MDC HOLDINGS INC
Form 10-K/A
April 30, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

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

For the Transition period from to

Commission File No. 1-08951

M.D.C. HOLDINGS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**84-0622967**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**
4350 South Monaco Street, Suite 500 Denver, Colorado	**80237**
(Address of principal executive offices)	**(Zip code)**

(303) 773-1100

(Registrant s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	**New York Stock Exchange**
5 $^{3}/_{8}$ Senior Notes due December 2014	**New York Stock Exchange**
5 $^{3}/_{8}$ Senior Notes due July 2015	**New York Stock Exchange**
5 $^{5}/_{8}$ Senior Notes due January 2020	**New York Stock Exchange**
6% Senior Notes due January 2043	**New York Stock Exchange**

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

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

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

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

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

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

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

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

As of April 25, 2013, 48,869,726 shares of M.D.C. Holdings, Inc. common stock were outstanding.

As of June 30, 2012, the aggregate market value of the Registrants common stock held by non-affiliates of the Registrants was $1.2 billion based on the closing sales price of $32.67 per share as reported on the New York Stock Exchange on June 29, 2012.

As of December 31, 2012, the number of shares outstanding of Registrant s common stock was 48,698,757.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of part III of this Form 10-K are incorporated by reference from the Registrant s 2012 definitive proxy statement, which was filed with the Securities and Exchange Commission on February 6, 2013.

EXPLANATORY NOTE

M.D.C. Holdings, Inc. (the Company) is filing this Amendment No. 1 on Form 10-K/A (the Form 10-K/A) to its Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the Securities and Exchange Commission on January 31, 2013 (the Original Filing), for the sole purpose of revising Note 22 Supplemental Guarantor Information (the Guarantor Footnote) contained in Part II, Item 8 as described below and to make corresponding amendments to the Interactive Data File included in the Original Filing as Exhibit 101. Part IV of the Original Filing has also been amended to contain currently dated certifications and a currently dated auditor s consent.

The Guarantor Footnote is being revised in order to (i) correct the presentation of cash flows from operating activities and financing activities in the MDC parent column in the supplemental condensed combining statements of cash flows and (ii) reclassify intercompany receivables as assets that were previously classified as liabilities with negative balances in the supplemental condensed combining balance sheets. See Note 22 in the notes to consolidated financial statements for a detailed explanation.

This revised presentation of the Guarantor Footnote has no impact or effect on M.D.C. Holdings, Inc. s consolidated financial statements for any period presented, including the Consolidated Balance Sheets, Statements of Operations and Comprehensive Income, Statements of Stockholders Equity or Statements of Cash Flows.

This Form 10-K/A is as of the original filing date of the Original Filing. This Form 10-K/A does not reflect any subsequent information or events, except as described above, and no other information included in the Original Filing has been modified or updated in any way. Without limitation to the foregoing, this Form 10-K/A does not purport to update the Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 the Original Filing or any information, uncertainties, transactions, risks, events or trends occurring, or known to management. Accordingly this Form 10-K/A should be read in conjunction with Original Filing. For updated information about the Company, refer to the Company s most recent filings with the SEC. These filings contain important information regarding events, developments and updates to certain expectations of the Company that have occurred since the Original Filing.

PART II

Item 8. Consolidated Financial Statements.

M.D.C. HOLDINGS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of

M.D.C. Holdings, Inc.

We have audited the accompanying consolidated balance sheets of M.D.C. Holdings, Inc. (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations and comprehensive income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of M.D.C. Holdings, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), M.D.C. Holdings, Inc. s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 31, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Denver, Colorado

January 31, 2013, except for

Note 22, as to which the

date is April 30, 2013

M.D.C. HOLDINGS, INC.

Consolidated Balance Sheets

	December 31, 2012	December 31, 2011
	(Dollars in thousands, except per share amounts)	
ASSETS		
Homebuilding:		
Cash and cash equivalents	$ 129,535	$ 316,418
Marketable securities	519,465	485,434
Restricted cash	1,859	667
Trade and other receivables	28,163	21,593
Inventories:		
Housing completed or under construction	512,949	300,714
Land and land under development	489,572	505,338
Total inventories	1,002,521	806,052
Property and equipment, net	33,125	36,277
Deferred tax asset, net of valuation allowance of $248,306 and $281,178 at December 31, 2012 and 2011, respectively	-	-
Prepaid expenses and other assets	44,777	50,423
Total homebuilding assets	1,759,445	1,716,864
Financial Services:		
Cash and cash equivalents	30,560	26,943
Marketable securities	32,473	34,509
Mortgage loans held-for-sale, net	119,953	78,335
Prepaid expenses and other assets	3,010	2,074
Total financial services assets	185,996	141,861
Total Assets	$ 1,945,441	$ 1,858,725
LIABILITIES AND EQUITY		
Homebuilding:		
Accounts payable	$ 73,055	$ 25,645
Accrued liabilities	118,456	119,188
Senior notes, net	744,842	744,108
Total homebuilding liabilities	936,353	888,941
Financial Services:		
Accounts payable and accrued liabilities	51,864	52,446
Mortgage repurchase facility	76,327	48,702
Total financial services liabilities	128,191	101,148
Total Liabilities	1,064,544	990,089
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; 48,698,757 issued and outstanding at December 31, 2012 and 48,017,108 and 47,957,196 issued and outstanding, respectively, at December 31, 2011	487	480
Additional paid-in-capital	896,861	863,128
Retained earnings (accumulated deficit)	(21,289)	12,927

Accumulated other comprehensive income (loss)	4,838	(7,240)
Treasury stock, at cost; 0 and 59,912 shares at December 31, 2012 and 2011, respectively	-	(659)
Total Stockholders Equity	880,897	868,636
Total Liabilities and Stockholders Equity	$ 1,945,441	$ 1,858,725

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

M.D.C. HOLDINGS, INC.

Consolidated Statements of Operations and Comprehensive Income

	Year Ended December 31,		
	2012	**2011**	**2010**
	(Dollars in thousands, except per share amounts)		
Homebuilding:			
Home sale revenues	$ 1,150,998	$ 805,164	$ 921,022
Land sale revenues	5,144	11,859	5,883
Total home sale and land revenues	1,156,142	817,023	926,905
Home cost of sales	(973,120)	(686,661)	(745,085)
Land cost of sales	(4,823)	(10,796)	(5,366)
Inventory impairments	(1,105)	(12,965)	(21,195)
Total cost of sales	(979,048)	(710,422)	(771,646)
Gross margin	177,094	106,601	155,259
Selling, general and administrative expenses	(167,295)	(179,105)	(219,685)
Interest income	23,398	26,068	23,960
Interest expense	(808)	(20,842)	(38,157)
Other income (expense)	228	(43,350)	(2,273)
Homebuilding pretax income (loss)	32,617	(110,628)	(80,896)
Financial Services:			
Revenues	46,881	26,086	30,473
Expenses	(21,645)	(26,306)	(23,351)
Interest and other income	3,262	3,376	3,173
Financial services pretax income (loss)	28,498	3,156	10,295
Income (loss) before income taxes	61,115	(107,472)	(70,601)
Benefit from income taxes	1,584	9,082	5,831
Net income (loss)	62,699	(98,390)	(64,770)
Other comprehensive income (loss):			
Unrealized gain (loss) related to available-for-sale securities	12,078	(12,124)	4,884
Comprehensive income (loss)	$ 74,777	$ (110,514)	$ (59,886)
Earnings (loss) per share:			
Basic	$ 1.29	$ (2.12)	$ (1.40)
Diluted	$ 1.28	$ (2.12)	$ (1.40)
Weighted Average Common Shares Outstanding:			
Basic	47,660,629	46,796,334	46,627,815
Diluted	48,064,839	46,796,334	46,627,815
Dividends declared per share	$ 2.00	$ 1.00	$ 1.00

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

M.D.C. HOLDINGS, INC.

Consolidated Statements of Stockholders Equity

(Dollars in thousands, except share amounts)

	Common Stock				Accumulated	Treasury Stock		
	Shares	Amount	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Other Comprehensive Income (Loss)	Shares	Amount	Total
Balances at December 31, 2009	47,069,561	$ 471	$ 802,675	$ 270,659	$ -	(52,789)	$ (659)	$ 1,073,146
Net loss	-	-	-	(64,770)	-	-	-	(64,770)
Unrealized gain on available-for-sale investments	-	-	-	-	4,884			4,884
Total comprehensive loss								(59,886)
Shares issued upon exercise of stock options and awards of restricted stock	128,520	1	52	-	-	-	-	53
Cash dividends paid	-	-	-	(47,140)	-	-	-	(47,140)
Stock-based compensation expense	-	-	17,510	-	-	-	-	17,510
Forfeitures of restricted stock	-	-	-	-	-	(2,834)	-	-
Balances at December 31, 2010	47,198,081	472	820,237	158,749	4,884	(55,623)	(659)	983,683
Net loss	-	-	-	(98,390)	-	-	-	(98,390)
Unrealized loss on available-for-sale investments	-	-	-	-	(12,124)	-	-	(12,124)
Total comprehensive loss								(110,514)
Shares issued upon exercise of stock options and awards of restricted stock	819,027	8	9,036	-	-	-	-	9,044
Cash dividends paid	-	-	-	(47,432)	-	-	-	(47,432)
Stock-based compensation expense	-	-	15,432	-	-	-	-	15,432
Forfeitures of restricted stock	-	-	-	-	-	(4,289)	-	-
Reinstatement of tax benefits on non-qualified stock options exercised in previous years (Footnote 13)			18,423					18,423
Balances at December 31, 2011	48,017,108	480	863,128	12,927	(7,240)	(59,912)	(659)	868,636
Net income	-	-	-	62,699	-	-	-	62,699
Unrealized gain on available-for-sale investments	-	-	-	-	12,078	-	-	12,078
Total comprehensive income								74,777
Shares issued upon exercise of stock options and awards of restricted stock	752,855	8	16,616	-	-	-	-	16,624
Cash dividends paid	-	-	-	(96,915)	-	-	-	(96,915)
Stock-based compensation expense	-	-	16,225	-	-	-	-	16,225
Reversal of uncertain tax positions due to statute of limitations	-	-	1,551	-	-	-	-	1,551
Retirement of treasury stock	(62,230)	(1)	(659)	-	-	62,230	659	(1)
Forfeitures of restricted stock	(8,976)	-	-	-	-	(2,318)	-	-
Balances at December 31, 2012	48,698,757	$ 487	$ 896,861	$ (21,289)	$ 4,838	-	$ -	$ 880,897

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

M.D.C. HOLDINGS, INC.

Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2012	**2011**	**2010**
	(Dollars in thousands)		
Operating Activities:			
Net income (loss)	$ 62,699	$ (98,390)	$ (64,770)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Loss on extinguishment of senior notes	-	38,795	-
Stock-based compensation expense	16,225	15,432	17,510
Depreciation and amortization	4,766	6,371	5,759
Inventory impairments and write-offs of land option deposits	1,843	20,009	24,297
Amortization of discount on marketable debt securities	596	1,271	2,557
Net changes in assets and liabilities:			
Restricted cash	(1,192)	(247)	56
Trade and other receivables	(6,223)	12,078	141,034
Mortgage loans held-for-sale	(41,618)	(13,221)	(2,799)
Housing completed or under construction	(212,154)	86,477	(116,960)
Land and land under development	15,314	(93,381)	(166,526)
Prepaid expenses and other assets	3,650	10,119	(15,054)
Accounts payable	47,473	(9,012)	(1,069)
Accrued liabilities	(198)	(56,585)	(33,116)
Net cash used in operating activities	(108,819)	(80,284)	(209,081)
Investing Activities:			
Purchase of marketable securities	(478,701)	(330,968)	(934,240)
Maturity of marketable securities	108,250	492,051	138,042
Sale of marketable securities	349,938	275,038	159,881
Purchase of property and equipment and other	(1,268)	(31,857)	(8,149)
Net cash provided by (used in) investing activities	(21,781)	404,264	(644,466)
Financing Activities:			
Extinguishment of senior notes	-	(537,724)	-
Payments on mortgage repurchase facility	(196,402)	(91,372)	(152,951)
Advances on mortgage repurchase facility	224,027	114,640	149,270
Dividend payments	(96,915)	(47,432)	(47,140)
Proceeds from issuance of senior notes	-	-	242,288
Proceeds from exercise of stock options	16,624	9,044	53
Net cash provided by (used in) financing activities	(52,666)	(552,844)	191,520
Net increase (decrease) in cash and cash equivalents	(183,266)	(228,864)	(662,027)
Cash and cash equivalents:			
Beginning of period	343,361	572,225	1,234,252
End of period	$ 160,095	$ 343,361	$ 572,225

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

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Principles of Consolidation. The Consolidated Financial Statements of M.D.C. Holdings, Inc. (MDC, the Company, we, us, or our which re to M.D.C. Holdings, Inc. and its subsidiaries) include the accounts of MDC and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. Certain prior year balances have been reclassified to conform to the current year s presentation.

Description of Business. Our homebuilding segments have operations in Arizona, California, Colorado, Florida, Maryland, (which includes Maryland, Pennsylvania, Delaware and New Jersey), Nevada, Utah, Virginia and Washington. The primary functions of our homebuilding segments include land acquisition and development, home construction, purchasing, marketing, merchandising, sales and customer service. We build and sell primarily single-family detached homes, which are designed and built to meet local customer preferences. We are the general contractor for all of our projects and retain subcontractors for site development and home construction.

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

Presentation. Our balance sheet presentation is unclassified due to the fact that certain assets and liabilities have both short and long-term characteristics.

Use of Accounting Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration of Credit Risk. There are a limited number of third-party purchasers of mortgage loans and, at any given point in time, our business may be impacted adversely if one of them were no longer able or willing to purchase mortgage loans originated by HomeAmerican. On August 31, 2011, Bank of America, one of our former primary third-party purchasers, announced its intention to sell its third-party mortgage operation and exit its correspondent mortgage lending business. Subsequently, Bank of America amended its prior announcement and indicated that no sale of the third-party mortgage operation was forthcoming, but that it would proceed with its original plan to exit its correspondent mortgage lending business, with the last date that they would purchase a mortgage being December 15, 2011. The following table sets forth the percent of mortgage loans sold by HomeAmerican to its primary third party purchasers during 2012, 2011 and 2010.

	Year Ended December 31,		
	2012	**2011**	**2010**
Wells Fargo Funding, Inc.	58%	52%	44%
Bank of America, N.A.	0%	17%	38%
JPMorgan Chase Bank, N.A.	36%	29%	16%

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash and Cash Equivalents. The Company periodically invests funds in highly liquid investments with an original maturity of three months or less, such as commercial paper, money market funds and time deposits, which are included in cash and cash equivalents in the consolidated balance sheets and consolidated statements of cash flows.

Marketable Securities. Our marketable securities consist of fixed rate and floating rate interest earning securities, primarily: (1) debt securities, which may include, among others, United States government and government agency debt and corporate debt; (2) holdings in mutual fund equity securities and (3) deposit securities, which may include, among others, certificates of deposit and time deposits. As of December 31, 2012, all of our marketable securities are treated as available-for-sale investments and, as such, we have recorded all of our marketable securities at fair value with changes in fair value being recorded as a component of accumulated other comprehensive income (loss) at December 31, 2012.

Restricted Cash. We receive cash earnest money deposits from our customers who enter into home sale contracts. In certain states we are restricted from using such deposits for general purposes, unless we take measures to release state imposed restrictions on such deposits received from homebuyers, which may include posting blanket security bonds. At December 31, 2012 and 2011, we had $2.5 million and $2.5 million, respectively, outstanding in blanket security bonds used to release restrictions on certain homebuyer deposits. We had $1.9 million and $0.7 million in restricted cash related to homebuyer deposits at December 31, 2012 and 2011, respectively.

Home Sales Receivables. Home sales receivables primarily consist of cash to be received from title companies or outside brokers associated with closed homes. Generally, we will receive cash from title companies and outside brokers within a few days of the home being closed.

Mortgage Loans Held-for-Sale, net. Mortgage loans held-for-sale are recorded at fair value based on quoted market prices and estimated market prices received from an outside third-party. Using fair value allows an offset of the changes in fair values of the mortgage loans and the derivative instruments used to hedge them without the burden of complying with the requirements for hedge accounting.

Inventories. Our inventories consist of housing completed or under construction and land and land under development in the consolidated balance sheets. Our inventories are primarily associated with subdivisions where we intend to construct and sell homes on the land, including model and unsold started homes. 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. 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.

Homebuilding inventories are carried at cost unless events and circumstances indicate that the carrying value of the underlying subdivision may not be recoverable. We determine impairments on a subdivision level basis as each

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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) 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 and homes in backlog;
- 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 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 that are commensurate with the risk of the subdivision under evaluation. For the years ended December 31, 2012, 2011 and 2010, we used discount rates generally ranging from 13% to 18% for the subdivisions that were impaired.

Property and Equipment, net. Property and equipment is carried at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the related assets, which range from 2 to 29 years. Depreciation and amortization expense for property and equipment was $4.4 million, $6.1 million and $5.6 million for the years ended December 31, 2012, 2011 and 2010, respectively.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the cost and carrying value of our property and equipment by major asset category.

	Cost	Accumulated Depreciation and Amortization	Carrying Value
		(Dollars in thousands)	
December 31, 2012:			
Airplane	$ 28,997	$ 6,055	$ 22,942
Computer software and equipment	17,905	9,513	8,392
Leasehold improvements	7,623	6,066	1,557
Other	1,991	1,757	234
Total	$ 56,516	$ 23,391	$ 33,125
December 31, 2011:			
Airplane	$ 28,997	$ 5,506	$ 23,491
Computer software and equipment	17,470	6,339	11,131
Leasehold improvements	6,881	5,471	1,410
Other	1,891	1,646	245
Total	$ 55,239	$ 18,962	$ 36,277

Deferred Tax Asset, net. Deferred tax assets and liabilities are recognized based on temporary differences between the carrying amounts of assets and liabilities in the financial statements and their respective tax bases. Deferred tax assets and liabilities are measured using current enacted tax rates in effect in the years in which those temporary differences are expected to reverse. Deferred tax assets should be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. At December 31, 2012 and 2011, based upon current facts and circumstances, we had recorded a valuation allowance of $248.3 million and $281.2 million, respectively, against our deferred tax assets (net of deferred tax liabilities).

Deferred Marketing Costs. Certain marketing costs related to model homes and sales offices are capitalized as they are: (1) reasonably expected to be recovered from the sale of the project; and (2) incurred for (A) tangible assets that are used directly throughout the selling period to aid in the sale of the project or (B) services that have been performed to obtain regulatory approval of sales. Capitalized marketing costs are included in prepaid and other assets in the Homebuilding section of the accompanying consolidated balance sheets and the associated amortization expense is included in selling, general and administrative (SG&A) in the Homebulding section of the accompanying consolidated statements of operations as the homes in the related subdivision are delivered. We allocate all capitalized marketing costs equally to each house within a subdivision and record expense as homes close over the life of a subdivision. All other marketing costs are expensed as incurred.

Variable Interest Entities. In accordance with ASC 810 Consolidation , we analyze our land option contracts and other contractual arrangements to determine whether the corresponding land sellers are variable interest entities (VIEs) and, if so, whether we are the primary beneficiary. Although we do not have legal title to the optioned land, ASC 810 requires a company to consolidate a VIE if the company is determined to be the primary beneficiary. In determining whether we are the primary beneficiary, we consider, among other things, whether we have the power to direct the activities of the VIE that most significantly impact VIE s economic performance, including, but not limited to, determining or limiting the scope or purpose of the VIE, selling or transferring property owned or controlled by the VIE, or arranging financing for the VIE. We also consider whether we have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. We have concluded that, as of December 31, 2012, we were not the primary beneficiary of any VIEs from which we are purchasing land under land option contracts.

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Related Party Assets. Our related party assets are debt security bonds acquired from a quasi-municipal corporation in the state of Colorado. (See Note 14 to the Consolidated Financial Statements).

Goodwill. We evaluate goodwill for possible impairment at least annually in the fourth quarter, and whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We use a three step process to assess the realizability of goodwill based on recently adopted accounting guidance. The first step is a qualitative assessment that analyzes current economic indicators associated with a particular reporting unit. For example, we analyze changes in economic, market and industry conditions, business strategy, cost factors, and financial performance, among others, to determine if there would be a significant decline to the fair value of a particular reporting unit. If the qualitative assessment indicates a stable or improved fair value, no further testing is required.

If a qualitative assessment indicates that a significant decline to fair value of a reporting unit is more likely than not, or if a reporting unit s fair value has historically been closer to its carrying value, we will proceed to the second step where we calculate the fair value of a reporting unit based on discounted future probability-weighted cash flows. If this step indicates that the carrying value of a reporting unit is in excess of its fair value, we will proceed to the third step where the fair value of the reporting unit will be allocated to assets and liabilities as they would in a business combination. Impairment occurs when the carrying amount of goodwill exceeds its estimated fair value calculated in the third step.

Based on our analysis, we have concluded as of December 31, 2012, our goodwill was not impaired.

Liability for Unrecognized Tax Benefits. Accounting literature regarding liabilities for unrecognized tax benefits provides guidance for the recognition and measurement in financial statements of uncertain tax positions taken or expected to be taken in a tax return.

The evaluation of a tax position is a two-step process, the first step being recognition. We determine whether it is more-likely-than-not that a tax position will be sustained upon tax examination, including resolution of any related appeals or litigation, based on the technical merits of the position. The technical merits of a tax position derive from both statutory and judicial authority (legislation and statutes, legislative intent, regulations, rulings, and case law) and their applicability to the facts and circumstances of the tax position. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements.

The second step is measurement. A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate resolution with a taxing authority. At December 31, 2012 and 2011, our liability for unrecognized tax benefits was $0.8 million and $3.3 million, respectively, which is included in accrued liabilities in the Homebuilding section of our consolidated balance sheets.

Warranty Reserves. Our homes are sold with limited third-party warranties. We record expenses and warranty reserves for general and structural warranty claims, as well as reserves for known, unusual warranty-related expenditures. Warranty reserves are established 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 establishment of warranty reserves for closed homes and the evaluation of our warranty reserve balance is 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.

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Warranty payments are recorded against the warranty reserve. Additional reserves may be established for known, unusual warranty-related expenditures not covered through the independent warranty reserve analysis performed by us. Warranty payments incurred for an individual house may differ from the related reserve established for the home at the time it was closed. The actual disbursements for warranty claims are evaluated in the aggregate to determine if an adjustment to the historical warranty reserve should be recorded.

Generally, warranty reserves are reviewed quarterly, using historical payment data and other relevant information, to determine the reasonableness and adequacy of both the reserve and the per-unit reserve amount originally included in home cost of sales, as well as the timing of the reversal of any excess reserve. Warranty reserves are included in accrued liabilities in the Homebuilding section of our consolidated balance sheets and adjustments to our warranty reserves are recorded as an increase or reduction to home cost of sales in the Homebuilding section of our consolidated statements of operations.

