UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016.

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

For the transition period from ____________ to _____________.

001-07395

Commission File Number

AV HOMES, INC.

(Exact name of registrant as specified in its charter)

Delaware	23-1739078
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

8601 N. Scottsdale Rd., Suite 225, Scottsdale, Arizona	85253
(Address of Principal Executive Offices)	(Zip Code)

(480) 214-7400

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of October 21, 2016, there were 22,570,116 shares of common stock, $1.00 par value, issued and outstanding.

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AV HOMES, INC. AND SUBSIDIARIES

FORM 10-Q

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PART I. Financial Information

ITEM 1. FINANCIAL STATEMENTS

AV HOMES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(in thousands)

	September 30, 2016 (unaudited)	December 31, 2015
Assets		
Cash and cash equivalents	$ 16,289	$ 46,898
Restricted cash	1,139	26,948
Land and other inventories	630,909	582,531
Receivables	8,248	7,178
Property and equipment, net	34,223	34,973
Investments in unconsolidated entities	1,177	1,172
Prepaid expenses and other assets	13,033	17,144
Deferred tax assets, net	110,501	—
Goodwill	19,285	19,295
Total assets	$ 834,804	$ 736,139
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable	$ 37,060	$ 33,606
Accrued and other liabilities	29,389	38,826
Customer deposits	12,223	8,629
Estimated development liability	32,257	32,551
Senior notes, net	290,258	320,846
Total liabilities	401,187	434,458
Stockholders' equity		
Common stock, par value $1 per share	22,692	22,444
Additional paid-in capital	401,358	399,719
Accumulated earnings (deficit)	12,586	(117,463)
	436,636	304,700
Treasury stock	(3,019)	(3,019)
Total stockholders’ equity	433,617	301,681
Total liabilities and stockholders' equity	$ 834,804	$ 736,139

See notes to consolidated financial statements.

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AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations and Comprehensive Income (Loss)

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenues				
Homebuilding	$ 201,821	$ 151,130	$ 507,659	$ 280,381
Amenity and other	3,315	2,691	8,834	8,195
Land sales	291	6	1,120	3,470
Total revenues	205,427	153,827	517,613	292,046
Expenses				
Homebuilding cost of revenues	163,911	121,089	414,290	228,911
Amenity and other	3,101	2,221	8,057	7,034
Land sales	295	2	685	385
Total real estate expenses	167,307	123,312	423,032	236,330
Selling, general and administrative expenses	25,484	23,191	71,639	52,492
Interest income and other	—	(36)	(1)	(325)
Interest expense	701	1,840	2,853	7,503
Income (loss) before income taxes	11,935	5,520	20,090	(3,954)
Income tax expense (benefit)	38	—	(109,959)	—
Net income (loss) and comprehensive income (loss)	$ 11,897	$ 5,520	$ 130,049	$ (3,954)
Basic income (loss) per share	$ 0.53	$ 0.25	$ 5.81	$ (0.18)
Diluted income (loss) per share	$ 0.49	$ 0.25	$ 5.02	$ (0.18)

See notes to consolidated financial statements.

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AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2016	2015
OPERATING ACTIVITIES		
Net income (loss)	$ 130,049	$ (3,954)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	4,729	2,786
Amortization of share-based compensation	1,911	2,320
Change in fair value of contingent consideration	(422)	(298)
Impairment charges	335	—
Equity in loss (income) from unconsolidated entities	15	(160)
Gain from disposal of assets	(1)	(31)
Deferred income taxes, net	(110,501)	—
Changes in operating assets and liabilities:		
Restricted cash	25,809	(9,826)
Land and other inventories	(48,713)	(121,154)
Receivables	(1,070)	(4,182)
Prepaid expenses and other assets	2,704	2,391
Accounts payable, estimated development liability, and accrued and other liabilities	(1,595)	16,822
Customer deposits	3,594	2,863
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	6,844	(112,423)
INVESTING ACTIVITIES		
Investment in property and equipment	(1,389)	(1,075)
Proceeds from sales of property and equipment	11	31
Business acquisitions	10	(95,182)
Investment in unconsolidated entities	(20)	(2,882)
NET CASH USED IN INVESTING ACTIVITIES	(1,388)	(99,108)
FINANCING ACTIVITIES		
Proceeds from issuance of debt	—	79,926
Gross proceeds from Senior Secured Credit Facility	35,000	40,000
Payments of Senior Secured Credit Facility	(20,000)	(10,000)
Debt issuance costs	—	(2,068)
Principal payments of notes	(46,793)	(53,163)
Contingent consideration and other financing activities	(4,272)	(1,246)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(36,065)	53,449

DECREASE IN CASH AND CASH EQUIVALENTS	(30,609)	(158,082)
Cash and cash equivalents at beginning of year	46,898	180,334
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 16,289	$ 22,252
Non-cash transactions:		
Transfer from assets held for sale to land and other inventories and property and equipment	$ —	$ 4,051
Distribution of land from unconsolidated joint venture	$ —	$ 19,860

See notes to consolidated financial statements.

