Comstock Homebuilding Companies, Inc.
Form 10-Q
May 13, 2009
Table of Contents

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 March 31, 2009

¨ **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 1-32375

Comstock Homebuilding Companies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-1164345**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

11465 Sunset Hills Road

5th Floor

Reston, Virginia 20190

(703) 883-1700

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

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 website, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ¨ NO ¨

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

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

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

As of April 30, 2009, 15,211,499 shares of the Class A common stock, par value $.01 per share, and 2,733,500 shares of Class B common stock, par value $0.01, of the Registrant were outstanding.

Table of Contents

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

FORM 10-Q

INDEX

Table of Contents

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)

	March 31, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 3,146	$ 5,977
Restricted cash	4,028	3,859
Receivables		
Due from related parties	77	
Real estate held for development and sale	126,123	129,542
Inventory not owned variable interest entities	19,250	19,250
Property, plant and equipment, net	661	829
Other assets	1,450	1,402
TOTAL ASSETS	$ 154,735	$ 160,859
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable and accrued liabilities	$ 7,188	$ 8,232
Obligations related to inventory not owned	19,050	19,050
Notes payable secured by real estate	82,123	84,563
Notes payable unsecured	18,209	18,266
TOTAL LIABILITIES	126,570	130,111
Commitments and contingencies (Note 9)		
SHAREHOLDERS EQUITY		
Class A common stock, $0.01 par value, 77,266,500 shares authorized, 15,608,438 and 15,608,438 issued and outstanding, respectively	156	156
Class B common stock, $0.01 par value, 2,733,500 shares authorized, 2,733,500 issued and outstanding	27	27
Additional paid-in capital	157,119	157,058
Treasury stock, at cost (391,400 Class A common stock)	(2,439)	(2,439)
Accumulated deficit	(126,921)	(124,277)
TOTAL COMSTOCK HOMEBUILDING COMPANIES, INC SHAREHOLDERS EQUITY	27,942	30,525
Noncontrolling interest	223	223
TOTAL EQUITY	28,165	30,749
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 154,735	$ 160,859

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	Three Months Ended March 31, 2009	2008
Revenues		
Revenue homebuilding	$ 4,726	$ 15,940
Revenue other	797	436
Total revenue	5,523	16,376
Expenses		
Cost of sales homebuilding	4,145	13,940
Cost of sales other		28
Impairments and write-offs		832
Selling, general and administrative	2,575	3,788
Interest, real estate taxes and indirect costs related to inactive projects	1,800	758
Operating loss	(2,997)	(2,970)
Loss (gain) on troubled debt restructuring		(8,325)
Other (income) loss, net	(353)	(1,185)
Total pre tax (loss) income	(2,644)	6,540
Income taxes expense	2	
Net (loss) income	(2,646)	6,540
Net (loss) income attributable to noncontrolling interest	1	2
Net (loss) income attributable to Comstock Homebuilding Companies, Inc	$ (2,645)	$ 6,542
Basic (loss) earnings per share	(0.15)	$ 0.40
Basic weighted average shares outstanding	17,554	16,544
Diluted (loss) earnings per share	(0.15)	$ 0.39
Diluted weighted average shares outstanding	17,554	16,589

The accompanying notes are an integral part of these consolidated financial statements.

2

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands, except per share data)