Insurance Reserves. We record expenses and liabilities for losses and loss adjustment expenses for claims associated with: (1) insurance policies issued by Allegiant and re-insurance agreements issued by StarAmerican; (2) self-insurance, including workers compensation; and (3) deductible amounts under our insurance policies. The establishment of the provisions for outstanding losses and loss adjustment expenses is based on actuarial or internally developed 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 such as those caused by natural disasters, fires, or accidents, depending on the business conducted, and changing regulatory and legal environments.

Mortgage Loan Loss Reserves. In the normal course of business, we establish reserves for potential losses associated with HomeAmerican s sale of mortgage loans to third-parties. These reserves are created to address repurchase and indemnity claims by third-party purchasers of the mortgage loans, which claims arise primarily out of allegations of homebuyer fraud at the time of origination of the loan. These reserves are based upon, among other things: (1) pending claims received from third-party purchasers associated with previously sold mortgage loans; and (2) a current assessment of the potential exposure associated with future claims of fraud in mortgage loans originated in prior periods. Our mortgage loan reserves are reflected as a component of accrued liabilities in the Financial Services section of the accompanying consolidated balance sheets, and the associated expenses are included in Expenses in the Financial Services section of the accompanying consolidated statements of operations. See Note 16 to the Consolidated Financial Statements.

Litigation Reserves. We and certain of our subsidiaries have been named as defendants in various cases. We reserve for estimated exposure with respect to these cases based upon currently available information on each case.

Revenue Recognition for Homebuilding Segments. Revenue from home closings and land sales is recognized when the closing has occurred, title has passed, adequate initial and continuing investment by the buyer is received, possession and other attributes of ownership have been transferred to the buyer and we are not obligated to perform significant additional activities after closing and delivery. If the buyer has provided sufficient initial and continuing investment, and all other revenue recognition criteria have been met, revenue is recognized on the date of closing. Revenue from a home closing includes the base sales price and any purchased options and upgrades and is reduced for any sales price incentives.

We defer Operating Margin related to the sale of a home if all of the following criteria are present: (1) HomeAmerican originates the mortgage loan; (2) HomeAmerican has not sold the mortgage loan, or loans, as of

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the end of the pertinent reporting period; and (3) the homebuyer s down payment does not meet the initial or continuing investment criteria. The deferral is subsequently recognized at the time HomeAmerican sells the homebuyer s mortgage loan, or loans, to a third-party purchaser. In the event the Operating Margin is a loss, we recognize such loss at the time the home is closed. We did not have any homes that closed during the years ended December 31, 2012, 2011 or 2010 that failed to meet the continuing investment criteria.

Revenue Recognition for HomeAmerican. Revenues recorded by HomeAmerican primarily include origination fees and the corresponding sale of a loan and its servicing rights. Origination fees are recognized when a loan is originated. When an interest rate lock commitment is made to a customer, we record the expected gain on sale of the mortgage including servicing rights, adjusted for a pull-through percentage (which is defined as the likelihood that an interest rate lock commitment will be originated), as revenue. As the interest rate lock commitment gets closer to being originated, the expected gain on the sale of that loan plus servicing rights is updated to reflect current market value and the increase or decrease in the fair value of that interest rate lock commitment is recorded through revenues. At the same time, as the likelihood of the interest rate lock commitment being originated increases resulting in an improvement to the expected pull-through percentage, additional revenues are recognized. After origination, our mortgage loans generally are transferred to third-party purchasers in accordance with sale agreements entered into by us with a third party purchaser of the loans. We make representations and warranties with respect to the status of loans transferred in the sale agreements. The sale agreements generally include statements acknowledging the transfer of the loans is intended by both parties to constitute a sale. Sale of a mortgage loan has occurred when the following criteria, among others, have been met: (1) fair consideration has been paid for transfer of the loan by a third party in an arms-length transaction, (2) all the usual risks and rewards of ownership that are in substance a sale have been transferred by us to the third party purchaser; and (3) we do not have a substantial continuing involvement with the mortgage loan. The related servicing rights are generally transferred by us to the third party purchaser for additional consideration. Revenue from the sale of mortgage loan servicing is recognized upon the exchange of consideration for the mortgage loans and related servicing rights between us and the third-party purchaser.

We measure mortgage loans held-for-sale at fair value with the changes in fair value being reported in earnings at each reporting date. The impact of recording changes in fair value to earnings did not have a material impact on our financial position, results of operations or cash flows during the years ended December 31, 2012, 2011 or 2010. Gains on sales of mortgage loans, net, were $21.7 million, $10.0 million and $16.1 million for the years ended December 31, 2012, 2011 and 2010, respectively, and are included as a component of revenues in the Financial Services section of the consolidated statements of operations.

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, both incurred and estimated to be incurred, 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 on a house-by-house basis.

When a home is closed, we generally have not yet paid and recorded all costs necessary to complete the construction of the home and certain land development costs. At the time of a home closing, we compare the home construction budgets to actual recorded costs to determine the additional costs remaining to be paid on each closed home. For amounts not incurred or paid as of the time of closing a home, we record an estimated accrual associated

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

with certain home construction and land development costs. Generally, these accruals are established based upon contracted work which has yet to be paid, open work orders not paid at the time of home closing, as well as land completion costs more likely than not to be incurred, and represent estimates believed to be adequate to cover the expected remaining home construction and land development costs. We monitor the adequacy of these accruals on a house-by-house basis and in the aggregate on both a market-by-market and consolidated basis. At December 31, 2012 and 2011, we had $9.5 million and $10.6 million, respectively, of land development and home construction accruals for closed homes. Actual results could differ from such estimates.

Stock-Based Compensation Expense. Stock-based compensation expense for all share-based payment awards is based on the grant date fair value. The grant date fair value for stock option awards is estimated using the Black-Scholes option pricing model and the grant date fair value for restricted stock awards is based upon the closing price of our common stock on the date of grant. We recognize these compensation costs net of estimated forfeitures. For stock option awards with service conditions only, we recognize stock-based compensation expense on a straight-line basis over the requisite service period of the award, which is currently the vesting term of up to seven years. For our stock option awards with performance conditions, we recognize stock-based compensation expense on a straight-line basis for each performance criteria tranche (if applicable) over the period between the date that it is determined the performance conditions related to each tranche (if applicable) are probable to be met and the date the option vests.

Derivative Financial Instruments. We utilize certain derivative instruments in the normal course of business, which primarily include interest rate lock commitments and forward sales of mortgage-backed securities, both of which typically are short-term in nature. Forward sales of securities and private investor sales commitments are utilized to hedge changes in fair value of mortgage loan inventory and interest rate lock commitments. At December 31, 2012 and 2011, we had an aggregate principal balance of approximately $50.8 and $24.4 million, respectively, and were under interest rate lock commitments at an average interest rate of 3.26% and 3.93%, respectively.

For forward sales of 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 with an offset to prepaid expenses and other assets or accounts payable and accrued liabilities in the Financial Services section of our accompanying consolidated balance sheets, depending on the nature of the change. For further discussion of our policies regarding interest rate lock commitments, see our Revenue Recognition for HomeAmerican accounting policy section above.

Earnings (Loss) Per Common Share. For purposes of calculating earnings (loss) per share (EPS), a company that has participating security holders (for example, unvested restricted stock that has nonforfeitable dividend rights) is required to utilize the two-class method for calculating earnings per share. 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) less dividends). Currently, we have one class of security and we have 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.

For purposes of calculating diluted EPS, basic EPS is further adjusted to include the effect of potential dilutive shares outstanding, including stock options and unvested restricted stock using the treasury stock method.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recently Issued Accounting Standards. In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, (ASU 2011-04). ASU 2011-04 amends Accounting Standards Codification (ASC) 820, *Fair Value Measurements* (ASC 820), providing a consistent definition and measurement of fair value, as well as similar disclosure requirements between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles, clarifies the application of existing fair value measurement and expands the ASC 820 disclosure requirements, particularly for Level 3 fair value measurements. ASU 2011-04 was effective for our interim and annual periods beginning January 1, 2012. The adoption of ASU 2011-04 did not have a material effect on our consolidated financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, (ASU 2011-05), which improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income (OCI) by eliminating the option to present components of OCI as part of the statement of changes in stockholders equity. The amendments in this standard require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this standard do not change the items that must be reported in OCI, when an item of OCI must be reclassified to net income, or change the option for an entity to present components of OCI gross or net of the effect of income taxes. The amendments in ASU 2011-05 were effective for our interim and annual periods beginning January 1, 2012 and were applied retrospectively. The adoption of the provisions of ASU 2011-05 did not have a material impact on our consolidated financial position or results of operations.

In September 2011, the FASB issued an amendment to ASC 350, *Intangibles Goodwill and Other* (ASC 350), which simplifies how entities test goodwill for impairment. Previous guidance under ASC 350 required an entity to test goodwill for impairment using a two-step process on at least an annual basis. First, the fair value of a reporting unit was calculated and compared to its carrying amount, including goodwill. Second, if the fair value of a reporting unit was less than its carrying amount, the amount of impairment loss, if any, was required to be measured. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads the entity to determine that it is more likely than not that its fair value is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then the two-step impairment test is unnecessary. If the entity concludes otherwise, then it is required to test goodwill for impairment under the two-step process as described under ASC 350. The amendments were effective for us for annual and interim goodwill impairment tests performed for fiscal years beginning January 1, 2012. We adopted this standard in the 2012 first quarter. The adoption of the amended provisions of ASC 350 did not have a material impact on our consolidated financial position or results of operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Supplemental Cash Flow Disclosure

The table below sets forth supplemental disclosures of cash flow information and non-cash investing and financing activities (in thousands).

	Year Ended December 31, 2012	2011	2010
	(Dollars in thousands)		
Cash paid for:			
Interest, net of interest capitalized	$ 1,083	$ 25,190	$ 32,824
Income taxes	$ 577	$ 3,532	$ 271
Non-cash investing and financing activities:			
Unrealized holding (losses) gains on marketable securities	$ 12,078	$ (12,124)	$ 4,884

3. Segment Reporting

Our operating segments are defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. We have identified our chief operating decision-makers (CODMs) as two key executives the Chief Executive Officer and the Chief Operating Officer.

We have identified each homebuilding division as an operating segment. Our 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, Illinois and Maryland, which includes Pennsylvania, Delaware and New Jersey)

In 2012, we combined our Florida and Illinois divisions into our East reportable segment as they exhibit similar criteria discussed above, including similar economic characteristics, with those divisions in our East reportable segment. As such, all years presented with segment data have been revised to reflect this new presentation.

Our Financial Services business consists of the operations of the following operating segments: (1) HomeAmerican Mortgage Corporation (HomeAmerican); (2) Allegiant; (3) StarAmerican; (4) American Home Insurance Agency, Inc.; and (5) American Home Title and Escrow Company. Due to its contributions to consolidated pretax income during the year ended December 31, 2012, HomeAmerican is now considered to be a reportable segment (Mortgage operations). All years presented with segment data have been revised to reflect this new presentation. 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 segment.

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

	Year Ended December 31,		
	2012	2011	2010
Homebuilding	(Dollars in thousands)		
West	$ 516,079	$ 272,800	$ 326,278
Mountain	355,368	316,189	345,794
East	284,695	228,034	254,833
Total home and land sale revenues	$ 1,156,142	$ 817,023	$ 926,905
Financial Services			
Mortgage operations	$ 35,123	$ 17,807	$ 21,839
Other	11,758	8,279	8,634
Total financial services revenues	$ 46,881	$ 26,086	$ 30,473

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

	Year Ended December 31,		
	2012	2011	2010
Homebuilding	(Dollars in thousands)		
West	$ 27,076	$ (16,889)	$ 9,910
Mountain	24,302	1,397	1,060
East	11,011	(7,195)	(3,048)
Corporate	(29,772)	(87,941)	(88,818)
Total homebuilding pretax income (loss)	$ 32,617	$ (110,628)	$ (80,896)
Financial Services			
Mortgage operations	$ 23,939	$ 394	$ 10,979
Other	4,559	2,762	(684)
Total financial services pretax income (loss)	$ 28,498	$ 3,156	$ 10,295

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes total assets for our homebuilding and financial services operations. The assets in our Corporate segment primarily include cash and cash equivalents, marketable securities, and property and equipment.

