

NVR INC
Form 10-Q
July 28, 2017

United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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: 1-12378

NVR, Inc.

(Exact name of registrant as specified in its charter)

Virginia 54-1394360
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

11700 Plaza America Drive, Suite 500

Reston, Virginia 20190

(703) 956-4000

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(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

(Not Applicable)

(Former name, former address, and former fiscal year if changed since last report)

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

Indicate by check mark whether the registrant 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, 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 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 July 24, 2017 there were 3,743,620 total shares of common stock outstanding.

NVR, Inc.

Form 10-Q

Table of Contents

	Page
PART I <u>FINANCIAL INFORMATION</u>	1
Item 1. <u>Condensed Consolidated Financial Statements</u>	1
<u>Condensed Consolidated Balance Sheets (unaudited)</u>	1
<u>Condensed Consolidated Statements of Income (unaudited)</u>	2
<u>Condensed Consolidated Statements of Cash Flows (unaudited)</u>	3
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	4
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
Item 3. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	29
Item 4. <u>Controls and Procedures</u>	29
PART II <u>OTHER INFORMATION</u>	29
Item 1. <u>Legal Proceedings</u>	29
Item 1A. <u>Risk Factors</u>	29
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
Item 6. <u>Exhibits</u>	31
<u>SIGNATURE</u>	32
<u>Exhibit Index</u>	33

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NVR, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

(unaudited)

	June 30, 2017	December 31, 2016
ASSETS		
Homebuilding:		
Cash and cash equivalents	\$518,482	\$375,748
Restricted cash	15,963	17,561
Receivables	22,110	18,937
Inventory:		
Lots and housing units, covered under sales agreements with customers	1,155,047	883,868
Unsold lots and housing units	147,195	145,065
Land under development	46,685	46,999
Building materials and other	16,024	16,168
	1,364,951	1,092,100
Assets related to consolidated variable interest entity	1,243	1,251
Contract land deposits, net	358,405	379,844
Property, plant and equipment, net	43,995	45,915
Reorganization value in excess of amounts allocable to identifiable assets, net	41,580	41,580
Goodwill and finite-lived intangible assets, net	1,908	2,599
Other assets	265,539	257,811
	2,634,176	2,233,346
Mortgage Banking:		
Cash and cash equivalents	9,632	19,657
Restricted cash	2,900	1,857
Mortgage loans held for sale, net	241,398	351,958
Property and equipment, net	5,530	4,903
Reorganization value in excess of amounts allocable to identifiable assets, net	7,347	7,347
Other assets	17,104	24,875
	283,911	410,597
Total assets	\$2,918,087	\$2,643,943
LIABILITIES AND SHAREHOLDERS' EQUITY		
Homebuilding:		
Accounts payable	\$271,899	\$251,212

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Accrued expenses and other liabilities	317,168	336,318
Liabilities related to consolidated variable interest entity	874	882
Customer deposits	165,684	122,236
Senior notes	596,760	596,455
	1,352,385	1,307,103
Mortgage Banking:		
Accounts payable and other liabilities	29,925	32,399
	29,925	32,399
Total liabilities	1,382,310	1,339,502
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.01 par value; 60,000,000 shares authorized; 20,555,330 shares issued as of both June 30, 2017 and December 31, 2016	206	206
Additional paid-in capital	1,607,958	1,515,828
Deferred compensation trust – 108,636 and 108,640 shares of NVR, Inc. common stock as of June 30, 2017 and December 31, 2016, respectively	(17,371)	(17,375)
Deferred compensation liability	17,371	17,375
Retained earnings	5,945,219	5,695,376
Less treasury stock at cost – 16,807,724 and 16,862,327 shares as of June 30, 2017 and December 31, 2016, respectively	(6,017,606)	(5,906,969)
Total shareholders' equity	1,535,777	1,304,441
Total liabilities and shareholders' equity	\$2,918,087	\$2,643,943

See notes to condensed consolidated financial statements.

NVR, Inc.

Condensed Consolidated Statements of Income

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Homebuilding:				
Revenues	\$1,512,714	\$1,361,741	\$2,760,301	\$2,483,245
Other income	1,447	753	2,549	1,520
Cost of sales	(1,218,083)	(1,126,369)	(2,244,100)	(2,052,129)
Selling, general and administrative	(99,100)	(100,043)	(199,004)	(198,058)
Operating income	196,978	136,082	319,746	234,578
Interest expense	(5,641)	(4,554)	(11,219)	(9,396)
Homebuilding income	191,337	131,528	308,527	225,182
Mortgage Banking:				
Mortgage banking fees	31,778	26,442	61,283	48,964
Interest income	1,554	1,437	3,215	3,111
Other income	506	409	815	667
General and administrative	(15,934)	(14,836)	(32,180)	(29,386)
Interest expense	(273)	(260)	(531)	(506)
Mortgage banking income	17,631	13,192	32,602	22,850
Income before taxes	208,968	144,720	341,129	248,032
Income tax expense	(61,091)	(53,044)	(90,329)	(91,053)
Net income	\$147,877	\$91,676	\$250,800	\$156,979
Basic earnings per share	\$39.46	\$23.51	\$67.30	\$40.34
Diluted earnings per share	\$35.19	\$22.01	\$60.36	\$37.82
Basic weighted average shares outstanding	3,748	3,900	3,726	3,892
Diluted weighted average shares outstanding	4,202	4,165	4,155	4,151

See notes to condensed consolidated financial statements.

