

MDC HOLDINGS INC
Form 10-K
February 01, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2017

OR

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

For the Transition period from _____ to _____

Commission file number 1-08951

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

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

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

Large Accelerated Filer Accelerated Filer

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2017, the aggregate market value of the Registrants' common stock held by non-affiliates of the Registrants was \$1.5 billion based on the closing sales price of \$35.33 per share as reported on the New York Stock Exchange on June 30, 2017.

As of December 31, 2017, the number of shares outstanding of Registrant's common stock was 56,123,228.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of part III of this Form 10-K are incorporated by reference from the Registrant's 2018 definitive proxy statement to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year.

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M.D.C. HOLDINGS, INC.

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For the Year Ended December 31, 2017

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M.D.C. HOLDINGS, INC.

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PART I

Forward-Looking Statements

Certain statements in this Annual Report on Form 10-K, as well as statements made by us in periodic press releases, oral statements made by our officials in the course of presentations about the Company and conference calls in connection with quarterly earnings releases, constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements regarding our business, financial condition, results of operation, cash flows, strategies and prospects. These forward-looking statements may be identified by terminology such as “likely,” “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential” or “continue,” or the negative of such terms and other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained in this Report are reasonable, we cannot guarantee future results. These statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from those expressed or implied by the forward-looking statements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in subsequent reports on Forms 10-K, 10-Q and 8-K should be considered.

Item 1. Business.

(a) General Development of Business

M.D.C. Holdings, Inc. is a Delaware corporation. We refer to M.D.C. Holdings, Inc. as the “Company,” “MDC,” “we” or “our” in this Annual Report on Form 10-K, and these designations include our subsidiaries unless we state otherwise. We have two primary operations, homebuilding and financial services. Our homebuilding operations consist of wholly owned subsidiary companies that generally purchase finished lots or develop lots to the extent necessary for the

construction and sale primarily of single-family detached homes to first-time and first-time move-up homebuyers under the name “Richmond American Homes.” Our homebuilding operations are comprised of various homebuilding divisions that we consider to be our operating segments. For financial reporting, we have aggregated our homebuilding operating segments into reportable segments as follows: (1) West (includes operating segments located in Arizona, California, Nevada and Washington); (2) Mountain (includes operating segments located in Colorado and Utah); and (3) East (includes operating segments located in Virginia, Florida and Maryland, which includes Pennsylvania, and New Jersey).

Our financial services operations primarily consist of (1) HomeAmerican Mortgage Corporation (“HomeAmerican”), which originates mortgage loans primarily for our homebuyers, (2) Allegiant Insurance Company, Inc., A Risk Retention Group (“Allegiant”), which provides insurance coverage primarily to our homebuilding subsidiaries on homes that have been delivered and most of our subcontractors for completed work on those delivered homes, (3) StarAmerican Insurance Ltd., which is a re-insurer on Allegiant claims, (4) American Home Insurance Agency, Inc., which offers third-party insurance products to our homebuyers, and (5) American Home Title and Escrow Company, which provides title agency services to our homebuilding subsidiaries and our customers in certain states. For financial reporting, we have aggregated our financial services operating segments into reportable segments as follows: (1) mortgage operations (represents HomeAmerican only) and (2) other (all remaining operating segments).

(b) Available Information

We make our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, available free of charge on our website as soon as reasonably practicable after we file or furnish the materials electronically with the Securities and Exchange Commission (“SEC”). To obtain any of this information, go to our website, www.mdcholdings.com, and select “SEC Filings” from the “Financial Reports” menu. Our website includes our: (1) Corporate Governance Guidelines; (2) Corporate Code of Conduct; (3) Rules for Senior Financial Officers; (4) Audit Committee Procedures for Handling Confidential Complaints; and (5) charters for the Audit, Compensation, Legal and Corporate Governance/Nominating Committees. These materials may also be obtained, free of charge, at www.mdcholdings.com (select “Corporate Governance”).

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Note 3 to the Consolidated Financial Statements contains information regarding our reportable segments for each of the years ended December 31, 2017, 2016 and 2015.

(d) Narrative Description of Business

Our business consists of two primary operations, homebuilding and financial services. Our homebuilding subsidiaries build and sell primarily single-family detached homes that are designed and built to meet local customer preferences. Each homebuilding subsidiary is the general contractor for its projects and retains subcontractors for land development and home construction. Our homebuilding subsidiaries build a variety of home styles in each of their markets, targeting primarily first-time and first-time move-up homebuyers.

