MDC HOLDINGS INC
Form 10-Q
May 03, 2018

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**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 March 31, 2018**

**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**<br><br>**of incorporation or organization)** | **(I.R.S. employer identification no.)** |
|---|---|

| **4350 South Monaco Street, Suite 500 Denver, Colorado** | **80237** |
|---|---|
| **(Address of principal executive offices)** | **(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, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth 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** |
| **Emerging growth company** | | |

**If an emerging growth company, indicate by check mark if the registrant has elected to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.**

**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 May 1, 2018, 56,223,613 shares of M.D.C. Holdings, Inc. common stock were outstanding.**

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**M.D.C. HOLDINGS, INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED MARCH 31, 2018**

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**PART I**

**ITEM 1. Unaudited Consolidated Financial Statements**

**M.D.C. HOLDINGS, INC.**

**Consolidated Balance Sheets.**

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in thousands, except per share amounts) (Unaudited) | |
| **ASSETS** | | |
| **Homebuilding:** | | |
| Cash and cash equivalents | $352,868 | $472,957 |
| Marketable securities | 49,817 | 49,634 |
| Restricted cash | 6,198 | 8,812 |
| Trade and other receivables | 52,909 | 53,362 |
| Inventories: | | |
| Housing completed or under construction | 1,009,197 | 936,685 |
| Land and land under development | 964,660 | 893,051 |
| Total inventories | 1,973,857 | 1,829,736 |
| Property and equipment, net | 53,368 | 26,439 |
| Deferred tax asset, net | 40,484 | 41,480 |
| Prepaid and other assets | 38,015 | 75,666 |
| Total homebuilding assets | 2,567,516 | 2,558,086 |
| **Financial Services:** | | |
| Cash and cash equivalents | 48,514 | 32,471 |
| Marketable securities | 40,912 | 42,004 |
| Mortgage loans held-for-sale, net | 113,158 | 138,114 |
| Other assets | 17,062 | 9,617 |
| Total financial services assets | 219,646 | 222,206 |
| Total Assets | $2,787,162 | $2,780,292 |
| **LIABILITIES AND EQUITY** | | |
| **Homebuilding:** | | |

| | | |
|---|---|---|
| Accounts payable | $53,347 | $39,655 |
| Accrued liabilities | 155,245 | 166,312 |
| Revolving credit facility | 15,000 | 15,000 |
| Senior notes, net | 986,932 | 986,597 |
| Total homebuilding liabilities | 1,210,524 | 1,207,564 |
| **Financial Services:** | | |
| Accounts payable and accrued liabilities | 54,019 | 53,101 |
| Mortgage repurchase facility | 90,126 | 112,340 |
| Total financial services liabilities | 144,145 | 165,441 |
| Total Liabilities | 1,354,669 | 1,373,005 |
| **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; 56,219,643 and 56,123,228 issued and outstanding at March 31, 2018 and December 31, 2017, respectively | 562 | 561 |
| Additional paid-in-capital | 1,146,102 | 1,144,570 |
| Retained earnings | 285,829 | 258,164 |
| Accumulated other comprehensive income | - | 3,992 |
| Total Stockholders' Equity | 1,432,493 | 1,407,287 |
| Total Liabilities and Stockholders' Equity | $2,787,162 | $2,780,292 |

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 and Comprehensive Income**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands, except per share amounts) (Unaudited) | |
| **Homebuilding:** | | |
| Home sale revenues | $607,688 | $563,479 |
| Land sale revenues | - | 247 |
| Total home and land sale revenues | 607,688 | 563,726 |
| Home cost of sales | (496,632) | (468,942) |
| Land cost of sales | - | (211) |
| Inventory impairments | (550) | (4,850) |
| Total cost of sales | (497,182) | (474,003) |
| Gross profit | 110,506 | 89,723 |
| Selling, general and administrative expenses | (71,341) | (66,298) |
| Interest and other income | 1,859 | 2,327 |
| Other expense | (563) | (351) |
| Other-than-temporary impairment of marketable securities | - | (50) |
| Homebuilding pretax income | 40,461 | 25,351 |
| **Financial Services:** | | |
| Revenues | 19,035 | 17,979 |
| Expenses | (8,831) | (7,898) |
| Interest and other income | 1,020 | 979 |
| Other expense | (1,153) | - |
| Other-than-temporary impairment of marketable securities | - | (51) |
| Financial services pretax income | 10,071 | 11,009 |
| Income before income taxes | 50,532 | 36,360 |
| Provision for income taxes | (11,768) | (14,111) |
| Net income | $38,764 | $22,249 |
| Other comprehensive income related to available for sale securities, net of tax | - | 1,986 |
| Comprehensive income | $38,764 | $24,235 |
| Earnings per share: | | |
| Basic | $0.69 | $0.40 |
| Diluted | $0.68 | $0.40 |

| | | |
|---|---|---|
| Weighted average common shares outstanding: | | |
| Basic | 55,871,087 | 55,448,161 |
| Diluted | 56,895,892 | 55,717,218 |
| | | |
| Dividends declared per share | $0.30 | $0.23 |

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**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) (Unaudited) | |
| **Operating Activities:** | | |
| Net income | $38,764 | $22,249 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Stock-based compensation expense | 1,251 | 595 |
| Depreciation and amortization | 4,636 | 1,328 |
| Inventory impairments | 550 | 4,850 |
| Other-than-temporary impairment of marketable securities | - | 101 |
| Net gain on sale of available-for-sale marketable securities | - | (561) |
| Net loss on marketable equity securities | 1,153 | - |
| Amortization of discount / premiums on marketable debt securities, net | (182) | - |
| Deferred income tax expense | 423 | 3,220 |
| Net changes in assets and liabilities: | | |
| Trade and other receivables | (3,261) | 7,326 |
| Mortgage loans held-for-sale | 24,956 | 41,401 |
| Housing completed or under construction | (65,378) | (20,866) |
| Land and land under development | (71,552) | 29,030 |
| Prepaid and other assets | 389 | (2,407) |
| Accounts payable and accrued liabilities | 6,765 | 8,071 |
| Net cash provided by (used in) operating activities | (61,486) | 94,337 |
| **Investing Activities:** | | |
| Purchases of marketable securities | (8,761) | (5,361) |
| Sales of marketable securities | 8,700 | 4,983 |
| Purchases of property and equipment | (6,316) | (1,122) |
| Net cash used in investing activities | (6,377) | (1,500) |
| **Financing Activities:** | | |
| Payments on mortgage repurchase facility, net | (22,214) | (43,943) |
| Dividend payments | (16,865) | (12,897) |
| Proceeds from exercise of stock options | 282 | 1,607 |
| Net cash used in financing activities | (38,797) | (55,233) |
| Net increase (decrease) in cash, cash equivalents and restricted cash | (106,660) | 37,604 |
| Cash, cash equivalents and restricted cash: | | |
| Beginning of period | 514,240 | 286,687 |
| End of period | $407,580 | $324,291 |

| **Reconciliation of cash, cash equivalents and restricted cash:** | | |
|---|---|---|
| Homebuilding: | | |
| Cash and cash equivalents | $352,868 | $296,731 |
| Restricted cash | 6,198 | 4,229 |
| Financial Services: | | |
| Cash and cash equivalents | 48,514 | 23,331 |
| Total cash, cash equivalents and restricted cash | $407,580 | $324,291 |

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**

## 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 March 31, 2018 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, 2017.

On November 20, 2017, MDC’s board of directors declared an 8% stock dividend that was distributed on December 19, 2017 to shareholders of record on December 5, 2017. In accordance with Accounting Standards Codification (“ASC”) Topic 260, *Earnings Per Share* (“ASC 260”), basic and diluted earnings per share amounts, share amounts and dividends declared per share have been restated for any periods or dates prior to the stock dividend record date.