NVR, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June	
	30,	2016
	2017	2016
Cash flows from operating activities:		
Net income	\$ 250,800	\$ 156,979
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,494	10,934
Equity-based compensation expense	21,467	21,378
Contract land deposit impairments (recoveries), net	3,567	(1,436)
Gain on sale of loans, net	(47,474)	(36,687)
Mortgage loans closed	(1,772,432)	(1,558,775)
Mortgage loans sold and principal payments on mortgage loans held for sale	1,936,118	1,644,385
Distribution of earnings from unconsolidated joint ventures	3,611	6,135
Net change in assets and liabilities:		
Increase in inventory	(272,851)	(240,708)
Decrease (increase) in contract land deposits	17,872	(30,340)
Increase in receivables	(2,888)	(7,406)
(Decrease) increase in accounts payable and accrued expenses	(3,013)	35,357
Increase in customer deposits	43,448	30,781
Other, net	(9,988)	(18,025)
Net cash provided by operating activities	179,731	12,572
Cash flows from investing activities:		
Investments in and advances to unconsolidated joint ventures	(455)	(321)
Distribution of capital from unconsolidated joint ventures	4,270	7,003
Purchase of property, plant and equipment	(9,784)	(11,773)
Proceeds from the sale of property, plant and equipment	472	446
Net cash used in investing activities	(5,497)	(4,645)
Cash flows from financing activities:		
Purchase of treasury stock	(159,506)	(96,508)
Distributions to partner in consolidated variable interest entity	—	(150)
Proceeds from the exercise of stock options	117,966	27,909
Net cash used in financing activities	(41,540)	(68,749)
Net increase (decrease) in cash and cash equivalents	132,694	(60,822)
Cash and cash equivalents, beginning of the period	396,619	425,316

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Cash and cash equivalents, end of the period	\$529,313	\$364,494
Supplemental disclosures of cash flow information:		
Interest paid during the period, net of interest capitalized	\$11,293	\$9,566
Income taxes paid during the period, net of refunds	\$99,370	\$90,078

See notes to condensed consolidated financial statements.

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

1. Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements include the accounts of NVR, Inc. (“NVR” or the “Company”) and its subsidiaries and certain other entities in which the Company is deemed to be the primary beneficiary (see Notes 2 and 3 to the accompanying condensed consolidated financial statements). Intercompany accounts and transactions have been eliminated in consolidation. The statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying condensed consolidated financial statements do not include all of the information and footnotes required by GAAP, they should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. In the opinion of management, all adjustments (consisting only of normal recurring accruals except as otherwise noted herein) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

The preparation of 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.

On January 1, 2017, the Company adopted Accounting Standards Update (“ASU”) 2016-09, Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting. In connection with the adoption of ASU 2016-09, the Company:

- Recorded the excess tax benefit from stock option exercises as a reduction to income tax expense prospectively beginning January 1, 2017. In the prior year, the excess tax benefit was recorded to additional paid-in capital within shareholders’ equity. The excess tax benefit recognized during the three months ended June 30, 2017 and 2016 was \$16,464 and \$2,394, respectively. The excess tax benefit recognized during the six months ended June 30, 2017 and 2016 was \$36,364 and \$8,678, respectively.

- Presented the aforementioned excess tax benefit recognized as an operating activity on the statement of cash flows and retrospectively adjusted the prior year Statement of Cash Flows accordingly. In the prior year, the excess tax benefit was recognized as a cash inflow from financing activities and a corresponding cash outflow from operating activities. The retrospective adjustment resulted in an \$8,678 increase to net cash provided by operating activities and an \$8,678 increase to net cash used in financing activities in the Consolidated Statement of Cash Flows for the six months ended June 30, 2016.

- Made the election to recognize forfeitures of equity-based awards in the period in which they occur. This election was applied using the modified retrospective transition method, which resulted in the Company recording a cumulative-effect adjustment, net of tax, to reduce beginning retained earnings by \$957. In the prior year, the Company estimated forfeitures based on its historical forfeiture rate.

No other adjustments were made as a result of the adoption of ASU 2016-09.

The Company also adopted ASU 2015-11, Inventory – Simplifying the Measurement of Inventory effective January 1, 2017. The standard requires inventory to be measured at the lower of cost or net realizable value. Under prior GAAP, impaired inventory was written down to net realizable value less a normal profit margin. Under the new standard, impaired inventory will only be written down to the net realizable value. ASU 2015-11 was adopted prospectively and did not have a material effect on the Company’s consolidated financial statements.

For the three and six months ended June 30, 2017 and 2016, comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying condensed consolidated financial statements.

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

2. Variable Interest Entities

Fixed Price Finished Lot Purchase Agreements (“Lot Purchase Agreements”)

NVR generally does not engage in the land development business. Instead, the Company typically acquires finished building lots at market prices from various development entities under Lot Purchase Agreements. The Lot Purchase Agreements require deposits that may be forfeited if NVR fails to perform under the Lot Purchase Agreements. The deposits required under the Lot Purchase Agreements are in the form of cash or letters of credit in varying amounts, and typically range up to 10% of the aggregate purchase price of the finished lots.

NVR believes this lot acquisition strategy reduces the financial requirements and risks associated with direct land ownership and land development. NVR may, at its option, choose for any reason and at any time not to perform under these Lot Purchase Agreements by delivering notice of its intent not to acquire the finished lots under contract. NVR’s sole legal obligation and economic loss for failure to perform under these Lot Purchase Agreements is limited to the amount of the deposit pursuant to the liquidated damage provisions contained within the Lot Purchase Agreements. In other words, if NVR does not perform under a Lot Purchase Agreement, NVR loses only its deposit. None of the creditors of any of the development entities with which NVR enters Lot Purchase Agreements have recourse to the general credit of NVR. NVR generally does not have any specific performance obligations to purchase a certain number or any of the lots, nor does NVR guarantee completion of the development by the developer or guarantee any of the developers’ financial or other liabilities.

NVR is not involved in the design or creation of the development entities from which the Company purchases lots under Lot Purchase Agreements. The developer’s equity holders have the power to direct 100% of the operating activities of the development entity. NVR has no voting rights in any of the development entities. The sole purpose of the development entity’s activities is to generate positive cash flow returns for the equity holders. Further, NVR does not share in any of the profit or loss generated by the project’s development. The profits and losses are passed directly to the developer’s equity holders.

