CALIFORNIA COASTAL COMMUNITIES INC
Form 10-Q
November 16, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

o **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: 0-17189

CALIFORNIA COASTAL COMMUNITIES, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**02-0426634** (I.R.S. Employer Identification No.)
6 Executive Circle, Suite 250 **Irvine, California** (Address of principal executive offices)	**92614** (Zip Code)

Registrant s telephone number, including area code: **(949) 250-7700**

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, par value $.05 per share	NASDAQ Global Market

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 o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o 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 o

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 o No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of November 16, 2009 there were 10,995,902 shares of Common Stock, par value $.05 outstanding

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CALIFORNIA COASTAL COMMUNITIES, INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that relate to future events or our future financial performance. In addition, other statements we may make from time to time, such as press releases, oral statements made by our officials and other reports that we file with the Securities and Exchange Commission (SEC) may also contain such forward-looking statements. Undue reliance should not be placed on these statements which involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipate believes, estimates, predicts, potential, continue, or the negative of such terms or other comparable terminology.

These forward-looking statements include, but are not limited to:

- the impact, effect or eventual result of our recent voluntary bankruptcy filing under Chapter 11 of the Bankruptcy Code;
- our ability to create stockholder value;
- potential inability to comply with covenants in our debt agreements;
- our ability to successfully complete the restructuring of our indebtedness;
- our future compliance with debt covenants and actions we may take with respect thereto;
- economic changes nationally or in local markets, including changes in consumer confidence, volatility of mortgage interest rates and inflation;
- continued or increased downturn in the homebuilding industry;
- statements about our strategies, plans, objectives, goals, expectations and intentions;

- information relating to anticipated operating results, financial resources, changes in revenues, changes in profitability, interest expense, growth and expansion;
- the impact of demographic trends and supply constraints on the demand for and supply of housing;
- housing market conditions in the geographic markets in which we operate;
- the number and types of homes and number of acres of land that we may develop and sell;
- our ability to deliver homes from backlog;
- the timing and outcomes of regulatory approval processes or administrative proceedings, which may result in delays in the land entitlement, development, construction, or the opening of new communities;
- our ability to secure materials and subcontractors;
- our ability to produce the liquidity and capital necessary to service our debt, fund operations, and expand and take advantage of future opportunities if current market conditions persist or become more pronounced;
- our cost of and ability to access additional capital;
- our ability to realize the value of our net operating loss carry forwards;
- our ability to continue relationships with current or future partners;
- the effectiveness and adequacy of our disclosure and internal controls;
- the impact of recent accounting pronouncements; and

- stock market valuations.

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Any or all of the forward-looking statements included in this report and in any other reports or public statements made by us are not guarantees of future performance and may turn out to be inaccurate. This can occur as a result of incorrect assumptions or as a consequence of known or unknown risks and uncertainties. These risks and uncertainties include the competitive environment in which we operate; local, regional and national economic conditions; the effects of the current national credit market crisis, inflation and the recession; our ability to comply with the covenants and amortization schedules contained in our revolving and term loan agreements; the demand for homes; adverse market conditions that could result in additional inventory impairments, including an oversupply of unsold homes and declining home prices, among other things; declines in consumer confidence; increases in competition; fluctuations in interest rates and the availability of mortgage financing; mortgage foreclosure rates; the availability and cost of land for future growth; the availability of capital, including access under our existing credit facilities; uncertainties and fluctuations in capital and securities markets; changes in tax laws and their interpretation; legal proceedings; the ability of customers to finance the purchase of homes or sell existing homes; the availability and cost of labor and materials; the amount of our debt and the impact of restrictive covenants in our loan agreements; adverse weather conditions; domestic and international political events; geopolitical risks and the uncertainties created by terrorist attacks; the effects of governmental regulation, including regulations concerning development of land, the home building industry, sales and customer financing processes, and the environment; and other risks discussed in our filings with the SEC. Many factors mentioned in this report or in other reports or public statements made by us, such as government regulation and the competitive environment, will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from our forward-looking statements. You should not place undue reliance on any of these forward-looking statements because they are based on current expectations or beliefs regarding future events or circumstances, which involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by these forward-looking statements.

Although we believe that our strategies, plans, objectives, goals, expectations and intentions reflected in, or suggested by these forward-looking statements are reasonable given current information available to us, we can give no assurance that any of them will be achieved. Forward-looking statements speak only as of the date they are made. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in our subsequent reports on Forms 10-K, 10-Q and 8-K should be consulted.

These forward-looking statements should be considered in light of the information included in this report and our other filings with the SEC, including, without limitation, the Risk Factors and the description of trends and other factors in Management s Discussion and Analysis of Financial Condition and Results of Operations, set forth in this Form 10-Q and in our Form 10-K for the year ended December 31, 2008. You should also read the following Consolidated Financial Statements and the related notes.

All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this report and are expressly qualified in their entirety by the cautionary statements included in this Form 10-Q. We assume no, and hereby disclaim any, obligation to update any of the foregoing or any other forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Form 10-Q. We nonetheless reserve the right to make such updates from time to time by press release, periodic report or other method of public disclosure without the need for specific reference to this Form 10-Q or any other report filed by us. No such update shall be deemed to indicate that other statements not addressed by such update remain correct or create an obligation to provide any other updates.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

CALIFORNIA COASTAL COMMUNITIES, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited)

(in millions)

		September 30, 2009		December 31, 2008
ASSETS				
Cash and cash equivalents	$	3.7	$	2.3
Restricted cash		3.3		5.4
Real estate inventories		248.5		260.7
Deferred tax assets				37.1
Other assets, net		4.2		7.0
	$	259.7	$	312.5
LIABILITIES AND STOCKHOLDERS EQUITY				
Liabilities:				
Accounts payable and accrued liabilities	$	3.3	$	5.0
Senior secured project revolver		81.7		74.4
Senior secured term loan		99.8		107.4
Model home financing		22.5		22.5
Other project debt		2.2		38.9
Other liabilities		8.9		8.8
Total liabilities		218.4		257.0
Commitments and contingencies				
Stockholders equity:				
Common Stock $.05 par value; 13,500,000 shares authorized; 10,995,902 and 10,870,902 shares issued and outstanding, respectively		.5		.5
Excess Stock $.05 par value; 13,500,000 shares authorized; no shares outstanding				

Additional paid-in capital		59.4		59.4
Accumulated deficit		(15.8)		(1.6)
Accumulated other comprehensive loss		(2.8)		(2.8)
Total stockholders equity		41.3		55.5
	$	259.7	$	312.5

See the accompanying notes to consolidated financial statements.

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CALIFORNIA COASTAL COMMUNITIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

(unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenues:				
Homebuilding	$ 9.6	$ 13.9	$ 32.9	$ 29.3
Land	1.8		1.8	
	11.4	13.9	34.7	29.3
Costs of sales:				
Homebuilding	8.0	10.6	25.4	22.7
Land	1.8		1.8	
Loss on impairment of real estate inventories		29.1	3.2	34.1
	9.8	39.7	30.4	56.8
Gross operating profit (loss)	1.6	(25.8)	4.3	(27.5)
Selling, general and administrative expenses	1.1	1.5	3.6	5.0
Interest expense		.6	.8	.6
Gains on debt restructuring and extinguishment	(4.1)		(24.8)	
Income from unconsolidated joint ventures		(.1)		(.2)
Other expense, net	1.1	.3	1.8	1.5
Income (loss) before income taxes	3.5	(28.1)	22.9	(34.4)
Income tax expense (benefit)	21.6	(7.0)	37.1	(9.5)
Net loss	$ (18.1)	$ (21.1)	$ (14.2)	$ (24.9)
Net loss per common share:				
Basic and diluted	$ (1.65)	$ (1.94)	$ (1.29)	$ (2.28)
Common equivalent shares:				
Basic and diluted	11.0	10.9	11.0	10.9

See the accompanying notes to consolidated financial statements.

