MDC HOLDINGS INC
Form 10-Q
August 03, 2016
Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

____

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

Commission File No. 1-8951

M.D.C. HOLDINGS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**84-0622967**
(State or other jurisdiction	

of incorporation or organization)	**(I.R.S. employer identification no.)**

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

(303) 773-1100

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large Accelerated Filer		**Accelerated Filer**
Non-Accelerated Filer	**(Do not check if a smaller reporting company)**	**Smaller Reporting Company**

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 1, 2016, 49,033,981 shares of M.D.C. Holdings, Inc. common stock were outstanding.

Table Of Contents

M.D.C. HOLDINGS, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2016

INDEX

		Page No.
Part I. Financial Information:		
Item 1.	Unaudited Consolidated Financial Statements:	
	Consolidated Balance Sheets at June 30, 2016 and December 31, 2015	1
	Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2016 and 2015	2
	Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015	3
	Notes to Unaudited Consolidated Financial Statements	4
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	40
Item 4.	Controls and Procedures	41
Part II. Other Information:		
Item 1.	Legal Proceedings	42
Item 1A.	Risk Factors	42
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 3.	Defaults Upon Senior Securities	43
Item 4.	Mine Safety Disclosures	43
Item 5.	Other Information	43
Item 6.	Exhibits	44

Signature 44

(i)

Table Of Contents

PART I

ITEM 1. Unaudited Consolidated Financial Statements

M.D.C. HOLDINGS, INC.

Consolidated Balance Sheets.

	June 30, 2016	December 31, 2015
	(Dollars in thousands, except per share amounts) (Unaudited)	
ASSETS		
Homebuilding:		
Cash and cash equivalents	$132,006	$144,342
Marketable securities	55,798	92,387
Restricted cash	3,946	3,750
Trade and other receivables	47,803	23,314
Inventories:		
Housing completed or under construction	933,922	747,036
Land and land under development	893,096	1,016,926
Total inventories	1,827,018	1,763,962
Property and equipment, net	29,143	28,226
Deferred tax asset, net	89,242	99,107
Metropolitan district bond securities (related party)	28,604	25,911
Prepaid and other assets	65,254	65,394
Total homebuilding assets	2,278,814	2,246,393
Financial Services:		
Cash and cash equivalents	39,300	36,646
Marketable securities	14,821	11,307
Mortgage loans held-for-sale, net	118,699	115,670
Other assets	9,766	5,883
Total financial services assets	182,586	169,506
Total Assets	$2,461,400	$2,415,899
LIABILITIES AND EQUITY		
Homebuilding:		
Accounts payable	$48,294	$40,472
Accrued liabilities	130,651	122,886

Revolving credit facility	15,000	15,000
Senior notes, net	841,076	840,524
Total homebuilding liabilities	1,035,021	1,018,882
Financial Services:		
Accounts payable and accrued liabilities	56,060	52,114
Mortgage repurchase facility	93,297	88,611
Total financial services liabilities	149,357	140,725
Total Liabilities	1,184,378	1,159,607
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; 49,008,835 and 48,888,424 issued and outstanding at June 30, 2016 and December 31, 2015, respectively	490	489
Additional paid-in-capital	921,660	915,746
Retained earnings	336,314	324,342
Accumulated other comprehensive income	18,558	15,715
Total Stockholders' Equity	1,277,022	1,256,292
Total Liabilities and Stockholders' Equity	$2,461,400	$2,415,899

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

Table Of Contents

M.D.C. HOLDINGS, INC.