The deposit placed by NVR pursuant to the Lot Purchase Agreement is deemed to be a variable interest in the respective development entities. Those development entities are deemed to be variable interest entities (“VIE”). Therefore, the development entities with which NVR enters into Lot Purchase Agreements, including the joint venture limited liability corporations discussed below, are evaluated for possible consolidation by NVR. An enterprise must consolidate a VIE when that enterprise has a controlling financial interest in the VIE. An enterprise is deemed to have a controlling financial interest if it has (i) the power to direct the activities of a VIE that most significantly impact the entity’s economic performance, and (ii) the obligation to absorb losses of the VIE that could be significant to the VIE or the rights to receive benefits from the VIE that could be significant to the VIE.

NVR believes the activities that most significantly impact a development entity’s economic performance are the operating activities of the entity. The development entity’s equity investors bear the full risk during the development process. Unless and until a development entity completes finished building lots through the development process, the entity does not earn any revenues. The operating development activities are managed solely by the development entity’s equity investors.

The development entities with which NVR contracts to buy finished lots typically select the respective projects, obtain the necessary zoning approvals, obtain the financing required with no support or guarantees from NVR, select who will purchase the finished lots and at what price, and manage the completion of the infrastructure improvements, all for the purpose of generating a cash flow return to the development entity's equity holders and all independent of NVR. The Company possesses no more than limited protective legal rights through the Lot Purchase Agreement in the specific finished lots that it is purchasing, and NVR possesses no participative rights in the development entities. Accordingly, NVR does not have the power to direct the activities of a developer that most significantly impact the developer's economic performance. For this reason, NVR has concluded that it is not the primary beneficiary of the development entities with which the Company enters into Lot Purchase Agreements, and therefore, NVR does not consolidate any of these VIEs.

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

As of June 30, 2017, NVR controlled approximately 79,100 lots under Lot Purchase Agreements with third parties through deposits in cash and letters of credit totaling approximately \$380,900 and \$2,400, respectively. As noted above, NVR's sole legal obligation and economic loss for failure to perform under these Lot Purchase Agreements is limited to the amount of the deposit pursuant to the liquidated damage provisions contained in the Lot Purchase Agreements.

In addition, NVR has certain properties under contract with land owners that are expected to yield approximately 8,400 lots, which are not included in the number of total lots controlled. Some of these properties may require rezoning or other approvals to achieve the expected yield. These properties are controlled with deposits in cash and letters of credit totaling approximately \$11,600 and \$200, respectively, as of June 30, 2017, of which approximately \$5,500 is refundable if certain contractual conditions are not met. NVR generally expects to assign the raw land contracts to a land developer and simultaneously enter into a Lot Purchase Agreement with the assignee if the project is determined to be feasible.

NVR's total risk of loss related to contract land deposits as of June 30, 2017 and December 31, 2016 was as follows:

	June 30, 2017	December 31, 2016
Contract land deposits	\$392,503	\$411,150
Loss reserve on contract land deposits	(34,098)	(31,306)
Contract land deposits, net	358,405	379,844
Contingent obligations in the form of letters of credit	2,575	2,379
Specific performance obligations (1)	1,505	1,505
Total risk of loss	\$362,485	\$383,728

(1) As of both June 30, 2017 and December 31, 2016, the Company was committed to purchase 10 finished lots under specific performance obligations.

3. Joint Ventures

On a limited basis, NVR obtains finished lots using joint venture limited liability corporations ("JVs"). The JVs are typically structured such that NVR is a non-controlling member and is at risk only for the amount the Company has invested, or has committed to invest, in addition to any deposits placed under Lot Purchase Agreements with the joint venture. NVR is not a borrower, guarantor or obligor on any debt of the JVs, as applicable. The Company enters into Lot Purchase Agreements to purchase lots from these JVs, and as a result has a variable interest in these JVs.

At June 30, 2017, the Company had an aggregate investment totaling approximately \$44,000 in six JVs that are expected to produce approximately 7,350 finished lots, of which approximately 4,050 lots were controlled by the Company and the remaining approximately 3,300 lots were either under contract with unrelated parties or not currently under contract. In addition, NVR had additional funding commitments totaling approximately \$5,800 in the aggregate to three of the JVs at June 30, 2017. The Company has determined that it is not the primary beneficiary of five of the JVs because either NVR and the other JV partner share power or the other JV partner has the controlling financial interest. The aggregate investment in unconsolidated JVs was approximately \$43,600 and \$49,000 at June 30, 2017 and December 31, 2016, respectively, and is reported in the "Other assets" line item on the accompanying condensed consolidated balance sheets. For the remaining JV, NVR has concluded that it is the primary beneficiary because the Company has the controlling financial interest in the JV.

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

The condensed balance sheets as of June 30, 2017 and December 31, 2016 of the consolidated JV were as follows:

	June 30, 2017	December 31, 2016
Assets:		
Cash	\$1,199	\$ 1,214
Other assets	44	37
Total assets	\$1,243	\$ 1,251
Liabilities and equity:		
Accrued expenses	\$542	\$ 550
Equity	701	701
Total liabilities and equity	\$1,243	\$ 1,251

The Company recognizes income from the JVs as a reduction to the lot cost of the lots purchased from the respective JVs when the homes are settled and is based on the expected total profitability and the total number of lots expected to be produced by the respective JVs. Distributions received from the unconsolidated JVs are allocated between return of capital and distributions of earnings based on the ratio of capital contributed by NVR to the total expected returns for the respective JVs, and are classified within the accompanying condensed consolidated statements of cash flows as cash flows from investing activities and operating activities, respectively.

4. Land Under Development

On a limited basis, NVR directly acquires raw land parcels already zoned for its intended use to develop into finished lots. Land under development includes the land acquisition costs, direct improvement costs, capitalized interest where applicable, and real estate taxes.

In January 2017, the Company purchased a raw land parcel for approximately \$14,400. The parcel is expected to produce approximately 90 lots.

As of June 30, 2017, NVR directly owned a total of four separate raw land parcels with a carrying value of \$46,685 that are expected to produce approximately 550 finished lots. The Company also has additional funding commitments of approximately \$10,000 under a joint development agreement related to one parcel, a portion of which the Company expects will be offset by development credits of approximately \$5,400.

None of the raw parcels had any indicators of impairment as of June 30, 2017. Based on market conditions, NVR may on a limited basis continue to directly acquire additional raw parcels to develop into finished lots.

