M I HOMES INC
Form 10-Q
November 04, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2011

o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES ACT OF 1934

Commission File Number 1-12434

M/I HOMES, INC.
(Exact name of registrant as specified in it charter)

Ohio (State or other jurisdiction of incorporation or organization)	31-1210837 (I.R.S. Employer Identification No.)

3 Easton Oval, Suite 500, Columbus, Ohio 43219
(Address of principal executive offices) (Zip Code)
(614) 418-8000
(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 X 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 X 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.

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
Common shares, par value $.01 per share: 18,736,357 shares outstanding as of November 2, 2011.

M/I HOMES, INC.
FORM 10-Q

TABLE OF CONTENTS

2

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par values)	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS:		
Cash	$46,829	$81,208
Restricted cash	46,218	41,923
Mortgage loans held for sale	36,666	43,312
Inventory	491,361	450,936
Property and equipment - net	14,741	16,554
Investment in Unconsolidated LLCs	10,256	10,589
Other assets	15,654	17,372
TOTAL ASSETS	$661,725	$661,894
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable	$45,842	$29,030
Customer deposits	5,377	3,017
Other liabilities	47,237	42,116
Community development district obligations	6,348	7,112
Obligation for consolidated inventory not owned	4,600	468
Note payable bank - financial services operations	31,658	32,197
Note payable - other	5,857	5,853
Senior notes	238,914	238,610
TOTAL LIABILITIES	385,833	358,403
Commitments and contingencies	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares - $.01 par value; authorized 2,000,000 shares; issued 4,000 shares	96,325	96,325
Common shares - $.01 par value; authorized 38,000,000 shares; issued 22,101,723 shares at both September 30, 2011 and December 31, 2010	221	221
Additional paid-in capital	139,509	140,418
Retained earnings	106,677	137,578
Treasury shares - at cost - 3,365,366 and 3,577,388 shares, respectively, at September 30, 2011 and December 31, 2010	(66,840)	(71,051)
TOTAL SHAREHOLDERS' EQUITY	275,892	303,491
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$661,725	$661,894

See Notes to Unaudited Condensed Consolidated Financial Statements.

3

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)	Three Months Ended September 30, 2011 (Unaudited)	Three Months Ended September 30, 2010 (Unaudited)	Nine Months Ended September 30, 2011 (Unaudited)	Nine Months Ended September 30, 2010 (Unaudited)
Revenue	$141,624	$135,609	$389,638	$451,402
Costs and expenses:				
Land and housing	116,269	108,659	322,886	373,030
Impairment of inventory and investment in Unconsolidated LLCs	1,697	1,796	18,013	11,206
General and administrative	13,896	13,148	38,064	39,601
Selling	11,213	11,735	30,621	36,482
Interest	3,384	1,952	10,884	6,172
Total costs and expenses	146,459	137,290	420,468	466,491
Loss before income taxes	(4,835)	(1,681)	(30,830)	(15,089)
Provision (benefit) for income taxes	(117)	389	71	123
Net loss	$(4,718)	$(2,070)	$(30,901)	$(15,212)
Loss per common share:				
Basic	$(0.25)	$(0.11)	$(1.65)	$(0.82)
Diluted	$(0.25)	$(0.11)	$(1.65)	$(0.82)
Weighted average shares outstanding:				
Basic	18,728	18,523	18,685	18,523
Diluted	18,728	18,523	18,685	18,523

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

	Nine Months Ended September 30, 2011 (Unaudited)							
	Preferred Shares		Common Shares		Additional			Total
(Dollars in thousands)	Shares Outstanding	Amount	Shares Outstanding	Amount	Paid-in Capital	Retained Earnings	Treasury Shares	Shareholders' Equity
Balance at December 31, 2010	4,000	$96,325	18,524,335	$221	$140,418	$137,578	$(71,051)	$303,491
Net loss	—	—	—	—	—	(30,901)	—	(30,901)
Income tax benefit from stock options and deferred compensation distributions	—	—	—	—	165	—	—	165
Stock options exercised	—	—	190,090	—	(2,275)	—	3,775	1,500
Share-based compensation expense	—	—	—	—	1,525	—	—	1,525
Deferral of executive and director compensation	—	—	—	—	112	—	—	112
Executive and director deferred compensation distributions	—	—	21,932	—	(436)	—	436	—
Balance at September 30, 2011	4,000	$96,325	18,736,357	$221	$139,509	$106,677	$(66,840)	$275,892