Consolidated Statements of Operations and Comprehensive Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands, except per share amounts) (Unaudited)			
Homebuilding:				
Home sale revenues	$571,195	$461,708	$965,615	$838,717
Land sale revenues	316	-	2,640	910
Total home and land sale revenues	571,511	461,708	968,255	839,627
Home cost of sales	(475,836)	(385,019)	(805,862)	(703,661)
Land cost of sales	(216)	-	(1,879)	(1,125)
Inventory impairments	(1,600)	-	(1,600)	(350)
Total cost of sales	(477,652)	(385,019)	(809,341)	(705,136)
Gross margin	93,859	76,689	158,914	134,491
Selling, general and administrative expenses	(64,440)	(54,781)	(120,717)	(105,313)
Interest and other income	2,553	2,720	3,489	4,574
Other expense	(278)	(1,055)	(905)	(2,189)
Other-than-temporary impairment of marketable securities	(288)	-	(719)	-
Homebuilding pretax income	31,406	23,573	40,062	31,563
Financial Services:				
Revenues	15,823	11,420	26,840	22,011
Expenses	(7,543)	(4,207)	(13,784)	(10,366)
Interest and other income	772	1,096	1,613	2,000
Financial services pretax income	9,052	8,309	14,669	13,645
Income before income taxes	40,458	31,882	54,731	45,208
Provision for income taxes	(13,545)	(11,884)	(18,255)	(16,790)
Net income	$26,913	$19,998	$36,476	$28,418
Other comprehensive income (loss) related to available for sale securities, net of tax	895	(360)	2,843	948
Comprehensive income	$27,808	$19,638	$39,319	$29,366
Earnings per share:				
Basic	$0.55	$0.41	$0.74	$0.58
Diluted	$0.55	$0.41	$0.74	$0.58
Weighted average common shares outstanding				
Basic	48,851,350	48,768,021	48,839,660	48,741,476
Diluted	48,861,742	49,005,037	48,848,914	48,954,059

Dividends declared per share	$0.25	$0.25	$0.50	$0.50

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

Table Of Contents

M.D.C. HOLDINGS, INC.

Consolidated Statements of Cash Flows

	Six Months Ended June 30,	
	2016	2015
	(Dollars in thousands) (Unaudited)	
Operating Activities:		
Net income	$36,476	$28,418
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Stock-based compensation expense	6,163	2,591
Depreciation and amortization	2,367	2,092
Inventory impairments	1,600	350
Other-than-temporary impairment of marketable securities	719	-
Gain on sale of marketable securities	(262)	(462)
Amortization of discount / premiums on marketable debt securities, net	-	100
Deferred income tax expense	7,873	16,267
Net changes in assets and liabilities:		
Restricted cash	(196)	(2,128)
Trade and other receivables	(26,235)	(292)
Mortgage loans held-for-sale	(3,029)	8,664
Housing completed or under construction	(186,805)	(41,474)
Land and land under development	122,701	36,919
Prepaid expenses and other assets	(2,975)	(3,118)
Accounts payable and accrued liabilities	19,517	(3,418)
Net cash provided by (used in) operating activities	(22,086)	44,509
Investing Activities:		
Purchases of marketable securities	(15,426)	(34,679)
Maturities of marketable securities	-	1,510
Sales of marketable securities	50,765	50,179
Purchases of property and equipment	(3,117)	(421)
Net cash provided by investing activities	32,222	16,589
Financing Activities:		
Advances (payments) on mortgage repurchase facility, net	4,686	(10,822)
Dividend payments	(24,504)	(24,425)
Proceeds from exercise of stock options	-	612
Net cash used in financing activities	(19,818)	(34,635)
Net increase (decrease) in cash and cash equivalents	(9,682)	26,463
Cash and cash equivalents:		
Beginning of period	180,988	153,825

End of period	$171,306	$180,288

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

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

1. Basis of Presentation

The Unaudited Consolidated Financial Statements of M.D.C. Holdings, Inc. ("MDC," "the Company," "we," "us," or "our" which refers to M.D.C. Holdings, Inc. and its subsidiaries) have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all information and footnotes required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements. These statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of MDC at June 30, 2016 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, 2015.

2. Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which is a comprehensive new revenue recognition model. Under ASU 2014-09, a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services. ASU 2014-09 is effective for our interim and annual reporting periods beginning after December 15, 2017, and is to be applied retrospectively. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. We do not plan to early adopt the guidance and are currently evaluating the method of adoption and impact the update will have on our consolidated financial statements and related disclosures.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis* ("ASU 2015-02"), which amends the consolidation requirements in Accounting Standards Codification ("ASC") Topic 810, *Consolidation* ("ASC 810"), primarily related to limited partnerships and variable interest entities. ASU 2015-02 was effective for our interim and annual reporting periods beginning January 1, 2016 and did not have a material impact on our consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"), which makes a number of changes to the current GAAP

