

TOUSA INC  
Form 10-Q  
August 09, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2007  
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 NUMBER: 001-32322  
TOUSA, INC.**

(Exact name of registrant as specified in its charter)

Delaware

76-0460831

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

4000 Hollywood Blvd., Suite 500 N  
Hollywood, Florida

33021

(Address of principal executive offices)

(ZIP code)

(954) 364-4000

(Registrant's telephone number, including area code)  
(Former name, former address and former fiscal year,  
if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 59,604,169 shares of common stock as of August 6, 2007.



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**TOUSA, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
(Dollars in millions, except par value)

	<b>June 30, 2007 (Unaudited)</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
<b>HOMEBUILDING:</b>		
Cash and cash equivalents:		
Unrestricted	\$ 20.9	\$ 47.4
Restricted	3.3	3.8
Inventory:		
Deposits	240.9	216.6
Homesites and land under development	822.0	725.6
Residences completed and under construction	660.3	835.7
Inventory not owned	221.1	300.6
	1,944.3	2,078.5
Property and equipment, net	28.9	28.5
Investments in unconsolidated joint ventures	132.7	129.0
Receivables from unconsolidated joint ventures, net of allowance of \$55.1 million and \$54.8 million at June 30, 2007 and December 31, 2006, respectively	41.2	27.2
Other assets	334.1	236.6
Goodwill	62.7	100.9
Assets held for sale	14.1	124.8
	2,582.2	2,776.7
<b>FINANCIAL SERVICES:</b>		
Cash and cash equivalents:		
Unrestricted	7.0	6.8
Restricted	4.0	4.2
Mortgage loans held for sale	36.2	41.9
Other assets	12.0	12.6
	59.2	65.5
Total assets	\$ 2,641.4	\$ 2,842.2
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>HOMEBUILDING:</b>		
Accounts payable and other liabilities	\$ 633.9	\$ 554.2

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Customer deposits	54.9	62.6
Obligations for inventory not owned	227.1	300.6
Notes payable	1,060.9	1,060.7
Bank borrowings	50.0	
Liabilities associated with assets held for sale	2.4	47.8
	2,029.2	2,025.9
<b>FINANCIAL SERVICES:</b>		
Accounts payable and other liabilities	5.9	6.0
Bank borrowings	28.6	35.4
	34.5	41.4
Total liabilities	2,063.7	2,067.3
Commitments and contingencies		
Stockholders' equity:		
Preferred stock \$0.01 par value; 3,000,000 shares authorized; none issued or outstanding		
Common stock \$0.01 par value; 97,000,000 shares authorized and 59,604,169 and 59,590,519 shares issued and outstanding at June 30, 2007, and December 31, 2006, respectively	0.6	0.6
Additional paid-in capital	483.3	481.2
Retained earnings	93.8	293.1
Total stockholders' equity	577.7	774.9
Total liabilities and stockholders' equity	\$ 2,641.4	\$ 2,842.2

See accompanying notes to consolidated financial statements.

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**TOUSA, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Dollars in millions, except per share amounts)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>HOMEBUILDING:</b>				
Revenues:				
Home sales	\$ 535.3	\$ 605.3	\$ 1,092.7	\$ 1,161.8
Land sales	30.4	16.1	33.7	43.0
	565.7	621.4	1,126.4	1,204.8
Cost of sales:				
Home sales	437.9	451.1	879.9	859.8
Land sales	26.8	11.4	29.1	37.9
Inventory impairments and abandonment costs	84.8	1.8	123.9	7.6
Other	(1.6)	(2.1)	(4.2)	(5.5)
	547.9	462.2	1,028.7	899.8
Gross profit	17.8	159.2	97.7	305.0
Selling, general and administrative expenses	85.0	99.9	176.4	193.3
(Income) loss from unconsolidated joint ventures, net	1.5	(37.9)	5.1	(65.7)
Provision for settlement of loss contingency	32.0		110.9	
Goodwill impairments	38.2		38.2	
Other (income) expense, net	(1.3)	(2.4)	(1.9)	(4.4)
Homebuilding pretax income (loss)	(137.6)	99.6	(231.0)	181.8
<b>FINANCIAL SERVICES:</b>				
Revenues	11.0	17.4	23.0	32.6
Expenses	8.7	11.0	18.0	21.7
Financial Services pretax income	2.3	6.4	5.0	10.9
Income (loss) from continuing operations before income taxes				
	(135.3)	106.0	(226.0)	192.7
Provision (benefit) for income taxes	(13.2)	39.0	(41.7)	71.1
Income (loss) from continuing operations, net of taxes	(122.1)	67.0	(184.3)	121.6
Discontinued operations:				



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Income (loss) from discontinued operations	(2.0)	0.9	(7.9)	1.5
Income (loss) from disposal of discontinued operations	(13.6)		(13.6)	
Provision (benefit) for income taxes	(5.7)	0.3	(7.8)	0.5
Income (loss) from discontinued operations, net of taxes	(9.9)	0.6	(13.7)	1.0
Net income (loss)	\$ (132.0)	\$ 67.6	\$ (198.0)	\$ 122.6
<b>EARNINGS (LOSS) PER COMMON SHARE, BASIC:</b>				
Earnings (loss) from continuing operations	\$ (2.04)	\$ 1.12	\$ (3.09)	\$ 2.04
Earnings (loss) from discontinued operations	(0.17)	0.01	(0.23)	0.02
Basic earnings (loss)	\$ (2.21)	\$ 1.13	\$ (3.32)	\$ 2.06
<b>EARNINGS (LOSS) PER COMMON SHARE, DILUTED:</b>				
Earnings (loss) from continuing operations	\$ (2.04)	\$ 1.09	\$ (3.09)	\$ 1.97
Earnings (loss) from discontinued operations	(0.17)	0.01	(0.23)	0.02
Diluted earnings (loss)	\$ (2.21)	\$ 1.10	\$ (3.32)	\$ 1.99
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:</b>				
Basic	59,604,169	59,572,856	59,599,569	59,580,962
Diluted	59,604,169	61,405,216	59,599,569	61,539,678
CASH DIVIDENDS PER SHARE	\$	\$ 0.015	\$	\$ 0.030

See accompanying notes to consolidated financial statements.