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2011	2010
(Dollars in thousands)	(Unaudited)	(Unaudited)
OPERATING ACTIVITIES:		
Net loss	$(30,901)	$(15,212)
Adjustments to reconcile net loss to net cash used in operating activities:		
Inventory valuation adjustments and abandoned land transaction write-offs	17,424	11,603
Impairment of investment in Unconsolidated LLCs	1,029	—
Mortgage loan originations	(256,708)	(301,419)
Proceeds from the sale of mortgage loans	266,737	305,430
Fair value adjustment of mortgage loans held for sale	(3,383)	(1,479)
Net loss from property disposals	—	7
Depreciation	3,819	3,859
Amortization of intangibles, debt discount and debt issue costs	1,866	1,935
Share-based compensation expense	1,525	2,179
Deferred income tax benefit	(11,657)	(5,684)
Deferred tax asset valuation allowance	11,657	5,684
Excess tax (benefit) expense from stock-based payment arrangements	(165)	14
Equity in undistributed income of Unconsolidated LLCs	—	(155)
Write-off of unamortized debt discount and financing costs	—	311
Change in assets and liabilities:		
Cash held in escrow	237	(9,358)
Inventory	(50,618)	(81,562)
Other assets	954	32,617
Accounts payable	16,089	15,601
Customer deposits	2,314	589
Accrued compensation	(703)	(1,141)
Other liabilities	5,918	(6,806)
Net cash used in operating activities	(24,566)	(42,987)
INVESTING ACTIVITIES:		
Restricted cash	(4,532)	(16,448)
Purchase of property and equipment	(889)	(1,455)
Acquisition, net of cash acquired	(4,654)	—
Investment in Unconsolidated LLCs	(648)	(661)
Return of investment from Unconsolidated LLCs	—	13
Net cash used in investing activities	(10,723)	(18,551)
FINANCING ACTIVITIES:		
Repayments of bank borrowings - net	(539)	(369)
Proceeds from (principal repayments of) note payable-other and community development district bond obligations	4	(246)
Debt issue costs	(220)	(3,874)
Proceeds from exercise of stock options	1,500	5
Excess tax expense (benefit) from stock-based payment arrangements	165	(14)
Net cash provided by (used in) financing activities	910	(4,498)

Net decrease in cash	(34,379)	(66,036)
Cash balance at beginning of period	81,208	109,930
Cash balance at end of period	$46,829	$43,894
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest — net of amount capitalized	$4,208	$372
Income taxes	$282	$274
NON-CASH TRANSACTIONS DURING THE PERIOD:		
Community development district infrastructure	$(764)	$(780)
Consolidated inventory not owned	$4,132	$(616)
Contingent consideration related to acquisition	$512	$—

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements (the "financial statements") of M/I Homes, Inc. and its subsidiaries (the "Company") and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial information. The financial statements include the accounts of M/I Homes, Inc. and its subsidiaries. All intercompany transactions have been eliminated. Results for the interim period are not necessarily indicative of results for a full year. In the opinion of management, the accompanying financial statements reflect all adjustments (all of which are normal and recurring in nature) necessary for a fair presentation of financial results for the interim periods presented. These financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 (the "2010 Form 10-K").

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during that period. Actual results could differ from these estimates and have a significant impact on the financial condition and results of operations and cash flows. With regard to the Company, estimates and assumptions are inherent in calculations relating to valuation of inventory and investment in unconsolidated limited liability companies ("Unconsolidated LLCs"), property and equipment depreciation, valuation of derivative financial instruments, accounts payable on inventory, accruals for costs to complete inventory, accruals for warranty claims, accruals for self-insured general liability claims, litigation, accruals for health care and workers' compensation, accruals for guaranteed or indemnified loans, stock-based compensation expense, income taxes, and contingencies. Items that could have a significant impact on these estimates and assumptions include the risks and uncertainties listed in "Item 1A. Risk Factors" in Part I of our 2010 Form 10-K and "Item 1A. Risk Factors"in Part II of our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2011, as the same may be updated from time to time in our subsequent filings with the SEC.