Included in these footnotes are certain statements that constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements regarding our business, financial condition, results of operations, cash flows, strategies and prospects. These forward-looking statements may be identified by terminology such as “likely,” “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “belie “estimates,” “predicts,” “potential” or “continue,” or the negative of such terms and other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained in this section are reasonable, we cannot guarantee future results. These statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from those expressed or implied by the forward-looking statements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in subsequent reports on Forms 10-K, 10-Q and 8-K should be considered.

When necessary, reclassifications have been made to our prior period financial information to conform to the current year presentation.

**2. Recently Issued Accounting Standards**

**Adoption of New Accounting Standards**

Accounting Standards Update ("ASU") 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220)* ("ASU 2018-02"). ASU 2018-02 allows for a reclassification from accumulated other comprehensive income to retained earnings for certain tax effects resulting from the Tax Cuts and Jobs Act that was signed into law in December of 2017 (the "Act"). ASU 2018-02 is effective for our interim and annual reporting periods beginning January 1, 2018, and is to be applied either (a) at the beginning of the period of adoption or (b) retrospectively to each period in which the income tax effects of the Act related to items remaining in accumulated other comprehensive income are recognized. On January 1, 2018, we adopted ASU 2018-02 by recognizing an adjustment to the opening balance of retained earnings for certain tax effects related to net unrealized gains on equity investments. The comparative information has not been restated and continues to be reported under the accounting standards in effect for the period. Please see the table below for a summary of all transition adjustments from adoption of new accounting guidance

ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* (a *consensus of the FASB Emerging Issues Task Force* ("ASU 2016-18"). ASU 2016-18 amends ASC 830, *Statement of Cash Flows* and requires restricted cash to be included with cash and cash equivalents when reconciling the beginning and ending amounts on the statement of cash flows. In certain states, we are restricted from using deposits received from our customers who enter into home sale contracts for general purposes unless we take measures to release state imposed restrictions on such deposits received from homebuyers, which may include posting blanket surety bonds. As a result, cash deposits with such restrictions are classified as restricted cash. On January 1, 2018, we adopted ASU 2016-18 using the retrospective transition method. The comparative information in our statement of cash flows has been restated and the impact from adoption of this guidance was not material to our statement of cash flows.

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)* ("ASU 2016-15"). ASU 2016-15 amends ASC 830, *Statement of Cash Flows* and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. On January 1, 2018, we adopted ASU 2016-15 using the retrospective transition method. There were no items in our comparative statement of cash flows that required restatement as a result of the adoption of ASU 2016-15 and the impact from adoption of this guidance was not material to our statement of cash flows.

ASU 2016-01, *Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"). On January 1, 2018, we adopted ASU 2016-01 using a modified retrospective transition method. Prior to this amendment, our equity investments with readily determinable fair values were classified as available for sale with changes in fair value being reported through other comprehensive income. Under the amended standard, any changes in fair value of equity investments with readily determinable fair values are now recognized in net income. We adopted the changes from ASU 2016-01 by recognizing an adjustment to beginning retained earnings for our net unrealized gains/losses on equity investments with readily determinable fair values. The comparative information has not been restated and continues to be reported under the accounting standards in effect for the period. Please see the table below for a summary of all transition adjustments from adoption of new accounting guidance. The effect of the change for the three months ended March 31, 2018 was a reduction to income before income taxes of approximately $1.4 million.

ASU 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). In May 2014, ASU 2014-09 was issued which created ASC Topic 606, *Revenue from Contracts with Customers* ("ASC 606") and is a comprehensive new revenue recognition model. In addition, ASU 2014-09 amended ASC 340, *Other Assets and Deferred Costs,* by adding ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers* ("ASC 340-40"). On January 1, 2018, we adopted ASC 606 and ASC 340-40 using the modified retrospective transition method applied to contracts that were not completed as of January 1, 2018. We recognized the cumulative effect of initially applying ASC 606 and ASC 340-40 as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for the period. Please see the table below for a summary of all transition adjustments from adoption of the new accounting guidance. As a result of adopting ASC 606 and ASC 340-40, there was not a material impact to our consolidated balance sheets or consolidated statements of operations and comprehensive income. Furthermore, there were no significant changes to our internal controls, processes, or systems as a result of adoption of this new guidance.

The cumulative effect of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASU 2018-02, ASU 2016-01 and ASU 2014-09 was as follows:

| Balance Sheet | Balance at December 31, 2017 | Adjustments due to ASU 2018-02 | Adjustments due to ASU 2016-01 | Adjustments due to ASU 2014-09 | Balance at January 1, 2018 |
|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | |
| **Assets:** | | | | | |
| Homebuilding: | | | | | |
| Housing completed or under construction | $936,685 | $ - | $ - | $ 7,406 | $944,091 |
| Property and equipment, net | 26,439 | - | - | 25,270 | 51,709 |
| Prepaid and other assets | 75,666 | - | - | (34,227) | 41,439 |
| Deferred tax asset, net | 41,480 | - | - | (573) | 40,907 |
| Financial Services: | | | | | |
| Other assets | 9,617 | - | - | 3,898 | 13,515 |
| **Stockholders' Equity:** | | | | | |
| Retained earnings | 258,164 | (860) | 4,852 | 1,774 | 263,930 |
| Accumulated other comprehensive income | 3,992 | 860 | (4,852) | - | - |

As substantially all of our contracts are completed within a year, we will not disclose the value of unsatisfied performance obligations. At January 1, 2018 and March 31, 2018, receivables from contracts with customers were $32.6 million and $32.8 million, respectively.

As a result of our adoption of ASU 2014-09, our significant accounting policies have been updated as follows:

*Revenue Recognition for Homebuilding Segments.* We recognize home sale revenues from home deliveries when we have satisfied the performance obligations within the sales agreement, which is generally when title to and possession of the home are transferred to the buyer at the home closing date. Revenue from a home delivery includes the base sales price and any purchased options and upgrades and is reduced for any sales price incentives.

**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

We generally do not record the sale of a home or recognize the associated revenue if all of the following criteria are present: (1) HomeAmerican originates the mortgage loan and has not sold the mortgage loan, or loans, as of the end of the pertinent reporting period; and (2) the homebuyer does not meet certain collectability thresholds, based on the type of mortgage loan, related to their credit score, debt to income ratio and loan to value ratio. The deferral is subsequently recognized at the time HomeAmerican sells the respective loan to a third-party purchaser. In the event the gross margin is a loss, we recognize such loss at the time the home is closed.

In certain states that we build, we are not always able to complete certain outdoor features (such as landscaping or pools) prior to closing the home. To the extent these separate deliverables are not complete upon the closing of a home, we will defer home sale revenues related to incomplete outdoor features, and recognize revenue upon completion of the outdoor features.

*Home Cost of Sales*. Home cost of sales includes the specific construction costs of each home and all applicable land acquisition, land development and related costs, warranty costs and finance and closing costs, including closing cost incentives. We use the specific identification method for the purpose of accumulating home construction costs and allocate costs to each lot within a subdivision associated with land acquisition and land development based upon relative fair value of the lots prior to home construction. Lots within a subdivision typically have comparable fair values, and, as such, we generally allocate costs equally to each lot within a subdivision. We record all home cost of sales when a home is closed and performance obligations have been completed on a house-by-house basis.

When a home is closed, we may not have paid for all costs necessary to complete the construction of the home. This includes (1) construction that has been completed on a house but has not yet been billed or (2) work still to be performed on a home (such as limited punch-list items or certain outdoor features). For each of these items, we create an estimate of the total expected costs to be incurred and, with the exclusion of outdoor features, the estimated total costs for those items, less any amounts paid to date, are included in home cost of sales. Actual results could differ from such estimates. For incomplete outdoor features, we will defer the revenue and any cost of sales on this separate stand-alone deliverable until complete.