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**TOUSA, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Dollars in millions)  
(Unaudited)

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (198.0)	\$ 122.6
(Income) loss from discontinued operations	13.7	(1.0)
Income (loss) from continuing operations	(184.3)	121.6
Adjustments to reconcile income (loss) from continuing operations to net cash used in operating activities:		
Depreciation and amortization	7.4	6.6
Non-cash compensation expense	2.1	6.9
Provision for settlement of loss contingency	110.9	
Loss on impairments of inventory and abandonment costs	123.9	7.6
Goodwill impairments	38.2	
Deferred income taxes	(27.9)	(2.1)
Equity in (earnings) losses from unconsolidated joint ventures	9.4	(22.6)
Distributions of earnings from unconsolidated joint ventures	0.6	19.2
Loss on impairment of investments in unconsolidated joint ventures	5.5	
Changes in operating assets and liabilities:		
Restricted cash	0.7	0.1
Inventory	(45.9)	(271.0)
Receivables from unconsolidated joint ventures	(23.9)	(15.0)
Other assets	(52.5)	35.4
Mortgage loans held for sale	5.7	(1.2)
Accounts payable and other liabilities	(45.4)	(47.2)
Customer deposits	(7.7)	(3.3)
Net cash used in operating activities	(83.2)	(165.0)
<b>Cash flows from investing activities:</b>		
Net additions to property and equipment	(7.5)	(9.9)
Loans to unconsolidated joint ventures		(7.5)
Investments in unconsolidated joint ventures	(21.1)	(8.2)
Capital distributions from unconsolidated joint ventures	9.7	25.2
Net cash used in investing activities	(18.9)	(0.4)
<b>Cash flows from financing activities:</b>		
Net borrowings from (repayments of) revolving credit facilities	50.0	(65.0)
Net proceeds from notes offering		248.8
Net proceeds from (repayments of) Financial Services bank borrowings	(6.8)	3.1
Payments for deferred financing costs	(11.2)	(3.2)
Excess income tax benefit from exercise of stock options		0.1

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Proceeds from stock option exercises		0.2
Dividends paid		(1.8)
Net cash provided by financing activities	32.0	182.2
Net cash provided by (used in) continuing operations	(70.1)	16.8
<b>Cash flows from discontinued operations:</b>		
Net cash used in operating activities	(8.5)	(2.5)
Net cash provided by (used in) investing activities	52.3	(0.4)
Net cash provided by (used in) discontinued operations	43.8	(2.9)
Increase (decrease) in cash and cash equivalents	(26.3)	13.9
Cash and cash equivalents at beginning of period	54.2	32.3
Cash and cash equivalents at end of period	\$ 27.9	\$ 46.2
Supplemental disclosure of non-cash financing activities:		
Increase (decrease) in obligations for inventory not owned	\$ (73.5)	\$ 94.4
Increase (decrease) in inventory not owned	\$ (79.5)	\$ 94.4

See accompanying notes to consolidated financial statements.

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**TOUSA, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2007**

**1. Business and Organization**

***Business***

TOUSA, Inc. is a homebuilder with a geographically diversified national presence. We operate in various metropolitan markets in ten states, located in four major geographic regions: Florida, the Mid-Atlantic, Texas, and the West. We design, build, and market detached single-family residences, town homes and condominiums. We also provide title insurance and mortgage brokerage services to our homebuyers and others. Generally, we do not retain or service the mortgages that we originate but, rather, sell the mortgages and related servicing rights.

***Organization***

Technical Olympic S.A. owns approximately 67% of our outstanding common stock. Technical Olympic S.A. is a publicly-traded Greek company whose shares are traded on the Athens Stock Exchange.

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation and Basis of Presentation***

The consolidated financial statements include our accounts and those of our subsidiaries. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Estimates and assumptions which, in the opinion of management, are significant to the underlying amounts included in the financial statements and for which it would be reasonably possible that future events or information could change those estimates include:

Impairment assessments of investments in unconsolidated joint ventures, long-lived assets, including our inventory, and goodwill;

Insurance and litigation related contingencies, including our accrual for settlement of loss contingency related to the Transeastern Joint Venture (Transeastern JV);

Realization of deferred income tax assets and liability for unrecognized tax benefits; and

Estimated costs associated with construction and development activities in connection with our homebuilding operations.

Due to our normal operating cycle being in excess of one year, we present unclassified consolidated statements of financial condition.

Certain amounts in the consolidated financial statements of prior periods have been reclassified to conform to current year classifications. Certain operations have been classified as discontinued. Associated results of operations and financial position are separately reported for all periods presented. For additional information, refer to Note 14. Information in these Notes to the Unaudited Consolidated Financial Statements, unless otherwise noted, does not include the accounts of discontinued operations.

***Interim Presentation***

The accompanying unaudited consolidated financial statements reflect all adjustments, consisting primarily of normal recurring items that, in the opinion of management, are considered necessary for a fair presentation of the financial position, results from operations, and cash flows for the periods presented. Results of operations achieved through June 30, 2007 are not necessarily indicative of those that may be achieved for the year ending December 31, 2007. The consolidated balance sheet as of December 31, 2006 was derived from audited financial statements included in our 2006 Annual Report on Form 10-K but does not include all disclosures required by accounting principles generally accepted in the United States. These consolidated financial statements should be read in conjunction with our December 31, 2006 audited financial statements in our 2006 Annual Report on Form 10-K and

the notes to the consolidated financial statements included therein.

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For the three months ended June 30, 2007 and 2006, we have eliminated inter-segment Financial Services revenues of \$4.5 million and \$1.2 million, respectively. For the six months ended June 30, 2007 and 2006, we have eliminated inter-segment Financial Services revenues of \$7.2 million and \$2.2 million, respectively.

**Earnings Per Share**

Basic earnings (loss) per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share is computed based on the weighted average number of shares of common stock and dilutive securities outstanding during the period. Dilutive securities are options or other common stock equivalents that are freely exercisable into common stock at less than market prices. Dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share or decrease the loss per share.

The following table represents a reconciliation of weighted average shares outstanding:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Basic weighted average shares outstanding	59,604,169	59,572,856	59,599,569	59,580,962
Net effect of common stock equivalents assumed to be exercised		1,832,360		1,958,716
Diluted weighted average shares outstanding	59,604,169	61,405,216	59,599,569	61,539,678

**Revenue Recognition**

In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 66, *Accounting for the Sales of Real Estate* ( SFAS 66 ), at June 30, 2007 and 2006, we deferred approximately \$1.0 million and \$1.5 million, respectively, in profit related to certain homes that were delivered for which our mortgage subsidiary originated interest-only loans or loans with high loan to value ratios which did not meet the initial and continuing investment requirements under SFAS 66, and the loans were still held for sale at the respective balance sheet dates. This profit will be recognized upon the sale of the loans to a third party, with non-recourse provisions, which generally occurs within 30 days from the date the loan is originated.