AV HOMES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

September 30, 2016

Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of AV Homes, Inc. and all subsidiaries, partnerships and other entities in which AV Homes, Inc. (“AV Homes,” “we,” “us,” “our,” or “the Company”) has a controlling interest. Our investments in unconsolidated entities in which we have less than a controlling interest are accounted for using the equity method. The interim consolidated financial statements have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all information and footnotes required by U.S generally accepted accounting principles (“GAAP”) for complete financial statements. These statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of AV Homes as of September 30, 2016 and for all periods presented. These statements should be read in conjunction with our consolidated financial statements and notes thereto included in AV Homes' Annual Report on Form 10-K for the year ended December 31, 2015. All significant intercompany accounts and transactions have been eliminated in consolidation.

Beginning with our Form 10-Q for the quarter ended March 31, 2016, the selling, general and administrative expenses related to homebuilding previously included in Homebuilding expenses have been combined with corporate general and administrative expenses and reclassified into a separate new line item called “Selling, general and administrative expenses” to enhance the visibility to our core homebuilding operations and conform with standard industry presentation. The selling, general and administrative expenses reclassified include commissions, other selling expenses and overhead incurred at the divisional level. For the three and nine months ended September 30, 2015, selling, general and administrative costs of $19.4 million and $40.7 million, respectively, that were previously presented in Homebuilding expenses are now included in selling, general and administrative expenses. In addition, in accordance with adoption of Accounting Standards Update No. 2015-03, Interest-Imputation of Interest, our debt issuance costs are now presented as a deduction from the corresponding debt liability. This guidance was applied retrospectively and had the effect of reducing our prepaid expenses and other assets and senior notes, net balances in our consolidated balance sheets. As of December 31, 2015, unamortized deferred debt issuance costs of $5.9 million were previously presented in prepaid expenses and other assets on the consolidated balance sheet and are now included as a reduction to senior notes, net.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents and Restricted Cash

We consider all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. As of September 30, 2016, our cash and cash equivalents were primarily available funds on deposit at financial institutions. Due to the short maturity period of the cash equivalents, the carrying amounts of these instruments approximates their fair values.

Our cash items that are restricted as to withdrawal or usage include deposits of $1.1 million and $26.9 million as of September 30, 2016 and December 31, 2015, respectively. The balance as of December 31, 2015 was comprised primarily of $25.6 million on deposit as a reserve to comply with a covenant in our Senior Secured Credit Facility (defined below). As of September 30, 2016, the Company was above the specified thresholds requiring the reserve.

Land and Other Inventories and Homebuilding Cost of Revenues

Land and other inventories include expenditures for land acquisition, land development, home construction, construction costs for amenities, and direct and allocated indirect costs, including interest cost capitalized until development and construction are substantially completed. These costs are assigned to components of land and other inventories based on specific identification, relative sales value, or area allocation methods.

Land and other inventories are stated at cost unless the asset is determined to be impaired, in which case the asset is written to its fair value, in accordance with Accounting Standards Codification ("ASC") 360, Property, Plant and Equipment ("ASC 360").

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Homebuilding cost of revenues is comprised of direct and allocated costs, including estimated future costs for the limited warranty we provide on our homes. Land acquisition, land development and other common costs are generally allocated on a relative sales value or area allocation basis to the homes or lots within the applicable community or land parcel. Land acquisition and land development costs include related interest and real estate taxes.

We evaluate our land and other inventories for impairment on a quarterly basis in accordance with ASC 360 to reflect market conditions, including a market-by-market consideration of supply of new and resale homes for sale, level of foreclosure activity and competition. For assets held and used, if indicators are present, we perform an impairment test in which the asset is reviewed for impairment by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset's carrying value, the carrying value is written down to its estimated fair value. Generally, fair value is determined by discounting the estimated cash flows at a rate commensurate with the inherent risks associated with the asset and related estimated cash flow streams. The discount rate used in the determination of fair value would vary, depending on the state of development. Assumptions and estimates used in the determination of the estimated future cash flows are based on expectations of future operations and economic conditions and certain factors described below. Changes to these assumptions could significantly affect the estimates of future cash flows, which could affect the potential for future impairments. Due to the uncertainties of the estimation process, actual results could differ significantly from such estimates.