model, including changes to the accounting for equity investments and financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Under ASU 2016-01, we will primarily be impacted by the changes to accounting for equity instruments with readily determinable fair values as they will no longer be permitted to be classified as available-for-sale (changes in fair value reported through other comprehensive income) and instead, all changes in fair value will be reported in earnings. ASU 2016-01 is effective for our interim and annual reporting periods beginning January 1, 2018 and is to be applied using a modified retrospective adoption method. Early adoption of this applicable guidance from ASU 2016-01 is not permitted. We are currently evaluating the impact the update will have on our consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases* (“ASU 2016-02”), which requires a lessee to recognize a right-of-use asset and a corresponding lease liability for virtually all leases. The liability will be equal to the present value of lease payments while the right-of-use asset will be based on the liability, subject to adjustment, such as for initial direct costs. In addition, ASU 2016-02 expands the disclosure requirements for lessees. ASU 2016-02 is effective for our interim and annual reporting periods beginning January 1, 2019 and is to be applied using a modified retrospective adoption method. We are currently evaluating the impact the update will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”), which amends ASC Topic 718, *Compensation – Stock Compensation* (“ASC 718”). The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the accounting for income taxes, classification of excess tax benefits on the statement of cash flows, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. ASU 2016-09 is effective for our interim and annual reporting periods beginning January 1, 2017. Early adoption is permitted. We are currently evaluating the method of adoption and impact the update will have on our consolidated financial statements and related disclosures.

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”), which requires measurement and recognition of expected credit losses for financial assets held. The amendments in ASU 2016-13 eliminate the probable threshold for initial recognition of a credit loss in current GAAP and reflect an entity’s current estimate of all expected credit losses. ASU 2016-13 is effective for our interim and annual reporting periods beginning January 1, 2021. Earlier adoption is permitted. We are currently evaluating the method of adoption and impact the update will have on our consolidated financial statements and related disclosures.

3. Segment Reporting

An operating segment is defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the Chief Operating Decision Maker (“CODM”), or decision-making group, to evaluate performance and make operating decisions. We have identified our CODM as two key executives—the Chief Executive Officer and the Chief Operating Officer.

We have identified each homebuilding division as an operating segment. Our homebuilding operating segments have been aggregated into the reportable segments noted below because they are similar in the following regards: (1) economic characteristics; (2) housing products; (3) class of homebuyer; (4) regulatory environments; and (5) methods used to construct and sell homes. Our homebuilding reportable segments are as follows:

- West (Arizona, California, Nevada and Washington)
- Mountain (Colorado and Utah)
- East (Virginia, Florida and Maryland, which includes Pennsylvania and New Jersey)

Our financial services business consists of the operations of the following operating segments: (1) HomeAmerican Mortgage Corporation (“HomeAmerican”); (2) Allegiant Insurance Company, Inc., A Risk Retention Group (“Allegiant”); (3) StarAmerican Insurance Ltd. (“StarAmerican”); (4) American Home Insurance Agency, Inc.; and (5) American Home Title and Escrow Company. Due to its contributions to consolidated pretax income, we consider HomeAmerican to be a reportable segment (“mortgage operations”). The remaining operating segments have been aggregated into one reportable segment (“other”) because they do not individually exceed 10 percent of: (1) consolidated revenue; (2) the greater of (a) the combined reported profit of all operating segments that did not report a loss or (b) the positive value of the combined reported loss of all operating segments that reported losses; or (3) consolidated

assets.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Homebuilding				
West	$270,031	$217,701	$461,406	$394,518
Mountain	190,334	156,893	328,158	280,914
East	111,146	87,114	178,691	164,195
Total home and land sale revenues	$571,511	$461,708	$968,255	$839,627
Financial Services				
Mortgage operations	$10,702	$7,104	$17,572	$13,753
Other	5,121	4,316	9,268	8,258
Total financial services revenues	$15,823	$11,420	$26,840	$22,011

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Homebuilding				
West	$15,740	$15,597	$25,438	$24,100
Mountain	20,748	14,970	30,832	22,390
East	4,500	19	5,867	(402)
Corporate	(9,582)	(7,013)	(22,075)	(14,525)
Total homebuilding pretax income	$31,406	$23,573	$40,062	$31,563
Financial Services				
Mortgage operations	$6,445	$4,097	$9,768	$6,889
Other	2,607	4,212	4,901	6,756
Total financial services pretax income	$9,052	$8,309	$14,669	$13,645
Total pretax income	$40,458	$31,882	$54,731	$45,208