7

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

5. Capitalized Interest

The Company capitalizes interest costs to land under development during the active development of finished lots. In addition, the Company capitalizes interest costs to its joint venture investments while the investments are considered qualified assets pursuant to Accounting Standards Codification 835-20, Interest. Capitalized interest is transferred to sold or unsold inventory as the development of finished lots is completed, then charged to cost of sales upon the Company's settlement of homes and the respective lots. Interest incurred in excess of the interest capitalizable based on the level of qualified assets is expensed in the period incurred. NVR's interest costs incurred, capitalized, expensed and charged to cost of sales during the three and six months ended June 30, 2017 and 2016 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest capitalized, beginning of period	\$5,564	\$5,358	\$5,106	\$4,434
Interest incurred	6,580	6,397	13,139	12,785
Interest charged to interest expense	(5,914)	(4,814)	(11,750)	(9,902)
Interest charged to cost of sales	(278)	(2,365)	(543)	(2,741)
Interest capitalized, end of period	\$5,952	\$4,576	\$5,952	\$4,576

6. Earnings per Share

The following weighted average shares and share equivalents were used to calculate basic and diluted earnings per share for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Weighted average number of shares outstanding used to calculate basic EPS	3,748	3,900	3,726	3,892
Dilutive securities:				
Stock options and restricted share units	454	265	429	259
Weighted average number of shares and share equivalents outstanding used to calculate diluted EPS	4,202	4,165	4,155	4,151

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The following stock options and restricted share units issued under equity incentive plans were outstanding during the three and six months ended June 30, 2017 and 2016, but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Anti-dilutive securities	9	78	15	78

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

7. Shareholders' Equity

A summary of changes in shareholders' equity is presented below:

	Additional		Retained	Treasury	Deferred	Deferred	
	Common	Paid-In	Earnings	Stock	Compensation	Compensation	Total
	Stock	Capital	Earnings	Stock	Trust	Liability	Total
Balance, December 31, 2016	\$ 206	\$ 1,515,828	\$ 5,695,376	\$ (5,906,969)	\$ (17,375)	\$ 17,375	\$ 1,304,441
Cumulative-effect adjustment from adoption of ASU 2016-09, net of tax	—	1,566	(957)	—	—	—	609
Net income	—	—	250,800	—	—	—	250,800
Deferred compensation activity	—	—	—	—	4	(4)	—
Purchase of common stock for treasury	—	—	—	(159,506)	—	—	(159,506)
Equity-based compensation	—	21,467	—	—	—	—	21,467
Proceeds from stock options exercised	—	117,966	—	—	—	—	117,966
Treasury stock issued upon option exercise and restricted share vesting	—	(48,869)	—	48,869	—	—	—
Balance, June 30, 2017	\$ 206	\$ 1,607,958	\$ 5,945,219	\$ (6,017,606)	\$ (17,371)	\$ 17,371	\$ 1,535,777

The Company repurchased 84 shares of its common stock during the six months ended June 30, 2017. The Company settles stock option exercises and vesting of restricted share units by issuing shares of treasury stock. Approximately 138 shares were issued from the treasury account during the six months ended June 30, 2017 in settlement of stock option exercises and vesting of restricted share units. Shares are relieved from the treasury account based on the weighted average cost basis of treasury shares acquired.

8. Product Warranties

The Company establishes warranty and product liability reserves (“Warranty Reserve”) to provide for estimated future expenses as a result of construction and product defects, product recalls and litigation incidental to NVR’s homebuilding business. Liability estimates are determined based on management’s judgment, considering such factors as historical experience, the likely current cost of corrective action, manufacturers’ and subcontractors’ participation in sharing the cost of corrective action, consultations with third party experts such as engineers, and discussions with the Company’s general counsel and outside counsel retained to handle specific product liability cases. The following table reflects the changes in the Company’s Warranty Reserve during the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Warranty reserve, beginning of period	\$93,503	\$86,692	\$93,895	\$87,407
Provision	13,206	12,867	22,167	21,709
Payments	(11,315)	(11,606)	(20,668)	(21,163)
Warranty reserve, end of period	\$95,394	\$87,953	\$95,394	\$87,953

9. Segment Disclosures

The following disclosure includes four homebuilding reportable segments that aggregate geographically the Company’s homebuilding operating segments, and the mortgage banking operations presented as a single reportable segment. The homebuilding reportable segments are comprised of operating divisions in the following geographic areas:

Mid Atlantic:	Maryland, Virginia, West Virginia, Delaware and Washington, D.C.
North East:	New Jersey and Eastern Pennsylvania

9

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

Mid East: New York, Ohio, Western Pennsylvania, Indiana and Illinois

South East: North Carolina, South Carolina, Florida and Tennessee

Homebuilding profit before tax includes all revenues and income generated from the sale of homes, less the cost of homes sold, selling, general and administrative expenses and a corporate capital allocation charge. The corporate capital allocation charge is eliminated in consolidation and is based on the segment's average net assets employed. The corporate capital allocation charged to the operating segment allows the Chief Operating Decision Maker ("CODM") to determine whether the operating segment's results are providing the desired rate of return after covering the Company's cost of capital. In addition, certain assets, including goodwill and intangible assets and consolidation adjustments as discussed further below, are not allocated to the operating segments as those assets are neither included in the operating segment's corporate capital allocation charge, nor in the CODM's evaluation of the operating segment's performance. The Company records charges on contract land deposits when it is determined that it is probable that recovery of the deposit is impaired. For segment reporting purposes, impairments on contract land deposits are charged to the operating segment upon the determination to terminate a Lot Purchase Agreement with the developer, or to restructure a Lot Purchase Agreement resulting in the forfeiture of the deposit. Mortgage banking profit before tax consists of revenues generated from mortgage financing, title insurance and closing services, less the costs of such services and general and administrative costs. Mortgage banking operations are not charged a corporate capital allocation charge.