*Costs Related to Sales Facilities.* Certain marketing costs related to model homes or on-site sales facilities are either recorded as inventory, capitalized as property and equipment, or expensed as incurred. Costs related to interior and exterior upgrades to the home that will be sold as part of the home, such as wall treatments and additional upgraded landscaping, are recorded as inventory costs attributable to homes completed or under construction. Costs to furnish and ready the model home or on-site sales facility that will not be sold as part of the model home, such as furniture, construction of the sales facility parking lot or construction of the sales center, are capitalized as property and

equipment, net. Other costs incurred related to the marketing of the community and readying the model home for sale are expensed as incurred.

*Property and Equipment, net.* Property and equipment is carried at cost less accumulated depreciation. For property and equipment related to on-site sales facilities, depreciation is recorded using a units of production method as homes are delivered. For all other property and equipment, depreciation is recorded using a straight-line method over the estimated useful lives of the related assets, which range from 2 to 29 years.

**Accounting Standards Issued But Not Yet Adopted**

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 the remaining 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. Upon adoption, we will be required to record a lease asset and lease liability related to our operating leases. 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 transition method. Early adoption is permitted. We do not plan to early adopt the guidance and we are currently evaluating the impact the update will have on our consolidated financial statements and related disclosures.

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, and is to be applied using a modified retrospective transition method. Earlier adoption is permitted. We do not plan to early adopt ASU 2016-13 and with our current holdings of financial instruments that are subject to credit losses, we do not believe adoption of this guidance will be material to our financial statements.

**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 (“CEO”) and the Chief Operating Officer (“COO”).

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, Washington and Oregon)
Mountain (Colorado and Utah)
East (Virginia, Florida and Maryland)

Our financial services business consists of the operations of the following operating segments: (1) HomeAmerican; (2) Allegiant; (3) 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.

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

Corporate is a non-operating segment that develops and implements strategic initiatives and supports our operating divisions by centralizing key administrative functions such as finance, treasury, information technology, insurance, 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 the homebuilding operations section of our consolidated statements of operations and comprehensive income.

The following table summarizes revenues for our homebuilding and financial services operations:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| **Homebuilding** | | |
| West | $319,509 | $309,079 |
| Mountain | 208,632 | 173,136 |
| East | 79,547 | 81,511 |
| Total homebuilding revenues | $607,688 | $563,726 |
| | | |
| **Financial Services** | | |
| Mortgage operations | $12,696 | $12,183 |
| Other | 6,339 | 5,796 |
| Total financial services revenues | $19,035 | $17,979 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |

| | (Dollars in thousands) | |
|---|---|---|
| **Homebuilding** | | |
| West | $24,373 | $15,455 |
| Mountain | 24,185 | 18,230 |
| East | 3,375 | 2,642 |
| Corporate | (11,472) | (10,976) |
| Total homebuilding pretax income | $40,461 | $25,351 |
| | | |
| **Financial Services** | | |
| Mortgage operations | $7,520 | $7,566 |
| Other | 2,551 | 3,443 |
| Total financial services pretax income | $10,071 | $11,009 |
| | | |
| Total pretax income | $50,532 | $36,360 |

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.

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in thousands) | |
| **Homebuilding assets** | | |
| West | $1,187,865 | $1,084,756 |
| Mountain | 717,796 | 674,057 |
| East | 189,483 | 201,684 |
| Corporate | 472,372 | 597,589 |
| Total homebuilding assets | $2,567,516 | $2,558,086 |
| | | |
| **Financial services assets** | | |
| Mortgage operations | $128,931 | $152,345 |
| Other | 90,715 | 69,861 |
| Total financial services assets | $219,646 | $222,206 |
| | | |
| Total assets | $2,787,162 | $2,780,292 |

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## 4. Earnings Per Share

ASC 260 requires a company that has participating security holders (for example, holders of unvested restricted stock that have non-forfeitable 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 shares of unvested restricted stock held by participating security holders. 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 potentially dilutive stock options outstanding. The table below shows our basic and diluted EPS calculations.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands, except per share amounts) | |
| **Numerator** | | |
| Net income | $38,764 | $22,249 |
| Less: distributed earnings allocated to participating securities | (105) | (68) |
| Less: undistributed earnings allocated to participating securities | (124) | (43) |
| Net income attributable to common stockholders (numerator for basic earnings per share) | 38,535 | 22,138 |
| Add back: undistributed earnings allocated to participating securities | 124 | 43 |
| Less: undistributed earnings reallocated to participating securities | (122) | (43) |
| Numerator for diluted earnings per share under two class method | $38,537 | $22,138 |
| **Denominator** | | |
| Weighted-average common shares outstanding | 55,871,087 | 55,448,161 |
| Add: dilutive effect of stock options | 1,024,805 | 269,057 |
| Denominator for diluted earnings per share under two class method | 56,895,892 | 55,717,218 |
| Basic Earnings Per Common Share | $0.69 | $0.40 |
| Diluted Earnings Per Common Share | $0.68 | $0.40 |

Diluted EPS for the three months ended March 31, 2018 and 2017 excluded options to purchase approximately 0.1 and 4.2 million shares of common stock, respectively, because the effect of their inclusion would be anti-dilutive. The year-over-year decreases in anti-dilutive shares and the year-over-year increases in dilutive shares were primarily the result of year-over-year increases in the average price of MDC stock.

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## 5. Accumulated Other Comprehensive Income

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| Beginning balance [1] | $3,992 | $22,071 |
| Adoption of accounting standards (Note 2) | (3,992) | - |
| Other comprehensive income before reclassifications | - | 2,271 |
| Amounts reclassified from AOCI [2] | - | (285) |
| Ending balance | $- | $24,057 |

(1) All amounts net-of-tax.

(2) See separate table below for details about these reclassifications.

During the first quarter of 2018, an election was made to reclassify the income tax effects of the Act related to net unrealized gains on equity investments from accumulated other comprehensive income to retained earnings. See Note 2 for further discussion of adoption of new accounting standards.

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

| | Three Months Ended March 31, | |
|---|---|---|
| Affected Line Item in the Statements of Operations | 2018 | 2017 |

| | (Dollars in thousands) | |
|---|---|---|
| Homebuilding: Interest and other income | $ - | $ 522 |
| Homebuilding: Other-than-temporary impairment of marketable securities | - | (50 ) |
| Financial services: Interest and other income | - | 39 |
| Financial services: Other-than-temporary impairment of marketable securities | - | (51 ) |
| Income before income taxes | - | 460 |
| Provision for income taxes | - | (175 ) |
| Net income | $ - | $ 285 |

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## 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 | Hierarchy | Fair Value<br>March 31,<br>2018 | December 31,<br>2017 |
|---|---|---|---|
| | | (Dollars in thousands) | |
| Cash and cash equivalents | | | |
| Debt securities (available-for-sale) | Level 1 | $134,505 | $99,863 |
| Marketable securities | | | |
| Equity securities | Level 1 | $40,912 | $42,004 |
| Debt securities (available-for-sale) | Level 1 | 49,817 | 49,634 |
| Total marketable securities | | $90,729 | $91,638 |
| Mortgage loans held-for-sale, net | Level 2 | $113,158 | $138,114 |

The following methods and assumptions were used to estimate the fair value of each class of financial instruments as of March 31, 2018 and December 31, 2017.

*Cash and cash equivalents (excluding debt securities with an original maturity of three months or less), 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.

*Equity securities*. Our equity securities consist of holdings in corporate equities, preferred stock and exchange traded funds. As of March 31, 2018, all of our equity securities were recorded at fair value with all changes in fair value recorded to either interest and other income or other expense, dependent upon whether there was a net gain or loss, respectively, in the homebuilding section or financial services section of our consolidated statements of operations and comprehensive income. As of December 31, 2017, all of our equity securities were treated as available-for-sale investments and as such, were 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, was other-than-temporary. See Note 2 for further discussion of adoption of new accounting standards.