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

	June 30,	December 31,
	2016	2015
	(Dollars in thousands)	
Homebuilding assets		
West	$1,066,722	$991,393
Mountain	559,287	536,831
East	317,013	324,457
Corporate	335,792	393,712
Total homebuilding assets	$2,278,814	$2,246,393

Financial services assets		
Mortgage operations	$131,572	$123,176
Other	51,014	46,330
Total financial services assets	$182,586	$169,506
Total assets	$2,461,400	$2,415,899

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

4. Earnings Per Share

ASC Topic 260, *Earnings Per Share* ("ASC 260"), requires a company that has participating security holders (for example, holders of unvested restricted stock that has nonforfeitable dividend rights) to utilize the two-class method for calculating earnings per share ("EPS") unless the treasury stock method results in lower 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/(loss)). Our common shares outstanding are comprised of shareholder owned common stock and participating security holders consisting of shareholders of unvested restricted stock. Basic EPS is calculated by dividing income or loss attributable to common stockholders by the weighted average number of shares of common stock outstanding, excluding participating shares in accordance with ASC 260. To calculate diluted EPS, basic EPS is further adjusted to include the effect of potential dilutive stock options outstanding. The table below shows basic and diluted EPS calculations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands, except per share amounts)			
Numerator				
Net income	$26,913	$19,998	$36,476	$28,418
Less: distributed earnings allocated to participating securities	(39)	(23)	(79)	(48)
Less: undistributed earnings allocated to participating securities	(47)	(15)	(36)	(9)
Net income attributable to common stockholders (numerator for basic earnings per share)	26,827	19,960	36,361	28,361
Add back: undistributed earnings allocated to participating securities	47	15	36	9
Less: undistributed earnings reallocated to participating securities	(47)	(15)	(36)	(9)
Numerator for diluted earnings per share under two class method	$26,827	$19,960	$36,361	$28,361
Denominator				
Weighted-average common shares outstanding	48,851,350	48,768,021	48,839,660	48,741,476
Add: dilutive effect of stock options	10,392	237,016	9,254	212,583

Denominator for diluted earnings per share under two class method	48,861,742	49,005,037	48,848,914	48,954,059
Basic Earnings Per Common Share	$0.55	$0.41	$0.74	$0.58
Diluted Earnings Per Common Share	$0.55	$0.41	$0.74	$0.58

Diluted EPS for the three and six months ended June 30, 2016 excluded options to purchase approximately 6.4 million and 6.5 million shares, respectively, of common stock because the effect of their inclusion would be anti-dilutive. For the same periods in 2015, diluted EPS excluded options to purchase approximately 3.6 million and 3.6 million shares, respectively.

5. Accumulated Other Comprehensive Income

The following table sets forth our changes in accumulated other comprehensive income ("AOCI"):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Unrealized gains (losses) on available-for-sale marketable securities [1] :				
Beginning balance	$5,016	$3,142	$3,657	$2,775
Other comprehensive income (loss) before reclassifications	880	(1,260)	1,404	(900)
Amounts reclassified from AOCI [2]	(552)	(293)	283	(286)
Ending balance	$5,344	$1,589	$5,344	$1,589
Unrealized gains on available-for-sale metropolitan district bond securities [1] :				
Beginning balance	$12,647	$8,621	$12,058	$7,680
Other comprehensive income before reclassifications	567	1,193	1,156	2,134
Amounts reclassified from AOCI	-	-	-	-
Ending balance	$13,214	$9,814	$13,214	$9,814
Total ending AOCI	$18,558	$11,403	$18,558	$11,403

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

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

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

Affected Line Item in the Statements of Operations	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(Dollars in thousands)			
Homebuilding interest and other income	$1,177	$137	$262	$125
Other-than-temporary impairment of marketable securities	(288)	-	(719)	-
Financial services interest and other income	-	336	-	337
Income before income taxes	889	473	(457)	462
Provision for income taxes	(337)	(180)	174	(176)
Net income	$552	$293	$(283)	$286

6. Fair Value Measurements

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

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

Financial Instrument	Fair Value Hierarchy	June 30, 2016	December 31, 2015

		(Dollars in thousands)	
Marketable equity securities (available-for-sale)	Level 1	$70,619	$103,694
Mortgage loans held-for-sale, net	Level 2	$118,699	$115,670
Metropolitan district bond securities (related party) (available-for-sale)	Level 3	$28,604	$25,911

The following methods and assumptions were used to estimate the fair value of each class of financial instruments as of June 30, 2016 and December 31, 2015.