	December 31, 2012	December 31, 2011
	(Dollars in thousands)	
Homebuilding assets:		
West	$ 459,807	$ 346,442
Mountain	332,939	262,787
East	274,199	255,074
Corporate	692,500	852,561
Total homebuilding assets	$ 1,759,445	$ 1,716,864
Financial services assets:		
Mortgage operations	$ 122,941	$ 80,097
Other	63,055	61,764
Total financial services assets	$ 185,996	$ 141,861

4. Earnings (Loss) Per Share

The following table shows our basic and diluted EPS calculations:

	Year Ended December 31, 2012	2011	2010
	(Dollars in thousands, except per share amounts)		
Basic and diluted earnings (loss) per common share:			
Net income (loss)	$ 62,699	$ (98,390)	$ (64,770)
Less: distributed and undistributed earnings allocated to participating securities	(1,101)	(711)	(523)
Net income (loss) attributable to common stockholders	$ 61,598	$ (99,101)	$ (65,293)
Basic weighted-average common shares outstanding	47,660,629	46,796,334	46,627,815
Effect of dilutive securities:			
Stock options	173,527	-	-
Restricted stock awards	230,683	-	-
Diluted weighted-average common shares outstanding	48,064,839	46,796,334	46,627,815
Basic earnings (loss) per common share	$ 1.29	$ (2.12)	$ (1.40)
Dilutive earnings (loss) per common share	$ 1.28	$ (2.12)	$ (1.40)

Diluted EPS for the year ended December 31, 2012 excluded options to purchase approximately 4.8 million shares of common stock because the effect of their inclusion would be anti-dilutive.

There was no dilutive effect of common stock equivalents for the years ended December 31, 2011 or December 31, 2010 because the effect of their inclusion would decrease the reported loss per share. Using the treasury stock method, the weighted-average common stock equivalents excluded from diluted EPS were 0.3 million shares and 0.4 million shares for the years ended December 31, 2011 and 2010, respectively.

5. Fair Value Measurements

ASC 820, as updated and amended by ASU 2011-04, 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:

		Fair Value	
Financial Instrument	Hierarchy	December 31, 2012	December 31, 2011
		(Dollars in thousands)	
Marketable Securities (available-for-sale)			
Equity securities	Level 1	$ 208,818	$ 160,021
Debt securities - maturity less than 1 year	Level 2	54,388	157,685
Debt securities - maturity 1 to 5 years	Level 2	277,514	202,237
Debt securities - maturity greater than 5 years	Level 2	11,218	-
Total available-for-sale securities		$ 551,938	$ 519,943
Mortgage loans held-for-sale, net	Level 2	$ 119,953	$ 78,335

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

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

Marketable Securities. Our marketable securities consist of fixed rate and floating rate interest earning securities, primarily: (1) debt securities, which may include, among others, United States government and government agency debt and corporate debt; (2) holdings in mutual fund equity securities, which invest primarily in corporate bonds and other fixed income securities; and (3) deposit securities, which may include, among others, certificates of deposit and time deposits. As of December 31, 2012 and December 31, 2011, all of our marketable securities were treated as available-for-sale investments and, as such, we have recorded all of our marketable securities at fair value with changes in fair value being recorded as a component of accumulated other comprehensive income (loss).

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The following tables set forth the amortized cost and estimated fair value of our available-for-sale marketable securities.

	December 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Homebuilding:	(Dollars in thousands)			
Equity security	$ 208,279	$ 208,818	$ 169,565	$ 160,021
Debt securities	306,793	310,647	323,454	325,413
Total homebuilding available-for-sale securities	$ 515,072	$ 519,465	$ 493,019	$ 485,434
Financial Services:				
Total financial services available-for-sale debt securities	$ 32,028	$ 32,473	$ 34,164	$ 34,509
Total available-for-sale marketable securities	$ 547,100	$ 551,938	$ 527,183	$ 519,943

As of December 31, 2012 and 2011, our marketable securities in homebuilding and financial services in the aggregate were in an unrealized gain position of $4.8 million and an unrealized loss position of $7.2 million, respectively. Of our four mutual fund equity securities, we had one which was in an unrealized loss position of $2.1 million as of December 31, 2012. Management currently has the ability and intent to hold this security before the anticipated recovery of its cost basis occurs. The unrealized loss related to this equity security at December 31, 2011 was $6.5 million. Given the significant improvement in the unrealized loss since December, 31, 2011 and the fact that the decline in market value occurred during a period of overall decline in market values, the unrealized loss is believed to be temporary and therefore the unrealized loss was not recognized in our consolidated statements of operations.

Mortgage Loans Held-for-Sale, Net. As of December 31, 2012, the primary components of our mortgage loans held-for-sale that are measured at fair value on a recurring basis are: (1) mortgage loans held-for-sale under commitments to sell; and (2) mortgage loans held-for-sale not under commitments to sell. At December 31, 2012 and December 31, 2011, we had $108.3 million and $77.5 million, respectively, of mortgage loans held-for-sale under commitments to sell for which fair value was based upon Level 2 inputs, which were the quoted market prices for those mortgage loans. At December 31, 2012 and December 31, 2011, we had $11.7 million and $0.8 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.

Metro District Bond Securities (Related Party). The Metro District Bond Securities are included in prepaid expenses and other assets in the Homebuilding section of our accompanying consolidated balance sheets. We acquired the Metro District Bond Securities from a quasi-municipal corporation in the state of Colorado (see Note 14 for further discussion related to the acquisition of these securities). Because these assets are accounted for under the cost-recovery method, they are not carried at fair value. We estimated the fair value of the bonds based upon discounted cash flows as we do not believe there is a readily available market for such assets. The estimated cash flows from the bonds are ultimately based upon our estimated cash flows associated with building, selling and closing homes in one of our Colorado communities. The estimated fair values of these assets are based upon Level 3 cash flow inputs. Based upon this evaluation, the carrying value and estimated fair value of the bonds at December 31, 2012 was $5.8 million and $12.9 million, respectively. At December 31, 2011, the fair value of the bonds approximated its carrying value which was $6.7 million as of December 31, 2011. The increase in fair value of the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

bonds from 2011 to 2012 was due to an increase in guaranteed future cash flows in our future cash flow model as they are no longer dependent on future closings of homes in one of our Colorado communities.

Mortgage Repurchase Facility. Our Mortgage Repurchase Facility is at floating rates or at fixed rates that approximate current market rates and have relatively short-term maturities, generally between 15 to 40 days. The fair value approximates carrying value.

Senior Notes. The estimated values of the senior notes in the following table are based on Level 2 inputs, including market prices of other homebuilder bonds.

	December 31, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
5.375% Senior Notes due 2014	$ 249,621	$ 267,208	$ 249,438	$ 254,667
5.375% Senior Notes due 2015	249,895	268,867	249,857	252,083
5.625% Senior Notes due 2020	245,326	273,125	244,813	227,467
Total	$ 744,842	$ 809,200	$ 744,108	$ 734,217

Inventories. The table below shows the carrying value, at each year end, of all inventories that were impaired during each year presented.

	Carrying Value of Impaired Inventory at December 31, 2012			Carrying Value of Impaired Inventory at December 31, 2011		
	Land and Land Under Development	Housing Completed or Under Construction	Total Inventory	Land and Land Under Development	Housing Completed or Under Construction	Total Inventory
	(Dollars in thousands)					
West	$ -	$ -	$ -	$ 12,904	$ 6,517	$ 19,421
Mountain	-	-	-	1,000	466	1,466
East	1,100	1,635	2,735	1,225	2,309	3,534
Total	$ 1,100	$ 1,635	$ 2,735	$ 15,129	$ 9,292	$ 24,421

Inventories with a carrying value of $3.8 million and $54.6 million were determined to be impaired during the years ended December 31, 2012 and 2011, respectively. The carrying value for some of these inventories at their respective year ends may not represent the fair value they were impaired to due to activities that occurred subsequent to the measurement date. The fair values of impaired inventories were determined using Level 3 inputs. We generally determine the estimated fair value of each subdivision by determining the present value of the estimated future cash flows at discount rates that are commensurate with the risk of the subdivision under evaluation.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Inventories

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

	December 31, 2012	December 31, 2011
	(Dollars in thousands)	
Housing Completed or Under Construction:		
West	$ 200,858	$ 121,343
Mountain	183,522	80,964
East	128,569	98,407
Subtotal	512,949	300,714
Land and Land Under Development:		
West	230,344	199,941
Mountain	137,221	164,961
East	122,007	140,436
Subtotal	489,572	505,338
Total Inventories	$ 1,002,521	$ 806,052

In accordance with ASC 360, *Property, Plant and Equipment* (ASC 360), homebuilding inventories 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. Please see *Inventories* in Note 1 for more detail on the methods and assumptions that were used to estimate the fair value of our inventories.

Inventory impairments recognized by segment for the years ended December 31, 2012, 2011 and 2010 are shown in the table below:

	Year Ended December 31, 2012	2011	2010
	(Dollars in thousands)		
Housing Completed or Under Construction:			
West	$ -	$ 7,270	$ 14,808
Mountain	-	1,850	555
East	295	1,804	542
Subtotal	295	10,924	15,905
Land and Land Under Development:			
West	-	1,499	3,163
Mountain	-	449	964
East	810	93	1,163
Subtotal	810	2,041	5,290
Inventory Impairments	$ 1,105	$ 12,965	$ 21,195

During the year ended December 31, 2012, we recorded $1.1 million of inventory impairments related to two projects in our Maryland division. Based on the slow sales absorption rates experienced during 2012 and the estimated sales price reductions required to sell the remaining lots and houses in these communities, it was determined that the fair values were less than the carrying values.

During the year ended December 31, 2011, we recorded $13.0 million of asset impairments. These impairments primarily were incurred during the 2011 second and third quarters in select subdivisions primarily in the California and

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nevada markets of our West segment, and the Utah market of our Mountain segment. The impairment of these specific subdivisions, most of which were purchased during 2010, primarily resulted from lowering anticipated home sales prices from those that were expected at the time we purchased the land, based on our experience with homes sold or closed in these subdivisions.

During the year ended December 31, 2010, we recorded $21.2 million of impairments. The impairments were concentrated in the Arizona and Nevada markets of our West segment and primarily resulted from lowering our estimated average selling prices of homes. This was primarily due to: (1) strong competition for sales of new homes; (2) overall low economic activity combined with high unemployment levels; (3) homebuyers having difficulty qualifying for new loans; and (4) the elevated levels of foreclosures and short sales of homes driving real estate values down.

For the years ended December 31, 2012, 2011 and 2010, we used discount rates generally ranging from 13% to 18% for the subdivisions that were impaired.

7. Capitalization of Interest

We capitalize interest on our senior notes associated with our qualified assets, which includes land and land under development that is actively being developed and homes under construction through the completion of construction. When construction of an unsold home is complete, such home is no longer considered to be a qualified asset and interest is no longer capitalized on that home. We expensed $0.8 million, $20.8 million and $38.2 million of interest for the years ended December 31, 2012, 2011 and 2010, respectively, primarily associated with interest incurred on our homebuilding debt during the same periods. The table set forth below summarizes homebuilding interest activity.