During the three and nine months ended September 30, 2016, our impairment assessments resulted in $0.1 million and $0.3 million of impairment charges, respectively, and are included in homebuilding cost of revenues in the consolidated statements of operations and comprehensive income (loss). During the three and nine months ended September 30, 2015, our impairment assessments resulted in no impairment charges.

Receivables

Receivables primarily consist of amounts in transit or due from title companies for house closings.

Property and Equipment, net

Property and equipment, net are stated at cost and depreciation is computed by the straight-line method over the following estimated useful lives of the assets: land improvements 10 to 25 years; buildings and improvements 8 to 39 years; and machinery, equipment and fixtures 3 to 7 years. Expenses for equipment utilized in the development of land are capitalized to land inventory while ordinary repairs and maintenance are expensed as incurred.

Property and equipment, net includes certain amenities such as club facilities on properties owned by us. These amenities include expenditures for land acquisition, land development, construction, and direct and allocated costs, including interest cost incurred during development and construction.

Each reporting period, we review our property and equipment for indicators of impairment in accordance with ASC 360. For our amenities, which are located within our housing communities, indicators of impairment are similar to those of our housing communities (described above), as these factors may impact our ability to generate revenues at our amenities or cause construction costs to increase. In addition, we factor in the collectability and potential delinquency of the membership dues for our amenities. For the three and nine months ended September 30, 2016 and 2015, we did not identify indicators of impairment for property and equipment.

Investments in Partnerships and LLCs

When we are either deemed to hold the controlling interest in a voting interest entity or deemed to be the primary beneficiary of a variable interest entity ("VIE"), we are required to consolidate the investment. The primary beneficiary of a VIE is the entity that has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb the majority of losses of the VIE or the right to receive the majority of benefits from the VIE. Investments where we do not hold the controlling interest and we are not the primary beneficiary are accounted for under the equity method.

Factors considered when determining if we hold the controlling interest in a voting interest entity include who holds the general partnership or managing member interests, which partner or member makes the day-to-day decisions regarding the operations of the entity, and whether or not the other partners or members have substantive participating rights. With respect to VIEs, our variable interests may be in the form of (1) equity ownership, (2) contracts to purchase assets and/or (3) loans provided by us to the investor. We examine specific criteria and use judgment when determining if we are the primary beneficiary of a VIE. Factors considered in determining whether we are the primary beneficiary include risk and reward sharing, experience and financial condition of other partner(s), sufficiency of equity to conduct the operations of the entity,

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voting rights, involvement in decisions significantly impacting the entity's economic performance, level of economic disproportionality between us and the other partner(s) and contracts to purchase assets from VIEs.

We have investments in unconsolidated entities, including joint ventures, with independent third parties. The equity method of accounting is used for unconsolidated entities over which we have significant influence. Under the equity method of accounting, we recognize our proportionate share of the earnings and losses of these entities.

We evaluate our investments in unconsolidated entities for recoverability in accordance with ASC 323, Investments - Equity Method and Joint Ventures (“ASC 323”). If we determine that a loss in the value of the investment is other than temporary, we write down the investment to its estimated fair value. Any such losses are recorded to equity in (earnings) loss of unconsolidated entities in the consolidated statements of operations and comprehensive income (loss). Due to uncertainties in the estimation process and the significant volatility in demand for new housing, actual results could differ significantly from such estimates. During the three and nine months ended September 30, 2016 and 2015, we did not identify indicators of impairment for our investments in unconsolidated entities.

Business Acquisitions

When acquiring a business, we allocate the purchase price of the business to the tangible and intangible assets and liabilities acquired based on their estimated fair values. In making estimates of fair values for this purpose, we use a number of sources, including independent appraisals and information obtained about each property as a result our pre-acquisition due diligence and its marketing and housing activities.

Goodwill

Goodwill arises from business combinations and represents the excess of the cost of an acquired entity over the net fair value amounts that were assigned to the identifiable assets acquired and the liabilities assumed. Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. There were no indicators of impairment during the three and nine months ended September 30, 2016 and 2015.

Homebuilding Revenue Recognition

In accordance with ASC 360, homebuilding revenue and related profit from the sales of housing units are recognized when title to and possession of the property are transferred to the buyer. In addition, revenues from land sales are recognized in full at closing, provided the buyer's initial and continuing investment is adequate, any financing is considered collectible and there is no significant continuing involvement.

Sales Incentives

When sales incentives involve a discount on the selling price of the home, we record the discount as a reduction of revenue at the time of house closing. If the sales incentive requires us to provide a free product or service to the customer, the cost of the free product or service is recorded as homebuilding cost of revenues at the time of house closing. This includes the cost related to optional upgrades and seller-paid financing costs, closing costs, homeowners' association fees, or merchandise.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs, sales commissions and closing costs are included in selling, general and administrative expenses in the accompanying consolidated statements of operations and comprehensive income (loss).

Warranty Costs

Warranty reserves for houses are established to cover estimated costs for materials and labor with regard to warranty-type claims to be incurred subsequent to the closing of a house. Reserves are determined based on historical data and other relevant factors. We have, and require our subcontractors to have, general liability, property, workers' compensation, and other business insurance. These insurance policies protect us against a portion of our risk of loss from claims, subject to certain self-insured per occurrence and aggregate retentions, deductibles, and available policy limits. We may have recourse against subcontractors for certain claims relating to workmanship and materials. Warranty reserves are included in accrued and other liabilities in the accompanying consolidated balance sheets.

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During the three and nine months ended September 30, 2016 and 2015, changes in the warranty reserve consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Accrued warranty reserve, beginning of period	$ 3,581	$ 1,767	$ 3,333	$ 1,528
Reserve provided	952	1,818	2,440	2,954
Payments	(1,004)	(1,168)	(2,244)	(2,065)
Accrued warranty reserve, end of period	$ 3,529	$ 2,417	$ 3,529	$ 2,417

Income Taxes

Our income tax expense (benefit) for the three and nine months ended September 30, 2016 was less than $0.1 million and $(110.0) million, respectively, compared to income tax expense of $0.0 million for each of the three and nine months ended September 30, 2015. The income tax benefit for the nine months ended September 30, 2016 is due primarily to a $117.2 million reduction of our deferred tax asset valuation allowance in the same period. Our effective tax rate is affected by a number of factors, the most significant of which is the valuation allowance related to our deferred tax assets. Due to the impact of the changes in the valuation allowance, our effective tax rates in 2016 and 2015 are not correlated to the amount of our income or loss before income taxes.

Income taxes have been provided for using the asset and liability method under ASC 740, Income Taxes (“ASC 740”). The asset and liability method is used in accounting for income taxes where deferred tax assets and liabilities are recognized by identifying the temporary differences arising from the different treatment of items for tax and accounting purposes. In assessing the realizability of deferred tax assets, we consider whether it is “more likely than not” that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is primarily dependent upon the generation of future taxable income. In determining the future tax consequences of events that have been recognized in the financial statements or tax returns, judgment is required. Differences between the anticipated and actual outcomes of these future tax consequences could have a material impact on our consolidated results of operations or financial position.

We evaluate our deferred tax assets quarterly to determine if valuation allowances are required. ASC 740 requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence using a “more likely than not” standard. The realization of the deferred tax assets ultimately depends upon the existence of sufficient taxable income in future periods. We established a full valuation allowance against our deferred tax assets beginning in 2009 and regularly analyzed all available positive and negative evidence in determining the continuing need for a valuation allowance with respect to our deferred tax assets. This evaluation considered, among other factors, historical operating results, our three-year cumulative profit or loss position, forecasts of future profitability, and the duration of statutory carryforward periods.

From 2007 to 2014, we generated significant deferred tax assets primarily from asset impairments and reduced operational profitability. As of September 30, 2016 and December 31, 2015, we had net deferred tax assets of $117.2 million and $124.5 million, respectively. The December 31, 2015 net deferred tax asset was offset by a valuation allowance of $124.5 million. During the three months ended March 31, 2016, we recognized a decrease of $0.6 million in the valuation allowance generated from the pre-tax income for the period. During the three months ended June 30, 2016, we evaluated both positive and negative evidence and determined it was "more likely than not" that our federal deferred tax assets and our state deferred tax assets will be realized. Accordingly, we reversed $112.9 million of valuation allowance during the three months ended June 30, 2016 and an additional $4.3 million during the three months ended September 30, 2016. The valuation allowance decreased $117.8 million during the nine months ended September 30, 2016. This reversal is reflected in our income tax benefit in the accompanying consolidated statements of operations and comprehensive income (loss). When a change in valuation allowance is recognized in an interim period, a portion of the valuation allowance to be reversed must be allocated to the remaining interim periods. The remaining valuation allowance of $6.7 million is expected to be reversed in the fourth quarter of 2016.