	Three Months Ended March 31, 2009	2008
Cash flows from operating activities:		
Net (loss) gain	$ (2,646)	$ 6,540
Adjustment to reconcile net (loss) gain to net cash provided by operating activities		
Amortization and depreciation	168	178
Impairments and write-offs		832
Gain on troubled debt restructuring		(8,325)
Gain on trade payable settlements	(333)	
Board of directors compensation		50
Amortization of stock compensation	61	25
Changes in operating assets and liabilities:		
Restricted cash	(169)	(455)
Receivables		(352)
Due from related parties	(77)	1
Real estate held for development and sale	3,419	(185)
Other assets	(48)	17,869
Accrued interest	1,233	
Accounts payable and accrued liabilities	(711)	(9,133)
Net cash provided by (used in) operating activities	897	7,045
Cash flows from investing activities:		
Purchase of property, plant and equipment		
Net cash provided by (used in) investing activities		
Cash flows from financing activities:		
Proceeds from notes payable	277	24,880
Payments on notes payable	(4,005)	(24,583)
Proceeds from shares issued under employee stock purchase plan		5
Net cash provided by (used in) financing activities	(3,728)	302
Net decrease in cash and cash equivalents	(2,831)	7,347
Cash and cash equivalents, beginning of period	5,977	6,822
Cash and cash equivalents, end of period	$ 3,146	$ 14,169
Supplemental disclosure for non-cash activity:		
Interest incurred but not paid in cash	$ 1,233	$ 290
Warrants issued in connection with troubled debt restructuring	$	$ 720

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

1. ORGANIZATION AND BASIS OF PRESENTATION

Comstock Companies, Inc. (the Company) was incorporated on May 24, 2004 as a Delaware corporation. On June 30, 2004, the Company changed its name to Comstock Homebuilding Companies, Inc.

On December 17, 2004, as a result of completing its initial public offering (IPO) of its Class A common stock, the Company acquired 100% of the outstanding capital stock of Comstock Holding Company, Inc. and subsidiaries (Comstock Holdings) by merger, which followed a consolidation that took place immediately prior to the closing of the IPO (the Consolidation). The Consolidation was effected through the mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries and Comstock Service Corp., Inc. and subsidiaries (Comstock Service) with and into Comstock Holdings. Pursuant to the terms of the merger agreement, shares of Comstock Holdings were canceled and replaced by 4,333 and 2,734 shares Class A and B common stock of the Company, respectively. Both Class A and B common stock shares bear the same economic rights. However, for voting purposes, Class A stock holders are entitled to one vote for each share held while Class B stock holders are entitled to fifteen votes for each share held.

The mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries with and into Comstock Holdings (collectively the Comstock Companies or Predecessor) and the Company s acquisition of Comstock Holdings was accounted for using the Comstock Companies historical carrying values of accounting as these mergers were not deemed to be substantive exchanges. The merger of Comstock Service was accounted for using the purchase method of accounting (see Note 2) as this was deemed to be a substantive exchange due to the disparity in ownership.

The Company s Class A common stock is traded on the NASDAQ Global market (NASDAQ) under the symbol CHCI and has no public trading history prior to December 17, 2004. In January 2008 the Company was notified by NASDAQ that it was not in compliance with requirements related to its listing on the NASDAQ Global Market. The Company was granted 180 days to regain compliance. On July 9, 2008 the Company was notified that it had not regained compliance and was going to be delisted from the NASDAQ Global Market. The Company requested a hearing on September 4, 2008 to appeal this decision and seek an additional extension. On October 24, 2008 the Company received a notice from NASDAQ indicating that the NASDAQ Listing Qualifications Panel had granted the Company s request for continued listing. The notice from NASDAQ indicated that continued listing was subject to: 1) the Company evidencing a closing bid price of $1.00 or more for a minimum of ten consecutive trading days on or before April 9, 2009, and 2) the Company evidencing a minimum market value of publicly held shares of $5,000 on or before May 10, 2009. In January 2009 and again in March 2009 NASDAQ suspended compliance obligations with respect to these rules. Our deadlines for compliance are now estimated to be October 13, 2009 and November 10, 2009.

The Company develops, builds and markets single-family homes, townhouses and condominiums in the Washington D.C., Raleigh, North Carolina and Atlanta, Georgia metropolitan markets. The Company also provides certain management and administrative support services to certain related parties.

The homebuilding industry is cyclical and significantly affected by changes in national and local economic, business and other conditions. During 2006, new home sales in our markets began to slow and that trend has continued to worsen in 2009. In response to these conditions, the Company has significantly reduced selling, general and administrative expenses in an effort to align its cost structure with the current level of sales activity, slowed land acquisition, delayed land development and construction activities (except where required for near term sales). The Company has also offered for sale various developed lots and land parcels that the Company believes are not needed based on carrying costs and anticipated absorption rates. Additional reductions may be required as the downturn is expected to continue throughout 2009.