Reclassifications

Certain amounts in the Unaudited Condensed Consolidated Financial Statements and the notes thereto for the nine months ended September 2010 have been reclassified to conform to the nine months ended September 2011 presentation. The Company believes these reclassifications are immaterial to the Unaudited Condensed Consolidated Financial Statements.

Impact of New Accounting Standards

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04: Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS ("ASU 2011-04"). ASU 2011-04 provides clarity to the fair value definition in order to achieve greater consistency in fair value measurements and disclosures between United States Generally Accepted Accounting Principles ("U.S. GAAP") and International Financial Reporting Standards ("IFRS"). Additional disclosures are required regarding transfers of assets between Level 1 and 2 of the fair value hierarchy and regarding sensitivity of fair values for Level 3 assets. The effective date of this amendment is for fiscal periods beginning after December 15, 2011. We do not anticipate the adoption of this amendment to have a material impact on the Company's financial condition, results of operations or liquidity.

On April 29, 2011, the FASB issued ASU No. 2011-03: Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreements ("ASU 2011-03"). ASU 2011-03 eliminates from U.S. GAAP the requirement for entities to consider whether a transferor (i.e., seller) has the ability to repurchase the financial assets in a repurchase agreement. This requirement was one of the criteria under Accounting Standards Codification 860 that entities used to determine whether the transferor maintained effective control. The effective date of this amendment is for fiscal periods beginning after December 15, 2011. We do not anticipate the adoption of this amendment to have a material impact on the Company's financial condition, results of operations or liquidity.

NOTE 2. Cash and Restricted Cash

The table below is a summary of our cash balances at September 30, 2011 and December 31, 2010:

(In thousands)	September 30, 2011	December 31, 2010
Homebuilding	$32,388	$71,874
Financial services	14,441	9,334
Unrestricted cash	$46,829	$81,208
Restricted cash	46,218	41,923
Total cash	$93,047	$123,131

Restricted cash consists of homebuilding cash the Company had designated as collateral at September 30, 2011 and December 31, 2010 in accordance with the four secured Letter of Credit Facilities that were entered into in July 2009 and the one secured Letter of Credit Facility that was entered into in June 2010 (collectively, as amended, the “Letter of Credit Facilities”). Restricted cash as of September 30, 2011 also consists of $25.0 million the Company was required to pledge as security to the lenders under the Company's three-year $140 million secured revolving credit facility dated June 9, 2010 (the "Credit Facility"). The security pledge was required in accordance with the terms of the Credit Agreement, as a result of the Company's ratios being less than both the required minimum Interest Coverage Ratio and the minimum Adjusted Cash Flow Ratio (as such terms are defined in the Credit Agreement) for the quarters ended June 30, 2011 and September 30, 2011. Restricted cash also includes cash held in escrow of $2.9 million and $3.1 million at September 30, 2011 and December 31, 2010, respectively.

NOTE 3. Fair Value Measurements

There are three measurement input levels for determining fair value: Level 1, Level 2, and Level 3. Fair values determined by Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

Assets Measured on a Recurring Basis

The Company measures both mortgage loans held for sale and interest rate lock commitments (“IRLCs”) at fair value. Fair value measurement results in a better presentation of the changes in fair values of the loans and the derivative instruments used to economically hedge them.

In the normal course of business, our financial services segment enters into contractual commitments to extend credit to buyers of single-family homes with fixed expiration dates. The commitments become effective when the borrowers “lock-in” a specified interest rate within established time frames. 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 an investor. To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into optional or mandatory delivery forward sale contracts to sell whole loans and mortgage-backed securities to broker/dealers. The forward sale contracts lock in an interest rate and price for the sale of loans similar to the specific rate lock commitments. The Company does not engage in speculative or trading derivative activities. Both the rate lock commitments to borrowers and the forward sale contracts to broker/dealers or investors are undesignated derivatives, and accordingly, are marked to fair value through earnings. Changes in fair value measurements are included in earnings in the accompanying statements of operations.