Cash and cash equivalents, restricted cash, trade and other receivables, prepaid and other assets, accounts payable, accrued liabilities and borrowings on our revolving credit facility. Fair value approximates carrying value.

Marketable securities. As of June 30, 2016 and December 31, 2015, we only held marketable equity securities. However, during 2015, we also held marketable debt securities. Our equity securities consist of holdings in corporate equities and holdings in mutual fund securities, which are primarily invested in debt securities. Our debt securities consisted primarily of fixed and floating rate interest earning debt securities, which may have included, among others, United States government and government agency debt and corporate debt. As of June 30, 2016 and December 31, 2015, all of our equity securities were treated as available-for-sale investments and as such, are recorded at fair value with all changes in fair value initially recorded through AOCI, subject to an assessment to determine if an unrealized loss, if applicable, is other-than-temporary.

Each quarter we assess all of our securities in an unrealized loss position for a potential other-than-temporary impairment ("OTTI"). If the unrealized loss is determined to be other-than-temporary, an OTTI is recorded in the consolidated statements of operations and comprehensive income. During the three months and six months ended June 30, 2016, we recorded pretax OTTIs of $0.3 million and $0.7 million, respectively, for certain of our equity securities that were in an unrealized loss position as of the end of each respective period. The OTTIs are included in other-than-temporary impairment of marketable securities in the homebuilding section of our consolidated statements of operations and comprehensive income. No such impairments were recorded during the three and six months ended June 30, 2015.

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

The following tables set forth the cost and fair value of our marketable equity securities:

	June 30, 2016			
	Amortized Cost	OTTI	Net Amortized Cost	Fair Value
	(Dollars in thousands)			
Homebuilding equity securities	$47,923	$(904)	$ 47,019	$55,798
Financial services equity securities	14,979	-	14,979	14,821
Total marketable equity securities	$62,902	$(904)	$ 61,998	$70,619

	December 31, 2015			
	Amortized Cost	OTTI	Net Amortized Cost	Fair Value
	(Dollars in thousands)			
Homebuilding equity securities	$89,738	$(3,969)	$ 85,769	$92,387
Financial services equity securities	12,026	-	12,026	11,307
Total marketable equity securities	$101,764	$(3,969)	$ 97,795	$103,694

As of June 30, 2016 and December 31, 2015, our marketable equity securities were in net unrealized gain positions totaling $8.6 million and $5.9 million, respectively. Our individual marketable equity securities that were in unrealized loss positions, excluding those that were impaired as part of any OTTI, aggregated to an unrealized loss of $0.6 million and $0.9 million as of June 30, 2016 and December 31, 2015, respectively. The table below sets forth the aggregated unrealized losses for individual equity securities that were in unrealized loss positions but did not have OTTIs recognized. We do not believe the decline in the value of these marketable securities as of June 30, 2016 is other-than-temporary.

June 30, 2016	December 31, 2015

	Number of Securities in an Unrealized Loss Position	Aggregate Unrealized Loss Position	Aggregate Fair Value of Securities in an Unrealized Loss Position	Number of Securities in an Unrealized Loss Position	Aggregate Unrealized Loss Position	Aggregate Fair Value of Securities in an Unrealized Loss Position
	(Dollars in thousands)					
Marketable equity securities	2	$ (604)	$ 2,394	4	$ (882)	$ 6,116