*Debt securities*. Our debt securities consist of U.S. government securities that have an original maturity of three to six months. As of March 31, 2018 and December 31, 2017, all of our debt 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 any unrealized loss, if applicable, is other-than-temporary.

Each quarter we assess all of our securities in an unrealized loss position (excluding marketable equity securities subsequent to the adoption of ASU 2016-01 – see Note 2 for further discussion of adoption of new accounting standards) for a potential other-than-temporary impairment (“OTTI”). If the unrealized loss is determined to be other-than-temporary, an OTTI is recorded in other-than-temporary impairment of marketable securities in the homebuilding or financial services sections of our consolidated statements of operations and comprehensive income. During the three months ended March 31, 2017, we recorded pretax OTTI’s of $0.1 million. No such impairments were recorded during the three months ended March 31, 2018.

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The following tables set forth the cost and estimated fair value of our available for sale debt securities:

| | March 31, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost Basis | OTTI | Net Amortized Cost | Fair Value |
| | (Dollars in thousands) | | | |
| **Homebuilding** | | | | |
| Cash and cash equivalents | | | | |
| Debt securities | $99,601 | $ - | $ 99,601 | $99,601 |
| Marketable securities | | | | |
| Debt securities | $49,817 | $ - | $ 49,817 | $49,817 |
| **Financial Services** | | | | |
| Cash and cash equivalents | | | | |
| Debt securities | $34,904 | $ - | $ 34,904 | $34,904 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost Basis | OTTI | Net Amortized Cost | Fair Value |
| | (Dollars in thousands) | | | |
| **Homebuilding** | | | | |
| Cash and cash equivalents | | | | |
| Debt securities | $99,663 | $ - | $ 99,663 | $99,663 |
| Marketable securities | | | | |
| Debt securities | $49,634 | $ - | $ 49,634 | $49,634 |
| **Financial Services** | | | | |
| Cash and cash equivalents | | | | |
| Debt securities | $200 | $ - | $ 200 | $200 |

The following table reconciles the net loss recognized during the period on equity securities to the unrealized loss recognized during the period on equity securities still held at the reporting date.

| | Three Months Ended March 31, 2018 (Dollars in thousands) |
|---|---|
| Net losses recognized during the period on equity securities | $ (1,153) |
| Less: Net losses recognized during the period on equity securities sold during the period | (96) |
| Unrealized losses recognized during the reporting period on equity securities still held at the reporting date | $ (1,057) |

*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 March 31, 2018 and December 31, 2017, we had $81.2 million and $103.5 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 March 31, 2018 and December 31, 2017, we had $32.0 million and $34.6 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.

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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 months ended March 31, 2018, we recorded net gains on the sales of mortgage loans of $9.0 million, compared to $8.5 million for the same period in the prior year.

*Mortgage Repurchase Facility.* The debt associated with our mortgage repurchase facility (see Note 18 for further discussion) is at floating 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 which were provided by multiple sources.

| | March 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (Dollars in thousands) | | | |
| $250 Million 5  % Senior Notes due February 2020, net | $248,097 | $257,922 | $247,853 | $261,991 |
| $250 Million 5½% Senior Notes due January 2024, net | 248,634 | 254,913 | 248,585 | 263,617 |
| $500 Million 6% Senior Notes due January 2043, net | 490,201 | 464,317 | 490,159 | 493,094 |
| Total | $986,932 | $977,152 | $986,597 | $1,018,702 |

**7. Inventories**

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

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in thousands) | |
| Housing completed or under construction: | | |
| West | $531,072 | $489,136 |

| | | |
|---|---|---|
| Mountain | 357,926 | 328,897 |
| East | 120,199 | 118,652 |
| Subtotal | 1,009,197 | 936,685 |
| Land and land under development: | | |
| West | 586,824 | 517,697 |
| Mountain | 322,262 | 309,072 |
| East | 55,574 | 66,282 |
| Subtotal | 964,660 | 893,051 |
| Total inventories | $1,973,857 | $1,829,736 |

Our inventories are primarily associated with communities where we intend to construct and sell homes, including models and unsold homes. Costs capitalized to land and land under development primarily include: (1) land costs; (2) land development costs; (3) entitlement costs; (4) capitalized interest; (5) engineering fees; and (6) title insurance, real property taxes and closing costs directly related to the purchase of the land parcel. Components of housing completed or under construction primarily include: (1) land costs transferred from land and land under development; (2) direct construction costs associated with a house; (3) real property taxes, engineering fees, permits and other fees; (4) capitalized interest; and (5) indirect construction costs, which include field construction management salaries and benefits, utilities and other construction related costs. Land costs are transferred from land and land under development to housing completed or under construction at the point in time that construction of a home on an owned lot begins.

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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 incremental costs associated directly with the subdivision, including sales commissions and marketing costs);
- estimated future undiscounted cash flows and Operating Margin;
- forecasted Operating Margin for homes in backlog;
- actual and trending net home orders;
- 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.

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 months ended March 31, 2018 and 2017 are shown in the table below.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| West | $375 | $4,100 |
| Mountain | 175 | - |
| East | - | 750 |
| Total inventory impairments | $550 | $4,850 |

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, 2018 | 24 | $ 550 | $ 5,223 | 2 | 12% |
| March 31, 2017 | 33 | $ 4,850 | $ 19,952 | 2 | 12% to 18% |

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## 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 during the period that 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. For all periods presented below, our qualified assets exceeded our homebuilding debt and as such, all interest incurred has been capitalized.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| Homebuilding interest incurred | $15,625 | $13,188 |
| Less: Interest capitalized | (15,625) | (13,188) |
| Homebuilding interest expensed | $- | $- |
| | | |
| Interest capitalized, beginning of period | $57,541 | $68,085 |
| Plus: Interest capitalized during period | 15,625 | 13,188 |
| Less: Previously capitalized interest included in home and land cost of sales | (14,428) | (15,197) |
| Interest capitalized, end of period | $58,738 | $66,076 |

## 9. Homebuilding Prepaid and Other Assets

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

| | March 31, 2018 | December 31, 2017 |
|---|---|---|

| | (Dollars in thousands) | |
|---|---|---|
| Deferred marketing costs (Note 2) | $ - | $ 34,227 |
| Land option deposits | 18,844 | 22,203 |
| Goodwill | 6,008 | 6,008 |
| Prepaid expenses | 5,615 | 6,128 |
| Deferred debt issuance costs on revolving credit facility, net | 5,622 | 5,880 |
| Other | 1,926 | 1,220 |
| Total | $ 38,015 | $ 75,666 |

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

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

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in thousands) | |
| Customer and escrow deposits | $42,967 | $36,144 |
| Warranty accrual | 25,113 | 21,909 |
| Accrued compensation and related expenses | 19,445 | 32,600 |
| Accrued interest | 13,281 | 27,734 |
| Construction defect claim reserves | 7,944 | 8,406 |
| Land development and home construction accruals | 7,337 | 8,001 |
| Other accrued liabilities | 39,158 | 31,518 |
| Total accrued liabilities | $155,245 | $166,312 |

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

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in thousands) | |
| Insurance reserves | $45,452 | $44,280 |
| Accounts payable and other accrued liabilities | 8,567 | 8,821 |
| Total accounts payable and accrued liabilities | $54,019 | $53,101 |

**11. Warranty Accrual**

Our homes are sold with limited third-party warranties and, under our agreement with the issuer of the third-party warranties, we are responsible for performing all of the work for the first two years of the warranty coverage and paying for substantially all of the work required to be performed during years three through ten of the warranties. We record accruals for general and structural warranty claims, as well as accruals for known, unusual warranty-related expenditures. Our warranty accrual is 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 months ended March 31, 2018 and 2017. For three months ended March 31, 2018 and 2017, we recorded adjustments to increase our warranty accrual by $3.1 million and $0.1 million, respectively. The adjustments recorded during the three months ended March 31, 2018 were due to higher than expected recent warranty related expenditures.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| Balance at beginning of period | $21,909 | $20,678 |
| Expense provisions | 2,598 | 2,407 |
| Cash payments | (2,500 ) | (2,365 ) |
| Adjustments | 3,106 | 50 |
| Balance at end of period | $25,113 | $20,770 |

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## 12. Insurance and Construction Defect Claim Reserves

The establishment of reserves for estimated losses associated with insurance policies issued by Allegiant and re-insurance agreements issued by StarAmerican are based on actuarial studies that include known facts and interpretations of circumstances, including our experience with similar cases and historical trends involving claim payment patterns, pending levels of unpaid claims, product mix or concentration, claim severity, frequency patterns depending on the business conducted, and changing regulatory and legal environments. It is possible that changes in the insurance payment experience used in estimating our ultimate insurance losses could have a material impact on our insurance reserves.