The fair value of mortgage loans held for sale is estimated based primarily on published prices for mortgage-backed securities with similar characteristics. To calculate the effects of interest rate movements, the Company 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. The Company sells the majority of its loans on a servicing released basis, and receives a servicing release premium upon sale. Thus, the value of the servicing rights included in the fair value measurement is based upon contractual terms with investors and depends on the loan type. The Company applies a fallout rate to IRLCs when measuring the fair value of rate lock commitments. Fallout is defined as locked loan commitments for which the Company does not close a mortgage loan and is based on management’s judgment and experience.

The fair value of the Company’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. The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

Loan Commitments. IRLCs are extended to certain home-buying customers who have applied for a mortgage loan and meet certain defined credit and underwriting criteria. Typically, the IRLCs will have a duration of less than six months; however, in certain markets, the duration could extend to twelve months.

Some IRLCs are committed to a specific third-party investor through the use of best-efforts whole loan delivery commitments matching the exact terms of the IRLC loan. The notional amount of the committed IRLCs and the best-efforts contracts was $1.5 million and $2.3 million at September 30, 2011 and December 31, 2010, respectively.

Uncommitted IRLCs are considered derivative instruments and are fair value adjusted, with the resulting gain or loss recorded in current earnings. At September 30, 2011 and December 31, 2010, the notional amount of the uncommitted IRLCs was $45.2 million and $24.9 million, respectively.

Forward Sales of Mortgage-Backed Securities. Forward sales of mortgage-backed securities (“FMBSs”) are used to protect uncommitted IRLC loans against the risk of changes in interest rates between the lock date and the funding date. FMBSs related to uncommitted IRLCs are classified and accounted for as non-designated derivative instruments and are recorded at fair value, with gains and losses recorded in current earnings. At September 30, 2011 and December 31, 2010, the notional amount under these FMBSs was $42.0 million and $27.0 million, respectively.

Mortgage Loans Held for Sale: Mortgage loans held for sale consist primarily of single-family residential loans collateralized by the underlying property. During the intervening period between when a loan is closed and when it is sold to an investor, the interest rate risk is covered through the use of a best-efforts contract or by FMBSs.

The notional amount of the best-efforts contracts and related mortgage loans held for sale was $5.1 million and $42.7 million at September 30, 2011 and December 31, 2010, respectively.

The notional amounts of both the FMBSs and the related mortgage loans held for sale were $30.0 million and $29.5 million, respectively, at September 30, 2011 and $2.0 million and $1.9 million, respectively, at December 31, 2010. The FMBSs are classified and accounted for as non-designated derivative instruments, with gains and losses recorded in current earnings.

The table below shows the level and measurement of assets and liabilities measured on a recurring basis at September 30, 2011 and December 31, 2010:

Description of Financial Instrument (in thousands)	Fair Value Measurements September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mortgage loans held for sale	$36,666	$—	$36,666	$—
Forward sales of mortgage-backed securities	(1,213)	—	(1,213)	—
Interest rate lock commitments	682	—	682	—
Best-efforts contracts	(115)	—	(115)	—
Total	$36,020	$—	$36,020	$—

	Fair Value		Significant Other	Significant

Description of Financial Instrument (in thousands)	Measurements December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Mortgage loans held for sale	$43,312	$—	$43,312	$—
Forward sales of mortgage-backed securities	121	—	121	—
Interest rate lock commitments	(43)	—	(43)	—
Best-efforts contracts	340	—	340	—
Total	$43,730	$—	$43,730	$—

The following table sets forth the amount of gain (loss) recognized, within our financial services revenue in the Unaudited Condensed Consolidated Statements of Operations, on assets and liabilities measured on a recurring basis:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Description (in thousands)	2011	2010	2011	2010
Mortgage loans held for sale	$1,233	$(1,339)	$3,383	$1,479
Forward sales of mortgage-backed securities	(1,350)	1,956	(1,334)	(828)
Interest rate lock commitments	497	(373)	725	474
Best-efforts contracts	(180)	22	(455)	(389)
Total gain (loss) recognized	$200	$266	$2,319	$736

The following tables set forth the fair value of the Company's derivative instruments and their location within the Unaudited Condensed Consolidated Balance Sheets for the periods indicated:

	Asset Derivatives September 30, 2011		Liability Derivatives September 30, 2011	
Description of Derivatives	Balance Sheet Location	Fair Value (in thousands)	Balance Sheet Location	Fair Value (in thousands)
Forward sales of mortgage-backed securities	Other assets	$—	Other liabilities	$1,213
Interest rate lock commitments	Other assets	682	Other liabilities	—
Best-efforts contracts	Other assets	—	Other liabilities	115
Total fair value measurements		$682		$1,328

	Asset Derivatives At December 31, 2010		Liability Derivatives At December 31, 2010	
Description of Derivatives	Balance Sheet Location	Fair Value (in thousands)	Balance Sheet Location	Fair Value (in thousands)
Forward sales of mortgage-backed securities	Other assets	$121	Other liabilities	$—
Interest rate lock commitments	Other assets	—	Other liabilities	43
Best-efforts contracts	Other assets	340	Other liabilities	—
Total fair value measurements		$461		$43

Assets Measured on a Non-Recurring Basis

The Company assesses inventory for recoverability on a quarterly basis if events or changes in local or national economic conditions indicate that the carrying amount of an asset may not be recoverable. In conducting our quarterly review for indicators of impairment on a community level, we evaluate, among other things, margins on sales contracts in backlog, the margins on homes that have been delivered, expected changes in margins with regard to future home sales over the life of the community, expected changes in margins with regard to future land sales, and the value of the land itself. We pay particular attention to communities in which inventory is moving at a slower than anticipated absorption pace, and communities whose average sales price and/or margins are trending downward and are anticipated to continue to trend downward. We also evaluate communities where management intends to lower the sales price or offer incentives in order to improve absorptions even if the community's historical results do not indicate a potential for impairment. From this review, we identify communities whose carrying values may exceed their undiscounted cash flows. For those communities whose carrying values exceed the estimated undiscounted future cash flows and which are deemed to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the communities exceeds the estimated fair value. Due to the fact that the Company's cash flow models and estimates of fair values are based upon management estimates and assumptions, unexpected changes in market conditions may lead the Company to incur additional impairment charges in the future.

Our determination of fair value is based on projections and estimates, which are Level 3 measurement inputs. Our analysis is completed at a phase level within each community; therefore, changes in local conditions may affect one or several of our communities. For all of the categories discussed below, the key assumptions relating to the valuations are dependent on project-specific local market and/or community conditions and are inherently uncertain. Because each inventory asset is unique, there are numerous inputs and assumptions used in our valuation techniques. Market factors that may impact these assumptions include:

- historical project results such as average sales price and sales pace, if closings have occurred in the project;
- competitors' market and/or community presence and their competitive actions;
- project specific attributes such as location desirability and uniqueness of product offering;
- potential for alternative product offerings to respond to local market conditions; and
- current economic and demographic conditions and related trends and forecasts.

These, and other market factors that may impact project assumptions, are considered by personnel in our homebuilding divisions as they prepare or update the forecasts for each community. Quantitative and qualitative factors other than home sales prices could significantly impact the potential for future impairments. The sales objectives can differ between communities, even within a given sub-market. For example, facts and circumstances in a given community may lead us to price our homes with the objective of yielding a higher sales absorption pace, while facts and circumstances in another community may lead us to price our homes to minimize deterioration in our gross margins, although it may result in a slower sales absorption pace. Furthermore, the key assumptions included in our estimated future undiscounted cash flows may be interrelated. For example, a decrease in estimated base sales price or an increase in home sales incentives may result in a corresponding increase in sales absorption pace. Changes in our key assumptions, including estimated average selling price, construction and development costs, absorption pace, selling strategies, or discount rates, could materially impact future cash flow and fair value estimates.