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

The table below sets forth gross realized gains and losses from the sale of available-for-sale marketable securities, which were included in other expense in the homebuilding section, or interest and other income in the financial services section, of our consolidated statements of operations and comprehensive income.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Gross realized gains on sales of available-for-sale securities				
Equity securities	$1,379	$638	$1,470	$875
Debt securities	-	205	-	371
Total	$1,379	$843	$1,470	$1,246
Gross realized losses on sales of available-for-sale securities				
Equity securities	$(202)	$(232)	$(1,208)	$(557)
Debt securities	-	(138)	-	(227)
Total	$(202)	$(370)	$(1,208)	$(784)
Net realized gain on sales of available-for-sale securities	$1,177	$473	$262	$462

Mortgage loans held-for-sale, net. Our mortgage loans held-for-sale, which are measured at fair value on a recurring basis, include (1) mortgage loans held-for-sale that are under commitments to sell and (2) mortgage loans held-for-sale that are not under commitments to sell. At June 30, 2016 and December 31, 2015, we had $94.9 million and $92.6 million, respectively, of mortgage loans held-for-sale under commitments to sell. The fair value for those loans was based on quoted market prices for those mortgage loans, which are Level 2 fair value inputs. At June 30, 2016 and December 31, 2015, we had $23.8 million and $23.1 million, respectively, of mortgage loans held-for-sale that were not under commitments to sell. The fair value for those loans was primarily based upon the estimated market price received from an outside party, which is a Level 2 fair value input.

Gains on sales of mortgage loans, net, are included as a component of revenues in the financial services section of our consolidated statements of operations and comprehensive income. For the three and six months ended June 30, 2016, we recorded net gains on the sales of mortgage loans of $6.9 million and $12.5 million, respectively, compared to $4.4 million and $8.8 million for the same periods in the prior year, respectively.

Metropolitan district bond securities (related party). The metropolitan district bond securities (the “Metro Bonds”) are included in the homebuilding section of our consolidated balance sheets. We acquired the Metro Bonds from a quasi-municipal corporation in the state of Colorado (the “Metro District”), which was formed to help fund and maintain the infrastructure associated with a master-planned community being developed by our Company. Cash flows received by the Company from these securities reflect principal and interest payments from the Metro District, which are generally received in the fourth quarter, and are supported by an annual levy on the taxable assessed value of real estate and personal property within the Metro District’s boundaries. The stated year of maturity for the Metro Bonds is 2037. However, if the unpaid principal and all accrued interest are not paid off by the year 2037, the Company will continue to receive principal and interest payments in perpetuity until the unpaid principal and accrued interest is paid in full.

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

In accordance with ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (“ASC 310-30”), we adjust the bond principal balance using an interest accretion model that utilizes future cash flows expected to be collected. Furthermore, as this investment is accounted for as an available-for-sale asset, we update its fair value on a quarterly basis, with the adjustment being recorded through AOCI. The fair value is based upon a discounted future cash flow model, which uses Level 3 inputs. The primary unobservable inputs used in our discounted cash flow model are (1) the forecasted number of homes to be closed, as they drive increases to the tax paying base for the Metro District, (2) the forecasted assessed value of those closed homes and (3) the discount rate. Cash receipts, which are typically only received in the fourth quarter, reduce the carrying value of the Metro Bonds. The increases in the value of the Metro Bonds during the past two years are based on a larger percentage of future cash flows coming from homes that have closed, which utilize a lower discount rate as those cash flows have a reduced amount of risk. The table below provides quantitative data, as of June 30, 2016, regarding each unobservable input and the sensitivity of fair value to potential changes in those unobservable inputs.

	Quantitative Data				Sensitivity Analysis	
Unobservable Input	Range			Weighted Average	Movement in Fair Value from Increase in Input	Movement in Fair Value from Decrease in Input
Number of homes closed per year	0	to	130	91	Increase	Decrease
Average sales price	$419,000	to	$1,200,000	486,000	Increase	Decrease
Discount rate	5%	to	12%	7.4%	Decrease	Increase

The table set forth below summarizes the activity for our Metro Bonds:

	Three Months Ended	Six Months Ended
	June 30,	June 30,

	2016	2015	2016	2015
	(Dollars in thousands)			
Balance at beginning of period	$27,277	$19,978	$25,911	$18,203
Increase in fair value (recorded in other comprehensive income)	915	1,925	1,865	3,343
Change due to accretion of principal	412	356	828	713
Cash receipts	-	-	-	-
Balance at end of period	$28,604	$22,259	$28,604	$22,259

Mortgage Repurchase Facility. The debt associated with our mortgage repurchase facility (see Note 18 for further discussion) is at floating rates or at fixed rates that approximate current market rates and have relatively short-term maturities, generally within 30 days. The fair value approximates carrying value and is based on Level 2 inputs.