**Recent Accounting Pronouncements**

In March 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 156, *Accounting for Servicing of Financial Assets* ( SFAS 156 ), which provides an approach to simplify efforts to obtain hedge-like (offset) accounting. This new statement amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for all separately recognized servicing assets and liabilities as of the beginning of an entity's fiscal year that begins after September 15, 2006, with earlier adoption permitted in certain circumstances. We adopted SFAS 156 effective January 1, 2007. Due to the short period of time our servicing rights are held, the adoption did not have a significant impact on our consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of SFAS 109*, ( FIN 48 ). FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before it is recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 effective January 1, 2007, and recognized a \$1.3 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the retained earnings balance at January 1, 2007.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands

disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (our fiscal year beginning January 1, 2008), and interim periods within those fiscal years. We are currently reviewing the effect of this statement on our consolidated financial statements.

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In November 2006, the FASB issued Emerging Issues Task Force Issue ( EITF ) No. 06-8, *Applicability of the Assessment of a Buyers Continuing Investment under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums*, ( EITF 06-8 ). EITF 06-8 establishes that a company should evaluate the adequacy of the buyer's continuing investment in determining whether to recognize profit under the percentage-of-completion method. EITF 06-8 is effective for the first annual reporting period beginning after March 15, 2007 (January 1, 2008 for us). The effect of EITF 06-8 is not expected to be material to our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, ( SFAS 159 ). SFAS 159 permits companies to measure many financial instruments and certain other items at fair value. This statement is effective for fiscal years beginning after November 15, 2007 (December 31, 2008 for us). The adoption of SFAS 159 is not expected to be material to our consolidated financial statements.

**3. Inventory**

A summary of homebuilding interest capitalized in inventory is as follows (dollars in millions):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Interest capitalized, beginning of period	\$ 75.4	\$ 49.1	\$ 68.7	\$ 44.2
Interest incurred*	29.3	24.5	56.5	46.5
Less interest included in:				
Cost of sales	(22.8)	(17.7)	(43.1)	(34.5)
Other adjustments		0.2	(0.2)	(0.1)
Interest capitalized, end of period	\$ 81.9	\$ 56.1	\$ 81.9	\$ 56.1

\* Included in interest incurred is the amortization of deferred finance costs which amounted to \$1.6 million and \$0.9 million for the three months ended June 30, 2007 and June 30, 2006, respectively, and \$2.7 million and \$1.8 million for the six months ended June 30, 2007 and June 30, 2006, respectively.

In the ordinary course of business, we enter into contracts to purchase homesites and land held for development. At June 30, 2007 and December 31, 2006, we had refundable and non-refundable cash deposits aggregating



\$240.9 million and \$216.6 million, respectively, included in inventory in the accompanying consolidated statements of financial condition. Under these option contracts, we have the right, but not the obligation, to buy homesites at predetermined prices on a predetermined takedown schedule anticipated to be commensurate with home starts. Option contracts generally require the payment of a cash deposit or the posting of a letter of credit, which is typically less than 20% of the underlying purchase price, and may require monthly maintenance payments. These option contracts are either with land sellers or third party financial entities who have acquired the land to enter into the option contract with us. Homesite option contracts are generally non-recourse, thereby limiting our financial exposure for non-performance to our cash deposits and/or letters of credit. In certain instances, we have entered into development agreements in connection with option contracts which require us to complete the development of the land, at a fixed price, even if we choose not to exercise our option and forfeit our deposit and even if our costs exceed the reimbursable amount.

Some of these option contracts for the purchase of land or homesites are with land sellers and third party financial entities, which qualify as variable interest entities ( VIEs ) under FASB Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities* ( FIN 46(R) ). FIN 46(R) addresses consolidation by business enterprises of VIEs in which an entity absorbs a majority of the expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Obligations for inventory not owned in our consolidated statements of financial condition represent liabilities associated with our land banking and similar activities, including obligations in VIEs which have been consolidated by us and in which we have a less than 50% ownership interest, and the creditors have no recourse against us. As a result, the obligations have been specifically excluded from the calculation of leverage ratios pursuant to the terms of our revolving credit facility.

In applying FIN 46(R) to our homesite option contracts and other transactions with VIEs, we make estimates regarding cash flows and other assumptions. We believe that our critical assumptions underlying these estimates are reasonable based on historical evidence and industry practice. Based on our analysis of transactions entered into with VIEs, we determined that we are the primary beneficiary of certain of these homesite option contracts. Consequently, FIN 46(R) requires us to consolidate the assets (homesites) at their fair value, although (1) we have no legal title to the assets, (2) our maximum exposure to loss is generally limited to the deposits or letters

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of credits placed with these entities, and (3) creditors, if any, of these entities have no recourse against us. The effect of FIN 46(R) at June 30, 2007 was to increase inventory by \$34.0 million (net of \$2.9 million in impairments), excluding cash deposits of \$5.9 million, which had been previously recorded, with a corresponding increase to obligations for inventory not owned of \$36.9 million in the accompanying consolidated statement of financial condition. Additionally, we have entered into arrangements with VIEs to acquire homesites in which our variable interest is insignificant and, therefore, we have determined that we are not the primary beneficiary and are not required to consolidate the assets of such VIEs. Our potential exposure to loss in VIEs where we are not the primary beneficiary would primarily be the forfeiture of our deposit and/or letters of credits placed on land purchase and option contracts. At June 30, 2007 and December 31, 2006, our cash deposits placed on land purchase and option contracts amounted to \$240.9 million and \$216.6 million, respectively, and our letters of credit placed on land purchase and option contracts amounted to \$168.1 million and \$257.8 million, respectively.

From time to time, we transfer title to certain parcels of land to unrelated third parties and enter into options with the purchasers to acquire fully developed homesites. As we have retained a continuing involvement in these properties, in accordance with SFAS 66, we have accounted for these transactions as financing arrangements. At June 30, 2007, \$187.1 million (net of \$3.1 million in impairments) of inventory not owned and \$190.2 million of obligations for inventory not owned relates to sales where we have retained a continuing involvement.

In accordance with SFAS No.144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ), we carry long-lived assets held for sale at the lower of the carrying amount or fair value. For active communities, we evaluate an asset for impairment when events and circumstances indicate that they may be impaired. Impairment is evaluated by estimating future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected undiscounted future cash flows is less than the carrying amount of the assets, an impairment loss is recognized. Fair value, for purposes of calculating impairment, is measured based on estimated future cash flows, discounted at a market rate of interest. During the three and six months ended June 30, 2007, we recorded an impairment loss of \$41.4 million and \$49.4 million, respectively, on active communities which is included in cost of sales inventory impairments and abandonment costs in the accompanying consolidated statement of operations, compared to \$0.2 million and \$5.5 million, respectively, for the three and six months ended June 30, 2006. Included in the impairment charges on active communities for both the three and six months ended June 30, 2007 is \$6.0 million of inventory impairments recognized on assets consolidated under FIN 46(R) or SFAS 66 for which we do not have title to the underlying asset.