Operating Communities: If an indicator for impairment exists for existing operating communities, the recoverability of assets is evaluated by comparing the carrying amount of the assets to estimated future undiscounted net cash flows expected to be generated by the assets based on home sales. These estimated cash flows are developed based primarily on management's assumptions relating to the specific community. The significant assumptions used to evaluate the recoverability of assets include: the timing of development and/or marketing phases; projected sales price and sales pace of each existing or planned community; the estimated land development, home construction, and selling costs of the community; overall market supply and demand; the local market; and competitive conditions. Management reviews these assumptions on a quarterly basis. While we consider available information to determine what we believe to be our best estimates as of the end of a reporting period, these estimates are subject to change in future reporting periods as facts and circumstances change. Some of the most critical assumptions in the Company's cash flow models are projected absorption pace for home sales, sales prices, and costs to build and deliver homes on a community by community basis.

In order to estimate the assumed absorption pace for home sales included in the Company's cash flow models, the Company analyzes the historical absorption pace in the community as well as other communities in the geographic area. In addition, the Company considers internal and external market studies and trends, which may include, but are not limited to, statistics on population demographics, unemployment rates, foreclosure sales, and availability of competing products in the geographic area where a community is located. When analyzing the Company's historical absorption pace for home sales and corresponding internal and external market studies, the Company places greater emphasis on more current metrics and trends such as the absorption pace realized in its most recent quarters.

In order to estimate the sales prices included in its cash flow models, the Company considers the historical sales prices realized on homes it delivered in the community and other communities in the geographic area, as well as the sales prices included in its current backlog for such communities. In addition, the Company considers internal and external market studies and trends, which may include, but are not limited to, statistics on sales prices in neighboring communities, which include the impact of short sales, if any, and sales prices on similar products in non-neighboring communities in the geographic area where the community is located. When analyzing its historical sales prices and corresponding market studies, the Company places greater emphasis on more current metrics and trends such as the sales prices realized in its most recent quarters and the sales prices in current backlog. Based upon this analysis, the Company sets a sales price for each house type in the community which it believes will achieve an acceptable gross margin and sales pace in the community. This price becomes the price published to the sales force for use in its sales efforts. The Company then considers the average of these published sales prices when estimating the future sales prices in its cash flow models.

In order to arrive at the Company's assumed costs to build and deliver homes, the Company generally assumes a cost structure reflecting contracts currently in place with its vendors and subcontractors adjusted for any anticipated cost reduction initiatives or increases in cost structure. With respect to overhead included in the cash flow models, the

Company uses forecasted rates included in the Company's annual budget adjusted for actual experience that is materially different than budgeted rates.

Future Communities: If an indicator of impairment exists for raw land, land under development, or lots that management anticipates will be utilized for future homebuilding activities, the recoverability of assets is evaluated by comparing the carrying amount of the assets to estimated future undiscounted cash flows expected to be generated by the assets based on home sales, consistent with the evaluations performed for operating communities discussed above.

For raw land, land under development, or lots that management intends to market for sale to a third party, but that do not meet all of the criteria to be classified as land held for sale as discussed below, the estimated fair value of the assets is determined based on either the estimated net sales proceeds expected to be realized on the sale of the assets or the estimated fair value determined using cash flow valuation techniques.

If the Company has not yet determined whether raw land or land under development will be utilized for future homebuilding activities or marketed for sale to a third party, the Company assesses the recoverability of the inventory using a probability-weighted approach.

Land Held for Sale: Land held for sale includes land that meets all of the following six criteria: (1) management, having the authority to approve the action, commits to a plan to sell the asset; (2) the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets; (3) an active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated; (4) the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year; (5) the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and (6) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The Company records land held for sale at the lower of its carrying value or estimated fair value less costs to sell. In performing the impairment evaluation for land held for sale, management considers, among other things, prices for land in recent comparable sales transactions, market analysis and recent bona fide offers received from outside third parties, as well as actual contracts. If the estimated fair value less the costs to sell an asset is less than the current carrying value, the asset is written down to its estimated fair value less costs to sell.

Investment In Unconsolidated Limited Liability Companies: The Company evaluates its investment in Unconsolidated LLCs for potential impairment on a quarterly basis. If the fair value of the investment is less than the investment's carrying value and the Company has determined that the decline in value is other than temporary, the Company would write down the value of the investment to fair value.