Senior Notes. The estimated values of the senior notes in the following table are based on Level 2 inputs, which primarily reflect estimated prices for our senior notes and were obtained from multiple pricing sources.

	June 30, 2016		December 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
5 % Senior Notes due February 2020, net	$246,466	$261,767	$246,032	$257,813
5½% Senior Notes due January 2024	248,299	249,892	248,209	252,188
6% Senior Notes due January 2043	346,311	275,228	346,283	276,938
Total	$841,076	$786,887	$840,524	$786,939

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

7. Inventories

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

	June 30, 2016	December 31, 2015
	(Dollars in thousands)	
Housing Completed or Under Construction:		
West	$498,341	$365,867
Mountain	295,775	253,578
East	139,806	127,591
Subtotal	933,922	747,036
Land and Land Under Development:		
West	511,643	580,682
Mountain	232,414	259,484
East	149,039	176,760
Subtotal	893,096	1,016,926
Total Inventories	$1,827,018	$1,763,962

Our inventories are primarily associated with communities where we intend to construct and sell homes, including models and unsold homes (defined as homes under construction without a sales contract). Costs capitalized to land and land under development primarily include: (1) land costs; (2) land development costs; (3) entitlement costs; (4) capitalized interest; (5) engineering fees; and (6) title insurance, real property taxes and closing costs directly related to the purchase of the land parcel. Components of housing completed or under construction primarily include: (1) land costs transferred from land and land under development; (2) direct construction costs associated with a house; (3) real property taxes, engineering fees, permits and other fees; (4) capitalized interest; and (5) indirect construction costs, which include field construction management salaries and benefits, utilities and other construction related costs. Land costs are transferred from land and land under development to housing completed or under construction at the point in time that construction of a home on an owned lot begins.

In accordance with ASC Topic 360, *Property, Plant, and Equipment* ("ASC 360"), homebuilding inventories, excluding those classified as held for sale, are carried at cost unless events and circumstances indicate that the carrying value of the underlying subdivision may not be recoverable. We evaluate inventories for impairment at each quarter end on a

subdivision level basis as each such subdivision represents the lowest level of identifiable cash flows. In making this determination, we review, among other things, the following for each subdivision:

- actual and trending “Operating Margin” (which is defined as home sale revenues less home cost of sales and all direct incremental costs associated with the home closing, including sales commissions) for homes closed;
- estimated future undiscounted cash flows and Operating Margin;
- forecasted Operating Margin for homes in backlog;
- actual and trending net and gross home orders;
- base sales price and home sales incentive information for homes closed, homes in backlog and homes available for sale;
- market information for each sub-market, including competition levels, home foreclosure levels, the size and style of homes currently being offered for sale and lot size; and
- known or probable events indicating that the carrying value may not be recoverable.

If events or circumstances indicate that the carrying value of our inventory may not be recoverable, assets are reviewed for impairment by comparing the undiscounted estimated future cash flows from an individual subdivision (including capitalized interest) to its carrying value. If the undiscounted future cash flows are less than the subdivision’s carrying value, the carrying value of the subdivision is written down to its then estimated fair value. We generally determine the estimated fair value of each subdivision by determining the present value of the estimated future cash flows at discount rates, which are Level 3 inputs, that are commensurate with the risk of the subdivision under evaluation. The evaluation for the recoverability of the carrying value of the assets for each individual subdivision can be impacted significantly by our estimates of future home sale revenues, home construction costs, and development costs per home, all of which are Level 3 inputs.

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

If land is classified as held for sale, in accordance with ASC 360, we measure it at the lower of the carrying value or fair value less estimated costs to sell. In determining fair value, we primarily rely upon the most recent negotiated price which is a Level 2 input. If a negotiated price is not available, we will consider several factors including, but not limited to, current market conditions, recent comparable sales transactions and market analysis studies. If the fair value less estimated costs to sell is lower than the current carrying value, the land is impaired down to its estimated fair value less costs to sell.