The establishment of reserves for estimated losses to be incurred by our homebuilding subsidiaries associated with (1) the self-insured retention ("SIR") portion of construction defect claims that are expected to be covered under insurance policies with Allegiant and (2) the entire cost of any construction defect claims that are not expected to be covered by insurance policies with Allegiant are based on actuarial studies that include known facts similar to those established for our insurance reserves. It is possible that changes in the payment experience used in estimating our ultimate losses for construction defect claims could have a material impact on our reserves.

The table set forth below summarizes our insurance and construction defect claim reserves activity for the three months ended March 31, 2018 and 2017. These reserves are included as a component of accrued liabilities in either the financial services or homebuilding sections of the consolidated balance sheets.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| Balance at beginning of period | $52,686 | $50,954 |
| Expense provisions | 2,304 | 2,116 |
| Cash payments, net of recoveries | (1,595 ) | (1,219 ) |
| Balance at end of period | $53,395 | $51,851 |

In the ordinary course of business, we make payments from our insurance and construction defect claim reserves to settle litigation claims arising from our homebuilding activities. These payments are irregular in both their timing and their magnitude. As a result, the cash payments, net of recoveries shown for the three months ended March 31, 2018 and 2017 are not necessarily indicative of what future cash payments will be for subsequent periods.

**13. Income Taxes**

At the end of each interim period, we are required 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. Our overall effective income tax rates were 23.3% and 38.8% for the three months ended March 31, 2018 and 2017, respectively, resulting in income tax expense of $11.8 million and $14.1 million for the same periods, respectively. The year-over-year decrease in our effective tax rate for the three months ended March 31, 2018 was impacted by the following items:

(1) The net impact from the enactment of the Act, which reduced the U.S. federal corporate income tax rate from 35% to 21% but also reduced the deductibility of certain executive based compensation and eliminated the domestic manufacturing deduction.

(2) Our 2017 first quarter estimated effective tax rate included no estimate for energy tax credits as the tax provision had expired and had not been extended for 2017. However, in February 2018, the Bipartisan Budget Act of 2018 was signed into law, retroactively extending energy tax credits for 2017. As a result, we recorded a discrete tax adjustment in the 2018 first quarter to recognize an estimated benefit of $1.2 million for energy credits earned in 2017. As of March 31, 2018, energy tax credits for 2018 were not approved and as a result, no such estimate has been included in our estimated effective tax rate for 2018.

(3) In the 2017 first quarter, we established a discrete valuation allowance against certain state net operating loss carryforwards. No such valuation allowances were established in the 2018 first quarter.

At March 31, 2018 and December 31, 2017 we had deferred tax assets, net of valuation allowances and deferred tax liabilities, of $40.5 million and $41.5 million, respectively. The valuation allowances were primarily related to various state net operating loss carryforwards where realization is more uncertain at this time due to the limited carryforward periods that exist in certain states.

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During the quarter ended March 31, 2018, there were no changes to the provisional amounts recorded in our December 31, 2017 financial statements. As the Internal Revenue Service has not yet issued additional guidance regarding performance-based executive compensation provisions that were changed as a result of the Act, we are still analyzing the impact this change will have on our estimates. In the first quarter, the Company continued to apply the guidance in SAB 118 when accounting for the enactment date effects of the Act.

## 14. Senior Notes

The carrying value of our senior notes as of March 31, 2018 and December 31, 2017, net of any unamortized debt issuance costs or discount, were as follows:

| | March 31, 2018 | December 31, 2017 |
|---|---|---|
| | (Dollars in thousands) | |
| 5 % Senior Notes due February 2020, net | $248,097 | $247,853 |
| 5½% Senior Notes due January 2024, net | 248,634 | 248,585 |
| 6% Senior Notes due January 2043, net | 490,201 | 490,159 |
| Total | $986,932 | $986,597 |

Our senior notes are not secured and, while the senior note indentures contain some restrictions on secured debt and other transactions, they do not contain financial covenants. Our senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by most of our homebuilding segment subsidiaries.

## 15. Stock-Based Compensation

We account for share-based awards in accordance with ASC Topic 718 *Compensation–Stock Compensation* ("ASC 718"), which requires the fair value of stock-based compensation awards to be amortized as an expense over the vesting period. Stock-based compensation awards are valued at fair value on the date of grant. The following table sets forth share-based award expense activity for the three months ended March 31, 2018 and 2017:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (Dollars in thousands) | |
| Stock option grants expense | $56 | $91 |
| Restricted stock awards expense | 744 | 504 |
| Performance share units expense | 451 | - |
| Total stock based compensation | $1,251 | $595 |

On June 20, 2017 and July 25, 2016, the Company granted long term performance stock unit awards ("PSUs") to each of the CEO, the COO, and the Chief Financial Officer ("CFO") under the Company's 2011 Equity Incentive Plan. The PSUs will be earned based upon the Company's performance, over a three year period (the "Performance Period"), measured by increasing home sale revenues over a "Base Period". Each award is conditioned upon the Company achieving an average gross margin from home sales (excluding impairments) of at least fifteen percent (15%) over the Performance Period. Target goals will be earned if the Company's three year average home sale revenues over the Performance Period ("Performance Revenues") exceed the home sale revenues over the Base Period ("Base Revenues") by at least 10% but less than 20%. If Performance Revenues exceed the Base Revenues by at least 5% but less than 10%, 50% of the Target Goals will be earned ("Threshold Goals"). If Performance Revenues exceed the Base Revenues by at least 20%, 200% of the Target Goals will be earned ("Maximum Goals"). For the PSUs granted in 2017, the number of PSUs earned shall be adjusted to be proportional to the partial performance between the Threshold Goals, Target Goals and Maximum Goals. Details for each defined term above for both grants have been provided in the table below.

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| | | | | | Threshold Goal | | Target Goal | | Maximum Goal | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Awardee | Date of Award | Performance Period | Base Period | Base Period Revenues | PSUs | Home Sale Revenues | PSUs | Home Sale Revenues | PSUs | Home Sale Revenues | Fair Value per Share | Maxi Poten Exper to be Recog |
| CEO | | July 1, 2016 | July 1, 2015 | | 56,700 | | 113,400 | | 226,800 | | | $4,81 |
| COO | July 25, 2016 | to | to | $1.975 billion | 56,700 | $2.074 billion | 113,400 | $2.173 billion | 226,800 | $2.370 billion | $21.23 | 4,81 |
| CFO | | June 30, 2019 | June 30, 2016 | | 14,175 | | 28,350 | | 56,700 | | | 1,20 |
| | | | | | | | | | | | | $10,8 |
| CEO | | April 1, 2017 | April 1, 2016 | | 59,400 | | 118,800 | | 237,600 | | | $7,14 |
| COO | June 20, 2017 | to | to | $2.426 billion | 59,400 | $2.547 billion | 118,800 | $2.669 billion | 237,600 | $2.911 billion | $30.06 | 7,14 |
| CFO | | March 31, 2020 | March 31, 2017 | | 14,850 | | 29,700 | | 59,400 | | | 1,78 |
| | | | | | | | | | | | | $16,0 |

* Dollars in thousands

In accordance with ASC 718, the PSUs were valued on the date of grant at their fair value. The fair value of these grants was equal to the closing price of MDC stock on the date of grant less the discounted cash flows of expected future dividends over the respective vesting period (as these PSUs do not participate in dividends). The grant date fair value and maximum potential expense if the Maximum Goals were met for these awards has been provided in the table above. ASC 718 does not permit recognition of expense associated with performance-based stock awards until achievement of the performance targets are probable of occurring.

*2016 PSU Grants.* In the 2017 fourth quarter, the Company determined that achievement of the Target Goals was probable for the PSUs granted in 2016. As of March 31, 2018 that assessment has not changed and as such, the Company recorded share-based award expense related to the awards of $0.5 million for the three months ended March 31, 2018. As of March 31, 2017, the Company had concluded that achievement of any of the performance targets had not met the level of probability required to record compensation expense at that time and, as such, no compensation expense was recognized related to these PSUs at that time.

*2017 PSU Grants*. For the PSUs granted in June of 2017, the Company concluded that achievement of any of the performance metrics has not met the level of probability required to record compensation expense and as such, no expense related to the grant of these awards has been recognized as of March 31, 2018.

## 16. Commitments and Contingencies

*Surety Bonds and Letters of Credit.* We are required to obtain surety bonds and letters of credit in support of our obligations for land development and subdivision improvements, homeowner association dues, warranty work, contractor license fees and earnest money deposits. At March 31, 2018, we had outstanding surety bonds and letters of credit totaling $183.9 million and $66.4 million, respectively, including $36.9 million in letters of credit issued by HomeAmerican. The estimated cost to complete obligations related to these bonds and letters of credit were approximately $50.1 million and $31.3 million, respectively. All letters of credit as of March 31, 2018, excluding those issued by HomeAmerican, were issued under our unsecured revolving credit facility (see Note 18 for further discussion of the revolving credit facility). We expect that the obligations secured by these performance bonds and letters of credit generally will be performed in the ordinary course of business and in accordance with the applicable contractual terms. To the extent that the obligations are performed, the related performance bonds and letters of credit should be released and we should not have any continuing obligations. However, in the event any such performance bonds or letters of credit are called, our indemnity obligations could require us to reimburse the issuer of the performance bond or letter of credit.

We have made no material guarantees with respect to third-party obligations.

*Litigation.* Due to the nature of the homebuilding business, we have been named as defendants in various claims, complaints and other legal actions arising in the ordinary course of business, including product liability claims and claims associated with the sale and financing of homes. In the opinion of management, the outcome of these ordinary course matters will not have a material adverse effect upon our financial condition, results of operations or cash flows.

*Lot Option Contracts*. In the ordinary course of business, we enter into lot option purchase contracts (“Option Contracts”), generally through a deposit of cash or a letter of credit, for the right to purchase land or lots at a future point in time with predetermined terms. The use of such land option and other contracts generally allow us to reduce the risks associated with direct land ownership and development, reduces our capital and financial commitments, and minimizes the amount of land inventories on our consolidated balance sheets. In certain cases, these contracts will be

settled shortly following the end of the period. Our obligation with respect to Option Contracts is generally limited to forfeiture of the related deposits. At March 31, 2018, we had cash deposits and letters of credit totaling $15.8 million and $5.4 million, respectively, at risk associated with the option to purchase 7,295 lots.

**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

## 17. Derivative Financial Instruments

The derivative instruments we utilize in the normal course of business are interest rate lock commitments and forward sales of mortgage-backed securities, both of which typically are short-term in nature. Forward sales of mortgage-backed securities are utilized to hedge changes in fair value of our interest rate lock commitments as well as mortgage loans held-for-sale not under commitments to sell. For forward sales of mortgage-backed securities, as well as interest rate lock commitments that are still outstanding at the end of a reporting period, we record the changes in fair value of the derivatives in revenues in the financial services section of our consolidated statements of operations and comprehensive income with an offset to other assets or accounts payable and accrued liabilities in the financial services section of our consolidated balance sheets, depending on the nature of the change.

At March 31, 2018, we had interest rate lock commitments with an aggregate principal balance of $132.3 million. Additionally, we had $31.0 million of mortgage loans held-for-sale at March 31, 2018 that had not yet been committed to a mortgage purchaser. In order to hedge the changes in fair value of our interest rate lock commitments and mortgage loans held-for-sale that had not yet been committed to a mortgage purchaser, we had forward sales of securities totaling $104.5 million at March 31, 2018.

For the three months ended March 31, 2018 and 2017, we recorded net gains of $1.5 million and net losses of $0.3 million, respectively, on our derivatives.

## 18. Lines of Credit

*Revolving Credit Facility.* We have an unsecured revolving credit agreement (“Revolving Credit Facility”) with a group of lenders which may be used for general corporate purposes. This agreement was amended on September 29, 2017 to (1) extend the Revolving Credit Facility maturity to December 16, 2022, (2) increase the aggregate commitment from $550 million to $700 million (the “Commitment”) and (3) provide that the aggregate amount of the commitments may increase to an amount not to exceed $1.25 billion upon our request, subject to receipt of additional commitments from existing or additional lenders and, in the case of additional lenders, the consent of the co-administrative agents. As defined in the Revolving Credit Facility, interest rates on base rate borrowings are equal to the highest of (1) 0.0%, (2) a prime rate, (3) a federal funds effective rate plus 1.50%, and (4) a specified eurocurrency rate plus 1.00% and, in each case, plus a margin that is determined based on our credit ratings and leverage ratio. Interest rates on eurocurrency borrowings are equal to a specified eurocurrency rate plus a margin that is determined based on our

credit ratings and leverage ratio. At any time at which our leverage ratio, as of the last day of the most recent calendar quarter, exceeds 55%, the aggregate principal amount of all consolidated senior debt borrowings outstanding may not exceed the borrowing base. There is no borrowing base requirement if our leverage ratio, as of the last day of the most recent calendar quarter, is 55% or less.

The Revolving Credit Facility is fully and unconditionally guaranteed, jointly and severally, by most of our homebuilding segment subsidiaries. The facility contains various representations, warranties and covenants that we believe are customary for agreements of this type. The financial covenants include a consolidated tangible net worth test and a leverage test, along with a consolidated tangible net worth covenant, all as defined in the Revolving Credit Facility. A failure to satisfy the foregoing tests does not constitute an event of default, but can trigger a “term-out” of the facility. A breach of the consolidated tangible net worth covenant (but not the consolidated tangible net worth test) or a violation of anti-corruption or sanctions laws would result in an event of default.

The Revolving Credit Facility is subject to acceleration upon certain specified events of default, including breach of the consolidated tangible net worth covenant, a violation of anti-corruption or sanctions laws, failure to make timely payments, breaches of certain representations or covenants, failure to pay other material indebtedness, or another person becoming beneficial owner of 50% or more of our outstanding common stock. We believe we were in compliance with the representations, warranties and covenants included in the Revolving Credit Facility as of March 31, 2018.

We incur costs associated with unused commitment fees pursuant to the terms of the Revolving Credit Facility. At March 31, 2018 and December 31, 2017, there were $29.5 million and $32.0 million, respectively, in letters of credit outstanding, which reduced the amounts available to be borrowed under the Revolving Credit Facility. We had $15.0 million outstanding under the Revolving Credit Facility as of March 31, 2018 and December 31, 2017. As of March 31, 2018, availability under the Revolving Credit Facility was approximately $655.5 million.

**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

*Mortgage Repurchase Facility.* HomeAmerican has a Master Repurchase Agreement (the “Mortgage Repurchase Facility”) with U.S. Bank National Association (“USBNA”). Effective August 10, 2017, the Mortgage Repurchase Facility was amended to extend its termination date to August 9, 2018. The Mortgage Repurchase Facility provides liquidity to HomeAmerican by providing for the sale of up to an aggregate of $75 million (subject to increase by up to $75 million under certain conditions) 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. In the event that an eligible mortgage loan becomes ineligible, as defined under the Mortgage Repurchase Facility, HomeAmerican may be required to repurchase the ineligible mortgage loan immediately. The maximum aggregate commitment of the Mortgage Repurchase Facility was temporarily increased on March 28, 2018 from $75 million to $115 million and was effective through April 26, 2018. The Mortgage Repurchase Facility also had a temporary increase in the maximum aggregate commitment from $75 million to $115 million on December 27, 2017 and was effective through January 25, 2018. At March 31, 2018 and December 31, 2017, HomeAmerican had $90.1 million and $112.3 million, respectively, of mortgage loans that HomeAmerican was obligated to repurchase under the Mortgage Repurchase Facility. Mortgage loans that HomeAmerican is obligated to repurchase under the Mortgage Repurchase Facility are accounted for as a debt financing arrangement and are reported as mortgage repurchase facility in the consolidated balance sheets. Advances under the Mortgage Repurchase Facility carry a price range that is LIBOR-based.

The Mortgage Repurchase Facility contains various representations, warranties and affirmative and negative covenants that we believe are customary for agreements of this type. The negative covenants include, among others, (i) a minimum Adjusted Tangible Net Worth requirement, (ii) a maximum Adjusted Tangible Net Worth ratio, (iii) a minimum adjusted net income requirement, and (iv) a minimum Liquidity requirement. The foregoing capitalized terms are defined in the Mortgage Repurchase Facility. We believe HomeAmerican was in compliance with the representations, warranties and covenants included in the Mortgage Repurchase Facility as of March 31, 2018.

**19. Related Party Transactions**

We contributed $1.5 million in cash to the MDC/Richmond American Homes Foundation (the “Foundation”) during the three months ended March 31, 2017. The Foundation is a non-profit organization operated exclusively for charitable, educational and other purposes beneficial to social welfare within the meaning of Section 501(c)(3) of the Internal Revenue Code. The following Directors and/or officers of the Company served as directors of the Foundation at March 31, 2018, all of whom serve without compensation:

| Name | MDC Title |
| --- | --- |
| Larry A. Mizel | Chairman and CEO |
| David D. Mandarich | President and COO |

Three other individuals, who are independent of the Company, also serve as directors of the Foundation. All directors of the Foundation serve without compensation.

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**20. Supplemental Guarantor Information**

Our senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by the following subsidiaries (collectively, the "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 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 Oregon, Inc. (formerly known as Richmond American Homes of Delaware, Inc.)
Richmond American Homes of Pennsylvania, Inc.
Richmond American Homes of Utah, Inc.
Richmond American Homes of Virginia, Inc.
Richmond American Homes of Washington, Inc.

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

We have determined that separate, full financial statements of the Guarantor Subsidiaries would not be material to investors and, accordingly, supplemental financial information for the Guarantor and Non-Guarantor Subsidiaries is presented below.

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**Supplemental Condensed Combining Balance Sheet**

| | March 31, 2018 | | | | |
|---|---|---|---|---|---|
| | MDC | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminating Entries | Consolidated MDC |
| | (Dollars in thousands) | | | | |
| **ASSETS** | | | | | |
| **Homebuilding:** | | | | | |
| Cash and cash equivalents | $348,609 | $4,259 | $ - | $- | $352,868 |
| Marketable securities | 49,817 | - | - | - | 49,817 |
| Restricted cash | - | 6,198 | - | - | 6,198 |
| Trade and other receivables | 2,904 | 52,327 | - | (2,322) | 52,909 |
| Inventories: | | | | | |
| Housing completed or under construction | - | 1,009,197 | - | - | 1,009,197 |
| Land and land under development | - | 964,660 | - | - | 964,660 |
| Total inventories | - | 1,973,857 | - | - | 1,973,857 |
| Intercompany receivables | 1,776,963 | 2,803 | - | (1,779,766) | - |
| Investment in subsidiaries | 239,705 | - | - | (239,705) | - |
| Property and equipment, net | 24,013 | 29,355 | - | - | 53,368 |
| Deferred tax asset, net | 41,463 | - | - | (979) | 40,484 |
| Prepaid and other assets | 8,867 | 29,148 | - | - | 38,015 |
| Total homebuilding assets | 2,492,341 | 2,097,947 | - | (2,022,772) | 2,567,516 |
| **Financial Services:** | | | | | |
| Cash and cash equivalents | - | - | 48,514 | - | 48,514 |
| Marketable securities | - | - | 40,912 | - | 40,912 |
| Intercompany receivables | - | - | 22,726 | (22,726) | - |
| Mortgage loans held-for-sale, net | - | - | 113,158 | - | 113,158 |
| Other assets | - | - | 16,083 | 979 | 17,062 |
| Total financial services assets | - | - | 241,393 | (21,747) | 219,646 |
| Total Assets | $2,492,341 | $2,097,947 | $ 241,393 | $(2,044,519) | $2,787,162 |
| **LIABILITIES AND EQUITY** | | | | | |
| **Homebuilding:** | | | | | |
| Accounts payable | $- | $53,347 | $ - | $- | $53,347 |
| Accrued liabilities | 32,387 | 121,968 | - | 890 | 155,245 |
| | 25,529 | 1,745,126 | 27,791 | (1,798,446) | - |

| | | | | | |
|---|---|---|---|---|---|
| Advances and notes payable to parent and subsidiaries | | | | | |
| Revolving credit facility | 15,000 | - | - | - | 15,000 |
| Senior notes, net | 986,932 | - | - | - | 986,932 |
| Total homebuilding liabilities | 1,059,848 | 1,920,441 | 27,791 | (1,797,556) | 1,210,524 |
| | | | | | |
| **Financial Services:** | | | | | |
| Accounts payable and other liabilities | - | - | 57,231 | (3,212) | 54,019 |
| Advances and notes payable to parent and subsidiaries | - | - | 4,046 | (4,046) | - |
| Mortgage repurchase facility | - | - | 90,126 | - | 90,126 |
| Total financial services liabilities | - | - | 151,403 | (7,258) | 144,145 |
| Total Liabilities | 1,059,848 | 1,920,441 | 179,194 | (1,804,814) | 1,354,669 |
| | | | | | |
| **Equity:** | | | | | |
| Total Stockholders' Equity | 1,432,493 | 177,506 | 62,199 | (239,705) | 1,432,493 |
| Total Liabilities and Stockholders' Equity | $2,492,341 | $2,097,947 | $ 241,393 | $(2,044,519) | $ 2,787,162 |

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**Supplemental Condensed Combining Balance Sheet**

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | MDC | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminating Entries | Consolidated MDC |
| | (Dollars in thousands) | | | | |
| **ASSETS** | | | | | |
| **Homebuilding:** | | | | | |
| Cash and cash equivalents | $468,718 | $4,239 | $ - | $- | $472,957 |
| Marketable securities | 49,634 | - | - | - | 49,634 |
| Restricted cash | - | 8,812 | - | - | 8,812 |
| Trade and other receivables | 8,200 | 47,422 | - | (2,260) | 53,362 |
| Inventories: | | | | | |
| Housing completed or under construction | - | 936,685 | - | - | 936,685 |
| Land and land under development | - | 893,051 | - | - | 893,051 |
| Total inventories | - | 1,829,736 | - | - | 1,829,736 |
| Intercompany receivables | 1,578,830 | 2,803 | 5,291 | (1,586,924) | - |
| Investment in subsidiaries | 317,400 | - | - | (317,400) | - |
| Property and equipment, net | 24,557 | 1,882 | - | - | 26,439 |
| Deferred tax assets, net | 42,862 | - | - | (1,382) | 41,480 |
| Other assets | 7,260 | 68,406 | - | - | 75,666 |
| Total Homebuilding Assets | 2,497,461 | 1,963,300 | 5,291 | (1,907,966) | 2,558,086 |
| **Financial Services:** | | | | | |
| Cash and cash equivalents | - | - | 32,471 | - | 32,471 |
| Marketable securities | - | - | 42,004 | - | 42,004 |
| Intercompany receivables | - | - | 40,139 | (40,139) | - |
| Mortgage loans held-for-sale, net | - | - | 138,114 | - | 138,114 |
| Other assets | - | - | 8,235 | 1,382 | 9,617 |
| Total Financial Services Assets | - | - | 260,963 | (38,757) | 222,206 |
| Total Assets | $2,497,461 | $1,963,300 | $ 266,254 | $(1,946,723) | $2,780,292 |
| **LIABILITIES AND EQUITY** | | | | | |
| **Homebuilding:** | | | | | |
| Accounts payable | $- | $39,655 | $ - | $- | $39,655 |
| Accrued liabilities | 40,344 | 122,544 | 37 | 3,387 | 166,312 |
| | 48,233 | 1,547,593 | 27,015 | (1,622,841) | - |

| | | | | | |
|---|---|---|---|---|---|
| Advances and notes payable to parent and subsidiaries | | | | | |
| Revolving credit facility | 15,000 | - | - | - | 15,000 |
| Senior notes, net | 986,597 | - | - | - | 986,597 |
| Total Homebuilding Liabilities | 1,090,174 | 1,709,792 | 27,052 | (1,619,454) | 1,207,564 |
| | | | | | |
| **Financial Services:** | | | | | |
| Accounts payable and accrued liabilities | - | - | 58,748 | (5,647) | 53,101 |
| Advances and notes payable to parent and subsidiaries | - | - | 4,222 | (4,222) | - |
| Mortgage repurchase facility | - | - | 112,340 | - | 112,340 |
| Total Financial Services Liabilities | - | - | 175,310 | (9,869) | 165,441 |
| Total Liabilities | 1,090,174 | 1,709,792 | 202,362 | (1,629,323) | 1,373,005 |
| | | | | | |
| **Equity:** | | | | | |
| Total Stockholders' Equity | 1,407,287 | 253,508 | 63,892 | (317,400) | 1,407,287 |
| Total Liabilities and Stockholders' Equity | $2,497,461 | $1,963,300 | $266,254 | $(1,946,723) | $2,780,292 |

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**Supplemental Condensed Combining Statement of Operations**

| | Three Months Ended March 31, 2018 | | | | |
|---|---|---|---|---|---|
| | MDC | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminating Entries | Consolidated MDC |
| | (Dollars in thousands) | | | | |
| **Homebuilding:** | | | | | |
| Revenues | $- | $ 607,688 | $ - | $ - | $ 607,688 |
| Cost of sales | - | (496,632 ) | - | - | (496,632 ) |
| Inventory impairments | - | (550 ) | - | - | (550 ) |
| Gross margin | - | 110,506 | - | - | 110,506 |
| Selling, general, and administrative expenses | (12,808) | (58,329 ) | - | (204 ) | (71,341 ) |
| Equity income of subsidiaries | 47,169 | - | - | (47,169 ) | - |
| Interest and other income | 1,773 | 318 | 2 | (234 ) | 1,859 |
| Other expense | 7 | (570 ) | - | - | (563 ) |
| Homebuilding pretax income (loss) | 36,141 | 51,925 | 2 | (47,607 ) | 40,461 |
| **Financial Services:** | | | | | |
| Financial services pretax income | - | - | 9,633 | 438 | 10,071 |
| Income before income taxes | 36,141 | 51,925 | 9,635 | (47,169 ) | 50,532 |
| (Provision) benefit for income taxes | 2,623 | (12,092 ) | (2,299 ) | - | (11,768 ) |
| Net income | $38,764 | $ 39,833 | $ 7,336 | $ (47,169 ) | $ 38,764 |
| Other comprehensive income related to available-for-sale securities, net of tax | - | - | - | - | - |
| Comprehensive income | $38,764 | $ 39,833 | $ 7,336 | $ (47,169 ) | $ 38,764 |

| | Three Months Ended March 31, 2017 | | | | |
|---|---|---|---|---|---|
| | MDC | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminating Entries | Consolidated MDC |
| | (Dollars in thousands) | | | | |
| **Homebuilding:** | | | | | |
| Revenues | $- | $ 563,726 | $ - | $ - | $ 563,726 |
| Cost of sales | - | (469,153 ) | - | - | (469,153 ) |
| Inventory impairments | - | (4,850 ) | - | - | (4,850 ) |
| Gross margin | - | 89,723 | - | - | 89,723 |
| Selling, general, and administrative expenses | (12,395) | (53,721 ) | - | (182 ) | (66,298 ) |
| Equity income of subsidiaries | 29,031 | - | - | (29,031 ) | - |
| Interest and other income | 1,676 | 674 | 1 | (24 ) | 2,327 |

| | | | | | |
|---|---|---|---|---|---|
| Other expense | 8 | (359) | - | - | (351) |
| Other-than-temporary impairment of marketable securities | (50) | - | - | - | (50) |
| Homebuilding pretax income (loss) | 18,270 | 36,317 | 1 | (29,237) | 25,351 |
| **Financial Services:** | | | | | |
| Financial services pretax income | - | - | 10,803 | 206 | 11,009 |
| Income before income taxes | 18,270 | 36,317 | 10,804 | (29,031) | 36,360 |
| (Provision) benefit for income taxes | 3,979 | (14,095) | (3,995) | - | (14,111) |
| Net income | $22,249 | $22,222 | $6,809 | $(29,031) | $22,249 |
| Other comprehensive income related to available-for-sale securities, net of tax | 1,986 | - | 834 | (834) | 1,986 |
| Comprehensive income | $24,235 | $22,222 | $7,643 | $(29,865) | $24,235 |

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**Supplemental Condensed Combining Statement of Cash Flows**

| | Three Months Ended March 31, 2018 | | | | |
|---|---|---|---|---|---|
| | MDC | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminating Entries | Consolidated MDC |
| | (Dollars in thousands) | | | | |
| Net cash provided by (used in) operating activities | $(8,950) | $ (79,547) | $ 27,011 | $ - | $ (61,486) |
| Net cash provided by (used in) investing activities | (94,576) | (6,250) | (60) | 94,509 | (6,377) |
| Financing activities: | | | | | |
| Payments from (advances to) subsidiaries | - | 83,203 | 11,306 | (94,509) | - |
| Mortgage repurchase facility | - | - | (22,214) | - | (22,214) |
| Dividend payments | (16,865) | - | - | - | (16,865) |
| Proceeds from exercise of stock options | 282 | - | - | - | 282 |
| Net cash provided by (used in) financing activities | (16,583) | 83,203 | (10,908) | (94,509) | (38,797) |
| Net increase in cash and cash equivalents | (120,109) | (2,594) | 16,043 | - | (106,660) |
| Cash and cash equivalents: | | | | | |
| Beginning of period | 468,718 | 13,051 | 32,471 | - | 514,240 |
| End of period | $348,609 | $ 10,457 | $ 48,514 | $ - | $ 407,580 |

| | Three Months Ended March 31, 2017 | | | | |
|---|---|---|---|---|---|
| | MDC | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminating Entries | Consolidated MDC |
| | (Dollars in thousands) | | | | |
| Net cash provided by (used in) operating activities | $24,806 | $ 22,396 | $ 47,135 | $ - | $ 94,337 |
| Net cash provided by (used in) investing activities | 23,051 | (57) | 139 | (24,633) | (1,500) |
| Financing activities: | | | | | |
| Payments from (advances to) subsidiaries | - | (20,811) | (3,822) | 24,633 | - |
| Mortgage repurchase facility | - | - | (43,943) | - | |