In addition to the corporate capital allocation and contract land deposit impairments discussed above, the other reconciling items between segment profit and consolidated profit before tax include unallocated corporate overhead (including all management incentive compensation), equity-based compensation expense, consolidation adjustments and external corporate interest expense. NVR's overhead functions, such as accounting, treasury and human resources, are centrally performed and the costs are not allocated to the Company's operating segments. Consolidation adjustments consist of such items necessary to convert the reportable segments' results, which are predominantly maintained on a cash basis, to a full accrual basis for external financial statement presentation purposes, and are not allocated to the Company's operating segments. External corporate interest expense primarily consists of interest charges on the Company's 3.95% Senior Notes due 2022 (the "Senior Notes") and is not charged to the operating segments because the charges are included in the corporate capital allocation discussed above.

The following tables present segment revenues, profit and assets, with reconciliations to the amounts reported for the consolidated enterprise, where applicable:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues:				
Homebuilding Mid Atlantic	\$872,148	\$772,147	\$1,594,416	\$1,405,718
Homebuilding North East	127,541	108,766	233,771	205,919
Homebuilding Mid East	313,237	306,257	556,268	550,534

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Homebuilding South East	199,788	174,571	375,846	321,074
Mortgage Banking	31,778	26,442	61,283	48,964
Total consolidated revenues	\$1,544,492	\$1,388,183	\$2,821,584	\$2,532,209

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Profit before taxes:				
Homebuilding Mid Atlantic	\$100,621	\$63,730	\$165,109	\$110,339
Homebuilding North East	14,112	5,578	23,218	9,643
Homebuilding Mid East	35,986	30,056	58,145	52,789
Homebuilding South East	22,911	15,825	37,481	28,611
Mortgage Banking	18,004	13,973	33,957	24,348
Total segment profit before taxes	191,634	129,162	317,910	225,730
Reconciling items:				
Contract land deposit reserve adjustment (1)	(2,064)	1,307	(2,792)	2,636
Equity-based compensation expense	(10,878)	(10,829)	(21,467)	(21,378)
Corporate capital allocation (2)	49,646	46,259	95,833	90,574
Unallocated corporate overhead	(23,360)	(26,517)	(50,594)	(56,026)
Consolidation adjustments and other	9,614	9,877	13,427	15,862
Corporate interest expense	(5,624)	(4,539)	(11,188)	(9,366)
Reconciling items sub-total	17,334	15,558	23,219	22,302
Consolidated profit before taxes	\$208,968	\$144,720	\$341,129	\$248,032

	June 30,	December
	2017	31, 2016
Assets:		
Homebuilding Mid Atlantic	\$1,177,147	\$1,054,779
Homebuilding North East	148,272	126,720
Homebuilding Mid East	274,846	222,736
Homebuilding South East	263,780	214,225
Mortgage Banking	276,564	403,250
Total segment assets	2,140,609	2,021,710
Reconciling items:		
Consolidated variable interest entity	1,243	1,251
Cash and cash equivalents	518,482	375,748
Deferred taxes	176,401	170,652
Intangible assets and goodwill	50,835	51,526
Contract land deposit reserve	(34,098)	(31,306)
Consolidation adjustments and other	64,615	54,362

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Reconciling items sub-total	777,478	622,233
Consolidated assets	\$2,918,087	\$2,643,943

- (1) This item represents changes to the contract land deposit impairment reserve, which are not allocated to the reportable segments.
- (2) This item represents the elimination of the corporate capital allocation charge included in the respective homebuilding reportable segments. The corporate capital allocation charge is based on the segment's monthly average asset balance, and was as follows for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Corporate capital allocation charge:				
Homebuilding Mid Atlantic	\$31,005	\$28,766	\$60,130	\$55,951
Homebuilding North East	4,133	4,447	7,947	9,400
Homebuilding Mid East	7,535	7,458	14,277	14,157
Homebuilding South East	6,973	5,588	13,479	11,066
Total	\$49,646	\$46,259	\$95,833	\$90,574

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

10. Fair Value

GAAP assigns a fair value hierarchy to the inputs used to measure fair value. Level 1 inputs are quoted prices in active markets for identical assets and liabilities. Level 2 inputs are inputs other than quoted market prices that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs.

Financial Instruments

The estimated fair value of NVR's Senior Notes as of June 30, 2017 was \$630,000. The estimated fair value is based on recent market prices of similar transactions, which is classified as Level 2 within the fair value hierarchy. The carrying value of the Senior Notes was \$596,760 at June 30, 2017. Except as otherwise noted below, NVR believes that insignificant differences exist between the carrying value and the fair value of its financial instruments, which consist of cash equivalents, due to their short term nature.

Derivative Instruments and Mortgage Loans Held for Sale

In the normal course of business, NVR's wholly-owned mortgage subsidiary, NVR Mortgage Finance, Inc. ("NVRM"), enters into contractual commitments to extend credit to NVR's homebuyers with fixed expiration dates. The commitments become effective when the borrowers "lock-in" a specified interest rate within time frames established by NVRM. All mortgagors are evaluated for credit worthiness prior to the extension of the commitment. Market risk arises if interest rates move adversely between the time of the "lock-in" of rates by the borrower and the sale date of the loan to a broker/dealer. To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, NVRM enters into optional or mandatory delivery forward sale contracts to sell whole loans and mortgage-backed securities to broker/dealers. The forward sales contracts lock in an interest rate and price for the sale of loans similar to the specific rate lock commitments. NVRM does not engage in speculative or trading derivative activities. Both the rate lock commitments to borrowers and the forward sale contracts to broker/dealers are undesignated derivatives and, accordingly, are marked to fair value through earnings. At June 30, 2017, there were contractual commitments to extend credit to borrowers aggregating \$655,409 and open forward delivery contracts aggregating \$777,148, which hedge both the rate lock loan commitments and closed loans held for sale.

The fair value of NVRM's rate lock commitments to borrowers and the related input levels include, as applicable:

- i) the assumed gain/loss of the expected resultant loan sale (Level 2);
- ii) the effects of interest rate movements between the date of the rate lock and the balance sheet date (Level 2); and
- iii) the value of the servicing rights associated with the loan (Level 2).