Any interest or penalties assessed have been minimal and immaterial to our financial results. In the event we are assessed any interest or penalties in the future, we plan to include them in our consolidated statements of operations and comprehensive income (loss) as income tax expense.

During the nine months ended September 30, 2016 and 2015, we made income tax payments of $0.8 million and $0.0 million, respectively, related to alternative minimum tax and state income tax in North Carolina and South Carolina.

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Share-Based Compensation

On June 3, 2015, shareholders approved and we adopted the 2015 Incentive Compensation Plan (the “2015 Plan”), which replaced the Amended and Restated 1997 Incentive and Capital Accumulation Plan (2011 Restatement), as amended (the “Incentive Plan”). Each of the Incentive Plan and 2015 Plan provide for the grant of stock options, stock appreciation rights, stock awards, performance awards, and stock units to officers, employees and directors of AV Homes. The exercise prices of stock options granted under the Incentive Plan or the 2015 Plan may not be less than the stock exchange closing price of our common stock on the date of grant. Stock option awards under the Incentive Plan and 2015 Plan generally expire 10 years after the date of grant.

As of September 30, 2016, there were an aggregate of 559,579 shares available for grant under the 2015 Plan and 35,483 shares reserved for future issuance relating to restricted stock units previously awarded and currently outstanding under the 2015 Plan. Additionally, as of September 30, 2016, for outstanding options and restricted stock units previously awarded under the Incentive Plan, an aggregate of 540,483 shares of our common stock were reserved for future issuance.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of AV Homes. The computation of diluted earnings per share for the three and nine months ended September 30, 2016 did not assume the effect of employee stock options because the effects were antidilutive. The computation of diluted earnings (loss) per share for the three and nine months ended September 30, 2015 did not assume the effect of restricted stock, restricted stock units, employee stock options, or convertible notes because the effects were antidilutive.

The following table represents a reconciliation of the net income (loss) and weighted average shares outstanding for the calculation of basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2016 and 2015 (in thousands, except share and per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator:				
Basic net income (loss)	$ 11,897	$ 5,520	$ 130,049	$ (3,954)

Diluted net income (loss)	$ 13,098	$ 5,520	$ 133,649	$ (3,954)
Denominator:				
Basic weighted average shares outstanding	22,415,780	22,018,449	22,402,799	22,006,460
Diluted weighted average shares outstanding	26,654,287	22,166,873	26,606,199	22,006,460
Basic earnings (loss) per share	$ 0.53	$ 0.25	$ 5.81	$ (0.18)
Diluted earnings (loss) per share	$ 0.49	$ 0.25	$ 5.02	$ (0.18)

Comprehensive Income (Loss)

Net income (loss) and comprehensive income (loss) are the same for the three and nine months ended September 30, 2016 and 2015 because we do not have components of comprehensive income.

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Recent Accounting Pronouncements

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 reduces the existing diversity in practice in financial reporting across all industries by clarifying certain existing principles in ASC 230, Statement of Cash Flows, including providing additional guidance on how and what an entity should consider in determining the classification of certain cash flows. ASU 2016-15 may be effective for us for the fiscal year beginning January 1, 2018 and subsequent interim periods. The adoption of ASU 2016-15 will modify our current disclosures and reclassifications within the consolidated statement of cash flows but is not expected to have a material effect on our consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 will require organizations that lease assets — referred to as “lessees” — to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under ASU 2016-02, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Lessor accounting remains substantially similar to current GAAP. In addition, disclosures of leasing activities are to be expanded to include qualitative along with specific quantitative information. For public entities, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. As a result, the standard is effective for us for annual and interim periods beginning January 1, 2019 and mandates a modified retrospective transition method. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In August 2015, the FASB issued Accounting Standards Update No. 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, which clarifies the treatment of debt issuance costs from line-of-credit arrangements after adoption of Accounting Standards Update 2015-03 (“ASU 2015-15”). ASU 2015-15 clarifies that the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. We have applied the provisions of ASU 2015-15 to the capitalized deferred financing costs related to our Senior Secured Credit Facility.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis (“ASU 2015-02”). ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. ASU 2015-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. We have applied the provisions of ASU 2015-02 and there was no material effect on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers. The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delayed the effective date by one year. As a result, the standard is effective for us for annual and interim periods beginning January 1, 2018 and allows for full retrospective or modified retrospective methods of adoption. We are currently evaluating the impact that the standard will have on our consolidated financial statements.