During the three and six months ended June 30, 2007, we also recorded a charge of \$43.4 million and \$74.5 million, respectively, in write-offs of deposits and abandonment costs which is included in cost of sales inventory impairments and abandonment costs in the accompanying consolidated statement of operations, related to land that we no longer intend to purchase or build on, compared to \$1.6 million and \$2.1 million, respectively, for the three and six months ended June 30, 2006. The following table summarizes information related to impairment charges on active communities and write-offs of deposits and abandonment costs by region (dollars in millions):

	<b>Three Months</b>		<b>Six Months Ended</b>	
	<b>Ended</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Impairment charges on active communities:</b>				
Florida	\$ 23.6	\$ 0.2	\$ 28.7	\$ 0.7
Mid-Atlantic	4.5		6.6	3.1
Texas	0.5		0.6	
West	12.8		13.5	1.7
	\$ 41.4	\$ 0.2	\$ 49.4	\$ 5.5

**Write-offs of deposits and abandonment costs:**

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Florida	\$ 12.1	\$ 1.0	\$ 12.8	\$ 1.1
Mid-Atlantic	13.5	0.3	13.9	0.5
Texas	0.2	0.1	0.3	0.1
West	17.6	0.2	47.5	0.4
	\$ 43.4	\$ 1.6	\$ 74.5	\$ 2.1
<b>Inventory impairments and abandonment costs</b>	<b>\$ 84.8</b>	<b>\$ 1.8</b>	<b>\$ 123.9</b>	<b>\$ 7.6</b>

**Table of Contents****4. Transeastern Joint Venture**

We acquired our 50% interest in the Transeastern JV on August 1, 2005, when the Transeastern JV acquired substantially all of the homebuilding assets and operations of Transeastern Properties including work in process, finished lots and certain land option rights. The Transeastern JV paid approximately \$826.2 million for these assets and operations (which included the assumption of \$127.1 million of liabilities and certain transaction costs, net of \$30.1 million of cash). The other member of the joint venture was an entity controlled by the former majority owners of Transeastern Properties, Inc. We continued to function as the managing member of the Transeastern JV through our wholly owned subsidiary, TOUSA Homes L.P.

When the Transeastern JV was initially formed, it had more than 3,000 homes in backlog and projected 2006 deliveries of approximately 3,500 homes. While management of the Transeastern JV began to curtail sales in its communities at the end of 2005, these actions were taken, not in anticipation of a declining home sales market, but rather in an attempt to address the Transeastern JV's backlog until there was a balance among sales, construction and deliveries. Both our management and the management of the Transeastern JV anticipated increased sales by the close of the summer of 2006.

After experiencing several months of continuous declines in deliveries as compared to forecasted amounts due to higher than expected cancellations and lower than expected gross sales, in early September 2006, management of the Transeastern JV finalized and distributed to its members six year financial projections based on the build-out and sale of its current controlled land positions. These revised projections from the Transeastern JV indicated that the joint venture would report a loss in the fourth quarter and would not have the liquidity to meet its debt obligations under the capital structure that was in place at that time. As a result of these and other factors, in September 2006, we evaluated the recoverability of our investment in the joint venture under Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* ( APB 18 ), and determined our investment to be fully impaired. As of September 30, 2006, we wrote off \$143.6 million related to our investment in the Transeastern JV, which included \$35.0 million of our member loans receivable and \$16.2 million of receivables for management fees, advances and interest due to us from the joint venture.

On October 31, 2006 and November 1, 2006, we received demand letters from the administrative agent for the lenders to the Transeastern JV demanding payment under certain guarantees. The demand letters allege that potential defaults and events of default had occurred under the credit agreements and that such potential defaults or events of default had triggered our obligations under the guarantees. The lenders claimed that our guarantee obligations equaled or exceeded all of the outstanding obligations under each of the credit agreements and that we were liable for default interest, costs and expenses.

On July 31, 2007, we consummated transactions to settle the disputes regarding the Transeastern JV with the lenders to the joint venture, its land bankers and its joint venture partner. The Transeastern JV has become a wholly owned subsidiary of ours by merger into one of our subsidiaries and has become a guarantor on our credit facilities and note indentures. See Note 15 for a description of the settlement agreements.

For its six months ended May 31, 2007, the Transeastern JV reported a net loss of \$68.6 million. The carrying value of the Transeastern JV's assets at May 31, 2007 approximated \$401.1 million, of which \$231.6 million represented land and construction in progress. At May 31, 2007, the liabilities of the Transeastern JV amounted to \$817.9 million, including \$625.0 million of borrowings from secured and unsecured lenders.

In accordance with SFAS No. 5, *Accounting for Contingencies* ( SFAS 5 ) and other authoritative guidance, as of June 30, 2007, we accrued \$385.9 million for settlement of loss contingency (determined by computing the difference between the estimated fair market value of the consideration paid in connection with the global settlement less the estimated fair market value of the business we acquired) of which, \$275.0 million was accrued during the year ended December 31, 2006 and \$78.9 million was accrued during the three months ended March 31, 2007. During the three months ended June 30, 2007, we accrued an additional \$32.0 million, calculated under the same basis, due primarily to changes in the settlement terms. For the three and six months ended June 30, 2007, the provision for settlement of loss contingency of \$32.0 million and \$110.9 million, respectively, is presented as a separate line item in our consolidated statements of operations. The accrual of \$385.9 million and \$275.0 million is included in accounts payable and other liabilities in our consolidated statements of financial condition as of



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June 30, 2007 and December 31, 2006, respectively. Our estimated loss could change upon the final determination of the estimated fair values of the consideration provided and the business acquired.

**5. Investments in Unconsolidated Joint Ventures (Excluding the Transeastern JV)**

Summarized condensed combined financial information of unconsolidated entities in which we have investments that are accounted for by the equity method, excluding the Transeastern JV, is (dollars in millions):

	<b>June 30, 2007</b>		
	<b>Engle/Sunbelt</b>	<b>Others</b>	<b>Total</b>
<b>Assets:</b>			
Cash and cash equivalents	\$ 9.4	\$ 16.1	\$ 25.5
Inventories	185.8	448.6	634.4
Other assets	3.2	4.9	8.1
<b>Total assets</b>	<b>\$ 198.4</b>	<b>\$ 469.6</b>	<b>\$ 668.0</b>
<b>Liabilities and equity:</b>			
Accounts payable and other liabilities	\$ 49.4	\$ 80.2	\$ 129.6
Notes payable	91.9	197.9	289.8
Equity of:			
TOUSA, Inc.	48.5	96.9	145.4
Others	8.6	94.6	103.2
Total equity	57.1	191.5	248.6
<b>Total liabilities and equity</b>	<b>\$ 198.4</b>	<b>\$ 469.6</b>	<b>\$ 668.0</b>
	<b>December 31, 2006</b>		
	<b>Engle/Sunbelt</b>	<b>Others</b>	<b>Total</b>
<b>Assets:</b>			
Cash and cash equivalents	\$ 22.5	\$ 13.5	\$ 36.0
Inventories	246.6	450.8	697.4
Other assets	2.9	9.5	12.4
<b>Total assets</b>	<b>\$ 272.0</b>	<b>\$ 473.8</b>	<b>\$ 745.8</b>
<b>Liabilities and equity:</b>			
Accounts payable and other liabilities	\$ 44.9	\$ 89.3	\$ 134.2
Notes payable	161.3	195.7	357.0
Equity of:			
TOUSA, Inc.	56.6	81.8	138.4
Others	9.2	107.0	116.2
Total equity	65.8	188.8	254.6
<b>Total liabilities and equity</b>	<b>\$ 272.0</b>	<b>\$ 473.8</b>	<b>\$ 745.8</b>



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	<b>Three Months Ended June 30, 2007</b>			<b>Three Months Ended June 30, 2006</b>		
	<b>Engle/Sunbelt</b>	<b>Others</b>	<b>Total</b>	<b>Engle/Sunbelt</b>	<b>Others</b>	<b>Total</b>
Revenues	\$ 83.3	\$ 22.8	\$ 106.1	\$ 151.4	\$ 40.1	\$ 191.5
Cost and expenses	90.1	24.0	114.1	127.2	36.8	164.0
Net earnings (losses) of unconsolidated joint ventures	\$ (6.8)	\$ (1.2)	\$ (8.0)	\$ 24.2	\$ 3.3	\$ 27.5
Our share of net earnings (losses)	\$ (5.7)	\$ (2.6)	\$ (8.3)	\$ 20.4	\$ 2.4	\$ 22.8
Management fees earned	3.8	0.7	4.5	7.0	2.5	9.5
Income (loss) from unconsolidated joint ventures	\$ (1.9)	\$ (1.9)	\$ (3.8)	\$ 27.4	\$ 4.9	\$ 32.3
	<b>Six Months Ended June 30, 2007</b>			<b>Six Months Ended June 30, 2006</b>		
	<b>Engle/Sunbelt</b>	<b>Others</b>	<b>Total</b>	<b>Engle/Sunbelt</b>	<b>Others</b>	<b>Total</b>
Revenues	\$ 176.1	\$ 96.2	\$ 272.3	\$ 300.4	\$ 83.1	\$ 383.5
Cost and expenses	185.6	96.0	281.6	253.2	72.9	326.1
Net earnings (losses) of unconsolidated joint ventures	\$ (9.5)	\$ 0.2	\$ (9.3)	\$ 47.2	\$ 10.2	\$ 57.4
Our share of net earnings (losses)	\$ (8.1)	\$ (1.3)	\$ (9.4)	\$ 40.2	\$ 2.4	\$ 42.6
Management fees earned	8.0	0.1	8.1	13.9	5.4	19.3
Income (loss) from unconsolidated joint ventures	\$ (0.1)	\$ (1.2)	\$ (1.3)	\$ 54.1	\$ 7.8	\$ 61.9

We have entered into strategic joint ventures to acquire, to develop and to sell land and/or homesites, as well as to construct and sell homes, in which we have a voting ownership interest of 50% or less and do not have a controlling interest. Our partners generally are unrelated homebuilders, land sellers, third party financial entities or other real estate entities. Certain of these joint ventures have third party debt that is secured by the assets of the joint venture; however, we may be responsible for certain indemnity and completion obligations in the event the joint venture fails to fulfill certain of its obligations and may be obligated to repay the entire indebtedness upon certain bankruptcy events. At June 30, 2007 and December 31, 2006, we had receivables of \$41.2 million and \$27.2 million, respectively, from these joint ventures, of which \$6.4 million and \$1.0 million represent notes receivable, respectively.



In many instances, we are appointed as the day-to-day manager of the unconsolidated entities and receive management fees for performing this function. We earned management fees from these unconsolidated entities of \$4.5 million and \$9.5 million for the three months ended June 30, 2007 and 2006, respectively, and \$8.1 million and \$19.3 million for the six months ended June 30, 2007 and 2006, respectively. These fees are included in income (loss) from unconsolidated joint ventures in the accompanying consolidated statements of operations. In the aggregate, these joint ventures delivered (excluding the Transeastern JV) 688 and 1,024 homes for the six months ended June 30, 2007 and 2006, respectively.

During the six months ended June 30, 2007, we evaluated the recoverability of our investments in and receivables from unconsolidated joint ventures located in Southwest Florida and Baltimore, Maryland, under APB 18, and recorded impairments of \$4.0 million and \$1.5 million, respectively, which is included in loss from unconsolidated joint ventures in the accompanying consolidated statement of operations for the six months ended June 30, 2007.

*Engle/Sunbelt Joint Venture*

In December 2004, we entered into a joint venture agreement with Suntous Investors, LLC ( Suntous ) to form Engle/Sunbelt Holdings, LLC ( Engle/Sunbelt ). Engle/Sunbelt was formed to develop finished homesites and deliver homes in the Phoenix, Arizona market, and upon its inception, the partnership acquired eight of our existing communities in Phoenix, Arizona. We and Suntous contributed capital of approximately \$28.0 million and \$3.2 million, respectively, to Engle/Sunbelt and the joint venture itself

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obtained financing arrangements with an aggregate borrowing capacity of \$180.0 million, of which \$150.0 million related to a term loan and \$30.0 million related to a revolving mezzanine financing instrument.

In July 2005, we contributed assets to Engle/Sunbelt resulting in a net capital contribution by us of \$5.4 million. At this time, Engle/Sunbelt amended its financing arrangements to increase the aggregate borrowing capacity to \$280.0 million, of which \$250.0 million related to a term loan and \$30.0 million related to a revolving mezzanine financing instrument. On April 30, 2007, Engle/Sunbelt amended its \$250.0 million term loan. The amendment reduced the aggregate commitment of the lenders from \$250.0 million to \$200.0 million and extended the maturity date of the facility to March 17, 2008. In addition, the amendment increased the minimum adjusted tangible net worth covenant and reduced the minimum interest coverage ratio covenant. The borrowings by Engle/Sunbelt are non-recourse to us; however, through our subsidiary Engle Homes Residential, LLC, we have agreed to complete any property development commitments in the event Engle/Sunbelt defaults. Additionally, we have indemnified the lenders for losses resulting from fraud, misappropriation and similar acts by Engle/Sunbelt.

In connection with this contribution of assets to Engle/Sunbelt, we realized a gain of \$42.6 million for the year ended December 31, 2005. Due to our continuing involvement with these assets through our investment, for the year ended December 31, 2005 we deferred \$36.3 million of this gain. In March 2006, we assigned to Engle/Sunbelt our rights under a contract to purchase approximately 539 acres of raw land. We received \$18.7 million for the assignment of the purchase contract and realized a gain of \$15.8 million. Due to our continuing involvement with this contract through our investment in the joint venture, we deferred \$13.5 million of this gain. For the six months ended June 30, 2007, we deferred an additional \$5.1 million related to the assignment of an option to purchase land. These deferrals are being recognized in the consolidated statement of operations as homes are delivered by the joint venture.

At June 30, 2007 and December 31, 2006, \$24.0 million and \$22.8 million, respectively, continued to be deferred as a result of the contributed assets and contract assignments to Engle/Sunbelt, and is included in accounts payable and other liabilities in the accompanying consolidated statements of financial condition. For the three and six months ended June 30, 2007, \$1.6 million and \$4.2 million, respectively, of the deferred gain was recognized and included in cost of sales-other in the accompanying consolidated statements of operations as compared to \$2.1 million and \$5.5 million, respectively, for the three and six months ended June 30, 2006.

*TOUSA / Kolter Joint Venture*

In January 2005, we entered into a joint venture with Kolter Real Estate Group LLC to form TOUSA/Kolter Holdings, LLC ( TOUSA/Kolter ) for the purpose of acquiring, developing and selling approximately 1,900 homesites and commercial property in a master planned community in South Florida. The joint venture obtained senior and senior subordinated term loans (the term loans ) of which \$47.0 million and \$7.0 million, respectively, were outstanding as of June 30, 2007. We entered into a Performance and Completion Agreement in favor of the lenders under which we agreed, among other things, to construct and complete the horizontal development of the lots and commercial property and related infrastructure in accordance with certain agreed plans. The term loans required, among other things, TOUSA/Kolter to have completed the development of certain lots by January 7, 2007. Due to unforeseen and unanticipated delays in the entitlement process and additional development requests by the county and water management district, TOUSA/Kolter was unable to complete the development of these certain lots by the required deadline. On June 21, 2007, and in response to missing the development deadline, TOUSA/Kolter amended the existing term loan agreements and we amended the Performance and Completion Agreement which remedied the situation by extending the Performance and Completion Agreement development deadline to May 31, 2008. The amendment to the term loan agreements increased the interest rate on the senior term loan by 100 basis points to LIBOR plus 3.25% and by 50 basis points to LIBOR plus 8.5% for the senior subordinated term loan. As a condition to the amendment, we have agreed to be responsible for the additional 150 basis points; accordingly, this will be paid by us and will be a cost of the lots we acquire from TOUSA/Kolter. The amendment also required us to increase the existing letter of credit by an additional \$1.8 million for a total letter of credit deposit of \$12.1 million and place an additional \$3.0 million cash deposit on the remaining lots under option which was used by TOUSA/Kolter to pay down a portion of the senior term loan. Our investment in TOUSA/Kolter at June 30, 2007 was \$15.1 million.

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Other assets consist of the following (dollars in millions):

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
<b>Homebuilding:</b>		
Deferred income taxes, net	\$ 188.5	\$ 160.6
Income taxes receivable	52.2	12.9
Accounts receivable	55.8	37.0
Deferred finance costs, net	24.6	16.1
Prepaid expenses	11.5	7.4
Other assets	1.5	2.6
<b>Total other assets</b>	<b>\$ 334.1</b>	<b>\$ 236.6</b>

**7. Goodwill**

Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the net assets acquired. Additional consideration paid in subsequent periods under the terms of purchase agreements is included as acquisition costs.

The change in goodwill for the six months ended June 30, 2007 and 2006 is as follows (dollars in millions):

	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Balance at January 1	\$ 100.9	\$ 105.6
Impairments	(38.2)	
Balance at June 30	\$ 62.7	\$ 105.6

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we test goodwill for impairment annually or more frequently if certain impairment indicators are present. For purposes of the impairment test, we consider each division a reporting unit. During the second quarter, we determined that the challenging housing market and the asset impairments taken in certain of our homebuilding divisions were indicators of impairment. We performed interim goodwill impairment tests as of June 30, 2007 and determined that the goodwill recorded in our Virginia (\$6.5 million), Mid-Atlantic (\$21.2 million) and Las Vegas (\$10.5 million) divisions was impaired; accordingly, we recognized a \$38.2 million goodwill impairment charge for the three and six months ended June 30, 2007.

**8. Accounts Payable and Other Liabilities**

Accounts payable and other liabilities consist of the following (dollars in millions):

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
<b>Homebuilding:</b>		
Accrual for settlement of loss contingency	\$ 385.9	\$ 275.0
Accounts payable	53.7	70.2
Interest	38.7	37.8
Compensation	16.1	27.8

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Taxes, including income and real estate	11.9	10.4
Accrual for unpaid invoices on delivered homes	19.6	23.6
Accrued expenses	55.1	51.3
Warranty costs	6.9	7.4
Deferred revenue	46.0	50.7
<b>Total accounts payable and other liabilities</b>	<b>\$ 633.9</b>	<b>\$ 554.2</b>

**Table of Contents****9. Homebuilding and Financial Services Borrowings*****Homebuilding Borrowings***

Homebuilding borrowings consisted of the following (dollars in millions):

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Senior notes due 2010, at 9%	\$ 300.0	\$ 300.0
Senior notes due 2011, at 8 1/4%	250.0	250.0
Discount on senior notes	(3.0)	(3.5)
Senior subordinated notes due 2012, at 10 3/8%	185.0	185.0
Senior subordinated notes due 2011, at 7 1/2%	125.0	125.0
Senior subordinated notes due 2015, at 7 1/2%	200.0	200.0
Premium on senior subordinated notes	3.9	4.2
Existing Revolving Loan Facility	50.0	
	<b>\$ 1,110.9</b>	<b>\$ 1,060.7</b>

On July 31, 2007, as part of the global settlement related to the Transeastern JV, we entered into a (i) new \$200.0 million aggregate principal amount first lien term loan facility (the First Lien Term Loan Facility ) and (ii) a new \$300.0 million aggregate principal amount second lien term loan facility (the Second Lien Term Loan Facility ), (First and Second Lien Term Loan Facilities taken together, the Facilities ) with Citicorp North America, Inc. as Administrative Agent, Sole Lead Arranger and Book Running Manager. The loans were issued at an original-issue discount of 99 percent. The First Lien Term Loan Facility expires on July 31, 2012 and the Second Lien Term Loan Facility expires on July 31, 2013.

On July 31, 2007, our existing \$800.0 million secured revolving loan facility (the Existing Revolving Loan Facility ) was amended and restated to (i) reduce the revolving commitments thereunder by \$100.0 million and (ii) permit the incurrence of the Facilities (and make other conforming changes relating to the Facilities) (the New Revolving Loan Facility ). The New Revolving Loan Facility has a letter of credit subfacility of \$350.0 million. In addition, we continue to have the right to increase the size of the facility to provide up to an additional \$150.0 million of revolving loans, provided we give 10 business days notice of our intention to increase the size of the facility, there are lenders (existing or new) who are willing to commit to such an increase and we meet the following conditions: (i) at the time of and after giving effect to the increase, we are in pro forma compliance with our financial covenants; (ii) no default or event of default has occurred and is continuing or would result from the increase; and (iii) the conditions precedent to a borrowing are satisfied as of such date. The New Revolving Loan Facility expires on March 9, 2010, at which time we will be required to repay all outstanding principal.

The interest rates on the Facilities and the New Revolving Loan Facility are based on LIBOR plus a margin or an alternate base rate plus a margin, at our option. For the New Revolving Loan Facility, the LIBOR rates are increased by between 1.50% and 4.25% depending on our leverage ratio (as defined in the Agreement) and credit ratings. Loans bearing interest at the base rate (the rate announced by Citibank as its base rate or 0.50% above the Federal Funds Rate) is increased between 0% and 3.25% in accordance with the same criteria. For the First Lien Term Loan Facility, the interest rate is LIBOR plus 4.00% or base rate plus 3.00%. For the Second Lien Term Loan Facility, the interest rate is LIBOR plus 7.25% or base rate plus 6.25%. We were required to pay fees in connection with the Facilities including, but not limited to, amending the Existing Revolving Loan Facility. The Facilities and the New Revolving Loan Facility are guaranteed by substantially all of our domestic subsidiaries (the Guarantors ). The obligations are secured by substantially all of our assets, including those of our Guarantors. Our mortgage and title subsidiaries are not Guarantors. The loans under the Facilities may be prepaid at certain times (the Second Lien Term Loan Facility may not be prepaid prior to its first anniversary), subject to certain premiums upon repayment. The Facilities and the New Revolving Loan Facility impose certain limitations on us, including with respect to: (i) dividends on,

redemptions and repurchases of, equity interests; (ii) prepayments of junior indebtedness, redemptions and repurchases of debt; (iii) the incurrence of liens and sale-leaseback transactions; (iv) loans and investments including joint ventures; and (v) incurrence of debt. The Facilities and New Revolving Loan Facility also contain events of default and have financial covenants, including but not limited to the following covenants: (i) minimum adjusted consolidated tangible net worth; (ii) maximum ratio of debt to adjusted consolidated tangible net worth; (iii) minimum ratio of EBITDA to interest incurred; (iv) maximum ratio of units owned to units closed; (v) maximum ratio of land to adjusted consolidated tangible net worth; and (vi) maximum ratio of unsold units to units closed. The New Revolving Loan Facility is subject to a borrowing base, which includes a reserve for amounts outstanding under the Facilities. The Second Lien Term Loan Facility contains a limitation on amounts outstanding under the New Revolving Loan Facility and the Facilities based on a percentage of inventory.

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As of June 30, 2007, we had \$50.0 million outstanding under the Existing Revolving Loan Facility, had issued letters of credit totaling \$236.1 million and had \$199.1 million in availability, all of which we could have borrowed without violating any of our debt covenants. Our pro-forma availability at June 30, 2007 was \$350.1 million under the New Revolving Loan Facility, all of which could have been borrowed without violating any of our debt covenants. This pro-forma availability is based on the June 30, 2007 borrowing base calculation adjusted for the \$100.0 million decrease in the facility, the issuance of the \$200.0 million First Lien Term Loan Facility and the estimated fair values of the Transeastern JV assets, which we acquired as a result of the Transeastern JV settlement.

On April 12, 2006, we issued \$250.0 million of the 8 1/4% senior notes due 2011 for net proceeds of \$248.8 million. In connection with the issuance of the 8 1/4% senior notes, we filed within 90 days of the issuance a registration statement with the SEC covering a registered offer to exchange the notes for exchange notes of ours having terms substantially identical in all material respects to the notes (except that the exchange notes will not contain terms with respect to special interest or transfer restrictions). The registration statement has not been declared effective within the required 180 days of issuance and, as a result, on October 9, 2006 in accordance with the terms of the notes became subject to special interest which accrues at a rate of 0.25% per annum during the 90-day period immediately following the occurrence of such default, and shall increase by 0.25% per annum at the end of each 90-day period, up to a maximum of 1.0% per annum. For the six months ended June 30, 2007, we incurred \$0.8 million of additional interest expense as a result of such default.

**Financial Services Borrowings**

Our mortgage subsidiary has the ability to borrow up to \$150.0 million under two warehouse lines of credit to fund the origination of residential mortgage loans. The primary revolving warehouse line of credit (the Primary Warehouse Line of Credit), which was amended on December 9, 2006, provides for revolving loans of up to \$100.0 million. The Primary Warehouse Line of Credit, as amended, expires on December 8, 2007. The Primary Warehouse Line of Credit, as amended, bears interest at the 30 day LIBOR rate plus a margin of 1.0% to 3.0%, except for certain specialty mortgage loans, determined based upon the type of mortgage loans being financed. The Primary Warehouse Line of Credit, as amended, also places certain restrictions on, among other things, our mortgage subsidiary's ability to incur additional debt, create liens, pay or declare dividends or other restricted payments, make equity investments, enter into transactions with affiliates, and merge or consolidate with other entities.

On August 7, 2007, we amended our mortgage subsidiary's other existing \$50.0 million warehouse line of credit (the Existing Secondary Warehouse Line of Credit) and reduced the size of the facility to \$35.0 million (the New Secondary Warehouse Line of Credit). The New Secondary Warehouse Line of Credit is comprised of (1) a credit facility providing for revolving loans of up to \$20.0 million, subject to meeting borrowing base requirements based on the value of collateral provided, and (2) a mortgage loan purchase and sale agreement which provides for the purchase by the lender of up to \$15.0 million in mortgage loans generated by our mortgage subsidiary. At no time may the amount outstanding under this Secondary Warehouse Line of Credit, plus the amount of purchased loans pursuant to the purchase and sale agreement exceed \$35.0 million. The New Secondary Warehouse Line of Credit bears interest at the 30 day LIBOR rate plus a margin of 1.125%, no change from the Existing Secondary Warehouse Line of Credit. The New Secondary Warehouse Line of Credit expires on August 8, 2008.

Both lines of credit are secured by funded mortgages, which are pledged as collateral, and require our mortgage subsidiary to maintain certain financial ratios and minimums. At June 30, 2007, we had \$28.6 million in borrowings under our mortgage subsidiary's warehouse lines of credit and had the capacity to borrow an additional \$121.4 million, subject to satisfying the relevant borrowing conditions. If the New Secondary Warehouse Line of Credit would have been in effect at June 30, 2007, we would have had \$106.4 million in availability, subject to satisfying the relevant borrowing conditions.

**10. Income Taxes**

We account for income taxes in accordance with SFAS 109, *Accounting for Income Taxes* (SFAS 109) as interpreted by FIN 48. Under SFAS 109, income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized based on the anticipated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the

years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. FIN 48, which became effective for us on January 1, 2007, prescribed the minimum threshold a tax position is required to meet before being recognized in the financial statements and provided guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, and transition. FIN 48 also requires expanded disclosure with respect to uncertainty in income taxes.

As a result of the implementation of FIN 48, we recognized a \$1.3 million increase in our liability for unrecognized tax benefits, which was accounted for as a reduction of retained earnings at January 1, 2007. After giving effect to the adjustment above, we have a \$5.1 million liability recorded for unrecognized tax benefits as of January 1, 2007, which includes interest and penalties of \$0.4 million. The liability for unrecognized tax benefits is included in accounts payable and other liabilities in the accompanying



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statement of financial condition as of June 30, 2007. We recognize interest and penalties accrued related to unrecognized tax benefits in our provision for tax expense. Total unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$5.1 million, which includes interest and penalties of \$0.4 million. We do not currently anticipate that the total amount of unrecognized tax benefits will significantly increase or decrease by the end of 2007.

Our policy for interest and penalties under FIN 48 related to income tax exposures was not impacted as a result of the adoption and measurement provisions of FIN 48. We continue to recognize interest and penalties as incurred within the provision for income taxes in our consolidated statements of operations. We have recorded a liability of \$0.4 million for interest and penalties, which is included as a component of the liabilities for unrecognized tax benefits at January 1, 2007. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

We are subject to U.S. federal income tax as well as to income tax in multiple state jurisdictions. We have effectively closed all U.S. federal income tax matters for years through 2002. The Internal Revenue Service is currently examining our consolidated tax return for fiscal year 2004. Management believes that the tax liabilities recorded are adequate. However, a significant assessment in excess of liabilities recorded against us could have a material adverse effect on our financial position, results of operations or cash flows.

As of June 30, 2007, we have gross deferred tax assets of \$264.5 million, resulting primarily from deductible temporary differences. At June 30, 2007, we have provided for a valuation allowance on our deferred tax assets of \$76.0 million as compared to \$42.1 million at December 31, 2006. The valuation allowance has been established and maintained for deferred tax assets on a more likely than not threshold. We have considered the following possible sources of taxable income when assessing the realization of the deferred tax assets: (i) future reversals of existing taxable temporary differences; (ii) taxable income in prior carryback years; (iii) tax planning strategies; and (iv) future taxable income exclusive of reversing temporary differences and carryforwards.

As a result of generating taxable income during 2005 and 2006, we have the ability to carryback \$635.0 million in taxable losses to prior years and have recognized the portion of our deferred tax assets which we anticipate realizing through the carrybacks. Due to our cumulative losses in recent years, we have not relied upon future taxable income exclusive of reversing temporary differences and carryforwards for the realization of any of our deferred tax assets. Reliance on future taxable income as a source is difficult when there is negative evidence such as in our situation where we have cumulative losses. Cumulative losses weigh heavily in our overall assessment. We determine cumulative losses on a rolling twelve-quarter basis. Income forecasts were considered in conjunction with other positive and negative evidence, including our current financial performance, the financial impact of the Transeastern JV settlement, our market environment and other factors. As a result, the conclusion was made that there was not sufficient positive evidence to enable us to conclude that it was more likely than not that the remaining deferred tax assets, after reduction through carrybacks, would be realized. Therefore, we have provided a valuation allowance on our net deferred tax assets. This assessment will continue to be undertaken in the future. Our results of operations may be impacted in the future by our inability to realize a tax benefit for future tax losses or for items that will generate additional deferred tax assets. Our results of operations might be favorably impacted in the future by reversals of valuation allowances if we are able to demonstrate sufficient positive evidence that our deferred tax assets will be realized. In addition, there could be restrictions on the amount of the carryforwards that can be utilized if certain changes in our ownership should occur. In light of the above, we believe that it is more likely than not that we will realize our net deferred tax asset of \$188.5 million.

Primarily as a result of the change in our valuation allowance during the three and six months ended June 30, 2007, the effective tax rate applied to our losses for the three and six months ended June 30, 2007 is below the federal statutory rate of 35%.

**11. Commitments and Contingencies**

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters are not expected to have a material adverse effect on our consolidated financial position or results of operations.

***Warranty***

We provide homebuyers with a limited warranty of workmanship and materials from the date of sale for up to two years. We generally have recourse against our subcontractors for claims relating to workmanship and materials. We also provide up to a ten-year homeowner's warranty which covers major structural and design defects related to homes sold by us during the policy period, subject to a significant self-insured retention per occurrence. Estimated warranty costs are recorded at the time of sale based on historical

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experience and current factor. Warranty costs are included in accounts payable and other liabilities in the accompanying consolidated statements of financial condition.

During the six months ended June 30, 2007 and 2006, the activity in our warranty cost accrual consisted of the following (dollars in millions):

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>
Accrued warranty costs at January 1	\$ 7.4	\$ 6.6
Liability recorded for warranties issued during the period	2.7	5.9
Warranty work performed	(4.2)	(4.2)
Adjustments	1.0	
Accrued warranty costs at June 30	\$ 6.9	\$ 8.3