The assumed gain/loss considers the excess servicing to be received or buydown fees to be paid upon securitization of the loan. The excess servicing and buydown fees are calculated pursuant to contractual terms with investors. To calculate the effects of interest rate movements, NVRM utilizes applicable published mortgage-backed security prices, and multiplies the price movement between the rate lock date and the balance sheet date by the notional loan commitment amount. NVRM sells all of its loans on a servicing released basis, and receives a servicing released

premium upon sale. Thus, the value of the servicing rights, which averaged 111 basis points of the loan amount as of June 30, 2017, is included in the fair value measurement and is based upon contractual terms with investors and varies depending on the loan type. NVRM assumes an approximate 15% fallout rate when measuring the fair value of rate lock commitments. Fallout is defined as locked loan commitments for which NVRM does not close a mortgage loan and is based on historical experience.

The fair value of NVRM's forward sales contracts to broker/dealers solely considers the market price movement of the same type of security between the trade date and the balance sheet date (Level 2). The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

Mortgage loans held for sale are recorded at fair value when closed, and thereafter are carried at the lower of cost or fair value, net of deferred origination costs, until sold. Fair value is measured using Level 2 inputs. The fair value of

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

loans held for sale of \$241,398 included on the accompanying condensed consolidated balance sheet has been increased by \$1,057 from the aggregate principal balance of \$240,341.

The undesignated derivative instruments are included on the accompanying condensed consolidated balance sheet, as of June 30, 2017, as follows:

	Fair Value	Balance Sheet Location
Rate lock commitments:		
Gross assets	\$6,559	
Gross liabilities	5,048	
Net rate lock commitments	\$1,511	NVRM - Other assets
Forward sales contracts:		
Gross assets	\$3,003	
Gross liabilities	26	
Net forward sales contracts	\$2,977	NVRM - Other assets

The fair value measurement as of June 30, 2017 was as follows:

	Notional or Principal Amount	Assumed Gain/(Loss) From Loan Sale	Interest Rate Movement Effect	Servicing Rights Value	Security Price Change	Total Fair Value Measurement Gain/(Loss)
Rate lock commitments	\$655,409	\$ (2,645)	\$ (2,111)	\$ 6,267	\$ —	\$ 1,511
Forward sales contracts	\$777,148	—	—	—	2,977	2,977
Mortgages held for sale	\$240,341	(997)	(549)	2,603	—	1,057
Total fair value measurement		\$ (3,642)	\$ (2,660)	\$ 8,870	\$ 2,977	\$ 5,545

For the three and six months ended June 30, 2017, NVRM recorded a fair value adjustment to income of \$3,376 and \$1,359, respectively. For the three and six months ended June 30, 2016, NVRM recorded a fair value adjustment to

income of \$589 and a fair value adjustment to expense of \$67, respectively. Unrealized gains/losses from the change in the fair value measurements are included in earnings as a component of mortgage banking fees in the accompanying condensed consolidated statements of income. The fair value measurement will be impacted in the future by the change in the value of the servicing rights, interest rate movements, security price fluctuations, and the volume and product mix of NVRM's closed loans and locked loan commitments.

11. Debt

Senior Notes

As of June 30, 2017, the Company had Senior Notes outstanding with a principal balance of \$600,000. The Senior Notes mature on September 15, 2022 and bear interest at 3.95%, payable semi-annually in arrears on March 15 and September 15. The Senior Notes were issued at a discount to yield 3.97% and have been reflected net of the unamortized discount and unamortized debt issuance costs in the accompanying condensed consolidated balance sheet.

Credit Agreement

NVR has an unsecured Credit Agreement (the "Credit Agreement"), which provides for aggregate revolving loan commitments of \$200,000 (the "Facility"). Under the Credit Agreement, the Company may request increases of up to \$300,000 to the Facility in the form of revolving loan commitments or term loans to the extent that new or existing lenders agree to provide additional revolving loan or term loan commitments. The Credit Agreement provides for a \$100,000 sublimit for the issuance of letters of credit, of which approximately \$8,600 was outstanding at June 30, 2017, and a \$25,000 sublimit for a swing line commitment. The Credit Agreement termination date is July 15, 2021. There was no debt outstanding under the Facility at June 30, 2017.

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

Repurchase Agreement

NVRM provides for its mortgage origination and other operating activities using cash generated from its operations, borrowings from its parent company, NVR, as well as a revolving mortgage repurchase agreement (the “Repurchase Agreement”), which is non-recourse to NVR. The Repurchase Agreement provides for loan purchases up to \$150,000, subject to certain sub-limits, and provides for an incremental commitment pursuant to which NVRM may from time to time request increases in the total commitment available under the Repurchase Agreement by up to \$50,000 in the aggregate. Amounts outstanding under the Repurchase Agreement are collateralized by the Company’s mortgage loans held for sale. The Repurchase Agreement was renewed in July 2017 with materially consistent terms and conditions and expires on July 25, 2018. At June 30, 2017, there were no borrowing base limitations reducing the amount available under the Repurchase Agreement. There was no debt outstanding under the Repurchase Agreement at June 30, 2017.

12. Commitments and Contingencies

In June 2010, the Company received a Request for Information from the United States Environmental Protection Agency (“EPA”) pursuant to Section 308 of the Clean Water Act. The request sought information about storm water discharge practices in connection with homebuilding projects completed or underway by the Company in New York and New Jersey. The Company cooperated with this request, and provided information to the EPA. The Company was subsequently informed by the United States Department of Justice (“DOJ”) that the EPA forwarded the information on the matter to the DOJ. The Company has entered a consent decree with the EPA and DOJ to settle this matter. The consent decree includes injunctive relief and payment of a civil penalty, which was accrued as of June 30, 2017. The consent decree has been submitted for approval in the U.S. District Court for the District of New Jersey. The Company believes the disposition of this matter will not have a material adverse effect on its results of operations and liquidity or on its financial condition.

The Company and its subsidiaries are also involved in various other litigation arising in the ordinary course of business. In the opinion of management, and based on advice of legal counsel, this litigation is not expected to have a material adverse effect on the financial position, results of operations or cash flows of the Company. Legal costs incurred in connection with outstanding litigation are expensed as incurred.

13. Income Taxes

The Company’s effective tax rate for the three and six months ended June 30, 2017 was 29.2% and 26.5%, respectively. For both the three and six months ended June 30, 2016, the Company’s effective tax rate was 36.7%. The 2017 effective tax rate was reduced as a result of the Company’s adoption of ASU 2016-09, which requires the excess tax benefit from stock option exercises to be recorded as a reduction to income tax expense in the

period stock options are exercised. During the three and six months ended June 30, 2017, the Company recognized \$16,464 and \$36,364, respectively, in excess tax benefits. During the three and six months ended June 30, 2016, excess tax benefits of \$2,394 and \$8,678, respectively, were recorded to additional paid-in capital within shareholders' equity.

14. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The standard will replace most existing revenue recognition guidance in GAAP when it becomes effective. The standard is effective for the Company as of January 1, 2018. The Company plans to adopt the standard using the cumulative effect transition method. The Company does not believe that the adoption of this standard will have a material effect on its consolidated financial statements and related disclosures.

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842), which requires lessees to recognize most leases on-balance sheet with a liability equal to the present value of lease payments over the lease term and a right-of-use asset for the right to use the underlying asset over the lease term. Lessees will recognize expenses on their income statements in

NVR, Inc.

Notes to Condensed Consolidated Financial Statements

(dollars and shares in thousands)

(unaudited)

a manner similar to current GAAP. The standard also requires additional disclosures of key information about leasing arrangements. The standard is effective for the Company as of January 1, 2019. The Company believes that the adoption of this standard will have a material effect on both assets and liabilities presented on the balance sheet, and is further evaluating the impact of its adoption.

In June 2016, FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326), which significantly changes the way impairment of financial assets is recognized. The standard will require immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets, which will generally result in earlier recognition of allowances for credit losses on loans and other financial instruments. The standard's provisions will be applied as a cumulative-effect adjustment to beginning retained earnings as of the effective date. The standard is effective for the Company as of January 1, 2020. Early adoption is permitted for annual and interim periods beginning January 1, 2019. The Company is currently evaluating the effect that the standard will have on its consolidated financial statements and related disclosures.

In August 2016, FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The objective of the standard is to address the diversity in practice of how certain cash receipts and payments are presented on the statement of cash flows. The standard requires that the guidance be applied retrospectively in the first interim and annual periods in which an entity adopts the guidance. The standard is effective for the Company as of January 1, 2018. The Company expects the standard to affect the presentation of the distributions from joint ventures in the consolidated statement of cash flows.

In November 2016, FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), Restricted Cash. The amendments in the standard require that the statement of cash flows explain the change during the period in the total of cash, cash equivalents and restricted cash or restricted cash equivalents. As a result, restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total cash amounts shown on the statement of cash flows. The standard is effective for the Company as of January 1, 2018. The Company does not believe that the adoption of this standard will have a material effect on its consolidated statements of cash flows and related disclosures.

In January 2017, FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment. The standard's objective is to simplify the subsequent measurement of goodwill by eliminating the second step from the goodwill impairment test. Under the amendments in the standard, an entity would perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, an impairment charge would then be recognized, not to exceed the amount of goodwill allocated to that reporting unit. The standard is effective for the Company on January 1, 2020, and early adoption is permitted. The Company does not believe that the adoption of this standard will have a material effect on its consolidated financial statements and related disclosures.

In May 2017, FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718), Scope of Modification Accounting. The amendments in the standard clarify when changes in a share-based payment award must be accounted for as a modification, and will allow entities to make certain changes to share-based payment awards

without accounting for them as modifications. Under the new guidance, entities will only apply modification accounting if there are substantive changes made to share-based payment awards. If a change made to a share-based payment award does not affect the fair value, vesting conditions and classification as either an equity or liability instrument, modification accounting will not need to be applied. The standard is effective for the Company on January 1, 2018, and early adoption is permitted. The Company does not believe that the adoption of this standard will have a material effect on its consolidated financial statements and related disclosures.

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

(dollars in thousands)

Forward-Looking Statements

Some of the statements in this Quarterly Report on Form 10-Q, as well as statements made by us in periodic press releases or other public communications, constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Certain, but not necessarily all, of such forward-looking statements can be identified by the use of forward-looking terminology, such as “believes,” “expects,” “may,” “will,” “should,” or “anticipates” or the negative thereof or other comparable terminology. All statements other than of historical facts are forward-looking statements. Forward-looking statements contained in this document may include those regarding market trends, NVR’s financial position, business strategy, the outcome of pending litigation, investigations or similar contingencies, projected plans and objectives of management for future operations. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance of NVR to be materially different from future results, performance or achievements expressed or implied by the forward-looking statements. Such risk factors include, but are not limited to the following: general economic and business conditions (on both a national and regional level); interest rate changes; access to suitable financing by NVR and NVR’s customers; increased regulation in the mortgage banking industry; the ability of our mortgage banking subsidiary to sell loans it originates into the secondary market; competition; the availability and cost of land and other raw materials used by NVR in its homebuilding operations; shortages of labor; weather related slow-downs; building moratoriums; governmental regulation; fluctuation and volatility of stock and other financial markets; mortgage financing availability; and other factors over which NVR has little or no control. NVR undertakes no obligation to update such forward-looking statements except as required by law. For additional information regarding risk factors, see Part II, Item 1A of this Quarterly Report on Form 10-Q and Part I, Item 1A of NVR’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

Unless the context otherwise requires, references to “NVR,” “we,” “us,” or “our” include NVR and its consolidated subsidiaries.