Liquidity Developments

During 2008 and continuing into 2009 the banking and credit markets experienced severe disruption as a result of a collapse in the sub-prime and securitized debt markets. As a result, commercial banks and other unregulated lenders have experienced a liquidity crisis which has made funding for real estate funding extremely difficult to secure. This tightening of the credit markets presents substantial risk to our ability to secure financing for our operations, construction and land development efforts. In addition, this disruption is affecting our customers ability to secure mortgage financing for the purchase of our homes. This limitation on available credit is having a devastating effect on our sales and revenue in 2009 which will further undermine our ability to generate enough cash to fund our operations, meet our obligations and survive as a going concern. This continuing erosion of our liquidity could result in our need to seek bankruptcy protections either for certain subsidiary entities or the Company as a whole.

Under normal market conditions it is customary for lenders in our industry to renew and extend debt obligations until a project or collection of projects is completed provided the obligations are kept current. This is no longer the case in our industry. Liquidity constraints among banks have limited their ability and willingness to renew loan facilities. As recently reported, and as further discussed in Note 14, several of the Company s loan facilities have matured with no extensions negotiated. At March 31, 2009 the Company and its subsidiaries had $24.3 million of cash obligations to debt which had either already matured or have payment obligations during the remainder of 2009. The Company is the guarantor of $79.1 million of debt, including that of subsidiaries. As a result, any significant failure to negotiate renewals and extensions to its debt obligations would severely compromise the Company s liquidity and would jeopardize the Company s ability to satisfy its capital requirements. This inability to meet our capital requirements could result in our need to seek bankruptcy protections either for certain subsidiary entities or the Company as a whole.

In response to changing conditions in the banking industry the Company retained external consultants in the second quarter of 2008 to act as a financial advisor to the Company in exploring debt restructuring and alternatives for raising additional capital for the Company. In connection with the exploration of available debt restructuring alternatives, the Company then elected to cease making certain scheduled interest and/or principal curtailment payments while it attempted to negotiate modifications or other satisfactory resolutions from its lenders. During 2008 the Company reported several loan covenant violations and notices of default from several of its lenders. As discussed further in Note 14, these violations and notices led to foreclosures of certain assets and have resulted in certain guarantee enforcement actions being initiated against the Company where no foreclosures have taken place. Many of the Company s loan facilities contain Material Adverse Effect clauses which, if invoked, could create an event of default under those loans. In the event certain of the Company s loans were deemed to be in default as a result of a Material Adverse Effect, the Company s ability to meet its cash flow and debt obligations would be compromised. During the fourth quarter of 2009 the Company discontinued its relationship with its external advisory consultants. The Company has continued to negotiate with its lenders into 2009 and has continued to report default notices and debt restructurings as they occur. The Company may consent to additional foreclosure actions in the future as a result of the continuing distress in the real estate and credit markets. The Company cannot at this time provide any assurances that it will be successful in its continuing efforts to work with its lenders on loan modifications. This inability to renegotiate debt could result in our need to seek bankruptcy protections either for certain subsidiary entities or the Company as a whole.

We require capital to operate, to post deposits on new deals, to purchase and develop land, to construct homes, to fund related carrying costs and overhead and to fund various advertising and marketing programs to generate sales. These expenditures include payroll, community engineering, entitlement, architecture, advertising, utilities and interest as well as the construction costs of our homes and related community amenities. Our current operations and inventory of owned and controlled home sites will require substantial capital to develop and construct. Our overall borrowing capacity is constrained by various loan covenants. There is no assurance either that we will return to compliance in the future or that our lenders will continue to refrain for exercising their rights related to our covenant violations. In the event our banks discontinue funding, accelerate the maturities of their facilities, refuse to waive future covenant defaults or refuse to renew the facilities at maturity we could experience an unrecoverable liquidity crisis in the future. We can make no assurances that cash advances available under our credit facilities, refinancing of existing underleveraged projects or access to public debt and equity markets will provide us with access to sufficient capital to meet our existing and expected operating capital needs in 2009. If we fail to meet our cash flow requirements we may be required to seek bankruptcy protection or to liquidate.