Note 2 - Business Acquisitions

Bonterra Builders Acquisition

On July 1, 2015, we acquired substantially all of the assets and certain liabilities of Bonterra Builders, LLC (“Bonterra Builders”) for approximately $99.8 million, subject to customary post-closing adjustments. Part of the aggregate consideration includes a $6.0 million estimated earn-out. The actual amount of the earn-out may be more or less than the $6.0 million target amount based on the performance of the Bonterra Builders business through the end of 2016, of which $3.3 million has been paid as of September 30, 2016. A portion of the aggregate consideration equal to $0.8 million was held back by us at the closing as security for Bonterra Builder's indemnification and other potential obligations under the purchase agreement, of which $0.4 million has been paid as of September 30, 2016. Bonterra Builders acquires raw and developed land, develops raw land and constructs single-family homes in the Charlotte, North Carolina area. With approximately 1,700 lots owned or

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controlled at the time of acquisition, Bonterra Builders significantly enhances our position in a key growth market. The results of Bonterra Builders operations are included in our consolidated financial statements from the acquisition date of July 1, 2015.

The Bonterra Builders acquisition was accounted for in accordance with ASC 805, Business Combinations ("ASC 805"). We recorded the acquired assets and liabilities at their estimated fair value. We determined the estimated fair values with the assistance of appraisals or valuations performed by independent third-party specialists, discounted cash flow analyses, quoted market prices where available, and estimates by management. To the extent the consideration transferred exceeded the fair value of the net assets acquired in this transaction, such excess was assigned to goodwill.

Note 3 - Land and Other Inventories

Land and other inventories consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Land held for future development	$ 22,429	$ 21,403
Land developed and in process of development	353,008	348,648
Homes completed or under construction	255,472	212,480
Total	$ 630,909	$ 582,531

We capitalize interest to inventories during the period of development in accordance with ASC 835, Interest ("ASC 835"). Homebuilding interest capitalized to cost of inventory is included in cost of sales as related units or lots are closed. To the extent our homebuilding debt exceeds our qualified assets, as defined in ASC 835, we expense a portion of interest incurred. Qualified homebuilding assets consist of land, lots and homes that are under development or construction, excluding finished unsold homes or finished models.

The following table represents interest incurred, interest capitalized, and interest expense for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015

Interest incurred	$ 6,483	$ 7,501	$ 19,873	$ 21,002
Interest capitalized	(5,782)	(5,661)	(17,020)	(13,499)
Interest expense	$ 701	$ 1,840	$ 2,853	$ 7,503

Note 4 - Investments in Unconsolidated Entities

We participate in entities with equity interests ranging from 20% to 58% for the purpose of acquiring and/or developing land. We determine the method for accounting for our investment at inception or upon a reconsideration event.

We share in the profits and losses of unconsolidated entities generally in accordance with our ownership interests. We and our equity partners typically make initial and ongoing capital contributions to these unconsolidated entities on a pro rata basis. The obligation to make capital contributions is governed by each unconsolidated entity's respective operating agreement or other governing documents. We made contributions totaling less than $0.1 million to our unconsolidated entities during the three and nine months ended September 30, 2016. We made contributions totaling $0.0 million and $2.9 million to our unconsolidated entities during the three and nine months ended September 30, 2015, respectively. The balance of our investments in unconsolidated entities was $1.2 million as of September 30, 2016 and December 31, 2015.

In May 2012, we entered into an agreement with JEN Arizona 4, LLC to form a limited liability company, EM 646, LLC ("EM 646"). We hold a 58% interest in the venture, which was organized for the purpose of acquiring, entitling, developing, and distributing specific sections of real property located in Mesa, Arizona. The property was originally acquired in November 2012 and in April 2015 the final distribution of developed land to the partners was completed at cost.

As of September 30, 2016, EM 646 was financed by partner equity and does not have third-party debt. In addition, we have not provided any guarantees to the entity or our equity partner. The assets of our investee can only be used to settle obligations of the investee.

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Note 5 – Senior Notes

Our senior notes are summarized as follows (in thousands):

	September 30, 2016	December 31, 2015
7.50% Senior Convertible Notes due 2016	$ —	$ 46,793
8.50% Senior Notes due 2019	200,000	200,000
6.00% Senior Convertible Notes due 2020	80,000	80,000
Senior Secured Credit Facility	15,000	—
Total Senior Notes	295,000	326,793
Deferred debt issuance costs	(4,684)	(5,877)
Debt discount	(58)	(70)
Total Senior Notes, net	$ 290,258	$ 320,846

We made interest payments of $11.4 million and $24.5 million for the three and nine months ended September 30, 2016, respectively. We made interest payments of $2.0 million and $24.0 million for the three and nine months ended September 30, 2015, respectively. We were in compliance with all debt covenants in our senior notes as of September 30, 2016 and December 31, 2015.

7.50% Senior Convertible Notes and 7.50% Senior Exchange Convertible Notes due 2016

On February 4, 2011, we completed an underwritten public offering for $100.0 million aggregate principal amount of our 7.50% Senior Convertible Notes due 2016 (the “7.50% Notes”). The maturity date of the 7.50% Notes was February 15, 2016. The 7.50% Notes were governed by the Indenture and the First Supplemental Indenture, each dated February 4, 2011, between us and the trustee named therein. Interest on the 7.50% Notes was payable semi-annually in arrears in cash on February 15 and August 15 of each year.

In July 2012, we entered into exchange agreements under which we retired $44.5 million in aggregate principal amount of our 7.50% Notes, in exchange for the issuance of $44.5 million in aggregate principal of new 7.50% Senior Exchange Convertible Notes due 2016 (“7.50% Exchange Notes”). The maturity date of the 7.50% Exchange Notes was February 15, 2016. The 7.50% Exchange Notes were governed by the Indenture dated February 4, 2011 and the Second Supplemental Indenture dated July 25, 2012 between us and the trustee named therein. Interest on the 7.50% Exchange Notes was payable semi-annually in arrears in cash on February 15 and August 15 of each year, commencing February 15, 2013. In connection with the issuance of the 6.00% Notes (defined below), $20.5 million of 7.50% Exchange Notes and $8.7 million of 7.50% Notes were repurchased on June 23, 2015. On July 20, 2015, the remaining 7.50% Exchange Notes were redeemed, pursuant to our option to redeem such notes at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest. On February 16, 2016, the remaining 7.50% Notes were repaid at maturity.

8.50% Senior Notes due 2019

On June 30, 2014, we completed an underwritten offering for $200.0 million aggregate principal amount of our 8.50% Senior Notes due 2019 (the “8.50% Notes”). The 8.50% Notes mature on July 1, 2019, unless earlier converted, redeemed or repurchased. Interest on the 8.50% Notes is 8.50% per year, payable semi-annually in arrears in cash on January 1 and July 1 of each year, commencing January 1, 2015. The 8.50% Notes are redeemable at our option, in whole or in part, at any time on or after July 1, 2016, at certain redemption prices, together with accrued and unpaid interest, if any, to, but excluding, the date of redemption.

Certain of our subsidiaries are guarantors of the 8.50% Senior Notes. All of the subsidiary guarantors are 100% owned by us, and all of the guarantees are full, unconditional, and joint and several. We have no independent assets or operations and our subsidiaries, other than the subsidiary guarantors, are minor.

6.00% Senior Convertible Notes due 2020

On June 23, 2015, we completed a private offering of $80.0 million aggregate principal amount of 6.00% Senior Convertible Notes due 2020 (the “6.00% Notes”). The proceeds of the 6.00% Notes were used to (i) repurchase 7.50% Exchange Notes and 7.50% Notes, and (ii) pay approximately $1.5 million of accrued interest (in respect of the notes being exchanged or repurchased) and premium (in respect of the notes being repurchased). The 6.00% Notes will mature on July 1, 2020, unless earlier repurchased or converted. The 6.00% Notes are governed by the Indenture dated February 4, 2011 and the Third Supplemental Indenture dated June 23, 2015 between us and the trustee named therein. The 6.00% Notes bear regular cash interest on the principal amount of each note, payable semi-annually in arrears on January 1 and July 1 of each year, beginning on January 1, 2016.

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The 6.00% Notes were issued pursuant a series of separate, privately negotiated note purchase agreements (the "Note Purchase Agreements") entered into on June 17, 2015 by us and certain qualified institutional buyers. TPG Aviator, L.P. ("TPG"), purchased $20.0 million aggregate principal amount of the 6.00% Notes for $20.0 million in cash and waived its rights to purchase additional 6.00% Notes, resulting in a fully diluted beneficial ownership for TPG of approximately 43.8% of our common stock. Pursuant to the terms of our Related Person Transaction Policy, the audit committee of our board of directors reviewed and approved the terms of the 6.00% Notes and TPG's purchase of 6.00% Notes.

Senior Secured Credit Facility

On April 7, 2014 we entered into a $65.0 million senior secured credit facility with JPMorgan Chase Bank, N.A., as agent, a lender and a letter of credit issuer, which became effective on June 6, 2014 (the "Senior Secured Credit Facility"). The other original lenders and letter of credit issuers include Royal Bank of Canada and Credit Suisse AG. Later in 2014, we increased the Senior Secured Credit Facility by $40.0 million with the addition of Citibank, N.A., and Deutsche Bank, A.G., as additional lenders. The Senior Secured Credit Facility included revolving credit and letter of credit facilities in an aggregate principal amount of up to $105.0 million, with an "accordion" feature that allowed us, with the consent of the lenders, to increase the aggregate amount to $175.0 million. The Senior Secured Credit Facility also included a swing line loan facility in an aggregate principal amount of up to $30.0 million.

On July 28, 2016, we entered into an amendment to our Senior Secured Credit Facility and existing Guarantee and Collateral Agreement (the "Amendment"), which included the addition of Flagstar Bank, FSB and U.S. Bank, National Association as additional lenders. Pursuant to the Amendment, from the period beginning on July 28, 2016 and ending on June 5, 2017, the Amendment increases the committed amount available under the Senior Secured Credit Facility to $165.0 million. On June 6, 2017, Deutsche Bank, A.G.'s commitment will expire and the total committed amount available under the Senior Secured Credit Facility will be reduced to $150.0 million (the "Extended Commitments"). The Extended Commitments will expire on July 28, 2019 and any loans outstanding on such date will mature and be payable. In connection with the Amendment, the "accordion" feature was increased from $175.0 million to $200.0 million and the $30.0 million swing line loan facility was discontinued. As of September 30, 2016, we had sufficient qualified assets in the borrowing base to cover the full $165.0 million capacity and had $15.0 million in borrowings outstanding.

Note 6 - Estimated Development Liability

The estimated development liability consists primarily of utility completion obligations in Rio Rico, Arizona and Poinciana, Florida for more than 8,000 home sites previously sold, in most cases prior to 1980. The estimated development liability is reduced by actual expenditures and is evaluated and adjusted, as appropriate, to reflect management's estimate of potential costs. In addition, we obtain third-party engineer evaluations on an annual basis and adjust this liability to reflect changes in the estimated completion costs. Cash expenditures associated with these obligations were $0.2 million and $0.3 million during the three and nine months ended September 30, 2016, respectively, and $0.1 million and $0.2 million during the three and nine months ended September 30, 2015, respectively. Future increases or decreases of costs for construction, material and labor, as well as other land development and utilities infrastructure costs, may have a significant effect on the estimated development liability. The balance of the estimated development liability was $32.3 million and $32.6 million as of September 30, 2016 and December 31, 2015, respectively.

Note 7 - Commitments and Contingencies

Legal

We are involved in litigation from time to time, primarily arising in the normal course of our business. These cases are in various procedural stages. In view of the inherent difficulty of predicting the outcome of these legal and regulatory matters, we generally cannot predict the ultimate resolution of the pending matters, the related timing, or the eventual loss. While the outcome of such contingencies cannot be predicted with certainty, we do not believe that the resolution of such matters will have a material adverse impact on our results of operations, financial position, or cash flows.

Surety Bonds

Surety bonds, issued by third-party entities, are used primarily to guarantee our performance to construct improvements in our various communities. As of September 30, 2016, we had outstanding surety bonds of approximately $28.3 million. The amount of outstanding surety bonds could fluctuate depending on the level of development activity. We do not believe that it is likely any of these outstanding surety bonds will be drawn upon.

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Note 8 - Segment Information

Our operating segments are defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision maker to evaluate performance and make operating decisions. We have identified our chief operating decision maker as our Chief Executive Officer. Our reportable segments are as follows: Florida, Arizona and the Carolinas.

The following table summarizes our information for reportable segments for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating income:				
Florida				
Revenues:				
Homebuilding	$ 96,943	$ 86,892	$ 251,587	$ 185,484
Amenity and other	3,315	2,691	8,834	8,195
Land sales	26	6	670	3,470
Total revenues	100,284	89,589	261,091	197,149
Expenses:				
Homebuilding cost of revenues	74,872	68,409	196,045	149,033
Homebuilding selling, general and administrative	12,189	11,419	33,374	26,172
Amenity and other	3,075	2,199	7,978	6,938
Land sales	6	2	225	385
Segment operating income	$ 10,142	$ 7,560	$ 23,469	$ 14,621
Arizona				
Revenues:				
Homebuilding	$ 42,014	$ 20,012	$ 104,255	$ 45,196
Land sales	—	—	185	—
Total revenues	42,014	20,012	104,440	45,196
Expenses:				
Homebuilding cost of revenues	35,236	16,497	87,672	38,704
Homebuilding selling, general and administrative	3,854	3,009		