Impairments of homebuilding inventory by segment for the three and six months ended June 30, 2016 and 2015 are shown in the table below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
West	$1,400	$ -	$1,400	$-
Mountain	-	-	-	-
East	200	-	200	350
Total Inventory Impairments	$1,600	$ -	$1,600	$350

The table below provides quantitative data, for the periods presented, used in determining the fair value of the impaired inventory.

	Impairment Data				Quantitative Data
Three Months Ended	Total Subdivisions Tested	Inventory Impairments	Fair Value of Inventory After Impairments	Number of Subdivisions Impaired	Discount Rate
	(Dollars in thousands)				
March 31, 2016	14	$ -	$ -	-	N/A

June 30, 2016	17	$	1,600	$	6,415	2	12%	to	15%
March 31, 2015	22	$	350	$	3,701	1		8.7%	
June 30, 2015	22	$	-	$	-	-		N/A	

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

8. Capitalization of Interest

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

The homebuilding interest expensed in the table below relates to the portion of interest incurred where our homebuilding debt exceeded our qualified inventory for such periods in accordance with ASC 835.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
	(Dollars in thousands)			
Homebuilding interest incurred	$13,106	$13,305	$26,324	$26,556
Less: Interest capitalized	(13,106)	(13,305)	(26,324)	(26,556)
Homebuilding interest expensed	$-	$-	$-	$-
Interest capitalized, beginning of period	$79,783	$79,991	$77,541	$79,231
Plus: Interest capitalized during period	13,106	13,305	26,324	26,556
Less: Previously capitalized interest included in home and land cost of sales	(15,739)	(14,439)	(26,715)	(26,930)
Interest capitalized, end of period	$77,150	$78,857	$77,150	$78,857

9. Homebuilding Prepaid Expenses and Other Assets

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

	June 30, 2016	December 31, 2015
	(Dollars in thousands)	
Land option deposits	$8,841	$ 11,997
Deferred marketing costs	33,735	31,152
Prepaid expenses	6,119	6,500
Goodwill	6,008	6,008
Deferred debt issuance costs, net	5,004	5,570
Other	5,547	4,167
Total	$65,254	$ 65,394

10. Homebuilding Accrued Liabilities and Financial Services Accounts Payable and Accrued Liabilities

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

	June 30, 2016	December 31, 2015
	(Dollars in thousands)	
Customer and escrow deposits	$30,067	$20,717
Warranty accrual	17,217	15,328
Accrued compensation and related expenses	21,072	25,492
Accrued interest	23,234	23,234
Land development and home construction accruals	10,904	11,465
Other accrued liabilities	28,157	26,650
Total accrued liabilities	$130,651	$122,886

Table Of Contents

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

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

	June 30, 2016	December 31, 2015
	(Dollars in thousands)	
Insurance reserves	$46,900	$ 45,811
Accounts payable and other accrued liabilities	9,160	6,303
Total accounts payable and accrued liabilities	$56,060	$ 52,114

11. Warranty Accrual

Our homes are sold with limited third-party warranties. We record accruals for general and structural warranty claims, as well as accruals for known, unusual warranty-related expenditures. Our warranty accruals are recorded based upon historical payment experience in an amount estimated to be adequate to cover expected costs of materials and outside labor during warranty periods. The determination of the warranty accrual rate for closed homes and the evaluation of our warranty accrual balance at period end are based on an internally developed analysis that includes known facts and interpretations of circumstances, including, among other things, our trends in historical warranty payment levels and warranty payments for claims not considered to be normal and recurring.

Our warranty accrual is included in accrued liabilities in the homebuilding section of our consolidated balance sheets and adjustments to our warranty accrual are recorded as an increase or reduction to home cost of sales in the homebuilding section of our consolidated statements of operations and comprehensive income.

The table set forth below summarizes accrual, adjustment and payment activity related to our warranty accrual for the three and six months ended June 30, 2016 and 2015. For the three and six months ended June 30, 2016 we recorded adjustments of $0.3 million and $3.2 million, respectively, to increase our warranty accrual primarily due to higher than expected recent warranty related expenditures. For the same periods in the prior year, we reduced our warranty reserve by $0.2 million.