	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Homebuilding interest incurred	$ 42,315	$ 62,290	$ 72,076
Less: Interest capitalized	(41,507)	(41,448)	(33,919)
Homebuilding interest expense	$ 808	$ 20,842	$ 38,157
Interest capitalized, beginning of period	$ 58,742	$ 38,446	$ 28,339
Interest capitalized during period	41,507	41,448	33,919
Less: Previously capitalized interest included in home cost of sales	(31,106)	(21,152)	(23,812)
Interest capitalized, end of period	$ 69,143	$ 58,742	$ 38,446

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Homebuilding Prepaid Expenses and Other Assets

The following table sets forth the information relating to prepaid expenses and other assets, net.

	December 31, 2012	December 31, 2011
	(Dollars in thousands)	
Deferred marketing costs	$ 13,874	$ 20,786
Land option deposits	8,246	6,952
Deferred debt issuance costs, net	2,641	3,235
Prepaid expenses	5,575	4,376
Metro district bond securities (related party)	5,818	6,663
Goodwill	6,008	6,008
Other	2,615	2,403
Total	$ 44,777	$ 50,423

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

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

	December 31, 2012	December 31, 2011
	(Dollars in thousands)	
Warranty reserves	$ 23,151	$ 25,525
Accrued interest payable	13,698	13,698
Accrued executive deferred compensation (note 12)	28,475	24,136
Liability for unrecognized tax benefits	835	3,303
Legal accruals	2,250	9,360
Land development and home construction accruals	9,545	10,619
Accrued compensation and related expenses	16,864	11,350
Customer and escrow deposits	9,413	5,468
Other accrued liabilities	14,225	15,729
Total accrued liabilities	$ 118,456	$ 119,188

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

	December 31, 2012	December 31, 2011
	(Dollars in thousands)	
Insurance reserves	$ 47,852	$ 49,376
Other accrued liabilities	4,012	3,070
Total accounts payable and accrued liabilities	$ 51,864	$ 52,446

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Warranty Accrual

The following table summarizes the warranty reserve activity for the years ended December 31, 2012, 2011 and 2010.

	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Balance at beginning of period	$ 25,525	$ 34,704	$ 59,022
Expense provisions	4,216	4,224	5,320
Cash payments	(6,590)	(7,925)	(8,793)
Adjustments	-	(5,478)	(20,845)
Balance at end of period	$ 23,151	$ 25,525	$ 34,704

During the years ended December 31, 2012, 2011 and 2010, we continued to experience lower than anticipated warranty payments on previously closed homes. We believe the lower warranty payment experience rate in the 2011 and 2010 periods were driven by, among other things, tighter focus and controls over our warranty expenditures, a significant drop in sales volumes over the last several years, which resulted in fewer homes under warranty, and better quality controls and construction practices. As a result of favorable warranty payment experience relative to our estimates at the time of home closing, partially offset by increases in specific warranty reserves established for warranty-related issues in a limited number of subdivisions, we recorded adjustments to reduce our warranty reserve by $5.5 million and $20.8 million for the years ended December 31, 2011 and 2010, respectively.

11. Insurance Reserves

The following table summarizes the insurance reserve activity for the years ended December 31, 2012, 2011 and 2010. The insurance reserve is included as a component of accounts payable and accrued liabilities in the Financial Services section of the accompanying consolidated balance sheets.

	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Balance at beginning of period	$ 49,376	$ 51,576	$ 49,631
Expense provisions	4,565	2,506	3,688
Cash payments	(8,020)	(7,115)	(5,959)
Adjustments	1,931	2,409	4,216
Balance at end of period	$ 47,852	$ 49,376	$ 51,576

The $1.9 million, $2.4 million and $4.2 million of adjustments to increase our insurance reserves during the years ended December 31, 2012, 2011 and 2010, respectively, primarily resulted from increases in the severity and frequency of insurance claim experience relative to prior period estimates.

In the ordinary course of business, we make payments from our insurance reserves to settle litigation claims arising primarily from our homebuilding activities. These payments are unpredictable in both their timing and their magnitude. As a result, the cash payments shown for the years ended December 31, 2012, 2011, and 2010 are not necessarily indicative of what future cash payments will be for subsequent periods.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Deferred Compensation Retirement Plans

During 2008, the Company entered into amended and restated employment agreements with Larry A. Mizel, Chairman of the Board and Chief Executive Officer, and David D. Mandarich, President and Chief Operating Officer. The annual retirement benefit in which Mr. Mizel and Mr. Mandarich currently are fully vested is $1,333,333 and $1,214,333, respectively. Under the provisions of the employment agreements, the annual retirement benefit will be increased to $1,666,666 for Mr. Mizel and $1,547,666 for Mr. Mandarich on December 31, 2014 and will reach the maximum amount at $2,000,000 for Mr. Mizel and $1,881,000 for Mr. Mandarich on December 31, 2016 pending successful completion of employment through that date. However, the annual retirement benefit will increase to $2,000,000 for Mr. Mizel and $1,881,000 for Mr. Mandarich prior to that date in the event of: (1) the executive s death or total disability; (2) a termination by the Company without cause; or (3) the executive s election to terminate his employment in the event of a change in control or material change in his employment.

We have accrued for the present value of the expected future retirement benefits to be paid to Mr. Mizel and Mr. Mandarich pursuant to their employment agreements with the Company. Our accrued liabilities for the deferred compensation retirement plans are included as accrued executive deferred compensation in the table in Note 9 to the Consolidated Financial Statements. We estimate the present value of the future retirement benefits based upon discount rates of high quality corporate bonds with a similar maturity as the estimated period of retirement benefits. At December 31, 2012 and 2011, the discount rate used in our present value calculation was 5.0% and 5.5%, respectively. During the years ended December 31, 2012, 2011 and 2010, the Company accrued $4.3 million, $3.2 million and $3.2 million, respectively, of expense associated with the deferred compensation components of Mr. Mizel s and Mr. Mandarich s employment agreements.

13. Income Taxes

Our provision for (benefit from) income taxes for the years ended December 31, 2012, 2011 and 2010 consisted of the following:

	Year Ended December 31,		
	2012	**2011**	**2010**
Current tax benefit:		(Dollars in thousands)	
Federal	$ (374)	$ (3,652)	$ (481)
State	(1,210)	(5,430)	(5,350)
Total current	(1,584)	(9,082)	(5,831)
Deferred tax expense:			
Federal	-	-	-
State	-	-	-
Total deferred	-	-	-
Benefit from income taxes	$ (1,584)	$ (9,082)	$ (5,831)

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The provision for (benefit from) income taxes differs from the amount that would be computed by applying the statutory federal income tax rate of 35% to income before income taxes as a result of the following:

	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Tax expense(benefit) computed at federal statutory rate	$ 21,390	$ (37,615)	$ (24,711)
State income tax expense(benefit), net of federal benefit	2,139	(3,762)	(2,471)
Permanent differences	1,771	93	319
Expiration of statute, Arizona net operating loss	2,634	-	-
Liability for unrecognized tax benefits	(1,857)	(9,173)	(4,082)
Change in valuation allowance	(27,661)	41,375	25,114
Benefit from income taxes	$ (1,584)	$ (9,082)	$ (5,831)
Effective tax rate	2.6%	8.5%	8.3%

During 2012, the Company recorded a $1.6 million benefit from income taxes, primarily from the release of reserves attributable to the expiration of the statute of limitation periods and refunds from various states relating to and our settlement with the IRS on its audit of the 2004 and 2005.

During 2011, the Company recorded a $9.1 million benefit from income taxes, primarily related to the settlements of various state income tax matters and our settlement with the IRS on its audit of the 2004 and 2005 federal income tax returns.

During 2010, the Company recorded a $5.8 million benefit from income taxes, primarily from our finalization of various state income tax examinations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of significant temporary differences that give rise to the net deferred tax asset are as follows:

	December 31,	
	2012	**2011**
Deferred tax assets:	**(Dollars in thousands)**	
Federal net operating loss carryforward	$ 129,695	$ 133,454
State net operating loss carryforward	49,551	53,350
Asset impairment charges	14,080	31,137
Stock-based compensation expense	29,196	26,771
Warranty, litigation and other reserves	14,556	18,933
Accrued liabilities	12,166	10,667
Alternative minimum tax and other tax credit carry forwards	10,988	10,296
Inventory, additional costs capitalized for tax purposes	3,930	3,466
Unrealized loss on marketable securities	-	2,787
Charitable contribution on carryforward	520	942
Deferred revenue	629	580
Total deferred tax assets	265,311	292,383
Valuation allowance	(248,306)	(281,178)
Total deferred tax assets, net of valuation allowance	17,005	11,205
Deferred tax liabilities:		
Deferred revenue	3,796	5,589
Property, equipment and other assets	5,753	706
Inventory, additional costs capitalized for financial statement purposes	450	542
Accrued liabilities	758	32
Unrealized gain on marketable securities	1,863	-
Other, net	4,385	4,336
Total deferred tax liabilities	17,005	11,205
Net deferred tax asset	$ -	$ -

At December 31, 2012, we had $129.7 million in tax effected federal net operating loss carryforwards. These operating loss carryforwards, if unused, will begin to expire in 2028. Additionally, we had $49.6 million in tax effected state net operating loss carryforwards. These operating loss carryforwards, if unused, will begin to expire in 2013.

The decrease in our valuation allowance between December 31, 2012 and 2011 was primarily due to income generated the Company during 2012. Our future realization of its deferred tax assets ultimately depends on the existence of sufficient taxable income in the carryforward periods under the tax laws. We will continue analyzing, in subsequent reporting periods, the positive and negative evidence in determining the expected realization of its deferred tax assets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes our liability associated with unrecognized tax benefits for the years ended December 31, 2012, 2011 and 2010:

	Year Ended December 31,		
	2012	2011	2010
	(Dollars in thousands)		
Gross unrecognized tax benefits at beginning of year	$ 2,712	$ 48,963	$ 52,837
Increases related to prior year tax positions	63	-	13
Decreases related to prior year tax positions	(84)	(286)	(2,323)
Increases related to current year tax positions	-	85	385
Decreases related to current year tax positions	-	-	-
Settlements with taxing authorities	-	(38,543)	(1,414)
Lapse of applicable statute of limitations	(2,116)	(7,507)	(535)
Gross unrecognized tax benefits at end of year	$ 575	$ 2,712	$ 48,963

Our liability for gross unrecognized tax benefits was $0.6 million and $2.7 million at December 31, 2012 and 2011, respectively. This decrease resulted primarily from the expiration of statutes of limitations.

In addition to unrecognized tax benefit activity noted above, additional paid-in-capital increased by $1.6 million and $18.4 million during the years ended December 31, 2012 and 2011, respectively. The 2012 increase was due to the expiration of various statutes of limitations while the 2011 increase was due to a settlement with the IRS and the expiration of various statutes of limitations. Finally, since we settled with the IRS for an amount less than the $35.6 million deposit we made with the IRS during 2008, the settlement resulted in an increase of $11.1 million to income taxes receivable in our consolidated balance sheets. We received payment from the IRS during the 2011 second quarter.

The total liabilities associated with unrecognized tax benefits that, if recognized, would impact the effective tax rates in our consolidated statements of operations is $0.5 million and $1.0 million at December 31, 2012 and 2011, respectively.

We accrue interest and penalties associated with unrecognized tax benefits in income tax expense in the consolidated statements of operations, and the corresponding liability in accrued liabilities in the Homebuilding section of our consolidated balance sheets. The expense (benefit) for interest and penalties reflected in the consolidated statements of operations for the years ended December 31, 2012, 2011 and 2010 was approximately $(0.4) million, ($4.8) million and ($1.8) million (interest net of related tax benefits), respectively. The corresponding liabilities in the consolidated balance sheets were $0.4 million and $0.8 million at December 31, 2012 and 2011, respectively.

We have taken positions in certain taxing jurisdictions for which it is reasonably possible that the total amounts of unrecognized tax benefits may decrease within the next twelve months. The possible decrease could result from the expiration of various statutes of limitation and the finalization of various state income tax matters. The estimated range of the reasonably possible decrease is $0 to $1.0 million.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. We are subject to U.S. federal income tax examination for calendar tax years ending 2009 through 2012. Additionally, we are subject to various state income tax examinations for the 2001 through 2012 calendar tax years. The Company currently is under state income tax examination in the states of California and Utah for various tax years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Related Party Transactions

We previously entered into a transaction (the Transaction) with the Villages at Castle Rock Metropolitan District No. 6 (the District). The District is a quasi-municipal corporation and political subdivision of the State of Colorado. The Board of Directors of the District currently is comprised of employees of the Company. The District was formed to provide funding for certain land development costs associated with the construction of homes in our Cobblestone subdivision. Pursuant to the terms of the Transaction, the District sold to the Company approximately $22.5 million in Limited Tax General Obligation Capital Appreciation Bonds Series 2007 (the 2007 Bonds) and a $1.6 million Limited Tax General Obligation Subordinate Bond (the Subordinate Bond) in exchange for title to approximately $28.6 million in land development improvements to the District.

We recorded the 2007 Bonds and Subordinate Bond at an estimated $8.9 million and $0 fair value, respectively, based upon discounted cash flows. During the year ended December 31, 2009, we updated our evaluation of the estimated fair value of the 2007 Bonds and through this evaluation, we determined there was a decrease in the estimated cash flows from this asset and, as a result, recorded a $1.0 million other-than-temporary-impairment associated with the 2007 Bonds in 2009. As discussed in Note 5, the fair value of 2007 Bonds as of December 31, 2012 was $12.9 million. However, as the 2007 Bonds are accounted for under the cost-recovery method, they are not carried at fair value and therefore no upward adjustment to the carrying value was recorded.

During the years ended December 31, 2012, 2011 and 2010, we received payments from the District in the amount of $0.8 million, $0.7 million and $0.5 million, respectively, which were recorded as a reduction to the carrying value of the 2007 Bonds and Subordinate Bond.

During the year ended December 31, 2012, we contributed $1 million in cash to the MDC/Richmond American Homes Foundation (the Foundation), a Delaware non-profit corporation that was incorporated on September 30, 1999. We did not make any contributions to the foundation during the years ended December 31, 2011 or December 31, 2010.

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 are the trustees of the Foundation at December 31, 2012, all of whom serve without compensation:

Name	Title
Larry A. Mizel	Trustee, Chairman and Chief Executive Officer
David D. Mandarich	Trustee, President
Raymond T. Baker	Trustee

15. Lines of Credit and Total Debt Obligations

Mortgage Lending. HomeAmerican has a Master Repurchase Agreement (the Mortgage Repurchase Facility) with U.S. Bank National Association (USBNA). This agreement was amended on September 21, 2012 and extended until September 20, 2013. The Mortgage Repurchase Facility provides liquidity to HomeAmerican by providing for the sale of eligible mortgage loans to USBNA with an agreement by HomeAmerican to repurchase the mortgage loans at a future date. Until such mortgage loans are transferred back to HomeAmerican, the documents

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

relating to such loans are held by USBNA, as custodian, pursuant to the Custody Agreement (Custody Agreement), dated as of November 12, 2008, by and between HomeAmerican and USBNA. As of December 31, 2012, the Mortgage Repurchase Facility had a temporary maximum aggregate commitment of $80 million which will return to $50 million after January 31, 2013. At December 31, 2012 and December 31, 2011, we had $76.3 million and $48.7 million, respectively, of mortgage loans that we were obligated to repurchase under our Mortgage Repurchase Facility. Mortgage loans that we are obligated to repurchase under the Mortgage Repurchase Facility are accounted for as a debt financing arrangement and are reported as mortgage repurchase facility on the consolidated balance sheets. Advances under the Mortgage Repurchase Facility carry a Pricing Rate equal to the greater of (i) the LIBOR Rate (as defined in the Mortgage Repurchase Facility) plus 2.5%, or (ii) 3.25%. The Mortgage Repurchase Facility contains various representations, warranties and affirmative and negative covenants customary for agreements of this type. The negative covenants include, among others, (i) an Adjusted Tangible Net Worth requirement, (ii) a minimum Adjusted Tangible Net Worth Ratio, (iii) an Adjusted Net Income requirement, and (iv) a minimum Liquidity requirement. The foregoing terms are defined in the Mortgage Repurchase Facility. We believe we were in compliance with the representations, warranties and covenants included in the Mortgage Repurchase Facility as of December 31, 2012.

Senior Notes. 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.

During 2011, we completed a debt tender offer and redemptions of our 7% Senior Notes due 2012 and 5 $^{1}/_{2}$% Senior Notes due 2013. As a result of these transactions, we paid $537.7 million to extinguish $500 million in debt principal with a carrying amount of $498.9 million and recorded a $38.8 million expense for loss on extinguishment of debt.

Our debt obligations at December 31, 2012 and December 31, 2011 were as follows:

	December 31,	
	2012	**2011**
	(Dollars in thousands)	
5 $^{3}/_{8}$% Senior Notes due 2014, net	$ 249,621	$ 249,438
5 $^{3}/_{8}$% Senior Notes due 2015, net	249,895	249,857
5 $^{5}/_{8}$% Senior Notes due 2020, net	245,326	244,813
Total Senior Notes, net	$ 744,842	$ 744,108

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 December 31, 2012, we had issued and outstanding surety bonds and letters of credit totaling $61.2 million and $14.7 million, respectively, including $6.7 million in letters of credit issued by HomeAmerican. The estimated cost to complete obligations related to these bonds and letters of credit was approximately $24.2 million and $6.5 million, respectively. Among our letter of credit facilities are three committed revolving facilities, the terms of which provide that up to $65 million of letters of credit may be issued thereunder. In the event any such surety bonds or letters of credit issued by third parties are called, MDC could be obligated to reimburse the issuer of the bond or letter of credit. We believe that we were in compliance with the covenants in the letter of credit facilities at December 31, 2012.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Mortgage Loan Loss Reserves. In the normal course of business, we establish reserves for potential losses associated with HomeAmerican s sale of mortgage loans to third-parties. These reserves are created to address repurchase and indemnity claims by third-party purchasers of the mortgage loans, which claims arise primarily out of allegations of homebuyer fraud at the time of origination of the loan. These reserves are based upon, among other things: (1) pending claims received from third-party purchasers associated with previously sold mortgage loans; and (2) a current assessment of the potential exposure associated with future claims of fraud in mortgage loans originated in prior periods. Our mortgage loan reserves are reflected as a component of accounts payable and accrued liabilities in the Financial Services section of the accompanying consolidated balance sheets, and the associated expenses are included in expenses in the Financial Services section of the accompanying consolidated statements of operations.

The following table summarizes the mortgage loan loss reserve activity for the years ended December 31, 2012, 2011, and 2010.

	Year Ended December 31,		
	2012	**2011**	**2010**
		(Dollars in thousands)	
Balance at beginning of period	$ 442	$ 6,881	$ 9,641
Expense provisions	589	-	-
Cash payments	(226)	(14,450)	(2,760)
Adjustments	-	8,011	-
Balance at end of period	$ 805	$ 442	$ 6,881

During 2011, HomeAmerican reached settlements with third parties concerning claims and potential claims to repurchase certain previously sold mortgage loans, including a comprehensive settlement with Bank of America. As a result of these settlements, we increased our loan loss reserve $8.0 million during the year ended December 31, 2011. We made payments of $14.5 million during the year ended December 31, 2011 primarily associated with the foregoing settlements. We believe that those settlements substantially reduced our future exposure to liabilities associated with previously sold mortgage loans.

Legal Reserves. Because of 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. At December 31, 2012 and 2011, respectively, we had $2.3 and $9.4 million of legal accruals.

For the year ended December 31, 2012, we had various significant legal recoveries totaling $9.8 million, respectively, which were included in selling, general and administrative expenses in the Homebuilding section of our consolidated statements of operations. These recoveries were realized primarily from prior claims we had made in connection with various construction defect cases.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Operating Leases. We have non-cancelable operating leases primarily associated with our office facilities. Rent expense under cancelable and non-cancelable operating leases totaled $6.6 million, $7.7 million and $8.7 million in 2012, 2011 and 2010, respectively, and is included in either selling, general and administrative expenses in the Homebuilding section or expenses in the Financial Services section of our consolidated statements of operations. The table below shows the future minimum payments under non-cancelable operating leases at December 31, 2012.

	Year Ended December 31, (Dollars in thousands)
2013	$ 4,451
2014	3,464
2015	3,489
2016	2,864
2017	698
Thereafter	651
Total	$ 15,617

17. Stockholders Equity

Common Stock Repurchase Program. At December 31, 2012, we were authorized to repurchase up to 4,000,000 shares of our common stock. We did not repurchase any shares of our common stock during the years ended December 31, 2012, 2011 or 2010. We did not hold any treasury stock at December 31, 2012. At December 31, 2011, we held 59,912 shares of treasury stock with an average cost of $11.00.

18. Equity Incentive and Employee Benefit Plans

A summary of our equity incentive plans follows.

Employee Equity Incentive Plans. Effective March 2001, we adopted the M.D.C. Holdings, Inc. 2001 Equity Incentive Plan (the 2001 Equity Incentive Plan). On March 26, 2011, the 2001 Equity Incentive Plan terminated and all stock option grants and restricted stock awards outstanding at the time of the plan termination may continue to be exercised, or become free of restrictions, in accordance with their terms. Non-qualified option awards previously granted generally vest over periods of up to seven years and expire ten years after the date of grant. Restricted stock awards generally were granted with vesting terms of up to five years. A total of 3.6 million shares of MDC common stock were reserved for issuance under the 2001 Equity Incentive Plan as of December 31, 2012.

On April 27, 2011, our shareholders approved the M.D.C Holdings, Inc. 2011 Equity Incentive Plan (the 2011 Equity Incentive Plan), which provides for the grant of non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units and other equity awards to employees of the Company. Stock options granted under the 2011 Equity Incentive Plan have an exercise price that is at least equal to the fair market value of our common stock on the date the stock option is granted, generally vest in periods up to five years and expire ten years after the date of grant. At December 31, 2012, a total of 1.6 million shares of MDC common stock were reserved for issuance under the 2012 Equity Incentive Plan, of which 0.3 million shares remained available for grant under this plan as of December 31, 2012.

Director Equity Incentive Plans. Effective March 2001, we adopted the M.D.C. Holdings, Inc. Stock Option Plan for Non-Employee Directors (the 2001 Director Stock Option Plan). The 2001 Director Stock Option Plan

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

terminated on May 21, 2011 and stock options outstanding at the time of plan termination may continue to be exercised in accordance with their terms. Each option granted under the Director Stock Option Plan vested immediately and expires ten years from the date of grant. A total of 0.9 million shares of MDC common stock were reserved for issuance under the Director Stock Option Plan as of December 31, 2012.

Effective April 27, 2011, our shareholders approved the M.D.C. Holdings, Inc. 2011 Stock Option Plan for Non-Employee Directors (the 2011 Director Stock Option Plan). Under the 2011 Director Stock Option Plan, non-employee directors of the Company are granted non-qualified stock options. Pursuant to the 2011 Director Stock Option Plan, on August 1 of each year, each non-employee director is granted options to purchase 25,000 shares of MDC common stock. Each option granted under the 2011 Director Stock Option Plan vests immediately, becomes exercisable six months after grant, and expires ten years from the date of grant. The option exercise price must be equal to the fair market value (as defined in the plan) of our common stock on the date of grant of the option. At December 31, 2012, a total of 0.9 million shares of MDC common stock were reserved for issuance under the 2011 Director Stock Option Plan and 0.7 million shares remained available for grant under this plan as of December 31, 2012.

Employee Benefit Plan. We have a defined contribution plan pursuant to Section 401(k) of the internal Revenue Code where each employee may elect to make before-tax contributions up to the current tax limits. We match employee contributions on a discretionary basis and our contribution for the year ended December 31, 2012 was $0.2 million. We did not make any matching contributions during the years ended December 31, 2011 or 2010.

19. Stock-Based Compensation

Determining Fair Value of Share-Based Payment Awards. We examine our historical pattern of option exercises in an effort to determine if there are any discernable activity patterns based on certain employee and non-employee populations. Based upon this evaluation, we have identified three distinct populations: (1) executives currently consisting of our Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, and General Counsel (collectively, the Executives); (2) Non-Executive employees (Non-Executives); and (3) non-employee members of our board of directors (Directors). Accordingly, during 2012, 2011 and 2010 the Company used separate Black-Scholes option pricing model assumptions for each of the aforementioned employee and non-employee populations. The fair values for stock options granted for the years ended December 31, 2012, 2011 and 2010 were estimated using the Black-Scholes option pricing model with the following weighted-average assumptions.

	Year Ended December 31,		
	2012	**2011**	**2010**
Weighted-average expected lives of options	7.8 yrs.	4.6 yrs.	7.6 yrs.
Expected volatility	44.6%	47.8%	44.2%
Risk free interest rate	1.7%	1.3%	2.8%
Dividend yield rate	4.0%	4.1%	3.5%

Based on calculations using the Black-Scholes option pricing model, the weighted-average grant date fair values of stock options granted during 2012, 2011 and 2010 were $7.54, $3.76 and $9.19, respectively. No stock options were granted to our Executives during the year ended December 31, 2011. As a result, the weighted average expected life of our options are higher in 2012 and 2010 when compared to 2011 as options were granted to Executives in 2012 and 2010.

The expected life of employee stock options represents the weighted-average period for which the stock options are expected to remain outstanding and are derived primarily from historical exercise patterns. The expected volatility

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

is based on the historical volatility in the price of our common stock over the most recent period commensurate with the estimated expected life of our stock options. The risk-free interest rate assumption is determined based upon observed interest rates appropriate for the expected term of our employee stock options. The dividend yield assumption is based on our history of dividend payouts.

An annual forfeiture rate is estimated at the time of grant for all share-based payment awards with service conditions only. That rate is revised, if necessary, in subsequent periods if the actual forfeiture rate differs from our estimate. For grants made in the year ended December 31, 2012, we estimated an forfeiture rate between 20% and 45% for those share-based payment awards granted to Non-Executives. We estimate the annual forfeiture rate to be 0% for share-based payment awards with service conditions only granted to our Executives.

Stock Option Award Activity. Stock option activity under our option plans for the years ended December 31, 2012, 2011 and 2010 were as follows.

	Year Ended December 31,					
	2012		2011		2010	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
Outstanding Stock Option Activity						
Outstanding, beginning of year	5,306,506	$ 42.69	6,002,174	$ 40.72	5,640,619	$ 41.53
Granted - at fair market value[1]	1,382,500	25.33	265,000	25.07	376,500	29.37
Granted - above fair market value	-	-	-	-	180,000	31.75
Exercised	(704,242)	23.69	(489,324)	18.47	(2,894)	18.47
Forfeited	(55,710)	27.46	(124,710)	32.20	(177,321)	32.62
Cancelled	(49,481)	44.75	(346,634)	33.87	(14,730)	44.94
Outstanding, end of year	5,879,573	$ 41.29	5,306,506	$ 42.69	6,002,174	$ 40.72

	Year Ended December 31,					
	2012		2011		2010	
	Number of Shares	Weighted-Average Fair Value	Number of Shares	Weighted-Average Fair Value	Number of Shares	Weighted-Average Fair Value
Unvested Stock Option Activity						
Unvested, beginning of year	1,251,328	$ 14.99	1,790,425	$ 13.50	2,233,717	$ 13.88
Granted - at fair market value[1]	1,382,500	7.54	265,000	7.42	376,500	8.99
Granted - above fair market value	-	-	-	-	180,000	9.45
Vested	(533,118)	8.61	(679,387)	14.76	(822,471)	19.19
Forfeited	(55,710)	8.45	(124,710)	10.13	(177,321)	11.59
Unvested, end of year	2,045,000	$ 13.99	1,251,328	$ 14.99	1,790,425	$ 13.50

(1) Total shares granted in 2012 include 1,000,000 performance based options granted to our CEO and COO. See further discussion regarding these grants in the Performance Based Stock Award Activity section below.

The total intrinsic value of options exercised during the years ended December 31, 2012, 2011 and 2010 was $7.0 million, $0.2 million and $0.1 million, respectively.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table provides outstanding, exercisable and vested or expected to vest in future reporting periods data for our stock options granted to Executives, Non-Executives and Directors as of December 31, 2012.

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding				
Executives	4,475,604	$ 41.03		
Directors	1,044,000	46.84		
Non-Executives	359,969	33.03		
Total	5,879,573	$ 41.29	5.40	$ 23,750
Exerciseable				
Executives	2,600,604	$ 51.11		
Directors	1,044,000	48.47		
Non-Executives	189,969	36.80		
Total	3,834,573	$ 48.83	3.76	$ 4,042
Exerciseable or expected to vest in the future				
Executives	4,475,604	$ 41.03		
Directors	1,044,000	44.46		
Non-Executives	279,193	37.36		
Total	5,798,797	$ 41.47	8.23	$ 3,669

The aggregate intrinsic values in the tables above represent the total pre-tax intrinsic values (the difference between the closing price of MDC s common stock on the last trading day of fiscal 2012 and the exercise price, multiplied by the number of in-the-money stock option shares) that would have been received by the option holders had all in-the-money outstanding stock options been exercised on December 31, 2012.

The following table summarizes information associated with outstanding and exercisable stock options at December 31, 2012.

	Options Outstanding			Options Exercisable		
Range of Exercise Price	**Number Outstanding**	**Weighted-Average Remaining Contractual Life (in years)**	**Weighted-Average Exercise Price**	**Number Exercisable**	**Weighted-Average Remaining Contractual Life (in years)**	**Weighted-Average Exercise Price**
$15.84 - $ 23.77	180,000	8.99	$ 20.91	30,000	8.98	$ 22.12
$23.78 - $ 39.61	2,955,830	7.75	$ 29.79	1,060,830	6.86	$ 33.61
$39.62 - $ 47.53	1,234,243	2.46	$ 43.84	1,234,243	2.52	$ 43.84
$47.54 - $ 63.38	892,500	3.06	$ 60.41	892,500	2.85	$ 60.41

$63.39 - $ 71.30	492,000	2.30	$	67.17	492,000	2.26	$	67.17
$71.31 - $ 78.89	125,000	2.75	$	78.89	125,000	2.75	$	78.89
Total	5,879,573	5.40	$	41.29	3,834,573	3.76	$	48.83

Total stock-based compensation expense relating to stock options granted by the Company was $10.6 million, $9.0 million and $12.7 million for the years ended December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012, $6.4 million of total unrecognized compensation cost related to stock options is expected to be recognized as an expense by the Company in the future over a weighted-average period of approximately 1.3 years.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We received cash proceeds from the exercise of stock options of $16.6 million, $9.0 million and $0.1 million during the years ended December 31, 2012, 2011 and 2010, respectively. We did not have any net tax benefit realized for stock options exercised during the years ended December 31, 2012, 2011 or 2010. We will will issue previously unissued shares and/or treasury stock upon the exercise of stock options.

Performance Based Stock Award Activity. On March 8, 2012, we granted a long term performance-based non-qualified stock option to each of our Chief Executive Officer and our Chief Operating Officer for 500,000 shares of common stock under our 2011 Equity Incentive Plan. The terms of the performance-based options provide that, over a three year period, one third of the option shares would vest as of March 1 following any fiscal year in which, in addition to the Company achieving a gross margin from home sales of at least 16.7% (as calculated in our 2011 Form 10-K, excluding warranty adjustments and interest), the Company achieved: (1) at least a 10% increase in total revenue over 2011 (166,667 option shares vest); (2) at least a 15% increase in total revenue over 2011 (166,667 option shares vest); or (3) at least a 20% increase in total revenue over 2011 (166,666 option shares vest). Any of the three tranches of option shares that are not performance vested by March 1, 2015 would be forfeited. ASC 718 prohibits recognition of expense associated with performance based stock awards until achievement of the performance targets are probable of occurring.

In accordance with ASC 718, the performance-based awards were valued at the fair value on the date of grant. The grant date fair value of these awards was $7.42 per share. The maximum potential expense that would be recognized by the Company if all of the performance targets were met is approximately $7.4 million. At December 31, 2012 all performance targets have been achieved. As such, $6.2 million of compensation expense was recognized related to the grant of these awards during the year ended December 31, 2012. The balance of the unamortized stock-based compensation expense is anticipated to be amortized during the first two months of 2013.

Restricted and Unrestricted Stock Award Activity. Non-vested restricted stock awards at December 31, 2012, 2011 and 2010 and changes during those years were as follows:

	Year Ended December 31,					
	2012		2011		2010	
	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested, beginning of year	667,849	$ 33.19	443,112	$ 36.15	420,862	$ 36.84
Granted	48,613	27.85	329,703	30.24	125,626	34.49
Vested	(197,801)	35.88	(100,677)	36.34	(100,542)	37.02
Forfeited	(11,294)	30.62	(4,289)	38.88	(2,834)	42.38
Unvested, end of year	507,367	$ 31.69	667,849	$ 33.19	443,112	$ 36.10

Total stock-based compensation expense relating to restricted stock awards was $5.6 million, $6.4 million and $4.8 million for the years ended December 31, 2012, 2011 and 2010, respectively. At December 31, 2012, there was $9.6 million of unrecognized stock-based compensation expense related to non-vested restricted stock awards that is expected to be recognized as an expense by us in the future over a weighted-average period of approximately 1.4 years. The total intrinsic value of unvested restricted stock awards at December 31, 2012 was $18.7 million. The total intrinsic value of restricted stock which vested during each of the years ended December 31, 2012, 2011 and 2010 was $5.9 million, $1.9 million and $2.9 million, respectively.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

20. Subsequent Events

On January 10, 2013, we completed a public offering of $250 million principal amount of 6% senior notes due 2043 (the 6% Notes). The 6% Notes, which pay interest semiannually in arrears on January 15 and July 15 of each year, commencing July 15, 2013, are general unsecured obligations of MDC and rank equally and ratably with our other general unsecured and unsubordinated indebtedness. In addition, the 6% Notes are fully guaranteed on an unsecured basis, jointly and severally, by most of our homebuilding subsidiaries. We received proceeds of $247.8 million, net of underwriting fees of $2.2 million. We will use the proceeds of the offering for general corporate purposes.

21. Results of Quarterly Operations (Unaudited)

	Quarter			
	First	**Second**	**Third**	**Fourth**
2012	**(Dollars in thousands, except per share amounts)**			
Home sales revenue	$ 184,678	$ 256,532	$ 320,647	$ 389,141
Total revenue	193,987	268,934	334,329	405,773
Asset impairments	-	-	-	1,105
Gross margin from home sales	14.1%	14.2%	15.5%	16.7%
Homebuilding selling, general and administrative expenses	34,124	39,223	44,788	49,160
Earnings before income taxes	2,125	9,655	19,484	29,851
Net income (loss)	2,265	10,638	20,126	29,670
Earnings (loss) per share				
Basic	$ 0.04	$ 0.22	$ 0.42	$ 0.60
Diluted	$ 0.04	$ 0.22	$ 0.41	$ 0.59
2011				
Home sales revenue	$ 163,383	$ 206,163	$ 204,886	$ 230,732
Total revenue	169,290	215,459	211,157	247,203
Asset impairments	279	9,119	4,692	811
Gross margin from home sales	13.5%	8.9%	14.8%	15.0%
Homebuilding selling, general and administrative expenses	47,654	49,158	46,360	35,933
Loss on extinguishment of senior notes	-	-	17,268	21,527
Loss before income taxes	(23,704)	(29,803)	(34,189)	(19,776)
Net income (loss)	(19,879)	(27,980)	(31,710)	(18,821)
Earnings (loss) per share				
Basic	$ (0.43)	$ (0.60)	$ (0.68)	$ (0.40)
Diluted	$ (0.43)	$ (0.60)	$ (0.68)	$ (0.40)

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

22. Revised 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 Delaware, Inc.
Richmond American Homes of Florida, LP
Richmond American Homes of Illinois, Inc.
Richmond American Homes of Maryland, Inc.
Richmond American Homes of Nevada, Inc.
Richmond American Homes of New Jersey, Inc.
Richmond American Homes of Pennsylvania, Inc.
Richmond American Homes of Utah, Inc.
Richmond American Homes of Virginia, Inc.

We added the following subsidiary as a Guarantor subsidiary as of January 3, 2013

Richmond American Homes of Washington, Inc.

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

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

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.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recently, the Company determined to revise certain presentations in the Supplemental Condensed Guarantor Financial Statements.

In the Supplemental Condensed Combining Statements of Cash Flows, the Company determined that it should have classified the non-cash impact of equity income (loss) of subsidiaries as a non-cash reconciling item. As reported, the Company classified the non-cash equity income (loss) of subsidiaries in the net cash provided by (used in) operating activities in the MDC parent column (along with a corresponding elimination of this amount in the eliminating entries column). As revised, the non-cash Equity income (loss) of subsidiaries is classified as a non-cash reconciling item in the MDC parent column and this item is no longer reported as an eliminating entry in the eliminating entries column of the Supplemental Condensed Combining Statements of Cash Flows statements. In addition, the Company also determined that an intercompany loan repayment from MDC to a non-guarantor subsidiary in 2010 that was presented as an operating activity in the MDC parent column, should have been presented as a financing activity (in the payments from (advances to) subsidiaries line item). These changes in reporting have no impact on (a) the net increase (decrease) in cash and cash equivalents column of the MDC column; (b) the previously reported consolidated net cash provided by (used in) (i) operating activities, (ii) financing activities or (iii) investing activities; or (c) the total net increase (decrease) in cash and cash equivalents line items in the consolidated MDC column.

In the Supplemental Condensed Combining Balance Sheets, the Company determined that it should not have classified intercompany receivables as negative balances within the advances and notes payable to parent and subsidiaries line in the liabilities section of the balance sheet. As revised, intercompany receivables are presented gross as assets in the asset section of the supplemental condensed combining balance sheets as advances and notes receivable from parent and subsidiaries. This change in reporting had no impact on any amounts in the previously reported consolidated MDC columns of the Supplemental Condensed Combining Balance Sheets.

None of the above changes in reporting had any impact on any amounts in the previously reported Supplemental Condensed Combining Statements of Operations.

Following is a reconciliation of the amounts previously reported to the reclassified amounts as stated in the following components of the Supplemental Condensed Combining Statements of Cash Flows for each of the years ended December 31, 2012, 2011 and 2010.

MDC Column for Year Ended December 31, 2012	As Previously Reported	Reclassify the non-cash equity income (loss) of subsidiaries	As Reclassified
		(Dollars in thousands)	
Net cash provided by (used in) operating activities	$ 83,797	$ (81,836)	$ 1,961
Payments from (advances to) subsidiaries	$ (168,169)	$ 81,836	$ (86,333)
Net cash provided by (used in) financing activities	$ (248,460)	$ 81,836	$ (166,624)
Net increase (decrease) in cash and cash equivalents	$ (187,662)	$ 0	$ (187,662)

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

MDC Column for Year Ended December 31, 2011	As Previously Reported	Reclassify the non-cash equity income (loss) of subsidiaries	As Reclassified
		(Dollars in thousands)	
Net cash provided by (used in) operating activities	$ (39,462)	$ 18,966	$ (20,496)
Payments from (advances to) subsidiaries	$ (44,961)	$ (18,966)	$ (63,927)
Net cash provided by (used in) financing activities	$ (621,073)	$ (18,966)	$ (640,039)
Net increase (decrease) in cash and cash equivalents	$ (221,469)	$ 0	$ (221,469)

MDC Column for Year Ended December 31, 2010	As Previously Reported	Reclassify the non-cash equity income (loss) of subsidiaries(1)	As Reclassified
		(Dollars in thousands)	
Net cash provided by (used in) operating activities	$ 36,971	$ 28,647	$ 65,618
Payments from (advances to) subsidiaries	$ (293,883)	$ (28,647)	$ (322,530)
Net cash provided by (used in) financing activities	$ (98,682)	$ (28,647)	$ (127,329)
Net increase (decrease) in cash and cash equivalents	$ (675,088)	$ 0	$ (675,088)

(1) Reclassification reflects net reclassification of (i) $14,653 of equity income of subsidiaries and (ii) $43,300 intercompany loan repayment to a non-guarantor subsidiary, from net cash provided (used in) operating activities to a financing activity (Payments from (advances to) subsidiaries).

Following is a reconciliation of the amounts previously reported to the reclassified amounts as stated in the following components of the Supplemental Condensed Combining Balance Sheets for each of the years ended December 31, 2012 and 2011.

	Homebuilding advances and notes payable to parent and subsidiaries at 12/31/2012, as previously reported	Reclassify negative balances to homebuilding intercompany receivables(2)	Homebuilding advances and notes payable to parent and subsidiaries at 12/31/2012, as reclassified
		(Dollars in thousands)	
MDC	$ (798,663)	$ 812,731	$ 14,068
Guarantor Subsidiaries	$ 755,566	$ 2,589	$ 758,155
Non-Guarantor Subsidiaries	$ 52,839	$	$ 52,839
Eliminating Entries	$ (9,742)	$ (815,320)	$ (825,062)
Consolidated MDC	$	$	$

	Financial services advances and notes payable to parent and subsidiaries at 12/31/2012, as previously reported		Reclassify negative balances to financial services intercompany receivables(2)		Financial services advances and notes payable to parent and subsidiaries at 12/31/2012, as reclassified	
			(Dollars in thousands)			
MDC	$		$		$	
Guarantor Subsidiaries	$		$		$	
Non-Guarantor Subsidiaries	$	(8,042)	$	9,779	$	1,737
Eliminating Entries	$	8,042	$	(9,779)	$	(1,737)
Consolidated MDC	$		$		$	

	Homebuilding advances and notes payable to parent and subsidiaries at 12/31/2011, as previously reported		Reclassify negative balances to homebuilding intercompany receivables(2) (Dollars in thousands)		Homebuilding advances and notes payable to parent and subsidiaries at 12/31/2011, as reclassified	
MDC	$	(700,520)	$	710,946	$	10,426
Guarantor Subsidiaries	$	682,088	$	696	$	682,784
Non-Guarantor Subsidiaries	$	21,998	$	4,161	$	26,159
Eliminating Entries	$	(3,566)	$	(715,803)	$	(719,369)
Consolidated MDC	$		$		$	

	Financial services advances and notes payable to parent and subsidiaries at 12/31/2011, as previously reported		Reclassify negative balances to financial services intercompany receivables(2) (Dollars in thousands)		Financial services advances and notes payable to parent and subsidiaries at 12/31/2011, as reclassified	
MDC	$		$		$	
Guarantor Subsidiaries	$		$		$	
Non-Guarantor Subsidiaries	$	(1,866)	$	5,569	$	3,703
Eliminating Entries	$	1,866	$	(5,569)	$	(3,703)
Consolidated MDC	$		$		$	

(2) The balances reclassified are equal to the new balances shown for intercompany receivables on the revised supplemental condensed combining balance sheets.

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

M.D.C. Holdings, Inc.

Revised Supplemental Condensed Combining Balance Sheet

	December 31, 2012				
	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
ASSETS			(Dollars in thousands)		
Homebuilding:					
Cash and cash equivalents	$ 125,904	$ 3,308	$ 323	$ -	$ 129,535
Marketable securities	519,465	-	-		519,465
Restricted cash	-	1,859	-		1,859
Trade and other receivables	6,563	18,846	2,754		28,163
Inventories:					
Housing completed or under construction	-	469,495	43,454		512,949
Land and land under development	-	467,915	21,657		489,572
Intercompany receivables	812,731	2,589	-	(815,320)	-
Investment in subsidiaries	198,465	-	-	(198,465)	-
Other assets, net	40,565	28,524	8,813	-	77,902
Total homebuilding assets	1,703,693	992,536	77,001	(1,013,785)	1,759,445
Financial Services:					
Cash and cash equivalents	-	-	30,560	-	30,560
Marketable securities	-	-	32,473	-	32,473
Intercompany receivables	-	-	9,779	(9,779)	-
Mortgage loans held-for-sale, net	-	-	119,953	-	119,953
Prepaid expenses and other assets	-	-	4,710	(1,700)	3,010
Total financial services assets	-	-	197,475	(11,479)	185,996
Total Assets	$ 1,703,693	$ 992,536	$ 274,476	$ (1,025,264)	$ 1,945,441
LIABILITIES AND EQUITY					
Homebuilding:					
Accounts payable	$ -	$ 67,257	$ 5,798	$ -	$ 73,055
Accrued liabilities	63,886	46,761	7,809	-	118,456
Advances and notes payable to parent and subsidiaries	14,068	758,155	52,839	(825,062)	-
Senior notes, net	744,842	-	-	-	744,842
Total homebuilding liabilities	822,796	872,173	66,446	(825,062)	936,353
Financial Services:					
Accounts payable and other liabilities	-	-	51,864	-	51,864
Advances and notes payable to parent and subsidiaries	-	-	1,737	(1,737)	-
Mortgage repurchase facility	-	-	76,327	-	76,327

Total financial services liabilities		-		-		129,928		(1,737)		128,191
Total Liabilities		822,796		872,173		196,374		(826,799)		1,064,544
Equity:										
Total Stockholder s Equity		880,897		120,363		78,102		(198,465)		880,897
Total Liabilities and Stockholders Equity	$	1,703,693	$	992,536	$	274,476	$	(1,025,264)	$	1,945,441

M.D.C. HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

M.D.C. Holdings, Inc.

Revised Supplemental Condensed Combining Balance Sheet

	December 31, 2011				
	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
ASSETS			(Dollars in thousands)		
Homebuilding:					
Cash and cash equivalents	$ 313,566	$ 2,771	$ 81	$ -	$ 316,418
Marketable securities	485,434	-	-	-	485,434
Restricted cash	-	667	-	-	667
Trade and other receivables	8,368	12,740	485	-	21,593
Inventories:					
Housing completed or under construction	-	280,932	19,782	-	300,714
Land and land under development	-	489,305	16,033	-	505,338
Intercompany receivables	710,946	696	4,161	(715,803)	-
Investment in subsidiaries	126,768	-	-	(126,768)	-
Other assets, net					