At March 31, 2009 we had $3.1 million in unrestricted cash and $4.0 million of restricted cash. Included in our restricted cash balance is $3.0 million on deposit with Wachovia as cash collateral for a $3.0 million irrevocable letter of credit relating to a captive insurance program. We are working with the insurance provider to obtain a release of, or reduction to, the letter of credit. Our access to working capital is very limited and our debt service obligations and operating costs for 2009 exceed our current cash reserves. If we are unable to identify new sources of liquidity and/or successfully modify our existing facilities, we will likely deplete our cash reserves and be forced to file for bankruptcy protection. There can be no assurances that in that event we would be able to reorganize through bankruptcy, and we might be forced into a trustee managed liquidation of our assets.

2. REAL ESTATE HELD FOR DEVELOPMENT AND SALE

Real estate held for development and sale includes land, land development costs, interest and other construction costs. Real estate held for sale is carried at the lower of cost or market less selling expenses. Land held for development is stated at cost, or when circumstances or events indicate that the land is impaired, at estimated fair value. Land, land development and indirect land development costs are accumulated by specific project and allocated to various lots or housing units within that project using specific identification and allocation based upon the relative sales value, unit or area methods. Direct construction costs are assigned to housing units based on specific identification. Construction costs primarily include direct construction costs and capitalized field overhead. Other costs are comprised of prepaid local government fees and capitalized interest and real estate taxes. Selling costs are expensed as incurred.

Estimated fair value is based on comparable sales of real estate in the normal course of business under existing and anticipated market conditions. The evaluation takes into consideration the current status of the property, various restrictions, carrying costs, costs of disposition and any other circumstances, which may affect fair value including management s plans for the property. Due to the large acreage of certain land holdings, disposition in the normal course of business is expected to extend over a number of years. A write-down to estimated fair value is recorded when the net carrying value of the property exceeds its estimated undiscounted fair value. These evaluations are made on a property-by-property basis as seen fit by management whenever events or changes in circumstances indicate that the net book value may not be recoverable.

Deteriorating market conditions, turmoil in the credit markets and increased price competition have continued to negatively impact the Company during 2008 and into the first quarter of 2009 resulting in reduced sales prices, increased customer concessions, reduced gross margins and extended estimates for project completion dates. The Company evaluates its projects on a quarterly basis to determine if recorded carrying amounts are recoverable. This quarter, the evaluation resulted in no impairment charges as compared to impairment charges of $828 for the three months ended March 31, 2008. These impairment evaluations are based both on a discounted cash flow models and projected liquidation values. Discounted cash flow models are dependent upon several subjective factors, including the selection of an appropriate discount rate, estimated average sales prices and estimated sales pace. In performing its impairment modeling the Company must select what it believes is an appropriate discount rate based on current market cost of capital and returns expectations. The Company has used its best judgment in determining an appropriate discount rate based on anecdotal information it has received from marketing its deals for sale in recent months. The Company has elected to use a rate of 17% in its discounted cash flow model. While the selection of a 17% discount rate was subjective in nature, the Company believes it is an appropriate rate in the current market. The estimates used by the Company are based on the best information available at the time the estimates were made. In the past, the Company has resorted to friendly-foreclosure and/or deed-in-lieu transactions as a way to address bank loans that have matured where extensions are not available and loans where covenant violations cannot be cured. The Company may be forced to return to this strategy in the future if it cannot resolve certain existing loan maturities and loan defaults. When an asset is turned over to a bank in a foreclosure action, all carrying cost in excess of the debt (net carry value) is recorded as a loss. To the extent our net carry value is negative and there is no post foreclosure deficiency liability, the difference is recorded as a gain.