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CALIFORNIA COASTAL COMMUNITIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(unaudited)

	Nine Months Ended September 30, 2009		Nine Months Ended September 30, 2008	
Cash flows from operating activities:				
Net loss	$	(14.2)	$	(24.9)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:				
Gains on debt restructuring and extinguishment (Note 8)		(24.8)		
Model homes depreciation		.2		.6
Stock-based compensation expense				.1
Distributions from unconsolidated joint ventures				.1
Equity in earnings of unconsolidated joint ventures				(.2)
Loss on change in fair value of derivative instrument				(.2)
Increase (decrease) in deferred tax assets		8.9		(14.0)
Deferred tax asset valuation allowance		28.2		4.5
Gains on sales of real estate inventories		(7.5)		(6.6)
Loss on impairment of real estate inventories		3.2		34.1
Proceeds from sale of real estate inventories, net		33.6		28.4
Investments in real estate inventories		(21.8)		(31.7)
Changes in assets and liabilities:				
(Increase) decrease in other assets		1.3		(.3)
Increase (decrease) in accounts payable, accrued and other liabilities		.3		(7.7)
Cash provided by (used in) operating activities		7.4		(17.8)
Cash flows from investing activities:				
Investments in unconsolidated joint ventures				(.4)
Change in restricted cash		.4		.1
Cash provided by (used in) investing activities:		.4		(.3)
Cash flows from financing activities:				
Borrowings of senior secured project revolver		26.5		40.7
Repayments of senior secured project revolver		(19.2)		(22.8)
Repayments of senior secured term loan		(7.6)		(5.8)
Borrowings of other project debt				1.1
Repayments of other project debt		(5.9)		(9.0)
Deferred financing costs		(.2)		(3.4)

Cash provided by (used in) financing activities		(6.4)		.8
Net increase (decrease) in cash and cash equivalents		1.4		(17.3)
Cash and cash equivalents - beginning of period		2.3		24.3
Cash and cash equivalents - end of period	$	3.7	$	7.0
Supplemental disclosures of cash flow information:				
Cash paid during the period for income taxes, net of refunds received	$	.1	$	
Supplemental disclosures of non-cash investing and financing activities:				
Amortization of deferred financing costs capitalized in real estate inventories	$	1.7	$	.9
Decrease in project debt and accrued liabilities due to debt restructuring	$	32.8	$	

See the accompanying notes to consolidated financial statements.

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CALIFORNIA COASTAL COMMUNITIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1 Basis of Presentation

The accompanying financial statements have been prepared by California Coastal Communities, Inc. and its consolidated subsidiaries (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Company believes that these unaudited consolidated financial statements reflect all material adjustments (consisting only of normal recurring adjustments) and disclosures necessary for the fair presentation of the results of operations and statements of financial position when read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 and the current year s previously issued Quarterly Reports on Form 10-Q. Intercompany accounts and transactions have been eliminated.

The results for interim periods are not necessarily indicative of the results to be expected for the full year. This report contains forward-looking statements. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties that actual events or results may differ materially from those described herein as a result of various factors, including without limitation, the factors discussed generally in this report.

Going Concern and Financial Reporting in Reorganization

While the Company is hopeful that it will be able to restructure its debt through the Chapter 11 reorganization process described below in Note 2, there can be no assurance that the Company will be able to successfully execute such plan. In the event that the Company is not successful in that regard, substantial doubt would exist as to its ability to continue as a going concern. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern and contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. As a result of the Chapter 11 Cases, the realization of assets and the satisfaction of liabilities are subject to uncertainty. While operating as debtors-in-possession under Chapter 11, the Debtors may sell or otherwise dispose of or liquidate assets or settle liabilities, subject to the approval of the Bankruptcy Court or as otherwise permitted in the ordinary course of business, in amounts other than those reflected in the accompanying consolidated financial statements. Further, a plan of reorganization could materially change the amounts and classifications of assets and liabilities in the historical consolidated financial statements. The accompanying consolidated financial statements do not include any direct adjustments related to the recoverability and classification of assets or the amounts and classification of liabilities or any other adjustments that might be necessary should the Company be unable to continue as a going concern or as a consequence of the Chapter 11 Cases.

Note 2 Chapter 11 Proceedings and Plans of Management

Commencement of Chapter 11 Bankruptcy Cases

On October 27, 2009, the Company and certain of its direct and indirect wholly-owned subsidiaries (collectively with the Company, the Debtors) filed voluntary petitions (the Chapter 11 Petitions) for relief under chapter 11 of title 11 (Chapter 11) of the United States Code (the Bankruptcy Code) in the United States Bankruptcy Court for the Central District of California (the Bankruptcy Court). The Chapter 11 Petitions are being jointly administered under the caption *In re California Coastal Communities, Inc.*, Case No. 09-21712-TA (the Chapter 11 Cases). The Debtors continue to operate their businesses and manage their properties as debtors in possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court. The Debtors have obtained the Bankruptcy Court s approval to, among other things, continue to pay critical vendors with lien rights, sell homes free and clear of all liens on an interim basis, use cash collateral on an interim basis, honor homeowner warranties on an interim basis, meet payroll obligations and provide employee benefits. There can be no assurance that the Company and the other Debtors will be able to successfully develop, execute, confirm and consummate one or more plans of reorganization with respect to the Chapter 11 Cases that are acceptable to the Bankruptcy Court and the creditors and other parties in interest.

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Loan Defaults Preceding Chapter 11 Cases

On September 28, 2009, the Company received a notice of an event of default from KeyBank National Association (KeyBank) with respect to the loan-to-value covenant of the senior secured revolving credit agreement (Revolving Loan) that would give KeyBank the right to accelerate the indebtedness under the Revolving Loan and senior secured term loan (Term Loan). As of September 30, 2009, approximately $81.7 million and $99.8 million of principal was outstanding under the Revolving Loan and Term Loan, respectively. In addition, on October 1, 2009, the Company received a notice of an event of default from KeyBank with respect to the Company s nonpayment of approximately $1.7 million of principal that was due on September 30, 2009 under the terms of the Revolving Loan that would give KeyBank the right to accelerate the indebtedness under the Revolving Loan and the Term Loan.

On October 1, 2009, the Company entered into the senior secured revolving loan forbearance agreement (Revolving Forbearance Agreement) and senior secured term loan forbearance agreement (Term Forbearance Agreement) with KeyBank, as a lender and as agent for the other loan syndicate members under the Revolving Loan and the Term Loan. However, the Company s subsequent failure to make required interest payments aggregating $759,000 on October 14, 2009 for the Revolving Loan and Term Loan terminated the forbearance period provided under the Forbearance Agreements. Therefore, as a result of the Company s nonpayment of $1.7 million of principal that was due on September 30, 2009 and $759,000 of interest that was due on October 14, 2009, triggering events have occurred that could give rise to the immediate acceleration of the payment of all outstanding principal and accrued interest under both the Term and Revolving Loans.

The filing of the Chapter 11 Cases also constituted events of default under the Revolving Loan and Term Loan that can trigger acceleration of the indebtedness. However, the filing of the Chapter 11 Petitions automatically stays most actions against the Company and the other Debtors, including actions with respect to Revolving Loan and Term Loan. As of October 27, 2009, approximately $82.3 million and $100.6 million of principal and accrued interest is outstanding under the Revolving Loan and Term Loan, respectively.

Plans of Management

The Company is working with KeyBank and its lenders to restructure its debt obligations under the Revolving Loan and the Term Loan through the Chapter 11 reorganization process. Among other things, the Company is seeking an extension of the maturity dates and changes to the repayment schedules to provide full repayment by the end of the third quarter of 2013. However, there can be no assurance that the Company and the other Debtors will be able to successfully develop, execute, confirm and consummate one or more plans of reorganization with respect to the Chapter 11 Cases that are acceptable to the Bankruptcy Court and the creditors and other parties in interest.

The Company and the other Debtors continue to operate their business as debtors-in-possession. The Company has incurred and will continue to incur significant costs associated with the reorganization which are expected to significantly affect the Company s results of operations.

An additional hearing is scheduled before the Bankruptcy Court on December 9, 2009 to consider final orders for, among other things, continued use of cash collateral, selling homes free and clear of liens, honoring homeowner warranties and continued use of the Company s existing cash management system.

The Company intends to maintain business operations through the reorganization process. The Company s liquidity and capital resources, however, are significantly affected by the Chapter 11 Cases, which have resulted in various restrictions on its activities, limitations on financing and a need to obtain Bankruptcy Court approval for various matters. In particular, the Debtors are not permitted to make any payments on pre-petition liabilities without prior Bankruptcy Court approval. However, the Debtors have been granted relief in order to continue wage and salary payments and other employment benefits to employees as well as other related pre-petition obligations; to continue to construct and sell homes as well as certain related pre-petition customer obligations through December 9, 2009; and to pay certain pre-petition trade claims held by critical vendors with lien rights. Under the priority schedule established by the Bankruptcy Code, certain post-petition and pre-petition liabilities need to be satisfied before general unsecured creditors and equity holders are entitled to receive any distribution. At this time, it is not possible to predict with certainty the effect of the Chapter 11 Cases on the Company s business or various creditors, or when the Company will emerge from these proceedings. Future results will depend upon the confirmation and successful implementation of a plan of reorganization. The continuation of the Chapter 11 Cases, particularly if a plan of reorganization is not timely confirmed, could further adversely affect the Company s operations.

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The Company depends on cash flows generated from operations and available borrowing capacity to fund its Brightwater development, and to meet its debt service and working capital requirements. However, the Company s ability to continue to generate sufficient cash flows has been and will continue to be adversely affected by continued difficulties in the homebuilding industry and continued weakness in the California economy. During the last eight months (March October), the Company generated 31 net sales orders at Brightwater, increased construction starts during the second and third quarters to keep pace with sales orders, and started construction of a limited number of speculative homes which are in greater demand in today s market than contract homes that are constructed over a five to nine month period. While sales of the Trails and Sands products, which are generally under $1.0 million, have increased during the first nine months of 2009, sales of the Company s larger Cliffs and Breakers homes continue to be challenged by limitations on jumbo-mortgage financing and the downturn in the housing market, which have reduced demand for homes exceeding $1.0 million.

Due to cash requirements for on-going home construction and scheduled debt amortization, the Company s ability to meet future loan repayment requirements will depend on the results of negotiations with the Company s lenders and the Chapter 11 reorganization proceedings. Based on Brightwater sales thus far in 2009, which have been primarily for the smallest Brightwater home product (The Trails), the current product mix of home sales is not expected to generate sufficient cash flow to meet the Company s future scheduled loan repayments for the Revolving Loan and Term Loan as currently structured, as described in greater detail in Notes 5 and 6.

Continuing negative conditions in the housing and credit markets give rise to uncertainty as to the Company s present and future ability to meet its projected home sale closings and whether modified or new financings can be obtained in order for the Company to meet its debt obligations. The Company, like many other homebuilders, is constantly evaluating potential alternatives regarding its capital structure including, but not limited to, various strategies for restructuring existing debt financings and raising additional capital. There can be no assurance that the Company will be successful in any of these endeavors. While the national credit markets appear to be improving, there is limited availability of financing for small businesses which presents uncertainty as to the ability of the Company to secure new financing, if needed, and the terms of such financing if it is available. The current housing and mortgage markets also present uncertainty as to the Company s ability to achieve sufficient positive cash flow from operations required to satisfy its debt obligations and meet financial covenant requirements. See Notes 5, 6 and 8 for further discussion.

While the Company is hopeful that it will be able to restructure its debt through the Chapter 11 reorganization process, unless the Company is successful in amending and extending the terms of the Revolving Loan and Term Loan agreements, the Company does not believe that its cash, cash equivalents and future real estate sales proceeds will be sufficient to meet its debt obligations or to meet anticipated operating and project development costs for Brightwater, and general and administrative expenses during the next 12 months.

Note 3 Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and all majority-owned and controlled subsidiaries and joint ventures. Certain of the Company s wholly-owned subsidiaries are members in joint ventures involved in the development and sale of residential projects and residential loan production. The financial statements of joint ventures in which the Company has a controlling or majority economic interest (and thus are controlled by the Company) are consolidated with the Company s financial statements. The Company s investments in unconsolidated joint ventures are accounted for using the equity method when the Company does not have voting or economic control of the venture operations, as further described in Note 4 to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008. All significant intercompany accounts and transactions have been eliminated in consolidation.

Consequences of Chapter 11 Proceedings

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 360-10-35, *Reorganizations Other Presentation Matters*, which is applicable to companies in Chapter 11, generally does not change the manner in which financial statements are prepared. However, it does require that the financial statements for periods subsequent to the filing of the Chapter 11 Cases distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Amounts that can be directly associated with the reorganization and restructuring of the business must be reported separately as reorganization items in the statements of operations beginning in the quarter ending December 31, 2009. The balance sheet must distinguish pre-petition liabilities subject to

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compromise from both those pre-petition liabilities that are not subject to compromise and from post-petition liabilities. Liabilities that may be affected by a plan of reorganization must be reported at the amounts expected to be allowed, even if they may be settled for lesser amounts. In addition, cash provided by reorganization items must be disclosed separately in the statement of cash flows. The Company applied ASC 360-10-35 effective on October 27, 2009 and will segregate those items as outlined above for all reporting periods subsequent to such date.

Subsequent Events

The Company evaluated events through the filing date of this Quarterly Report on Form 10-Q on November 12, 2009, including the October 27, 2009 commencement of the Chapter 11 Cases. On October 28, 2009, the Company received a delisting determination letter from the NASDAQ Stock Market Listing Qualifications Staff indicating their decision to delist the Company s common stock from the NASDAQ Stock Market pursuant to NASDAQ Marketplace Rules 5100, 5110(b) and IM-5101-1. The determination was made following the Company s filing of a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code (described above). On November 4, 2009, the Company requested a hearing before a NASDAQ Listing Qualifications Hearing Panel to appeal the proposed delisting. The hearing is currently scheduled to take place on December 3, 2009. The Company s common stock will remain listed on the NASDAQ Stock Market pending the outcome of the hearing.

On November 6, 2009, the Worker, Homeownership and Business Assistance Act of 2009 (the WHB Act) was passed and signed into law. The WHB Act allows businesses with net operating losses (NOLs) for 2008 and 2009 to carry back losses for up to five years and suspends the 90% limitation on the use of any alternative tax NOL deduction attributable to carrybacks of the applicable NOL. Based upon the estimated tax loss for 2009, the Company anticipates filing refund claims approximating $900,000 for federal alternative minimum tax paid for years prior to 2009.

Real Estate

Real estate inventories primarily consist of homes available for sale, homes under construction and lots under development and are carried at the lower of cost or fair value less costs to sell. The estimation process involved in the determination of fair value is inherently uncertain because it requires estimates as to future events and market conditions. Such estimation process assumes the Company s ability to complete development and dispose of its real estate properties in the ordinary course of business based on management s present plans and intentions. Economic, market, and environmental conditions will affect management s development and marketing plans. In addition, the implementation of such development and marketing plans could be affected by the availability of future financing for development and construction activities. Accordingly, the ultimate values of the Company s real estate properties depend upon future economic and market conditions, and the availability of financing.

The cost of sales of multi-unit projects is computed using the relative sales value method. Interest and other carrying costs are capitalized to real estate projects during their development and construction period.

Impairment of Long-Lived Assets

The Company assesses the impairment of real estate inventories and other long-lived assets in accordance with ASC 360-10-35, *Impairment or Disposal of Long-Lived Assets,* which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is evaluated by comparing an asset s carrying value to the undiscounted estimated cash flows expected from the asset s operations and eventual disposition. If the sum of the undiscounted estimated future cash flows is less than the carrying value of the asset, an impairment loss is recognized based on the fair value of the asset. If impairment occurs, the fair value of an asset is deemed to be the amount a willing buyer would pay a willing seller for such asset in a current transaction. Additionally, as appropriate, the Company identifies alternative courses of action to recover the carrying value of its long-lived assets and evaluates all likely alternatives under a probability-weighted approach as described in ASC 360-10-35.

During the three and nine months ended September 30, 2009, the Company recorded inland project impairment charges totaling zero and $3.2 million, respectively. See Note 4 Real Estate Inventories.

In accordance with ASC 360-10-35, in developing estimated future cash flows for impairment testing for its real estate inventories, the Company has incorporated its own market assumptions including those regarding home prices, sales pace, sales and marketing costs, infrastructure and home-building costs, and financing costs regarding real estate inventories. The Company s assumptions are based, in part, on general economic conditions, the current state of the homebuilding industry, expectations about the short- and long-term outlook for the housing market, and competition from other homebuilders in the areas in which the Company builds and sells homes. These assumptions can significantly affect the Company s estimates of future cash flows. For those communities deemed to be impaired, the Company determines fair value based on discounted estimated future cash flows using estimated absorption rates for each community.

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The estimation process involved in the determination of value is inherently uncertain since it requires estimates as to future events and market conditions. Such estimation process assumes the Company s ability to complete development and disposition of its real estate properties in the ordinary course of business based on management s present plans and intentions. Economic and market conditions may affect management s development and marketing plans. In addition, the implementation of such development and marketing plans could be affected by the availability of future financing for development and construction activities. Accordingly, the amount ultimately realized from such project may differ materially from current estimates and the project s carrying value.

The Company believes that accounting for the impairment of long-lived assets is a critical accounting policy because the valuation analysis involves a number of assumptions that may differ from actual results and the impact of recognizing impairment losses has been material to the Company s consolidated financial statements. The critical assumptions in the Company s evaluation of real estate inventories impairment included projected sales prices, anticipated sales pace within each community, and applicable discount rates, any of which could change materially as economic conditions change.

Fair Value of Financial Instruments

The Company adopted ASC 820-10 *Fair Value Measurements and Disclosures,* as it applies to financial assets and liabilities measured at fair value on a recurring basis on January 1, 2008 and as it applies to non-financial assets and liabilities on January 1, 2009. The carrying amounts of the Company s financial instruments including cash and cash equivalents, restricted cash, accounts payable and accrued liabilities, model home financing, and other liabilities approximate their respective fair values because of the relatively short period of time between origination of the instruments and their expected realization. Due to the Chapter 11 Cases and current default status of the Company s Revolving Loan and Term Loan, the carrying amounts of the debt may not approximate fair value as of September 30, 2009. The Company has been notified that purchase/sale transactions involving the Revolving Loan and Term Loan have occurred or may have been negotiated between certain members of the loan syndicates and other financial institutions. However, it is not practicable for the Company to determine the fair value of the Revolving Loan and Term Loan as the transactions are occurring in a private market. The carrying amounts of the project debt approximate fair value given its current maturities.

The following table summarizes the Company s fair value measurements at September 30, 2009 (in millions):

Description	**Fair Value Hierarchy**	**Fair Value (a)**	**Impairment Charges for the Nine Months Ended September 30, 2009**
Real estate inventories	Level 3	$ 3.0	$ 3.2

(a) Amount represents the aggregate fair value for a community where the Company recognized a noncash inventory impairment charge during the period, as of the date that the fair value measurement was made. The carrying value for this community may have subsequently increased or decreased from the fair value reflected due to activity that has occurred since the measurement date.

During the three months ended March 31, 2009, real estate inventories with a carrying value of $6.2 million related to the Woodhaven project in Beaumont, California were determined to be impaired and were written down to their estimated fair value of $3.0 million, resulting in an impairment charge of $3.2 million. See *Impairment of Real Estate Inventories* above and Note 4 Real Estate Inventories.

On September 30, 2009, a subsidiary of Hearthside Homes completed a sale of the 62 remaining finished lots at the Woodhaven project for $1.8 million and sold the four remaining model homes for approximately $500,000, thereby disposing of all remaining assets of the project. See Note 8 for additional discussion.

Income Taxes

The Company accounts for income taxes on the liability method, in accordance with ASC 740-10, *Income Taxes.* Deferred income taxes are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect in the years in which these differences are expected to reverse. The liability method requires an evaluation of the probability of being able to realize the future benefits indicated by deferred tax assets. A valuation allowance is established against a deferred tax asset if, based on the available evidence, it is more likely than not that such asset will not be realized. The realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under tax law. The Company evaluates on a quarterly basis,

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whether a valuation allowance should be established based on its determination of whether it is more likely than not that some portion or all of the deferred tax assets will be realized. In the Company s assessment, appropriate consideration is given to all positive and negative evidence related to the realization of the deferred tax assets. This assessment considers, among other matters, the nature, frequency and magnitude of current and cumulative income and losses, forecasts of future profitability, the duration of statutory carryback or carryforward periods, the Company s experience with operating loss and tax credit carryforwards not expiring unused, and tax planning alternatives.

The Company s assessment of the need for a valuation allowance on its deferred tax assets includes assessing the likely future tax consequences of events that have been recognized in the Company s consolidated financial statements or tax returns. The Company bases its estimate of deferred tax assets and liabilities on current tax laws and rates and, in certain cases, on business plans and other expectations about future outcomes. Changes in existing tax laws or rates could affect the Company s actual tax results and its future business results may affect the amount of the Company s deferred tax liabilities or the valuation of its deferred tax assets over time.

Due to uncertainties in the estimation process, particularly with respect to changes in facts and circumstances in future reporting periods (carryforward period assumptions), it is reasonably possible that actual results could differ from the estimates used in the Company s historical analyses. The Company s assumptions require significant judgment because the residential homebuilding industry is cyclical and is highly sensitive to changes in economic conditions. The Company s current assessment of the need for a valuation allowance is primarily dependent upon utilization of tax net operating losses in the carryforward period and its future projected taxable income. If the Company s results of operations are more or less than projected and there is objectively verifiable evidence to support the realization of a different amount of its deferred tax assets, an adjustment to the Company s valuation allowance may be required to reflect greater expected utilization.

Homebuilding Revenues and Cost of Sales

The Company s homebuilding operation generates revenues from the sale of homes to homebuyers. The majority of these homes are designed to appeal to move-up homebuyers and are generally offered for sale in advance of their construction. Sales contracts are usually subject to certain contingencies such as the buyer s ability to qualify for financing. Revenue from the sale of homes is recognized at the close of escrow when title passes to the buyer and the earnings process is complete. As a result, the Company s revenue recognition process does not involve significant judgments or estimates. However, the Company does rely on certain estimates to determine the related construction costs and resulting gross margins associated with revenues recognized. The cost of sales is recorded based upon total estimated costs within a subdivision and allocated using the relative sales value method. The Company s construction costs are comprised of direct and allocated costs, including estimated costs for future warranties and indemnities. The Company s estimates are based on historical results, adjusted for current factors.

Earnings Per Common Share

Earnings per common share is accounted for in accordance with ASC 260-10, *Earnings Per Share*. Basic earnings per common share is computed using the weighted-average number of common shares outstanding for the period. Diluted earnings per common share is computed using the weighted-average number of common shares outstanding and the dilutive effect of potential common shares outstanding.

New Accounting Pronouncements

In August 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-05 (ASU 2009-05), *Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value*, which provides guidance on measuring the fair value of liabilities under FASB ASC 820. ASU 2009-05 is effective for interim and annual periods beginning after August 28, 2009. The Company does not expect the adoption of ASU 2009-05 to have a material effect on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (SFAS 168 , or ASC 105), which establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles in the United States of America. SFAS 168 is effective for interim and annual reporting periods ending after September 15, 2009. The Company adopted SFAS 168 for the reporting period ended September 30, 2009. The adoption of SFAS 168 did not have a material effect on the Company s consolidated financial statements.

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Note 4 Real Estate Inventories

Real estate inventories primarily consist of homes under construction and lots under development at Brightwater, along with a five-acre project being planned for 22 homes, in Huntington Beach in coastal Orange County and two inland communities in Lancaster in Los Angeles County. As of September 30, 2009, real estate inventories aggregated 430 lots and homes, including 17 model homes, five standing inventory homes completed and unsold, one home completed and in escrow, and 16 homes under construction and in escrow. Real estate inventories at September 30, 2009 included $242.0 million recorded for 286 lots and homes under development and 17 model homes held under a financing lease at the Brightwater community which is located on a 105-acre parcel on a mesa north of the Bolsa Chica wetlands in Huntington Beach, California and our adjacent five-acre parcel. An additional $6.5 million in real estate inventories is recorded for 127 lots at the Company s subsidiary s inland projects in Lancaster, California. The Company capitalizes carrying costs including interest and property taxes, as well as direct construction costs, to real estate inventories during the development and construction period.

The Brightwater planned community offers a broad mix of home choices, averaging 2,860 square feet and ranging in size from 1,710 square feet to 4,339 square feet. The community also has 37 acres of open space and conservation area. With 356 homes permitted on 68 acres, the resulting low-density plan equates to approximately five homes per acre, consistent and compatible with the neighboring Huntington Beach communities.

The Company began selling homes at The Trails and The Sands in August 2007 and began delivering homes for these products during December 2007. Construction of models for the larger two products, The Cliffs and The Breakers, was completed in January 2008. In February 2008, the Company began selling homes to homebuyers who had previously registered on the Brightwater priority list. The Company held a grand opening for these products in March 2008 and began delivering homes at The Cliffs and The Breakers neighborhoods during the third quarter of 2008.

On September 30, 2009, a subsidiary of Hearthside Homes completed a sale of the remaining 62 finished lots and four model homes at the Woodhaven project in Beaumont, California for $2.3 million. See Note 8 for additional discussion.

On March 31, 2009, a subsidiary of Hearthside Homes completed a deed-in-lieu transaction for the Hearthside Lane project in the City of Corona with the investor that had acquired the project loan secured by the property from IndyMac Federal Bank. The subsidiary conveyed the remaining 134 finished lots to the investor in exchange for a $28.7 million reduction in the note balance and retained seven homes which secured the then remaining note balance of $2.5 million. See Note 8 for additional discussion.

The Company recorded inland project impairment charges totaling zero and $3.2 million, respectively, during the three and nine months ended September 30, 2009, compared with $29.1 million and $34.1 million, respectively, during the same periods in 2008. The impairment charges recorded during the first quarter of 2009 relate to a subsidiary s Woodhaven project in Beaumont, California which was sold on September 30, 2009 in a transaction which extinguished the related project debt for less than 100% of the principal balance.

During 2007 and 2008, the Company recorded impairment charges aggregating $67.0 million related to five of its inland projects. The impairment charges were calculated based on market conditions and assumptions made by management that reflected current conditions at the time such impairment charges were determined, which may differ materially from actual results if market conditions change. As required by ASC 360-10-35, should market conditions deteriorate in the future or other events occur that indicate the carrying amount of the Company s real estate inventories may not be recoverable, the Company will reevaluate the expected cash flows from each project to determine whether any additional impairment exists at any point in time.

Capitalized interest is allocated to real estate inventories when incurred and charged to cost of sales when the related property is delivered. Changes in capitalized interest follow (in millions):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Capitalized interest, beginning of period	$ 37.5	$ 32.3	$ 37.3	$ 26.2
Interest incurred and capitalized	5.0	3.2	12.2	10.7
Charged to cost of sales	(2.9)	(1.2)	(5.7)	(2.6)
Charged to gain on debt restructuring	(2.8)		(7.0)	
Capitalized interest, end of period	$ 36.8	$ 34.3	$ 36.8	$ 34.3

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Note 5 Senior Secured Project Revolver

See Note 2 for a detailed discussion of the Company s default under the Revolving Loan and the status of the Chapter 11 Cases which commenced October 27, 2009.

As of September 30, 2009 and December 31, 2008, $81.7 million and $74.4 million, respectively, was outstanding under the Revolving Loan at weighted average interest rates of 3.50% and 5.09%, respectively, based upon the Company s elected rates. The Company did not pay $1.7 million of principal due on September 30, 2009, and received a notice of event of default from KeyBank on October 1, 2009. As of September 30, 2009, one syndicate member holding 12% of the loan was in default. The terms of the facility prevent a defaulting member from receiving repayments.

Outstanding advances bear interest based on the following loan-to-value grid:

Loan-to-Value	LIBOR Margin	Prime Margin
Greater than or equal to 30% to less than 40%	350	200
Greater than or equal to 20% to less than 30%	325	175
Less than 20%	300	150

Interest on the facility is calculated on the average, outstanding daily balance and is paid monthly. Interest incurred on the Revolving Loan for the three and nine months ended September 30, 2009 was $1.0 million and $3.2 million, respectively, at weighted-average interest rates of 3.54% and 3.67%, respectively. Interest incurred on the Revolving Loan for the three and nine months ended September 30, 2008 was $1.1 million and $3.1 million, respectively, at weighted-average interest rates of 4.49% and 4.90%, respectively. Following the Company s default in paying $1.7 million of principal when due, effective October 1, 2009, interest is incurred at the default rate stated in the loan. As of November 2, 2009, the Revolving Loan weighted average interest rate is 9% based on the Prime rate plus the default margin.

During March 2009, the Company exercised its option to extend the Revolving Loan maturity from September 15, 2009 to June 30, 2010. The Revolving Loan is subject to mandatory repayments and commitment reductions based on 40% of the $600,000 release price on the first 70 homes closed at the Brightwater project, and 40% of the $1 million release price per unit thereafter. As of September 30, 2009, the Company has delivered 70 homes. These mandatory repayments are applicable to the commitment reductions set forth below. The commitment amount under the Revolving Loan reduces to zero by the final maturity as follows (in millions):

Date	Commitment Reduction		Commitment
September 30, 2009	$		80.0
December 31, 2009		10.0	70.0
March 31, 2010		10.0	60.0
June 30, 2010		60.0	

During the three and nine months ended September 30, 2009, the Company delivered seven and 21 homes, respectively, at Brightwater and made mandatory repayments on the Revolving Loan of $1.7 million and $5.1 million, respectively. As of September 30, 2009, the Company has made cumulative mandatory repayments for the Revolving Loan of $16.8 million, reflecting 70 homes delivered to date, including the 17 model homes included in the sale-leaseback transaction completed on December 31, 2008. In addition, the Company has made additional repayments of $1.5 million. Since the $100.0 million Revolving Loan commitment was reduced to $80.0 million and the outstanding balance at September 30, 2009 is $81.7 million, there is no availability under the Revolving Loan.

As of September 30, 2009 and December 31, 2008, approximately $700,000 and $1.4 million, respectively, of deferred loan fees and closing costs related to the Revolving Loan are included in other assets and amortized over the life of the loan. Amortization of these costs is included in the capitalization of interest allocated to real estate inventories and charged to cost of sales when the related homes are delivered.

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Under the Revolving Loan, the Company is required to comply with a number of covenants, including the following financial covenants which the Company considers to be the most restrictive of all of the debt covenants:

- A leverage covenant that prohibits the Company s ratio of consolidated total liabilities to consolidated tangible net worth from exceeding a maximum ratio of 2.5 to 1.0. The calculation of the covenant excludes impairment charges related to the Hearthside Lane project in Corona and the Las Colinas project in Lancaster and valuation allowances on deferred tax assets.

- A loan-to-value ratio, which prohibits the Company s ratio of Revolver Loan debt outstanding to borrowing base value from exceeding a maximum ratio, regarding which the Company has been notified it is in default:

Reporting Period	**Maximum Loan-to-Value Ratio**
September 30, 2009 through March 30, 2010	35%
March 31, 2010 and thereafter	30%

- A minimum consolidated tangible net worth covenant of $80 million, excluding impairment charges for the Hearthside Lane and Las Colinas projects and valuation allowances on deferred tax assets.

As of September 30, 2009, the Company s consolidated total liabilities are $218.4 million, tangible net worth after excluding the 2008 Hearthside Lane and Las Colinas impairment charges and valuation allowances on deferred tax assets is $108.5 million and the leverage ratio is 2.01. The Company is in compliance with the leverage and net worth covenants. However, the Company was notified on September 28, 2009 that it is not in compliance with the loan-to-value ratio covenant of the Revolving Loan based on a recent appraisal obtained by the agent for the Revolving Loan and Term Loan. The Company disputes the validity of that appraisal and has obtained its own appraisal.

While the sales pace at Brightwater is close to expectations at the beginning of 2009, the mix is heavily weighted towards smaller homes which are generating less liquidity than the larger homes. Therefore, the Company does not expect to be able to meet its mandatory principal repayments due on December 31, 2009, as well as March 31, 2010, or fully re-pay the Revolving Loan by its maturity date on June 30, 2010 from cash flow from operations. The Company is currently negotiating with its lenders to restructure the Revolving Loan and Term Loan through the court reorganization process to defer scheduled amortization payments in order to accommodate the expected sales pace of the Brightwater project and provide sufficient liquidity to fund construction and extend the maturity dates of the loans. There can be no assurance that the Company will be successful in any of these endeavors. While the national credit markets appear to be improving, there is limited availability of financing for small businesses, which presents significant uncertainty as to the ability of the Company to secure additional financing, and the terms of such financing if available. The current housing and mortgage markets also present uncertainty as to the ability of the Company to achieve sufficient positive cash flow from operations required to satisfy its debt obligations.

Note 6 Senior Secured Term Loan

See Note 2 for detailed discussion of the Company s default under the Revolving Loan and the status of the Chapter 11 Cases which commenced October 27, 2009.

On September 30, 2008, the Company entered into the third amendment to the five-year, $125 million Term Loan with KeyBank National Association, as a lender and as agent for the other loan syndicate members. The Term Loan is secured by a second trust deed on the Brightwater project, and a general pledge and assignment of the Company s ownership interests in all material subsidiaries. All existing material subsidiaries of the Company have provided full unconditional guarantees. The Term Loan includes financial covenants which may limit the amount that may be outstanding. In January 2009, a major shareholder of the Company purchased 6% of the Term Loan from certain members of the loan syndicate.

As of September 30, 2009 and December 31, 2008, $99.8 million and $107.4 million, respectively, was outstanding under the Term Loan at interest rates of 4.25% and 6.38%, respectively, based upon the Company s elected rates. The outstanding balance currently bears interest based on the following loan-to-value grid:

Loan-to-Value	**LIBOR Margin**	**Prime Margin**
Greater than or equal to 65% to less than 70%	450	300
Greater than or equal to 50% to less than 65%	400	250
Less than 50%	350	200

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Interest on the facility is calculated on the average, outstanding daily balance and is paid monthly. Interest incurred on the Term Loan for the three and nine months ended September 30, 2009 was $1.4 million and $4.6 million, respectively, at weighted-average interest rates of 4.29% and 4.61%, respectively. Interest incurred on the Term Loan for the three and nine months ended September 30, 2008 was $1.7 million and $5.5 million, respectively, at weighted-average interest rates of 5.23% and 5.68%, respectively. Following the Company s default in paying $1.7 million of principal on the Revolving Loan when due, effective October 1, 2009, interest is incurred at the default rate stated in the loan. As of November 2, 2009, the Term Loan interest rate is 9.25% based on the Prime rate plus the default margin.

The Term Loan is subject to mandatory repayments and commitment reductions based on 60% of the $600,000 release price on the first 70 units closed at the Brightwater project, and 60% of the $1 million release price per unit thereafter. As of September 30, 2009, the Company has delivered the first 70 homes.

These mandatory repayments are applicable to the commitment reductions set forth below. Debt repayments are due as follows until the final maturity on September 15, 2011 (in millions):

Date	Commitment Reduction	End of Period Commitment
September 30, 2009	$	99.8
December 31, 2009	9.8	90.0
March 31, 2010	15.0	75.0
June 30, 2010	10.0	65.0
September 30, 2010	15.0	50.0
December 31, 2010	12.5	37.5
March 31, 2011	12.5	25.0
June 30, 2011	12.5	12.5
September 15, 2011	12.5	

During the three and nine months ended September 30, 2009, the Company delivered seven and 21 homes, respectively, at Brightwater and made mandatory repayments on the Term Loan of $2.5 million and $7.6 million, respectively. As of September 30, 2009, the Company has made cumulative mandatory repayments for the Term Loan of $25.2 million, reflecting 70 homes delivered to date, including the 17 model homes included in the sale-leaseback transaction completed on December 31, 2008. Availability under the $125.0 million Term Loan has been reduced to $99.8 million. The Company has met the minimum debt repayments as of September 30, 2009, which limits the maximum outstanding under the Term Loan to $105.0 million.

As of September 30, 2009 and December 31, 2008, approximately $2.1 million and $3.1 million, respectively, of deferred loan fees and closing costs related to the Term Loan are included in other assets and amortized over the life of the loan. Amortization of these costs is included in the capitalization of interest allocated to real estate inventories, and charged to cost of sales when the related homes are delivered.

Under the Term Loan, the Company is required to comply with a number of covenants, including the following financial covenants which the Company considers to be the most restrictive of all of the debt covenants:

• A leverage covenant that prohibits the Company s ratio of consolidated total liabilities to consolidated tangible net worth from exceeding a maximum ratio of 2.50 to 1.0. The calculation of the covenant excludes impairment charges related to the Hearthside Lane project in Corona and the Las Colinas project in Lancaster and valuation allowances on deferred tax assets.

• A loan-to-value ratio, which prohibits the Company s ratio of Term Loan debt outstanding to borrowing base value from exceeding a maximum ratio, regarding which the Company has been notified it is in default:

Reporting Period	**Maximum Loan-to-Value Ratio**	
Through December 30, 2009	70	%
December 31, 2009 through March 30, 2010	65	%
March 31, 2010 through September 29, 2010	60	%
September 30, 2010 and thereafter	45	%

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• An interest coverage covenant which prohibits the Company s ratio of EBITDA to interest incurred from being less than the following:

Period	Minimum Coverage Ratio
September 30, 2009 through December 30, 2009	1.50 to 1.00
December 31, 2009 and thereafter	2.00 to 1.00

• A minimum consolidated tangible not worth covenant of $80 million, excluding impairment charges for the Hearthside Lane and Las Colinas projects and valuation allowances on deferred tax assets.

As of September 30, 2009, the Company s consolidated total liabilities are $218.4 million, tangible net worth after excluding the 2008 Hearthside Lane and Las Colinas impairment charges and valuation allowances on deferred tax assets is $108.5 million and the leverage ratio is 2.01. The Company is in compliance with the aforementioned covenants except for the loan-to-value covenant. The Company was notified on September 28, 2009 that it is not in compliance with the loan-to-value ratio covenant of the Term Loan based on a recent appraisal obtained by the agent for the Revolving Loan and Term Loan. The Company disputes the validity of that appraisal and has obtained its own appraisal.

While the sales pace at Brightwater is close to expectations at the beginning of 2009, the mix is heavily weighted towards smaller homes which are generating less liquidity than the larger homes. Therefore, the Company does not expect to be able to make the mandatory repayments due on December 31, 2009, as well as March 31, 2010, under the Term Loan and the Revolving Loan. The Company is currently negotiating with its lenders to restructure the Revolving Loan and Term Loan through the court reorganization process to defer scheduled amortization payments in order to accommodate the expected sales pace of the Brightwater project and provide sufficient liquidity to fund construction and extend the maturity dates of the loans. There can be no assurance that the Company will be successful in any of these endeavors. While the national credit markets appear to be improving, there is limited availability of financing for small business, which presents uncertainty as to the ability of the Company to secure additional financing, and the terms of such financing, if available. The current housing and mortgage markets also present uncertainty as to the ability of the Company to achieve sufficient positive cash flow from operations required to satisfy its debt obligations.

Note 7 Model Home Financing

On December 31, 2008, the Company entered into a sale-leaseback transaction for 17 model homes at its Brightwater project with an unrelated third party investor for $25.0 million, consisting of $22.5 million cash, $2.0 million deferred and payable in two years provided there has not been a significant decrease in the value of the model homes, and $500,000 payable for conversion of the model homes for sale to homebuyers upon termination of the lease agreement. The Company has an option to repurchase the model homes after at least 90% of the homes of the respective model type have sold, but no earlier than January 1, 2011. If the Company does not repurchase the models, after the lessor receives a 16% internal rate of return, the Company is entitled to receive 75% of any profit resulting from the sale of the models at the end of the lease. Due to the Company s repurchase option and profit participation which constitute continuing interest, and in accordance with ASC 840-40, *Sale-Leaseback Transactions*, the Company accounted for the transaction as a financing transaction rather than as a sale and recorded model home financing debt of $22.5 million.

The Company utilized $10.2 million of the model home financing proceeds to make mandatory repayments under the Revolving Loan and the Term Loan, thereby reducing the payments that would have been due in 2009. The Company used an additional $10.7 million of the proceeds to reduce the balance outstanding under the Revolving Loan. See Notes 5 and 6 for additional discussion.

In connection with the sale-leaseback transaction, the Company agreed to assign the first $500,000 of proceeds from sales commissions resulting from the eventual resale of the model homes, or additional purchase price received, to its subsidiary s partner in the Oxnard joint venture, which is an affiliate of the investor who purchased the model homes. The $500,000 payment represents additional capital contributions that become payable upon the dissolution of the joint venture.

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The model home lease allows the Company to utilize the 17 model homes for continued customer display for a term of three years expiring December 31, 2011, with two renewal options for one year each. As required by the lease agreement, the Company prepaid six months of rent totaling $1.6 million on December 31, 2008. Monthly lease payments of $262,500 per month are due through December 2010, and $279,167 per month in 2011. The future minimum lease payments under the terms of the related lease agreement are as follows (in millions):

Year		**Amount**
2009	$	.8
2010		3.2
2011		3.3
Total	$	7.3

Note 8 Other Project Debt

In conjunction with the acquisition of single-family residential lots, the Company s homebuilding subsidiary, Hearthside Homes, Inc. and its subsidiaries, entered into construction loan agreements with commercial banks. These loan facilities finance a portion of land acquisitions and the majority of the construction of infrastructure and homes. Each loan facility requires a guaranty of project completion and an environmental indemnity by Hearthside Homes, Inc., however these loans are nonrecourse to California Coastal Communities, Inc. The loans are secured by first trust deeds and bear an interest rate of prime to prime plus one-half. The Lancaster loan facility currently bears interest at the default rate of 10.25%. During the nine months ended September 30, 2009, Hearthside Homes, Inc. and its subsidiaries did not enter into any new loan facilities.

The following amounts were available and outstanding under these loan facilities as of September 30, 2009 and December 31, 2008 ($ in millions):

						Outstanding at			
	Amount of Facility		**Interest Rate at 9/30/09**	**Lender**	**Number of Lots / Homes**	**Maturity Date**	**September 30, 2009**		**December 31, 2008**
Lancaster	$	14.0 (1)	10.25%	IndyMac Federal Bank/ OneWest of California	54	9/30/08	$ 2.2	$	2.7
Beaumont		n/a	n/a	Comerica Bank		n/a			7.0
Corona-Hellman		n/a	n/a	Third party investor (2)		n/a			29.2
							$ 2.2	$	38.9

(1) The Lancaster loan facility is currently in default as discussed below.

(2) IndyMac Federal Bank sold the Corona-Hellman loan facility to a third party investor in December 2008.

On September 30, 2009 a subsidiary of Hearthside Homes completed a sale of four model homes and the remaining 62 finished lots for its Woodhaven project in Beaumont, California for $2.3 million. The lender for the loan secured by the project accepted the proceeds of the sale in full settlement of the loan without further recourse or obligation and the Company recognized a $4.1 million gain on debt cancellation. The transaction was accounted for in accordance with ASC 470-60, *Troubled Debt Restructurings by Debtors* and the gain was determined as follows (in millions):

Land sale proceeds	$	1.8
Model home sale proceeds		.5
Transaction costs		(.2)
Net consideration		2.1
Debt balance at September 30, 2009		6.2
Gain on debt restructuring	$	(4.1)

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On March 31, 2009, a subsidiary of Hearthside Homes, Inc. completed a deed-in-lieu transaction with a third party investor that acquired the Corona-Hellman loan facility (Hellman Loan) from IndyMac Federal Bank in December 2008. As a result of this transaction, the Company recognized a pre-tax gain on debt restructuring of $20.7 million. The transaction was accounted for in accordance with ASC 470-60 and the gain was determined as follows (in millions):

Net book value of real estate inventories	$	6.2
Restricted cash assigned to investor		1.7
Transaction costs		0.1
Total consideration		8.0
Debt balance at March 31, 2009		26.7
Accrued interest and property taxes		2.0
Carrying amount of debt settled in full		28.7
Gain on debt restructuring	$	(20.7)

The subsidiary conveyed the remaining 134 finished lots to the investor in exchange for a $28.7 million reduction in the note balance and retained seven completed homes which secured the then remaining note balance of $2.5 million. The subsidiary also assigned $1.7 million of restricted cash related to the project to the investor as part of the transaction. During the three and nine months ended September 30, 2009, the Company delivered six and seven homes, respectively, and the related debt has been paid in full.

In June 2009, a subsidiary of Hearthside Homes received a notice of default relating to the loan facility which matured on September 30, 2008 for development of the Las Colinas project in Lancaster. The current balance of the loan plus additional amounts due for delinquent interest and property tax advances is approximately $3 million. Unless the Company is able to sell the property to a third party, the Company expects that the property will be sold to the lender in satisfaction of the loan upon approval of the Bankruptcy Court. If the property is sold or transferred to the lender in full settlement of the loan without further recourse or obligation, the Company expects to recognize a modest gain as a result of sale or debt cancellation. The loan is nonrecourse to California Coastal Communities, Inc.; however, the subsidiary s parent, Hearthside Homes, Inc., guaranteed payment of the debt.

During the third quarter of 2008, in accordance with EITF 91-2 and a FASB staff interpretation thereof, the Company reduced the carrying value of the Las Colinas real estate project to its estimated fair value. During the nine months ended September 30, 2009, the Company delivered two homes at the Las Colinas project resulting in loan repayments of $424,000.

Note 9 Other Liabilities

Other liabilities were comprised of the following (in millions):

		September 30, 2009		December 31, 2008
Accrued pensions and benefits	$	5.8	$	5.9
Home warranty reserves		1.8		1.7
Contingent indemnity and environmental obligations		1.1		1.1
Capital contribution due to joint venture		.5		.5

Unamortized discount		(.3)		(.4)
	$	8.9	$	8.8

Contingent indemnity and environmental obligations primarily reflect reserves before related discount (recorded pursuant to Fresh-Start Reporting in 1997) for contingent indemnity obligations for businesses disposed of by former affiliates and unrelated to the Company s current operations.

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Home Warranty Reserve

The Company provides a home warranty reserve to reflect its contingent obligation for product liability. The Company generally records a provision as homes are delivered, based upon historical and industry experience, for the items listed in the homeowner warranty manual, which does not include items that are covered by manufacturers warranties or items that are not installed by the Company s employees or contractors. The home warranty reserve activity is presented below (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Balance at beginning of period	$ 1.8	$ 2.0	$ 1.7	$ 2.3
Provision		.1	.1	.1
Adjustment due to change in estimate				(.1)
Payments		(.1)		(.3)
Balance at end of period	$ 1.8	$ 2.0	$ 1.8	$ 2.0

Note 10 Income Taxes

The following is a summary of the tax expense (benefit):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Current taxes	$	$	$	$
Deferred taxes	1.0	(7.0)	8.9	(9.5)
Valuation allowances on deferred tax assets	20.6		28.2	
Income tax expense (benefit)	$ 21.6	$ (7.0)	$ 37.1	$ (9.5)

On October 27, 2009, the Company filed Chapter 11 Petitions in the Bankruptcy Court. Due to uncertainties regarding the resolution of the Chapter 11 Cases and the Company s ability to utilize its NOLs in the future, during the third quarter of 2009, a valuation allowance was recorded for the remaining amount of its net deferred tax assets of approximately $20.6 million. The net deferred tax balance at December 31, 2008 is primarily composed of federal NOLs. During the second quarter of 2009, the Company concluded it was not more likely than not that the Company would be able to generate sufficient taxable income in 2009, 2010 and 2011 to realize certain expiring federal NOLs and recorded valuation allowances of $7.6 million. While the Company expects to report profitable operations before income taxes for 2009, it expects to report a taxable loss due to tax losses recognized upon dispositions of inland properties. These tax losses were previously recognized for financial statement purposes when impairment losses were recorded. The Company monitors the availability of real estate for development at economically viable prices, market conditions and other objectively verifiable economic factors affecting the Company s operations, as well as other positive and negative factors, as it assesses valuation allowances against its deferred tax assets. The Chapter 11 filing constitutes significant negative evidence under ASC 740-10 as it creates uncertainties related to future projected taxable income. The most critical uncertainties are whether the Company will be able to continue selling homes at its Brightwater project using currently projected sales prices and absorption rates in light of the continuing deterioration in the housing and credit markets, the Company s recent Chapter 11 filing, and the timing of dispositions of inland properties and the related recognition of losses for tax reporting purposes.

The federal NOLs available as of September 30, 2009 were approximately $164 million. The amount of federal NOLs which expire if not utilized is $11 million in 2009, $49 million in 2010, $42 million in 2011, zero in 2012 and 2013, and $62 million thereafter.

The Internal Revenue Code (the Code) generally limits the availability of NOLs if an ownership change occurs within any three-year period under Section 382. If the Company were to experience an ownership change of more than 50%, the use of all remaining NOLs would generally be subject to an annual limitation equal to the value of the Company s equity before the ownership change, multiplied by the long-term tax-exempt rate (4.48% as of October 2009) plus (ii) recognized built-in-gains, defined as those gains recognized within five years of the ownership change subject to an overall limitation of the net unrealized built-in gains existing as of the ownership change date. The Company estimates that after giving effect to various transactions by stockholders who hold a 5% or greater interest in the Company, it has experienced a three-year cumulative ownership shift of approximately 16% as of November 2, 2009, as computed in accordance with Section 382. A valuation allowance is recorded against the net deferred tax assets, which are primarily composed of federal NOLs. In the event of an ownership change, the Company s use of the NOLs may be limited and not fully available for realization.

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In September 2006, the Company s Board of Directors suspended enforcement of the Company s charter documents that restrict stockholders from acquiring more than 5% of the outstanding shares of Common Stock. The Board determined that such restrictions were not currently required to preserve the tax benefits of the Company s $164 million of NOLs. While the Company remains subject to Code section 382, which limits the availability of NOLs in the event of an ownership change, the Company would have five years from the date of any such ownership change to recognize its built in gains and utilize its NOLs. However, the Board may reinstitute the 5% ownership limitation if required by currently unanticipated events.

Of the Company s unrecognized tax benefits of $5.1 million at September 30, 2009, no amount would affect the Company s effective tax rate if recognized. The Company does not expect that its unrecognized tax benefits will significantly fluctuate or change within 12 months of the reporting date.

The Company recognizes interest expense and penalties related to uncertain tax positions as interest or other expense. As of September 30, 2009, the Company has not recorded any interest or penalties related to unrecognized tax benefits, due to the substantial NOLs available.

Certain tax year filings remain open to Federal and California examination, which are the Company s primary tax jurisdictions. The years 2006 through 2009 and the years 2005 through 2009 remain open for Federal and California purposes, respectively, for which the Company utilized NOLs generated between 1990 and 1993 to offset taxable income. Except as reserved, the Company expects to utilize Federal NOLs generated between 1994 and 1997 and in 1999, 2006 and 2007 in future years. In addition, the Company expects to utilize California NOL generated in 2007 in future years.

Pursuant to ASC 718-740, *Stock Compensation Income Taxes*, the Company has elected to recognize stock option deductions on the tax law ordering method, which maximizes the realization of the stock option deductions in the current year. While the Company realized the majority of its 2006 stock option deductions, approximately $400,000 of unrealized tax benefits related to stock option deductions are not reflected in the consolidated financial statements. Upon realization of the tax benefits, the Company would increase its additional paid-in capital.

Note 11 Commitments and Contingencies

Real Estate Matters

The Company has outstanding performance and surety bonds, for the benefit of city and county jurisdictions, related principally to its obligations for site improvements and fees at various projects as of September 30, 2009. At this time, the Company does not believe that a material amount of any currently outstanding performance or surety bonds will be called. The Company believes that all work required to be completed at this time under the bonding agreements has been completed and, therefore, draws upon these bonds, if any, will not have a material effect on the Company s financial position, results of operations or cash flows.

Legal Proceedings

General. There are various lawsuits and claims pending against the Company and certain subsidiaries. In the opinion of the Company s management, ultimate liability, if any, will not have a material adverse effect on the Company s financial condition or results of operations.

Chapter 11 Cases. On October 27, 2009 (the Petition Date), the Debtors commenced the Chapter 11 Cases and they continue to operate their businesses as debtors-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with applicable provisions of the Bankruptcy Code and the orders of the Bankruptcy Court. As debtors-in-possession, the Debtors are authorized to continue to operate as ongoing businesses, and may pay all debts and honor all obligations arising in the ordinary course of their businesses after the Petition Date. However, the Debtors may not pay creditors on account of obligations arising before the Petition Date or engage in transactions outside the ordinary course of business without approval of the Bankruptcy Court, after notice and an opportunity for a hearing.

Under the Bankruptcy Code, actions to collect pre-petition indebtedness, as well as most litigation pending against the Debtors, are stayed. Other pre-petition contractual obligations against the Debtors generally may not be enforced. Absent an order of the Bankruptcy Court providing otherwise, substantially all pre-petition liabilities are subject to settlement under a plan of reorganization to be voted upon by creditors and other stakeholders, and approved by the Bankruptcy Court.

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The Debtors have received approval from the Bankruptcy Court of their first day motions, which were filed as part of the Chapter 11 Cases. Among other first day relief, the Debtors received approval to continue wage and salary payments and other benefits to employees as well as certain related pre-petition obligations; to continue to honor customer programs as well as certain related pre-petition customer obligations; and to pay certain pre-petition trade claims held by critical vendors with lien rights. Subject to receiving approval of final orders from the court at a hearing scheduled for December 9, 2009, the Debtors intend to continue to pay their vendors and suppliers in the ordinary course of business for goods and services delivered post-petition.

Under the priority scheme established by the Bankruptcy Code, certain post-petition and secured or priority pre-petition liabilities need to be satisfied before general unsecured creditors and holders of the Debtors equity are entitled to receive any distribution. No assurance can be given as to what values, if any, will be ascribed in the bankruptcy proceedings to the claims and interests of each of these constituencies. Additionally, no assurance can be given as to whether, when or in what form unsecured creditors and holders of the Debtors equity may receive a distribution on such claims or interests.

Under the Bankruptcy Code, the Debtors may assume, assume and assign, or reject certain executory contracts and unexpired leases, including, without limitation, leases of real property and equipment, subject to the approval of the Bankruptcy Court and certain other conditions. Any description of an executory contract or unexpired lease in this Form 10-Q, including where applicable our express termination rights or a quantification of Debtor obligations, must be read in conjunction with, and is qualified by, any overriding rejection rights the Debtors have under the Bankruptcy Code. As of the Petition Date, virtually all pending litigation against the Debtors is stayed as to the Debtors, and absent further order of the Bankruptcy Court, no party, subject to certain exceptions, may take any action, also subject to certain exceptions, to recover on pre-petition claims against the Debtors.

California Department of Toxic Substances Control

In October 2006, the California Department of Toxic Substances Control (DTSC) filed a civil complaint against the Company s Hearthside Residential Corp. subsidiary (HRC) in the Federal District Court for the Southern Division of the Central District of California The DTSC s complaint requests that HRC pay for approximately $1.0 million of costs incurred by the DTSC, together with interest on that amount, primarily in connection with the oversight and remediation of PCB contamination found on residential properties never owned by HRC adjacent to a 43-acre site where HRC completed the removal of PCB contaminated soil during September 2005. HRC s remediation process was approved by the DTSC in December 2005 when it issued a final acceptance of the remediation work. The complaint also seeks an order for HRC to pay any future costs which may be incurred in connection with further remediation, together with court costs and attorney s fees.

Since May 2004, HRC has received invoices from DTSC seeking reimbursement for these costs; however, HRC contends, based upon advice of counsel, that it is not responsible for such costs because neither HRC nor any affiliate ever developed or built the neighboring residential properties, neither HRC nor any affiliate generated the contamination, the contamination did not emanate from the 43-acre site that HRC remediated, and, even if the contamination did emanate from the 43-acre site, it did not do so while HRC owned the site. Furthermore, HRC has also disputed such charges due to the fact that DTSC improperly submitted its bill. The Company s subsidiary is vigorously defending itself in this matter. Therefore, the Company has not accrued for any of DTSC s approximately $1.0 million of claims related to these residential properties.

Prior to the commencement of trial that was scheduled for December 2, 2008, the District Court ruled that HRC can be held liable as a current owner of the site under applicable law. HRC applied to have that ruling certified for appeal. In March 2009, the District Court granted permission to hear HRC s appeal and the appellate process commenced. HRC currently expects that it could take three to six months to complete the appellate process. There can be no assurance that HRC will receive a favorable ruling that it is not deemed to be a current owner of the site. Once the appellate process is complete, the parties will return to the District Court within 30 to 60 days to commence a trial.

See Note 9 for a discussion of other contingencies.

Corporate Indemnification Matters

The Company and its former affiliates have, through a variety of transactions effected since 1986, disposed of several assets and businesses, many of which are unrelated to the Company s current operations. By operation of law or contractual indemnity provisions, the Company may have retained liabilities relating to certain of these assets and businesses. There is generally no maximum obligation or amount of indemnity provided for such liabilities. A portion of such liabilities is supported by insurance or by indemnities from certain of the Company s previously affiliated companies. The Company believes its consolidated balance sheet reflects adequate reserves for these matters

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Note 12 Stock Plan

1993 Stock Option/Stock Issuance Plan

The 1993 Stock Option/Stock Issuance Plan (1993 Plan) was approved at the 1994 Annual Meeting of Stockholders, reserving 7.5 million shares each of Series A Preferred Stock and Class A Common Stock for issuance to officers, key employees and consultants of the Company and its subsidiaries and the non-employee members of the Board of Directors (the Board). On April 28, 1997, in connection with the Recapitalization, a new class of Common Stock replaced the Series A Preferred Stock and Class A Common Stock, and the Compensation Committee of the Board authorized the grant of stock options for 759,984 shares, equivalent at that time to 6% of the Company s fully diluted equity, for certain directors and officers. At the May 2004 and June 2006 stockholder meetings, the stockholders of the Company authorized an additional 150,000 and 250,000 stock options, respectively, for the 1993 Plan, resulting in total authorized grants of 1,159,984.

In January 2009 and 2008, the Company issued a total of 125,000 shares and 15,817 shares, respectively, of its common stock to three independent directors in 2009 and four independent directors in 2008, under the Director Fee Program, which is a component of the 1993 Plan. These restricted shares vest at a rate of 25% per quarter during 2008 and 2009, respectively. On October 16, 2008, one of the Company s independent directors resigned from the Board and forfeited 878 unvested restricted shares.

The Company did not grant any options during the nine months ended September 30, 2009 and 2008. Pursuant to ASC 718-10, *Compensation - Stock Compensation*, the Company recorded $53,000 and $78,000 of compensation expense during the nine months ended September 30, 2009 and 2008, respectively, which is reflected in additional paid-in capital.

A summary of the status of the Company s 1993 plan for the nine months ended September 30, 2009 follows:

	Number of Options		Weighted-Average Exercise Price	Weighted-Average Remaining Life
Outstanding, January 1	17,500	$	21.58(a)	
Granted		$		
Exercised		$		
Outstanding, September 30	17,500	$	21.58(a)	6.35 years
Fully vested and exercisable at September 30	17,500	$	21.58(a)	6.35 years
Available for future grants at September 30	221,794			

(a) Adjusted for special dividend of $12.50

As of September 30, 2009, there were 17,500 options outstanding with a weighted-average exercise price of $21.58 (ranging from $13.35 to $25.99) and a weighted-average remaining life of 6.35 years. All outstanding stock options are fully vested. The aggregate intrinsic value of all outstanding, fully-vested and exercisable stock options at September 30, 2009 was zero. Following the January 2009 issuance of 125,000 shares of restricted stock under the Director Fee Program, there are 221,794 options available for future grants.

The Company estimates the fair value of its stock options using the Black-Scholes option pricing model (the Option Model). The Option Model requires the use of subjective and complex assumptions, including the option s expected term and the estimated future price volatility of the underlying stock, which determine the fair value of the share-based awards. The Company s estimate of expected term is determined based on the weighted-average period of time that options granted are expected to be outstanding considering current vesting schedules and the historical exercise patterns of the existing option plan. The expected volatility assumption used in the Option Model is based on historical volatility on traded options on the Company s stock. The risk-free interest rate used in the Option Model is based on the yield of U.S. Treasuries with a maturity closest to the expected term of the Company s stock options.

Note 13 Stockholders Equity

As of September 30, 2009, total stockholders equity is $41.3 million, reflecting beginning stockholders equity of $55.5 million and net loss of $14.2 million during the nine months ended September 30, 2009.

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

This item contains forward-looking statements that involve risks and uncertainties as set forth in Cautionary Statements About Forward-Looking Statements at the beginning of this Quarterly Report on Form 10-Q. Actual results may differ materially from those indicated in the forward-looking statements set forth below. Factors that may cause such a difference include, but are not limited to, those discussed in Item 1A. Risk Factors of both Part II of this Report and in our Annual Report on Form 10-K for the year ended December 31, 2008.

Liquidity and Capital Resources

Recent Chapter 11 Cases