Results of Operations for the Three and Six Months Ended June 30, 2017 and 2016

Overview

Business

Our primary business is the construction and sale of single-family detached homes, townhomes and condominiums, all of which are primarily constructed on a pre-sold basis. To fully serve customers of our homebuilding operations, we also operate a mortgage banking and title services business. We primarily conduct our operations in mature markets. Additionally, we generally grow our business through market share gains in our existing markets and by expanding into markets contiguous to our current active markets. Our four homebuilding reportable segments consist of the following regions:

Mid Atlantic:	Maryland, Virginia, West Virginia, Delaware and Washington, D.C.
North East:	New Jersey and Eastern Pennsylvania
Mid East:	

New York, Ohio, Western Pennsylvania, Indiana and
Illinois

South East: North Carolina, South Carolina, Florida and Tennessee

Our lot acquisition strategy is predicated upon avoiding the financial requirements and risks associated with direct land ownership and development. We generally do not engage in land development (see discussion below of our land development activities). Instead, we typically acquire finished lots at market prices from various third party land developers pursuant to fixed price finished lot purchase agreements (“Lot Purchase Agreements”). These Lot Purchase Agreements require deposits, typically ranging up to 10% of the aggregate purchase price of the finished lots, in the form of cash or letters of credit that may be forfeited if we fail to perform under the Lot Purchase Agreement. This strategy has allowed us to maximize inventory turnover, which we believe enables us to minimize market risk and to operate with less capital, thereby enhancing rates of return on equity and total capital.

In addition to constructing homes primarily on a pre-sold basis and utilizing what we believe is a conservative lot acquisition strategy, we focus on obtaining and maintaining a leading market position in each market we serve. This strategy allows us to gain valuable efficiencies and competitive advantages in our markets, which we believe contributes to minimizing the adverse effects of regional economic cycles and provides growth opportunities within these markets. Our continued success is contingent upon our ability to control an adequate supply of finished lots on which to build.

In certain specific strategic circumstances, we deviate from our historical lot acquisition strategy and engage in joint venture arrangements with land developers or directly acquire raw ground already zoned for its intended use for development. Once we acquire control of raw ground, we determine whether to sell the raw parcel to a developer and enter into a Lot Purchase Agreement with the developer to purchase the finished lots or to hire a developer to develop the land on our behalf. While joint venture arrangements and direct land development activity are not our preferred method of acquiring finished building lots, we may enter into additional transactions in the future on a limited basis where there exists a compelling strategic or prudent financial reason to do so. We expect, however, to continue to acquire substantially all our finished lot inventory using Lot Purchase Agreements with forfeitable deposits.

As of June 30, 2017, we controlled lots as described below.

Lot Purchase Agreements

We controlled approximately 79,100 lots under Lot Purchase Agreements with third parties through deposits in cash and letters of credit totaling approximately \$380,900 and \$2,400, respectively. Included in the number of controlled lots are approximately 3,900 lots for which we have recorded a contract land deposit impairment reserve of approximately \$34,100 as of June 30, 2017.

Joint Venture Limited Liability Corporations (“JVs”)

We had an aggregate investment totaling approximately \$44,000 in six JVs, expected to produce approximately 7,350 lots. Of the lots to be produced by the JVs, approximately 4,050 lots were controlled by us and approximately 3,300 were either under contract with unrelated parties or currently not under contract.

Land Under Development

We directly owned four separate raw land parcels, zoned for their intended use, with a current cost basis, including development costs, of approximately \$46,700 that we intend to develop into approximately 550 finished lots. We had additional funding commitments of approximately \$10,000 under a joint development agreement related to one parcel, a portion of which we expect will be offset by development credits of approximately \$5,400. During January 2017, we purchased one land parcel under development for approximately \$14,400. The parcel is expected to produce approximately 90 lots.

See Notes 2, 3 and 4 to the condensed consolidated financial statements included herein for additional information regarding Lot Purchase Agreements, JVs and land under development, respectively.

Raw Land Purchase Agreements

In addition to the lots we currently control as discussed above, we have certain properties under contract with land owners that are expected to yield approximately 8,400 lots. Some of these properties may require rezoning or other approvals to achieve the expected yield. These properties are controlled with deposits in cash and letters of credit totaling approximately \$11,600 and \$200, respectively, as of June 30, 2017, of which approximately \$5,500 is

refundable if certain contractual conditions are not met. We generally expect to assign the raw land contracts to a land developer and simultaneously enter into a Lot Purchase Agreement with the assignee if the project is determined to be feasible.

Current Business Environment and Key Financial Results

During the first six months of 2017 we continued to experience steady new home demand, consistent with that seen during 2016. However, new home prices continued to be constrained due to the competitive market environment.

Our consolidated revenues for the second quarter of 2017 totaled \$1,544,492, an 11% increase from the second quarter of 2016. Net income for the second quarter ended June 30, 2017 was \$147,877, or \$35.19 per diluted share, increases of 61% and 60% when compared to net income and diluted earnings per share in the second quarter of 2016, respectively. Our homebuilding gross profit margin percentage increased to 19.5% in the second quarter of 2017 from 17.3% in the second quarter of 2016. New orders, net of cancellations (“New Orders”) increased 8% in the second quarter

of 2017 compared to the second quarter of 2016. The average sales price for New Orders in the second quarter of 2017 of \$377.0 decreased 2% compared to the second quarter of 2016.

Net income and diluted earnings per share were favorably impacted by the reduction in our effective tax rate in the second quarter of 2017 to 29.2% from 36.7% in the second quarter of 2016. The reduction in the effective tax rate was primarily due to our January 1, 2017 adoption of Accounting Standard Update (“ASU”) 2016-09, Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting. See additional discussion regarding the income tax impact of the adoption of ASU 2016-09 in the “Effective Tax Rate” section below.

We believe that a continuation of the housing market recovery is dependent upon a sustained overall economic recovery, driven by continued improvements in job and wage growth and household formation. We expect to continue to face gross margin pressure currently impacted by modest pricing power and our ability to manage higher land and construction costs. We also expect to face pressure on mortgage banking profit due to the competitive pricing pressures in the mortgage market. We believe that we are well positioned to take advantage of opportunities that may arise from future economic and homebuilding market volatility due to the strength of our balance sheet.

Homebuilding Operations

The following table summarizes the results of operations and other data for the consolidated homebuilding operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Financial Data:				
Revenues	\$1,512,714	\$1,361,741	\$2,760,301	\$2,483,245
Cost of sales	\$1,218,083	\$1,126,369	\$2,244,100	\$2,052,129
Gross profit margin percentage				