For 2017, the percentage of our home deliveries and home sale and land sale revenues by state were as follows:

	Percentage of Deliveries		Percentage of Home Sale Revenues	
Arizona	15	%	10	%
California	16	%	22	%
Nevada	16	%	12	%
Washington	7	%	8	%
West	54	%	52	%
Colorado	27	%	28	%
Utah	4	%	4	%
Mountain	31	%	32	%
Maryland	3	%	4	%
Virginia	4	%	5	%
Florida	8	%	7	%
East	15	%	16	%
Total	100	%	100	%

Our financial services operations include subsidiaries that provide mortgage financing, place title insurance and homeowner insurance for our homebuyers, and provide general liability insurance for our subsidiaries and most of our subcontractors.

Homebuilding Operations

Operating Divisions. The primary functions of our homebuilding segments include land acquisition and development, home construction, sales and marketing, and customer service. Operating decisions are made by our local management teams under the oversight of our Chief Operating Decision Maker (“CODM”), or decision-making group, defined as two key executives - our Chief Executive Officer and Chief Operating Officer. Our organizational structure (i.e., the grouping and reporting of divisions) changes based upon the current needs of the Company. We had 15, 13 and 13 active homebuilding operating divisions at the end of each year ended December 31, 2017, 2016 and 2015, respectively.

Corporate Management. Our homebuilding business is managed primarily through members of senior management in our Corporate segment and our Asset Management Committees (“AMCs”). Each AMC is comprised of the Chief Operating Officer, Chief Financial Officer and one of our other corporate officers. All real estate acquisition transactions are reviewed to confirm that the transaction is projected to achieve the objectives established by our decision-making group and must be approved by one of the AMCs. Generally, the role of our senior management team and/or AMC includes:

- review and approval of division business plans and budgets;
- oversight of land and home inventory levels;
- review of major personnel decisions; and
- review of capital allocation decisions.

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Additionally, our corporate executives and corporate departments generally are responsible for establishing and monitoring compliance with our policies and procedures. Among other things, the corporate office has primary responsibility for:

- asset management and capital allocation;
- treasury;
- insurance and risk management;
- merchandising and marketing;
- national purchasing contracts;
- accounting, tax and internal audit functions;
- legal matters;
- human resources and payroll;
- information technology; and
- training and development.

Housing. Generally, our homebuilding subsidiaries build single-family detached homes in a number of standardized series, designed to provide variety in the size and style of homes for our potential homebuyers. In certain markets, our homebuilding subsidiaries build and sell attached townhomes. Within each series of our single-family detached homes, our homebuilding subsidiaries build several different floor plans offering standard and optional features (such as upgraded appliances, cabinetry, flooring, etc.). Differences in sales prices of similar models from market-to-market depend primarily upon homebuyer demand, home prices offered by our competitors, market conditions (such as home inventory supply levels), location, cost of land, optional features and design specifications. The series of homes offered at a particular location is based on perceived customer preferences, lot size, area demographics and, in certain cases, the requirements of major land sellers and local municipalities. In general, our homebuilding subsidiaries focus on selling “to be built homes”, also referred to as “dirt sales”, and limit the number of homes started without a contract.

Land Acquisition and Development. Our homebuilding subsidiaries acquire lots with the intention of constructing and selling homes on the acquired land. Generally, we prefer to purchase finished lots using option contracts, in phases or in bulk for cash. However, competition for finished lots has increased and therefore, approximately one-half of the lots we now purchase require some level of development. In making land purchases, we consider a number of factors, including projected rates of return, estimated gross margins from home sales, sales prices of the homes to be built, mortgage loan limits within the respective county, population and employment growth patterns, proximity to developed areas, estimated cost and complexity of development including environmental and geological factors, quality of schools, estimated levels of competition and demographic trends.

In their option contracts, our homebuilding subsidiaries generally obtain the right to purchase lots in consideration for an option deposit in the form of cash or letters of credit. In the event they elect not to purchase the lots within a specified period of time, they may be required to forfeit the option deposit. Our option contracts do not contain provisions requiring our specific performance.

Our homebuilding subsidiaries may own or have the right under option contracts to acquire undeveloped parcels of real estate that they intend to develop into finished lots. They generally develop our land in phases in order to limit our risk in a particular subdivision and to efficiently employ available capital resources. Generally, building permits and utilities are available and zoning is suitable for the current intended use of substantially all of our undeveloped land. When developed, these lots generally will be used in our homebuilding activities. See “**Forward-Looking Statements**” above.

Labor and Raw Materials. Materials used in our homebuilding operations are mainly standard items carried by major suppliers. We generally contract for our materials and labor at a fixed price for the anticipated construction period of our homes. This allows us to mitigate the risks associated with increases in the cost of building materials and labor between the time construction begins on a home and the time it is closed. Increases in the cost of building materials and subcontracted labor may reduce gross margins from home sales to the extent that market conditions prevent the recovery of increased costs through higher home sales prices. From time to time and to varying degrees, we may experience shortages in the availability of building materials and/or labor in each of our markets. These shortages and delays may result in delays in the delivery of homes under construction, reduced gross margins from home sales, or both. See “**Forward-Looking Statements**” above.

Warranty. Our homebuilding subsidiaries sell their homes with limited third-party warranties that generally provide for ten years of structural coverage, two years of coverage for plumbing, electrical, heating, ventilation and air conditioning systems, and one year of coverage for workmanship and materials. Under our agreement with the issuer of the third-party warranties, our homebuilding subsidiaries perform all of the work for the first two years of the warranty coverage and pay for substantially all of the work required to be performed during years three through ten of the warranties.

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Seasonal Nature of Business. The homebuilding industry can experience noticeable seasonality and quarter-to-quarter variability in homebuilding activity levels. The seasonal nature of our business is described in more detail in our description of Risk Factors under the heading “***Because of the seasonal nature of our business, our quarterly operating results can fluctuate.***”

Backlog. At December 31, 2017 and 2016, homes under contract but not yet delivered (“backlog”) totaled 3,159 and 2,884, respectively, with an estimated sales value of \$1.60 billion and \$1.38 billion, respectively. We anticipate that homes in backlog at December 31, 2017 generally will close during 2018 under their existing home order contracts or through the replacement of an existing contract with a new home order contract. The estimated backlog sales value at December 31, 2017 may be impacted by, among other things, subsequent home order cancellations, incentives provided, and/or options and upgrades selected. See “**Forward-Looking Statements**” above.

Customer Service and Quality Control. Our homebuilding divisions are responsible for pre-closing quality control inspections and responding to customers’ post-closing needs. We have a product service and quality control program, focused on improving and/or maintaining the quality of our customers’ complete home buying and homeownership experience.

Sales and Marketing. Our sales and marketing programs are designed to attract homebuyers in a cost effective manner. We have a centralized in-house advertising and marketing department, including digital marketing, that oversees our efforts to communicate the inherent value of our homes to our prospective homebuyers and distinguish our Richmond American Homes brand from our competitors or other home buying opportunities. The main objective of this team is to generate homebuyer leads, which are actively pursued by our community sales associates. Our centralized in-house merchandising team furnishes our model homes and sales offices.

Another important part of our marketing presentation takes place in our design centers (also known as Home Galleries). Here, homebuyers are able to personalize their homes with a variety of options and upgrades. These locations also serve as an information center for prospective homebuyers and real estate agents who may opt to receive personalized attention from one of our new home specialists, resulting in a more focused and efficient home search across all of our Richmond American communities in a given market place. We believe that the services provided by our Home Galleries represent a key competitive advantage in attracting and retaining prospective homebuyers.

Competition. The homebuilding industry is fragmented and highly competitive. The competitive nature of our business is described in more detail in our description of Risk Factors.

Regulation. Our homebuilding operations are subject to compliance with applicable laws and regulations, which are described in more detail in our description of Risk Factors.

Financial Services Operations

Mortgage Lending Operations

General. HomeAmerican is a full-service mortgage lender and the principal originator of mortgage loans for our homebuyers. HomeAmerican has a centralized loan processing center where it originates mortgage loans, primarily for our homebuyers.

HomeAmerican is authorized to originate Federal National Mortgage Association (“Fannie Mae”), Federal Home Loan Mortgage Corporation (“Freddie Mac”) (together “the government-sponsored enterprises”), Federal Housing Administration-insured (“FHA”), and Department of Veterans Affairs-guaranteed (“VA”) mortgages and is an authorized issuer of Government National Mortgage Association (“Ginnie Mae”) mortgage-backed securities. Furthermore, HomeAmerican also is an authorized loan servicer for Fannie Mae, Freddie Mac and Ginnie Mae and, as such, is subject to the rules and regulations of these entities.

HomeAmerican uses a mortgage repurchase facility, internally generated funds, and temporary financing provided by its parent, to finance the origination of mortgage loans until they are sold. HomeAmerican sells originated mortgage loans to third-party purchasers on either a bulk or flow basis. Mortgage loans sold on a bulk basis include the sale of a package of substantially similar originated mortgage loans, while sales of mortgage loans on a flow basis are completed as HomeAmerican originates each loan. Mortgage loans sold to third-party purchasers include HomeAmerican’s representations and warranties with respect to certain borrower payment defaults, credit quality issues and/or misrepresentations made by HomeAmerican or our homebuyers. Substantially all of the mortgage loans originated by HomeAmerican are sold to third-party purchasers, generally within 10 to 35 days of origination.