If market conditions continue to deteriorate, additional adverse changes to these estimates in future periods could result in further material impairment amounts to be recorded. In addition, and from time to time, the Company will write-off deposits it has made for options on land that it has decided not to purchase. These deposits and any related capitalized pre-acquisition feasibility or project costs are written off at the earlier of the option expiration or the decision to terminate the option.

The following table summarizes impairment charges and write-offs for the three months ended:

	March 31, 2009	March 31, 2008
Impairments	$	$ 828
Write-offs		4
	$	$ 832

After impairments and write-offs, real estate held for development and sale consists of the following:

	March 31, 2009	December 31, 2008
Land and land development costs	$ 50,685	$ 51,421
Cost of construction (including capitalized interest and real estate taxes)	75,438	78,121
	$ 126,123	$ 129,542

3. CONSOLIDATION OF VARIABLE INTEREST ENTITIES

The Company typically acquires land for development at market prices from various entities under fixed price purchase agreements. The purchase agreements require deposits that may be forfeited if the Company fails to perform under the agreements. The deposits required under the purchase agreements are in the form of cash or letters of credit in varying amounts. The Company may, at its option, choose for any reason and at any time not to perform under these purchase agreements by delivering notice of its intent not to acquire the land under contract. The Company s sole legal obligation and economic loss for failure to perform under these purchase agreements is typically limited to the amount of the deposit pursuant to the liquidated damages provision contained within the purchase agreement. As a result, none of the creditors of any of the entities with which the Company enters into forward fixed price purchase agreements have recourse to the general credit of the Company.

COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

The Company also does not share in an allocation of either the profit earned or loss incurred by any of these entities with which the Company has fixed price purchase agreements. The Company has concluded that whenever it options land or lots from an entity and pays a significant non-refundable deposit as described above, a variable interest entity is created under the provisions of Financial Accounting Standards Board (FASB) issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46-R). This is because the Company has been deemed to have provided subordinated financial support, which creates a variable interest which limits the equity holder s returns and may absorb some or all of an entity s expected theoretical losses if they occur. The Company, therefore, examines the entities with which it has fixed price purchase agreements for possible consolidation by the Company under FIN 46-R. This requires the Company to compute expected losses and expected residual returns based on the probability of future cash flows as outlined in FIN 46-R. This calculation requires substantial management judgments and estimates. In addition, because the Company does not have any contractual or ownership interests in the entities with which it contracts to buy the land, the Company does not have the ability to compel these development entities to provide financial or other data to assist the Company in the performance of the primary beneficiary evaluation.

The Company has evaluated its fixed price purchase agreement with Belmont Bay, LC relating to Phase II of Beacon Park and has determined that it is the primary beneficiary of that entity. See Note 9 for a status of the Company s litigation with Belmont Bay, LC related to the Beacon Park condominium purchase money promissory note. As a result, at March 31, 2009 and December 31, 2008, the Company consolidated one entity in the accompanying consolidated balance sheets. The effect of the consolidation was the inclusion of $19,250 in Inventory not owned-variable interest entities with a corresponding inclusion of $19,050 (net of land deposits paid of $200) to Obligations related to inventory not owned. Creditors, if any, of this variable interest entity have no recourse against the Company relating to this purchase contract.

4. WARRANTY RESERVE

Warranty reserves for houses settled are established to cover potential costs for materials and labor with regard to warranty-type claims expected to arise during the one-year warranty period provided by the Company or within the five-year statutorily mandated structural warranty period. Since the Company subcontracts its homebuilding work, subcontractors are required to provide the Company with an indemnity and a certificate of insurance prior to receiving payments for their work. Claims relating to workmanship and materials are generally the primary responsibility of the subcontractors and product manufacturers. The warranty reserve is established at the time of closing, and is calculated based upon historical warranty cost experience and current business factors. Variables used in the calculation of the reserve, as well as the adequacy of the reserve based on the number of homes still under warranty, are reviewed on a periodic basis. Warranty claims are directly charged to the reserve as they arise. The following table is a summary of warranty reserve activity which is included in accounts payable and accrued liabilities: