of spec homes, which historically have yielded margins significantly below margins on homes that are started with a buyer under contract. In most of our markets, we intend to start very few spec homes and anticipate that our spec inventory should continue to decrease in these markets. See **Forward-Looking Statements** below.

In light of our subdivision count and current demand for new homes, we are in the process of better aligning our debt structure with our operating needs. Accordingly, we completed a debt tender offer in July 2011 that extinguished $63.7 million of our 7% Senior Notes due 2012 and $173.3 million of our 5 ½% Senior Notes due 2013. On October 19, 2011, we redeemed the remaining $86.3 million of our outstanding 7% Senior Notes due 2012 and, in November 2011, we anticipate redeeming the remaining $176.7 million of our 5 ½% Senior Notes due 2013.

Summary Company Results

Our net orders for homes have been negatively impacted by: (1) strong competition for prospective homebuyers; (2) homebuyer anxiety about the housing market; (3) our prospective homebuyers having difficulty qualifying for mortgage loans; (4) home sales promotions during the 2011 second quarter that captured many potential home buyers who subsequently cancelled their purchase during the 2011 third quarter; and (5) selling efforts during the 2010 third quarter that resulted in the sale of a significant number of aged specs. The decline in net orders during the nine months ended September 30, 2011 was also impacted by the expiration of the federal homebuyer tax credit (which required the sale of homes to be completed by April 30, 2010), which significantly influenced the period to period comparisons. We believe our ability to execute a revised sales and marketing strategy to help capture more market share in the current homebuilding environment is a key factor to improve our net orders for homes. See **Forward-Looking Statements** below.

Our closed homes were down 2% and 17%, respectively, during the three and nine months ended September 30, 2011 compared with the same periods in 2010. This decline partially reflects our decision to limit the number of speculative homes. Our Home Gross Margins were 16.8% and 14.6% during the three and nine months ended September 30, 2011, respectively, and 20.9% and 19.9% during the three and nine months ended September 30, 2010, respectively. These items contributed significantly to our loss from operations for the three and nine months ended September 30, 2011.

On the expense side of our business, we incurred asset impairments of $4.7 million and $14.1 million during the three and nine months ended September 30, 2011 compared with $3.7 million during the same periods in 2010. We saw a combined decrease of $1.8 million and $4.1 million, respectively, in marketing and commission expenses during the three and nine months ended September 30, 2011, compared with the same periods in 2010, generally attributable to closing fewer homes during the 2011 periods. Additionally, we experienced a $3.7 million and a $15.5 million decrease, respectively, in our general and administrative expenses during the three and nine months ended September 30, 2011, compared with the same periods in 2010, primarily due to lower costs associated with legal-related matters and employee compensation.

Because we closed fewer homes (which had lower Home Gross Margins) our losses from operations during the three and nine months ended September 30, 2011 were $20.1 million and $72.6 million, respectively, compared with $9.4 million and $26.7 million during the same periods in 2010.

During the three months ended September 30, 2011, we had net interest income of $3.1 million compared to net interest expense of $1.5 million during the same period in 2010. We had net interest income of $2.1 million during the nine months ended September 30, 2011, compared to net interest expense of $9.3 million during the same period in 2010. The improvement during the 2011 periods primarily related to capitalizing interest incurred to our inventory during the first nine months of 2011 compared with the same period in 2010. The debt tender offer we completed in July 2011, which extinguished $237 million of certain of our Senior Notes, resulted in a loss on extinguishment of debt of $18.6 million.

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CRITICAL ACCOUNTING ESTIMATES AND POLICIES

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

Our critical accounting estimates and policies have not changed from those reported in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2010.

Results of Operations

The following discussion compares results for the three and nine months ended September 30, 2011 with the three and nine months ended September 30, 2010.

Home Sales Revenue. Home sales revenue from a home closing includes the base sales price and any purchased options and upgrades and is reduced for any Sales Price Incentives (defined as discounts on the sales price of a home) or paid Mortgage Loan Origination Fees (defined as mortgage loan origination fees paid by Richmond American Homes to HomeAmerican) and interest rate buydowns by HomeAmerican in mortgage loan financing offered to our homebuyers. The combination of base sales price and any purchased options and upgrades, less any of the foregoing incentives, for each closed home constitutes the selling price of our closed homes.

Our home sales revenue can be impacted by changes in our home closing levels and changes in the average selling prices of closed homes. The combination of home sales incentives offered to prospective homebuyers may vary from subdivision-to-subdivision and from home-to-home, and may be revised during the home closing process based upon homebuyer preferences or upon changes in market conditions, such as changes in our competitors pricing.

The table below summarizes home sales revenue by reportable segment (dollars in thousands).

	Three Months Ended September 30, 2011	2010	Change Amount	%
West	$ 71,241	$ 66,076	$ 5,165	8%
Mountain	82,537	88,080	(5,543)	-6%
East	36,566	58,243	(21,677)	-37%
Other Homebuilding	15,939	7,345	8,594	117%
Total Homebuilding	206,283	219,744	(13,461)	-6%
Intercompany	(1,397)	(3,243)	1,846	57%
Consolidated	$ 204,886	$ 216,501	$ (11,615)	-5%

	Nine Months Ended September 30, 2011	2010	Change Amount	%
West	$ 180,585	$ 240,555	$ (59,970)	-25%
Mountain	231,700	244,751	(13,051)	-5%
East	130,525	162,351	(31,826)	-20%
Other Homebuilding	36,707	32,741	3,966	12%
Total Homebuilding	579,517	680,398	(100,881)	-15%
Intercompany	(5,085)	(11,678)	6,593	56%
Consolidated	$ 574,432	$ 668,720	$ (94,288)	-14%

West Segment The increase in home sales revenue during the three months ended September 30, 2011 primarily was driven by closing 49 homes in our new Washington market, which generated $13.2 million in home sales revenue. Additionally, we closed 15 more homes in the Arizona market, which resulted in home sales revenue increasing by $3.0 million. This was partially offset by the impact of closing 35 fewer homes in our California and Nevada markets, which resulted in a $7.4 million decrease in home sales revenue. Additionally, a decrease of $64,600 in the average selling price of closed homes in the California market resulted in a $3.7 million decline in home sales revenue.

The decline in home sales revenue during the nine months ended September 30, 2011 primarily resulted from (1) closing 372 fewer homes in the Arizona, California and Nevada markets of this segment as this caused home sales revenue to decrease by $73.0 million and (2) a decline of $14.7 million associated with reductions in the average selling prices of homes in our Arizona and California markets. This was partially offset by the impact of closing 100 homes in our new Washington market, which generated $26.9 million of home sales revenue.

Mountain Segment The decline in home sales revenue during the three months ended September 30, 2011 primarily resulted from closing 39 fewer homes. This decrease in an $11.5 million decline in home sales revenue. Partially offsetting this decline was the impact of increases in the average selling prices of closed homes in both markets of this segment, which resulted in a $6.0 million increase in home sales revenue.

During the nine months ended September 30, 2011, the impact of closing 108 fewer homes resulted in a $29.8 million reduction in home sales revenue. This was partially offset by a $29,200 increase in the average selling price of closed homes in the Colorado market.

East Segment The decline in home sales revenue during the three months ended September 30, 2011 primarily was driven by: (1) closing 43 fewer homes as this resulted in home sales revenue decreasing by $20.2 million; and (2) a decrease of $1.9 million associated with reductions in the average selling prices of homes in the Virginia market.

The decline in home sales revenue during the nine months ended September 30, 2011 was the result of closing 47 fewer homes as this caused home sales revenue to decrease by $21.5 million and a decline of $10.3 million associated with reductions in the average selling prices of homes in the markets of this segment.

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Other Homebuilding Segment During the three months ended September 30, 2011, the impact of closing 38 more homes resulted in an $8.6 million increase in home sales revenue.

During the nine months ended September 30, 2011, the impact of closing 17 more homes resulted in a $4.3 million increase in home sales revenue.

Home Gross Margins. We define Home Gross Margins to mean home sales revenue less home cost of sales as a percent of home sales revenue.

The following table sets forth our Home Gross Margins by reportable segment.

	Three Months Ended September 30,		
	2011	**2010**	**Change**
Homebuilding			
West	20.6%	35.3%	-14.7%
Mountain	16.1%	12.0%	4.1%
East	10.3%	18.5%	-8.2%
Other Homebuilding	17.0%	9.2%	7.8%
Consolidated	16.8%	20.9%	-4.1%

	Nine Months Ended September 30,		
	2011	**2010**	**Change**
Homebuilding			
West	18.2%	25.7%	-7.5%
Mountain	13.7%	14.9%	-1.2%
East	10.5%	17.7%	-7.2%
Other Homebuilding	15.0%	18.7%	-3.7%
Consolidated	14.6%	19.9%	-5.3%

Home Gross Margins can be impacted positively or negatively in a reporting period by adjustments to our warranty reserves. During the three and nine months ended September 30, 2011 and 2010, we continued to experience lower warranty payments on previously closed homes. As a result of favorable warranty payment experience relative to our estimates at the time of home closing, we recorded adjustments to reduce our warranty reserve of $1.0 million and $3.2 million during the three and nine months ended September 30, 2011, respectively, and $7.2 million and $12.8 million during the three and nine months ended September 30, 2010, respectively.

Interest in home cost of sales as a percent of home sale revenue was 2.5% and 2.6% during the three and nine months ended September 30, 2011, respectively, compared with 2.6% and 2.5% during the same periods of 2010.

The following table sets forth our Home Gross Margins excluding warranty adjustments and interest in home cost of sales during the three and nine months ended September 30, 2011 and 2010.

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	Three Months Ended September 30, 2011	2010	Change
West	22.4%	24.0%	-1.6%
Mountain	18.3%	17.5%	0.8%
East	14.3%	18.8%	-4.5%
Other Homebuilding	14.6%	21.0%	-6.4%
Consolidated	18.8%	20.2%	-1.4%

	Nine Months Ended September 30, 2011	2010	Change
West	19.9%	23.0%	-3.1%
Mountain	15.6%	18.0%	-2.4%
East	13.8%	19.1%	-5.3%
Other Homebuilding	14.4%	21.1%	-6.7%
Consolidated	16.6%	20.5%	-3.9%

West Segment Home Gross Margins excluding warranty and interest decreased during the three and nine months ended September 30, 2011 primarily due declines of $64,600 and $79,900 in the average selling price of closed home in our California market without corresponding declines in the cost of home construction or cost of land. These items partially were offset by the impact of recording adjustments associated with unused land budget commitments of $4.1 million and $5.2 million during the three and nine months ended September 30, 2011, respectively, compared with $1.9 million and $3.7 million during the same periods in 2010.

Mountain Segment Home Gross Margins excluding warranty and interest increased slightly during the three months ended September 30, 2011. Contributing to this increase was the impact of settling a construction defect claim the Company had against certain of its venders in Colorado, the results of which had a $2.3 million benefit to Home Gross Margins in this segment.

East Segment Home Gross Margins decreased during the three and nine months ended September 30, 2011 primarily resulting from declines of $54,000 and $50,900 in the average selling price of closed home in our Virginia market without corresponding decreases in land and home construction costs.

Other Homebuilding Segment Home Gross Margins excluding warranty and interest decreased during the three and nine months ended September 30, 2011 primarily resulting from closing, in our Florida market, a higher percentage of speculative homes that had been in the final stage of completion. These specific homes that were closed during the 2011 periods yielded significantly lower Home Gross Margins from those sold as dirt starts.

Future Home Gross Margins may be impacted negatively by, among other things: (1) selling and closing more spec homes than homes that are sold as dirt starts; (2) increases in the costs of subcontracted labor, building materials, and other resources, to the extent that market conditions prevent the recovery of increased costs through higher selling prices; (3) negative changes in our warranty payment experiences, increases in warranty expenses or litigation expenses associated with construction defect claims, and/or fewer adjustments to decrease warranty reserves based upon our actuary analysis of warranty payments; (4) increases in the costs of finished lots; (5) a weaker economic environment as well as homebuyers reluctance to purchase new homes based on concerns about employment conditions; (6) increased competition and increases in the level of home order cancellations, which could affect our ability to maintain existing home prices and/or home sales incentive levels; (7) continued and/or increases in home foreclosure levels; (8) further tightening of mortgage loan origination requirements; (9) deterioration in the demand for new homes in our markets; (10) fluctuating energy costs, including oil and gasoline; (11) increases in interest expense included in home cost of sales; and (12) other general risk factors. See **Forward-Looking Statements** above.

The following table sets forth by reportable segment a reconciliation of our home cost of sales, as reported, to home cost of sales excluding warranty adjustments and interest in home cost of sales, which is used in the calculation of Home Gross Margins, excluding warranty adjustments and interest in home cost of sales (dollars in thousands).

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Three Months Ended September 30, 2011	Home Sales Revenue - As reported	Home Cost of Sales - As reported	Warranty Adjustments	Interest in Cost of Sales	Home Cost of Sales - Excluding Warranty Adjustments and Interest	Home Gross Margins - Excluding Warranty Adjustments and Interest
West	$ 71,241	$ 56,565	$ (564)	$ 1,845	$ 55,284	22.4%
Mountain	82,537	69,225	(169)	1,951	67,443	18.3%
East	36,566	32,817	431	1,067	31,319	14.3%
Other	15,939	13,233	(653)	277	13,609	14.6%
Intercompany	(1,397)	(1,397)	-	-	(1,397)	N/A
Consolidated	$ 204,886	$ 170,443	$ (955)	$ 5,140	$ 166,258	18.9%
Three Months Ended September 30, 2010						
West	$ 66,076	$ 42,775	$ (9,287)	$ 1,825	$ 50,237	24.0%
Mountain	88,080	77,505	2,550	2,254	72,701	17.5%
East	58,243	47,494	(1,197)	1,370	47,321	18.8%
Other Homebuilding	7,345	6,668	737	132	5,799	21.0%
Intercompany	(3,243)	(3,243)	-	-	(3,243)	N/A
Consolidated	$ 216,501	$ 171,199	$ (7,197)	$ 5,581	$ 172,815	20.2%

Nine Months Ended September 30, 2011	Home Sales Revenue - As reported	Home Cost of Sales - As reported	Warranty Adjustments	Interest in Cost of Sales	Home Cost of Sales - Excluding Warranty Adjustments and Interest	Home Gross Margins - Excluding Warranty Adjustments and Interest
West	$ 180,585	$ 147,678	$ (1,782)	$ 4,845	$ 144,615	19.9%
Mountain	231,700	199,877	(1,268)	5,677	195,468	15.6%
East	130,525	116,853	674	3,657	112,522	13.8%
Other	36,707	31,198	(842)	618	31,422	14.4%
Intercompany	(5,085)	(5,085)	-	-	(5,085)	N/A
Consolidated	$ 574,432	$ 490,521	$ (3,218)	$ 14,797	$ 478,942	16.6%
Nine Months Ended September 30, 2010						
West	$ 240,555	$ 178,738	$ (13,114)	$ 6,540	$ 185,312	23.0%
Mountain	244,751	208,310	1,869	5,820	200,621	18.0%
East	162,351	133,650	(1,767)	4,031	131,386	19.1%
Other Homebuilding	32,741	26,631	209	594	25,828	21.1%
Intercompany	(11,678)	(11,678)	-	-	(11,678)	N/A
Consolidated	$ 668,720	$ 535,651	$ (12,803)	$ 16,985	$ 531,469	20.5%

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Home Gross Margins excluding the impact of warranty adjustments and interest in home cost of sales is a non-GAAP financial measure. We believe this information is meaningful as it isolates the impact that warranty adjustments and interest have on our Home Gross Margins.

Land Sales Revenue. Land sale transactions were not material during the three and nine months ended September 30, 2011. Land sales revenue during the three and nine months ended September 30, 2010 was $0.9 million and $6.6 million, respectively, primarily in our West segment.

Other Revenue. Gains on the sale of mortgage loans primarily represent revenue earned by HomeAmerican from the sale of HomeAmerican s originated mortgage loans to third-parties. Insurance revenue primarily represents premiums collected by StarAmerican and Allegiant from our homebuilding subcontractors in connection with the construction of homes. Title and other revenue primarily consist of forfeitures of homebuyer deposits on home sales contracts and revenue associated with our American Home Title operations.

The table below sets forth the components of other revenue (dollars in thousands).

	Three Months Ended September 30,		Change	
	2011	2010	Amount	%
Gains on sales of mortgage loans	$ 3,575	$ 5,920	$ (2,345)	-40%
Insurance revenue	1,629	1,525	104	7%
Title and other revenue	540	831	(291)	-35%
Total other revenue	$ 5,744	$ 8,276	$ (2,532)	-31%

	Nine Months Ended September 30,		Change	
	2011	2010	Amount	%
Gains on sales of mortgage loans	$ 12,190	$ 16,523	$ (4,333)	-26%
Insurance revenue	4,609	4,702	(93)	-2%
Title and other revenue	2,062	2,526	(464)	-18%
Total other revenue	$ 18,861	$ 23,751	$ (4,890)	-21%

Gains on sales of mortgage loans decreased during the three and nine months ended September 30, 2011 primarily due to declines of 1,300 and 900 basis points in the Capture Rates (as defined below) during the 2011 periods, respectively, and due to the Company closing 15 and 410 fewer homes.

Home Cost of Sales. Home cost of sales primarily includes land acquisition, land development and related costs (both incurred and estimated to be incurred), specific construction costs of each home, warranty costs and finance and closing costs, including Closing Cost Incentives (defined as homebuyer closing costs assistance paid by Richmond American Homes to a third-party).

Our home cost of sales can be impacted primarily by changes in our home closing levels and changes in the cost of land acquisition, land development incurred and estimated to be incurred, construction cost of homes and changes in our estimated costs for warranty repairs.

The table below sets forth the home cost of sales by reportable segment (dollars in thousands).

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	Three Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ 56,565	$ 42,775	$ 13,790	32%
Mountain	69,225	77,505	(8,280)	-11%
East	32,817	47,494	(14,677)	-31%
Other Homebuilding	13,233	6,668	6,565	98%
Total Homebuilding	171,840	174,442	(2,602)	-1%
Intercompany adjustments	(1,397)	(3,243)	1,846	57%
Consolidated	$ 170,443	$ 171,199	$ (756)	0%

	Nine Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ 147,678	$ 178,738	$ (31,060)	-17%
Mountain	199,877	208,310	(8,433)	-4%
East	116,853	133,650	(16,797)	-13%
Other Homebuilding	31,198	26,631	4,567	17%
Total Homebuilding	495,606	547,329	(51,723)	-9%
Intercompany adjustments	(5,085)	(11,678)	6,593	56%
Consolidated	$ 490,521	$ 535,651	$ (45,130)	-8%

West Segment Home cost of sales increased during the three months ended September 30, 2011 due to a $4.4 million increase associated with closing 29 more homes and $8.7 million from adjustments to decrease warranty reserves during 2010 that we did not experience during 2011.

Home cost of sales decreased during the nine months ended September 30, 2011 primarily resulting from a $45.7 million decline associated with closing 272 fewer homes, partially offset by an increase of $11.3 million associated with adjustments to decrease warranty reserves incurred in 2010 which we did not experience during 2011.

Mountain Segment Home cost of sales decreased during the three months ended September 30, 2011 as we closed 39 fewer homes, which caused a $10.6 million decline and $2.7 million associated with adjustments to increase warranty reserves incurred in 2010 that were not incurred during 2011. These items partially were offset by a $4.3 million increase in home cost of construction associated with a change in the mix of homes that were closed during the 2011 period compared with the 2010 period.

Home cost of sales decreased during the nine months ended September 30, 2011 as we closed 108 fewer homes, which caused a $27.3 million decline and $3.1 million associated with adjustments to increase warranty reserves incurred in 2010 that were not incurred during 2011. These items partially were offset by a $16.2 million increase in home cost of construction associated with a change in the mix of homes that were closed during the 2011 period compared with the 2010 period.

East Segment During the three months ended September 30, 2011, home cost of sales decreased $16.2 million associated with closing 43 fewer homes and $8.7 million associated with adjustments to warranty reserves incurred in 2010 that were not incurred during 2011.

Home cost of sales decreased during the nine months ended September 30, 2011 resulting from closing 47 fewer homes, which caused a $17.9 million decline, partially offset by an increase of $2.4 million associated with adjustments to decrease warranty reserves incurred in 2010 that were not incurred during 2011.

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Other Homebuilding Segment   Home cost of sales during the 2011 third quarter increased primarily resulting from an $8.7 million increase associated with closing 38 more homes, partially offset by a $1.4 million decrease associated with warranty adjustments.

Home cost of sales the nine months ended September 30, 2011 increased primarily resulting from a $3.2 million increase associated with closing 17 more homes.

Land Cost of Sales. Land sale transactions were not material during the three and nine months ended September 30, 2011. Land cost of sales during the three and nine months ended September 30, 2010 was $0.8 million and $6.0 million, respectively, and related to the sale of lots, primarily in our West segment.

Asset Impairments. We recorded $4.7 million and $14.1 million of asset impairments during the three and nine months ended September 30, 2011, respectively, resulting from a decline in the market value of land and homes in certain subdivisions of our West, Mountain and Other Homebuilding segments. We recorded $3.7 million of asset impairments during the three and nine months ended September 30, 2010 resulting from a decline in the market value of land and homes in several subdivisions of our West segment.

The following table sets forth the asset impairments by reportable segment (dollars in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Land and Land Under Development				
West	$ 1,193	$ 2,490	$ 7,112	$ 2,490
Mountain	550	-	1,786	-
East	-	-	285	-
Other Homebuilding	1,519	-	1,519	-
Subtotal	3,262	2,490	10,702	2,490
Housing Completed or Under Construction				
West	484	1,143	1,438	1,143
Mountain	210	-	449	-
East	-	-	-	-
Other Homebuilding	93	-	93	-
Subtotal	787	1,143	1,980	1,143
Other Assets	643	85	1,408	85
Consolidated Asset Impairments	$ 4,692	$ 3,718	$ 14,090	$ 3,718

Marketing Expenses. Marketing expenses primarily include advertising, amortization of deferred marketing costs, model home expenses, compensation related expenses and other selling costs. The following table summarizes our marketing expenses by reportable segment (in thousands).

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	Three Months Ended September 30,		Change	
	2011	2010	Amount	%
Homebuilding				
West	$ 4,400	$ 4,940	$ (540)	-11%
Mountain	3,155	3,491	(336)	-10%
East	1,549	1,902	(353)	-19%
Other Homebuilding	898	858	40	5%
Consolidated	$ 10,002	$ 11,191	$ (1,189)	-11%

	Nine Months Ended September 30,		Change	
	2011	2010	Amount	%
Homebuilding				
West	$ 12,925	$ 13,188	$ (263)	-2%
Mountain	9,445	9,137	308	3%
East	4,998	5,196	(198)	-4%
Other Homebuilding	2,364	2,205	159	7%
Consolidated	$ 29,732	$ 29,726	$ 6	0%

Marketing expense during the three months ended September 30, 2011 decreased in our West, Mountain and East segments primarily resulting from a decline in sales office and product advertising expenses. Marketing expenses increased slightly during the three months ended September 30, 2011 in our Other Homebuilding segment primarily resulting from an increase in amortization of deferred marketing costs associated with closing more homes during the 2011 third quarter.

Marketing expenses during the nine months ended September 30, 2011 increased in our Mountain and Other Homebuilding segments primarily from increase in the amortization of deferred marketing costs associated with closed homes and increases in compensation related expenses. The declines in marketing expenses in our West and East segments during the nine months ended September 30, 2011 primarily resulted from lower compensation related costs, partially offset by increases in the amortization of deferred marketing costs.

Commission Expenses. Commission expenses include direct incremental commissions paid for closed homes. The following table summarizes our commission expenses by reportable segment (in thousands).

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	Three Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ 2,495	$ 2,655	$ (160)	-6%
Mountain	2,991	3,176	(185)	-6%
East	1,369	1,903	(534)	-28%
Other Homebuilding	621	344	277	81%
Consolidated	$ 7,476	$ 8,078	$ (602)	-7%

	Nine Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ 6,442	$ 9,320	$ (2,878)	-31%
Mountain	8,166	8,649	(483)	-6%
East	4,516	5,428	(912)	-17%
Other Homebuilding	1,575	1,421	154	11%
Consolidated	$ 20,699	$ 24,818	$ (4,119)	-17%

Commission expense in our West segment decreased during the three months ended September 30, 2011 primarily due to closing fewer homes in our Nevada and California markets. This decline was partially offset by incurring $0.4 million in commission expense in our new Washington market. The decline in commission expense during the three months ended September 30, 2011 in our Mountain and East segments resulted from closing 39 and 43 fewer homes, respectively. Commission expense increased during the three months ended September 30, 2011 in our Other Homebuilding segment due to closing 38 more homes.

Commission expense in our West segment decreased during the nine months ended September 30, 2011 primarily due to closing a combined 372 fewer homes in the Arizona, Nevada and California markets of this segment. This decline was partially offset by incurring $0.9 million in commission expense in our new Washington market. The decline in commission expense during the nine months ended September 30, 2011 in our Mountain and East segments resulted from closing 108 and 47 fewer homes, respectively. Commission expense increased during the three months ended September 30, 2011 in our Other Homebuilding segment due to closing 17 more homes.

General and Administrative Expenses. The following table summarizes our general and administrative expenses by reportable segment (in thousands).

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	Three Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ 7,052	$ 6,717	$ 335	5%
Mountain	2,782	3,532	(750)	-21%
East	3,194	4,805	(1,611)	-34%
Other Homebuilding	738	1,057	(319)	-30%
Total Homebuilding	13,766	16,111	(2,345)	-15%
Financial Services and Other	6,701	4,521	2,180	48%
Corporate	15,113	18,637	(3,524)	-19%
Consolidated	$ 35,580	$ 39,269	$ (3,689)	-9%

	Nine Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ 20,872	$ 22,037	$ (1,165)	-5%
Mountain	10,790	12,004	(1,214)	-10%
East	10,182	16,043	(5,861)	-37%
Other Homebuilding	2,703	4,242	(1,539)	-36%
Total Homebuilding	44,547	54,326	(9,779)	-18%
Financial Services and Other	15,832	14,267	1,565	11%
Corporate	48,190	55,467	(7,277)	-13%
Consolidated	$ 108,569	$ 124,060	$ (15,491)	-12%

West Segment The increase during the three months ended September 30, 2011 was primarily due to legal related expenses and supervisory fees that increased by a combined $1.0 million, partially offset by a $0.7 million decline in salary and compensation related expenses. The decrease during the nine months ended September 30, 2011 primarily resulted from a $0.8 million decrease in salary and compensation related expenses.

Mountain Segment The decrease during the three and nine months ended September 30, 2011 primarily resulted from a $0.7 million and $1.2 million decrease, respectively, in salary and compensation related expenses.

East Segment The decrease during the three months ended September 30, 2011 primarily resulted from a $0.9 million decline in salary and compensation related expenses and legal related expenses, which were lower by $0.6 million. The decrease during the nine months ended September 30, 2011 primarily resulted from incurring $4.3 million less in legal related matters and a $1.7 million reduction in salary and compensation related expenses.

Other Homebuilding Segment The decrease during the 2011 third quarter was attributable to lower salary and compensation related expenses. The decrease during the nine months ended September 30, 2011 primarily resulted from incurring $1.0 million less in legal related matters and a $0.4 million reduction in salary and compensation related expenses.

Financial Services and Other Segment General and administrative expense increased during the three months ended September 30, 2011 resulting from a $3.0 million increase in the estimated mortgage loan loss reserve, partially offset by decreases in salary and compensation related expenses.

The increase during the nine months ended September 30, 2011, primarily resulted from a $4.2 million increase in expenses associated with our mortgage loan loss reserve, partially offset by a $1.2 million reduction in salary and compensation related expenses and a $1.0 million reduction in insurance expense associated with closing fewer homes.

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Corporate Segment During the three months ended September 30, 2011, general and administrative expenses were down due to the following decreases: (1) $1.9 million associated with executive bonuses; (2) $2.5 million in salary and compensation related expenses; and (3) $0.3 million primarily associated with office related costs. These items partially were offset by the impact of a $1.0 million expense during the 2011 third quarter associated with stock options granted to our Board of Directors, which in prior years were recorded during the fourth quarter. With the new Board of Directors stock option plan, the stock option grant to our Board of Directors now takes place during the third quarter.

During the nine months ended September 30, 2011 general and administrative expenses were down $7.3 million due to the following decreases: (1) $5.4 million associated with salary and compensation related expenses; (2) $1.9 million associated with executive bonuses; and (3) $0.9 million associated with office related expenses. These items partially were offset by the impact of a $1.0 million expense during the 2011 third quarter associated with stock options granted to our Board of Directors.

Other Operating Expense. Other operating expenses increased by $1.6 million and $1.5 million, respectively, during the three and nine months ended September 30, 2011 primarily due to $2.4 million and $5.3 million in write-offs of land option deposits and pre-acquisition costs associated with lot option contracts that we elected not to exercise. Other operating expenses during the nine months ended September 30, 2011 also included $0.6 million in due diligence costs associated with an asset acquisition in April 2011. These items partially were offset by the release of a $2.7 million employment tax contingency reserve as a result of the finalization of an IRS examination.

Other Income (Expense). Other income (expense) primarily includes interest and dividend income on our cash, cash equivalents and marketable securities, interest expense primarily on our senior notes, loss on extinguishment of senior notes and gain or loss on the sale of other assets. Interest income was $6.7 million and $21.9 million during the three and nine months ended September 30, 2011, respectively, compared with $7.5 million and $19.5 million, respectively, during the three and nine months ended September 30, 2010. Our available-for-sale marketable securities include certain debt securities, primarily corporate debt and holdings in equity security mutual funds.

Interest expense during the three and nine months ended September 30, 2011 decreased $5.3 million and $9.0 million, respectively. We capitalize interest on our senior notes associated with our qualifying assets. We have determined that inventory is a qualifying asset during the period of active development of our land and through the completion of construction of a home. When construction of a home is complete, the home is no longer considered to be a qualifying asset and interest is no longer capitalized on that home. As a result of the increase in our inventory levels from the first nine months of 2010, we capitalized $10.8 million and $31.1 million of interest incurred during the three and nine months ended September 30, 2011, respectively, compared with $9.4 million and $24.9 million from the same periods during 2010, respectively.

During the 2011 third quarter, we completed a debt tender offer purchasing $63.7 million of our 7% Senior Notes due 2012 and $173.3 million of our 5 $^{1}/2$% Senior Notes due 2013. We paid $254.9 million, including interest and fees, for the acquired notes and, as a result of the tender, we recorded an $18.6 million charge associated with the extinguishment of senior notes.

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

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	Three Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ (2,584)	$ 4,900	$ (7,484)	153%
Mountain	2,988	520	2,468	-475%
East	(2,518)	2,021	(4,539)	225%
Other Homebuilding	(1,514)	(1,673)	159	10%
Total Homebuilding	(3,628)	5,768	(9,396)	163%
Financial Services and Other	(450)	4,326	(4,776)	-110%
Corporate	(30,111)	(20,688)	(9,423)	-46%
Consolidated	$ (34,189)	$ (10,594)	$ (23,595)	-223%

	Nine Months Ended September 30, 2011	2010	Change Amount	%
Homebuilding				
West	$ (18,981)	$ 13,611	$ (32,592)	239%
Mountain	552	6,652	(6,100)	92%
East	(6,819)	1,957	(8,776)	448%
Other Homebuilding	(3,206)	(1,897)	(1,309)	-69%
Total Homebuilding	(28,454)	20,323	(48,777)	240%
Financial Services and Other	4,419	10,261	(5,842)	-57%
Corporate	(63,661)	(66,119)	2,458	4%
Consolidated	$ (87,696)	$ (35,535)	$ (52,161)	-147%

West Segment We had a loss before income taxes of $2.6 million during the three months ended September 30, 2011 compared with income before income taxes of $4.9 million during the same period in 2010. This decline primarily resulted from a 1,470 basis point reduction in Home Gross Margins and a $0.3 million increase in general and administrative expenses. Also contributing to this decline was an increase in expenses associated with the write-offs of land option deposits and pre-acquisition costs associated with lot option contracts that we elected not to exercise. Partially offsetting these items was a combined decrease of $0.7 million in marketing and commission expense and $2.0 million decrease in inventory impairments.

We had a loss before income taxes of $19.0 million during the nine months ended September 30, 2011 compared with income before income taxes of $13.6 million during the same period in 2010. This decline primarily resulted from: (1) a $4.9 million increase in inventory impairments; (2) a 750 basis point decline in Home Gross Margins; and (3) closing 372 fewer homes in the Arizona, California and Nevada markets. These items were partially offset by a combined decrease of $4.0 million in commission and general and administrative expenses.

Mountain Segment Income before income taxes increased $2.5 million during the three months ended September 30, 2011 primarily from a combined decrease of $1.3 million in general and administrative, marketing and commission expenses and a 410 basis point increase in Home Gross Margins, partially offset by closing 39 fewer homes and a $0.8 million increase in inventory impairments.

Income before income taxes decreased $6.1 million during the nine months ended September 30, 2011 primarily resulting from closing 108 fewer homes, a 120 basis point decline in Home Gross Margins and an increase of $2.3 million in inventory impairments. These items were partially offset by a combined decrease of $1.7 million in commission and general and administrative expenses.

East Segment We had a loss before income taxes of $2.5 million during the three months ended September 30, 2011 compared with income before income taxes of $2.0 million during the same period in 2010. This decline primarily resulted from an 820 basis point decline in Home Gross Margins and closing 43 fewer homes. These items were partially offset by a combined decrease of $2.5 million in marketing, commission and general and administrative expenses.

We had a loss before income taxes of $6.8 million during the nine months ended September 30, 2011 compared with income before income taxes of $2.0 million during the same period in 2010. This decline primarily resulted from a 720 basis point decline in Home Gross Margins and closing 47 fewer homes. These items were partially offset by a combined decrease of $7.0 million in marketing, commission and general and administrative expenses.

Other Homebuilding Segment Our loss before income taxes was $0.2 million lower during the three months ended September 30, 2011, primarily resulting from a 780 basis point increase in Home Gross Margins and closing 38 more homes in this segment. These items partially were offset by a $1.6 million increase in inventory impairments.

Our loss before income taxes during the nine months ended September 30, 2011 increased by $1.3 million primarily resulting from a $1.6 million increase in inventory impairments and a 370 basis reduction in Home Gross Margins. These items partially were offset by a $1.5 million decrease in general and administrative expenses and the impact of closing 17 more homes.

Financial Services and Other Segment We had a loss before income taxes during the three months ended September 30, 2011 of $0.5 million compared with income before income taxes of $4.3 million in the prior 2010 period. This decline primarily resulted from a $2.2 million increase in general and administrative expenses and a $2.3 million decline in gains on the sale of mortgage loans.

Income before income taxes during the nine months ended September 30, 2011 decreased $5.8 million due to a $4.3 million decrease in gains on sale of mortgage loans and a $1.6 million increase in general and administrative expenses.

Corporate Segment Loss before income taxes during the three months ended September 30, 2011 increased $9.4 million as we incurred an $18.6 million charge associated with the extinguishment of senior notes during the 2011 third quarter. This item was partially offset by a $3.6 million decline in interest expense and a $3.5 million decrease in general and administrative expenses.

Loss before income taxes during the nine months ended September 30, 2011 decreased by $2.5 million primarily resulting from a $7.3 million decrease in general and administrative expenses, a $1.8 million increase in interest income and an $8.8 million decrease in interest expense. These items partially were offset by the $18.6 million charge we incurred associated with the extinguishment of debt during the 2011 third quarter.

Income Taxes. We are required, at the end of each interim period, to estimate our annual effective tax rate for the fiscal year and use that rate to provide for income taxes for the current year-to-date reporting period. Due to the effects of the deferred tax valuation allowance and changes in unrecognized tax benefits, our effective tax rates in 2011 and 2010 are not meaningful as the income tax benefit is not directly correlated to the amount of pretax loss. The income tax benefits of $2.5 million and $8.1 million during the three and nine months ended September 30, 2011, respectively, resulted primarily from our 2011 second and third quarter settlement of various state income tax matters and our 2011 first quarter settlement with the IRS on its audit of the 2004 and 2005 federal income tax returns. Our income tax benefits during the three and nine months ended September 30, 2010 were not material to our results of operations.

Homebuilding Operating Activities

Orders for Homes, net. The table below sets forth information relating to orders for homes (dollars in thousands).

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	Three Months Ended September 30, 2011	2010	Change Amount	%	Nine Months Ended September 30, 2011	2010	Change Amount	%
Orders For Homes, net (units)								
Arizona	104	119	(15)	-13%	390	471	(81)	-17%
California	53	101	(48)	-48%	247	236	11	5%
Nevada	107	106	1	1%	349	471	(122)	-26%
Washington	42	-	42	N/M	68	-	68	N/M
West	306	326	(20)	-6%	1,054	1,178	(124)	-11%
Colorado	147	220	(73)	-33%	560	722	(162)	-22%
Utah	38	73	(35)	-48%	214	308	(94)	-31%
Mountain	185	293	(108)	-37%	774	1,030	(256)	-25%
Maryland	48	67	(19)	-28%	168	176	(8)	-5%
Virginia	42	60	(18)	-30%	205	202	3	1%
East	90	127	(37)	-29%	373	378	(5)	-1%
Florida	16	50	(34)	-68%	158	156	2	1%
Illinois	(2)	-	(2)	N/M	5	-	5	N/M
Other Homebuilding	14	50	(36)	-72%	163	156	7	4%
Total	595	796	(201)	-25%	2,364	2,742	(378)	-14%
Estimated Value of Orders for Homes, net	$ 175,000	$ 231,000	$ (56,000)	-24%	$ 682,000	$ 770,000	$ (88,000)	-11%
Estimated Average Selling Price of Orders for Homes, net	$ 294.1	$ 290.2	$ 3.9	1%	$ 288.5	$ 280.8	$ 7.7	3%

N/M Not meaningful

Net order for homes during the three months ended September 30, 2011 decreased in each of our homebuilding segments driven primarily by: (1) previously discussed volatility in our Cancellation Rates; (2) the impact of severe competition for home orders with other homebuilders; and (3) the continued uncertainty in the housing market.

During the nine months ended September 30, 2011, our net orders for homes decreased, which was driven by a 256 unit decline in the markets of our Mountain segment and 203 unit decline in the Arizona and Nevada markets of our West segment. The decline in these markets was driven primarily by the impact of the expiration of the 2010 federal homebuyer tax credit and increased volatility in our Cancellation Rates. These declines partially were offset by the 68 net orders for homes we received in our new Washington market. In certain markets, we did see some increases in net orders for homes, which were primarily the result of higher active subdivision counts.

Homes Closed. The following table sets forth homes closed for each market within our homebuilding segments (in units).

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	Three Months Ended September 30, 2011	2010	Change Amount	%	Nine Months Ended September 30, 2011	2010	Change Amount	%
Arizona	126	111	15	14%	301	461	(160)	-35%
California	58	62	(4)	-6%	168	176	(8)	-5%
Nevada	77	108	(31)	-29%	223	427	(204)	-48%
Washington	49	-	49	N/M	100	-	100	N/M
West	310	281	29	10%	792	1,064	(272)	-26%
Colorado	189	208	(19)	-9%	537	546	(9)	-2%
Utah	58	78	(20)	-26%	178	277	(99)	-36%
Mountain	247	286	(39)	-14%	715	823	(108)	-13%
Maryland	47	68	(21)	-31%	153	185	(32)	-17%
Virginia	36	58	(22)	-38%	151	166	(15)	-9%
East	83	126	(43)	-34%	304	351	(47)	-13%
Florida	63	29	34	117%	154	142	12	8%
Illinois	4	-	4	0%	5	-	5	0%
Other Homebuilding	67	29	38	131%	159	142	17	12%
Total	707	722	(15)	-2%	1,970	2,380	(410)	-17%

Homes closed in our West and Other Homebuilding segments were up during the three months ended September 30, 2011. In our West segment, the increase of 29 units resulted from closing 49 homes in our new Washington market. Homes closed in our Florida market increased during the three months ended September 30, 2011. During 2010, due to the Federal Homebuyer Tax Credit, we closed more homes during the 2010 second quarter, thus resulting in an increase in closing during the 2011 third quarter when compared with the 2010 third quarter.

Homes closed during the nine months ended September 30, 2011 were down in our West, Mountain and East segments each of our homebuilding segments. Contributing to the decline in home closings was the negative impact from the federal homebuyer tax credit, which expired during 2010. In our West segment, this item was partially offset by closing 100 homes in our new Washington market.

Backlog. The following table below sets forth information relating to Backlog for each market within our homebuilding segments (dollars in thousands).

Backlog (units)	September 30, 2011	December 31, 2010	September 30, 2010
Arizona	173	84	113
California	158	79	136
Nevada	202	76	132
Washington	44	-	-
West	577	239	381
Colorado	296	273	383
Utah	105	69	125
Mountain	401	342	508
Maryland	141	126	117
Virginia	124	70	109
East	265	196	226
Florida	68	64	73
Illinois	1	1	-
Other Homebuilding	69	65	73
Total	1,312	842	1,188
Backlog Estimated Sales Value	$ 405,000	$ 269,000	$ 368,000
Estimated Average Selling Price of Homes in Backlog	$ 308.7	$ 319.5	$ 309.8

We define Backlog as homes under contract but not yet delivered. Our Backlog at a point in time is impacted by net orders for homes and closed homes during a reporting period. The increase in our Backlog at September 30, 2011 compared with September 30, 2010 can be attributed to the ratio of closings to beginning Backlog which decreased to 50% for the 2011 third quarter, compared with 65% in the 2010 third quarter. This decline primarily resulted from the year-over-year decrease in the percentage of our Backlog under construction at the beginning of the quarter.

Cancellation Rate. We define our home order Cancellation Rate as the approximate number of cancelled home order contracts during a reporting period as a percentage of total home order contracts received during such reporting period. The following tables set forth our Cancellation Rate by segment.

	Three Months Ended September 30, 2011	2010	Increase
Homebuilding			
West	42%	27%	15%
Mountain	42%	34%	8%
East	42%	30%	12%
Other Homebuilding	79%	30%	49%
Consolidated	44%	30%	14%

	Nine Months Ended September 30, 2011	2010	Increase
Homebuilding			
West	33%	22%	11%
Mountain	36%	29%	7%
East	33%	28%	5%
Other Homebuilding	41%	31%	10%
Consolidated	35%	26%	9%

Our consolidated Cancellation Rates during the three and nine months ended September 30, 2011 increased in each of our homebuilding segments. During both 2011 periods, we experienced a significant increase in the number of home orders that were cancelled. As a result of our gross number of home orders remaining constant between the 2011 periods and the 2010 periods, coupled with the higher volume of cancellations in 2011, we experienced a higher cancellation rate during the three and nine months ended September 30, 2011.

The cancellations that we experienced during the 2011 periods primarily resulted from: (1) our homebuyers having difficulties qualifying for mortgage loans; (2) low consumer confidence in the housing market; and (3) home orders that were contingent upon our prospective homebuyers being able to sell their existing home, which has been difficult given the challenging housing market.

Active Subdivisions. The following table displays the number of our active subdivisions for each market within our homebuilding segments.

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	September 30, 2011	December 31, 2010	September 30, 2010
Arizona	26	26	28
California	16	13	10
Nevada	20	18	19
Washington	10	-	-
West	72	57	57
Colorado	47	39	39
Utah	21	19	19
Mountain	68	58	58
Maryland	14	14	9
Virginia			