The determination of whether an investment's fair value is less than the carrying value requires management to make certain assumptions regarding the amount and timing of future contributions to the Unconsolidated LLC, the timing of distribution of lots to the Company from the Unconsolidated LLC, the projected fair value of the lots at the time of distribution to the Company, and the estimated proceeds from, and timing of, the sale of land or lots to third parties. In determining the fair value of investments in Unconsolidated LLCs, the Company evaluates the projected cash flows associated with each Unconsolidated LLC. As of September 30, 2011, the Company used a discount rate of 16% in determining the fair value of investments in Unconsolidated LLCs.

In addition to the assumptions management must make to determine if the investment's fair value is less than the carrying value, management must also use judgment in determining whether the impairment is other than temporary. The factors management considers are: (1) the length of time and the extent to which the market value has been less than cost; (2) the financial condition and near-term prospects of the Company; and (3) the intent and ability of the Company to retain its investment in the Unconsolidated LLC for a period of time sufficient to allow for any anticipated recovery in market value. Because of the high degree of judgment involved in developing these assumptions, it is possible that the Company may determine the investment is not impaired in the current period but, due to passage of time or change in market conditions leading to changes in assumptions, impairment could occur.

The table below shows the level and measurement of assets and liabilities measured on a non-recurring basis for the nine months ended September 30, 2011 and the year ended December 31, 2010:

Description of asset or liability (In thousands)	Fair Value Measurements September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Inventory	$31,118	$—	$—	$31,118	$16,984

Investments in Unconsolidated LLCs	$970	$—	$—	$970	$1,029
Total fair value measurements	$32,088	$—	$—	$32,088	$18,013

Description of asset or liability (In thousands)	Fair Value Measurements December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Inventory	$16,793	$—	$—	$16,793	$12,506
Investments in Unconsolidated LLCs	$50	$—	$—	$50	$32
Total fair value measurements	$16,843	$—	$—	$16,843	$12,538

Financial Instruments

Counterparty Credit Risk. To reduce the risk associated with accounting losses that would be recognized if counterparties failed to perform as contracted, the Company limits the entities with whom management can enter into commitments. This risk of accounting loss is the difference between the market rate at the time of non-performance by the counterparty and the rate to which the Company committed.

The following table presents the carrying amounts and fair values of the Company's financial instruments at September 30, 2011 and December 31, 2010. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).

	September 30, 2011		December 31, 2010	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash, including restricted cash	$93,047	$93,047	$123,131	$123,131
Mortgage loans held for sale	36,666	36,666	43,312	43,312
Other assets	14,089	14,111	14,998	15,052
Notes receivable	883	790	919	771
Commitments to extend real estate loans	682	682	—	—
Best-efforts contracts for committed IRLCs and mortgage loans held for sale	—	—	340	340
Forward sales of mortgage-backed securities	—	—	121	121
Liabilities:				
Note payable - banks	31,658	31,658	32,197	32,197
Mortgage notes payable	5,857	6,253	5,853	6,564
Senior Notes	238,914	216,549	238,610	243,263
Commitments to extend real estate loans	—	—	43	43
Best-efforts contracts for committed IRLCs and mortgage loans held for sale	115	115	—	—
Forward sales of mortgage-backed securities	1,213	1,213	—	—
Other liabilities	45,909	45,909	38,301	38,301
Off-Balance Sheet Financial Instruments:				
Letters of credit	—	808	—	627

The following methods and assumptions were used by the Company in estimating its fair value disclosures of financial instruments at September 30, 2011 and December 31, 2010:

Cash, Restricted Cash and Other Liabilities. The carrying amounts of these items approximate fair value.

Mortgage Loans Held for Sale, Forward Sales of Mortgage-Backed Securities, Commitments to Extend Real Estate Loans, Best-Efforts Contracts for Committed IRLCs and Mortgage Loans Held for Sale, Note Payable - Other and Senior Notes. The fair value of these financial instruments was determined based upon market quotes at September 30, 2011 and December 31, 2010. The market quotes used were quoted prices for similar assets or liabilities along with inputs taken from observable market data by correlation. The inputs were adjusted to account for the condition of the asset or liability.

Other Assets and Notes Receivable. The estimated fair value was determined by calculating the present value of the amounts based on the estimated timing of receipts using discount rates that incorporate management's estimate of risk associated with the corresponding note receivable.

Note Payable - Banks. The interest rate available to the Company fluctuates with the Alternate Base Rate or the Eurodollar Rate (for the Credit Facility) or LIBOR (for M/I Financial Corp.'s $50 million secured mortgage warehousing agreement dated April 18, 2011 (the "MIF Mortgage Warehousing Agreement")), and thus their carrying value is a reasonable estimate of fair value.

Mortgage Notes Payable. The estimated fair value was determined by calculating the present value of the future cash flows using the Company's current incremental borrowing rate.

Letters of Credit. Letters of credit of $38.0 million and $39.2 million represent potential commitments at September 30, 2011 and December 31, 2010, respectively. The letters of credit generally expire within one or two years. The estimated fair value of letters of credit was determined using fees currently charged for similar agreements.

NOTE 4. Inventory

A summary of the Company's inventory as of September 30, 2011 and December 31, 2010 is as follows:

(In thousands)	September 30, 2011	December 31, 2010
Single-family lots, land and land development costs	$240,916	$262,960
Homes under construction	204,338	151,524
Model homes and furnishings - at cost (less accumulated depreciation: September 30, 2011 - $3,989; December 31, 2010 - $3,230)	28,425	23,255
Community development district infrastructure	6,348	7,112
Land purchase deposits	3,081	1,965
Consolidated inventory not owned	8,253	4,120
Total inventory	$491,361	$450,936

Single-family lots, land and land development costs include raw land that the Company has purchased to develop into lots, costs incurred to develop the raw land into lots, and lots for which development has been completed but which have not yet been used to start construction of a home.

Homes under construction includes homes that are in various stages of construction. As of September 30, 2011 and December 31, 2010, we had 638 homes (with a carrying value of $80.8 million) and 561 homes (with a carrying value of $74.4 million), respectively, included in homes under construction that were not subject to a sales contract.

Model homes and furnishings include homes that are under construction or have been completed and are being used as sales models. The amount also includes the net book value of furnishings included in our model homes. Depreciation on model home furnishings is recorded using an accelerated method over the estimated useful life of the assets, typically three years.

The Company assesses inventory for recoverability on a quarterly basis, by reviewing for impairment whenever events or changes in local or national economic conditions indicate that the carrying amount of an asset may not be recoverable. Refer to Note 3 for additional details relating to our procedures for evaluating our inventories for impairment.

Land purchase deposits include both refundable and non-refundable amounts paid to third party sellers relating to the purchase of land. On an ongoing basis, the Company evaluates the land option agreements relating to the land purchase deposits. In the period during which the Company makes the decision not to proceed with the purchase of land under an agreement, the Company writes off any deposits and accumulated pre-acquisition costs relating to such agreement. For the three and nine months ended September 30, 2011, the Company wrote off $0.1 million and $0.4 million, respectively, in option deposits and pre-acquisition costs. Refer to Note 5 for additional details relating to write-offs of land option deposits and pre-acquisition costs.

NOTE 5. Valuation Adjustments and Write-offs

The Company assesses inventory for recoverability on a quarterly basis, by reviewing for impairment whenever events or changes in local or national economic conditions indicate that the carrying amount of an asset may not be recoverable.

A summary of the Company's valuation adjustments and write-offs for the three and nine months ended September 30, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2011	2010	2011	2010
Impairment of operating communities:				
Midwest	$962	$141	$3,944	$276
Southern	594	72	2,459	583
Mid-Atlantic	—	110	17	3,086
Total impairment of operating communities (a)	$1,556	$323	$6,420	$3,945
Impairment of future communities:				
Midwest	$141	$—	$6,519	$2,837
Southern	—	1,473	3,455	3,134
Mid-Atlantic	—	—	—	1,290
Total impairment of future communities (a)	$141	$1,473	$9,974	$7,261
Impairment of land held for sale:				
Midwest	$—	$—	$—	$—
Southern	—	—	590	—
Mid-Atlantic	—	—	—	—
Total impairment of land held for sale (a)	$—	$—	$590	$—
Option deposits and pre-acquisition costs write-offs:				
Midwest	$121	$5	$143	$94
Southern	19	94	56	95
Mid-Atlantic	—	41		