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Pipeline. HomeAmerican's mortgage loans in process for which a rate and price commitment had been made to a borrower that had not closed (the "locked pipeline") at December 31, 2017 and 2016 had an aggregate principal balance of approximately \$66.6 million and \$110.9 million, respectively, and were under interest rate lock commitments at an average interest rate of 4.15% and 4.11%, respectively.

Forward Sales Commitments. HomeAmerican is exposed to market risks related to fluctuations in interest rates. HomeAmerican creates certain derivative instruments in the normal course of business, which primarily include commitments to originate mortgage loans (interest rate lock commitments or locked pipeline). HomeAmerican uses forward sales of mortgage-backed securities and commitments from third-parties to purchase loans to hedge the interest rate risk inherent with the locked pipeline, as well as its loan inventory held for sale. The market related risks in our business are described in more detail in our description of Risk Factors.

Competition. HomeAmerican has significant competition with other mortgage bankers to arrange financing for our homebuyers. However, in selling its originated mortgages to third parties, HomeAmerican has benefited from an increased number of smaller non-bank entities entering the third-party purchaser space, resulting in better prices and a potentially wider array of product options. The competitive nature of our mortgage business is described in more detail in our description of Risk Factors.

Regulation. Our mortgage lending operations are subject to compliance with applicable laws and regulations, which are described in more detail in our description of Risk Factors.

Insurance Operations

General. Allegiant and StarAmerican were formed to provide insurance coverage of homebuilding risks for our homebuilding subsidiaries and most of our homebuilding subcontractors. Allegiant was organized as a risk retention group under the Federal Liability Risk Retention Act of 1981. Allegiant, which began operations in June of 2004, is licensed as a Class 3 Stock Insurance Company by the Division of Insurance of the State of Hawaii and is subject primarily to the regulations of its state of incorporation. StarAmerican is a single parent captive insurance company licensed by the Division of Insurance of the State of Hawaii. Pursuant to agreements executed on an annual basis since June of 2004, StarAmerican has re-insured Allegiant for all claims in excess of \$50,000 per occurrence up to \$3.0 million per occurrence, subject to various aggregate limits.

Allegiant generates premium revenue generally by providing to its customers, comprised of the Company's homebuilding subsidiaries and most subcontractors of the Company's homebuilding subsidiaries, general liability insurance on homes sold by our homebuilding subsidiaries and for work performed in completed subdivisions. Allegiant seeks to provide to its customers coverage and insurance rates that are competitive with other insurers.

StarAmerican generates premium revenue by providing re-insurance coverage to Allegiant. Allegiant and StarAmerican incur expenses for actual losses and loss adjustment expenses and for reserves established based on actuarial studies including known facts, such as our experience with similar insurance cases and historical trends involving insurance claim payment patterns, pending levels of unpaid insurance claims, claim severity, claim frequency patterns and interpretations of circumstances including changing regulatory and legal environments.

Regulation. Allegiant and StarAmerican are licensed in the State of Hawaii and, therefore, are subject to regulation by the Hawaii Insurance Division. This regulation includes restrictions and oversight regarding: types of insurance provided; investment options; required capital and surplus; financial and information reporting; use of auditors, actuaries and other service providers; periodic examinations; and other operational items. Additionally, as a risk retention group, Allegiant is also registered in other states where certain MDC homebuilding subsidiaries do business.

Insurance Agency Operations

American Home Insurance is an insurance agency that sells primarily homeowners' personal property and casualty insurance products in the same markets as our homebuilding subsidiaries and primarily to our homebuyers.

Title Operations

American Home Title provides title agency services to the Company and its homebuyers in Colorado, Florida, Maryland, Nevada and Virginia.

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Employees.

The table below summarizes the approximate number of employees for our combined Homebuilding, combined Financial Services and Corporate segments at December 31, 2017 and 2016.

	December 31,	
	2017	2016
Homebuilding	1,109	963
Financial Services	146	135
Corporate	236	220
Total	1,491	1,318

Item 1A. Risk Factors.

Changes in general economic, real estate and other business conditions may have an adverse effect on the homebuilding and mortgage industries, which could have a negative impact on our business.

The homebuilding industry is cyclical and is significantly affected by changes in both industry conditions and general economic conditions such as:

- employment levels;

- availability of financing for homebuyers;

- interest rates;

- consumer confidence;

- wage growth;

-