

M I HOMES INC
Form 10-Q
October 25, 2013

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2013

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company	

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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: 24,357,943 shares outstanding as of October 23, 2013.

M/I HOMES, INC.
FORM 10-Q

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

(Dollars in thousands, except par values)	September 30, 2013	December 31, 2012
ASSETS:		
Cash and cash equivalents	\$ 142,475	\$ 145,498
Restricted cash	15,806	8,680
Mortgage loans held for sale	60,388	71,121
Inventory	676,336	556,817
Property and equipment - net	10,346	10,439
Investment in unconsolidated joint ventures	34,088	11,732
Deferred income taxes, net of valuation allowance of \$14.9 million and \$135.7 million at September 30, 2013 and December 31, 2012, respectively	112,682	—
Other assets	30,946	27,013
TOTAL ASSETS	\$ 1,083,067	\$ 831,300
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Accounts payable	\$ 85,804	\$ 47,690
Customer deposits	14,918	10,239
Other liabilities	62,310	49,972
Community development district ("CDD") obligations	3,419	4,634
Obligation for consolidated inventory not owned	1,576	19,105
Notes payable bank - financial services operations	55,614	67,957
Notes payable - other	8,126	11,105
Convertible senior subordinated notes due 2017	57,500	57,500
Convertible senior subordinated notes due 2018	86,250	—
Senior notes	227,970	227,670
TOTAL LIABILITIES	603,487	495,872
Commitments and contingencies	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares - \$.01 par value; authorized 2,000,000 shares; 2,000 and 4,000 shares issued at September 30, 2013 and December 31, 2012, respectively; 2,000 and 4,000 shares outstanding as of September 30, 2013 and December 31, 2012, respectively	48,163	96,325
Common shares - \$.01 par value; authorized 38,000,000 shares; issued 27,092,723 and 24,631,723 shares at September 30, 2013 and December 31, 2012, respectively	271	246
Additional paid-in capital	235,880	180,289
Retained earnings	249,582	117,048
Treasury shares - at cost - 2,734,780 and 2,944,470 shares at September 30, 2013 and December 31, 2012, respectively	(54,316)	(58,480)
TOTAL SHAREHOLDERS' EQUITY	479,580	335,428
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,083,067	\$ 831,300

See Notes to Unaudited Condensed Consolidated Financial Statements.

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

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue	\$275,195	\$208,875	\$700,475	\$510,994
Costs and expenses:				
Land and housing	218,150	164,452	556,799	408,893
Impairment of inventory and investment in unconsolidated joint ventures	2,136	1,309	4,237	1,876
General and administrative	18,261	16,016	52,389	42,299
Selling	17,999	14,647	47,383	38,483
Equity in income of unconsolidated joint ventures	(278)	—	(278)	—
Interest	3,449	3,999	12,186	12,066
Loss on early extinguishment of debt	1,726	—	1,726	—
Total costs and expenses	261,443	200,423	674,442	503,617
Income before income taxes	13,752	8,452	26,033	7,377
(Benefit) provision for income taxes	(111,559)	138	(111,129)	(955)
Net income	\$125,311	\$8,314	\$137,162	\$8,332
Preferred dividends	1,219	—	2,438	—
Excess of fair value over book value of preferred shares redeemed	—	—	2,190	—
Net income to common shareholders	\$124,092	\$8,314	\$132,534	\$8,332
Earnings per common share:				
Basic	\$5.09	\$0.43	\$5.61	\$0.44
Diluted	\$4.22	\$0.42	\$4.79	\$0.43
Weighted average shares outstanding:				
Basic	24,358	19,434	23,642	19,014
Diluted	29,745	20,273	28,410	19,238

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Dollars in thousands)	Nine Months Ended		September 30, 2013		Additional Paid-in Capital	Retained Earnings	Treasury Shares	Total Shareholders' Equity
	Preferred Shares	Common Shares	Preferred Shares	Common Shares				
	Shares Outstanding	Amount	Shares Outstanding	Amount				
Balance at December 31, 2012	4,000	\$96,325	21,687,253	\$ 246	\$180,289	\$117,048	\$(58,480)	\$ 335,428
Net income	—	—	—	—	—	137,162	—	137,162
Fair value over carrying value of preferred shares redeemed	—	2,190	—	—	—	(2,190)	—	—
Dividends to shareholders, \$609.375 per preferred share	—	—	—	—	—	(2,438)	—	(2,438)
Common share issuance	—	—	2,461,000	25	54,592	—	—	54,617
Preferred shares redeemed	(2,000)	(50,352)	—	—	—	—	—	(50,352)
Income tax effect of stock options and executive deferred compensation distributions	—	—	—	—	383	—	—	383
Stock options exercised	—	—	184,832	—	(1,031)	—	3,671	2,640
Stock-based compensation expense	—	—	—	—	1,835	—	—	1,835
Deferral of executive and director compensation	—	—	—	—	305	—	—	305
Executive and director deferred compensation distributions	—	—	24,858	—	(493)	—	493	—
Balance at September 30, 2013	2,000	\$48,163	24,357,943	\$ 271	\$235,880	\$249,582	\$(54,316)	\$ 479,580

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September	
	30,	2012
(Dollars in thousands)	2013	2012
OPERATING ACTIVITIES:		
Net income	\$137,162	\$8,332
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Inventory valuation adjustments and abandoned land transaction write-offs	4,237	2,132
Equity in income of unconsolidated joint ventures	(278)	—
Bargain purchase gain	—	(1,219)
Mortgage loan originations	(426,636)	(355,075)
Proceeds from the sale of mortgage loans	439,151	354,443
Fair value adjustment of mortgage loans held for sale	(1,782)	(431)
Depreciation	3,777	4,940
Amortization of intangibles, debt discount and debt issue costs	2,555	1,822
Loss on early extinguishment of debt	1,726	—
Stock-based compensation expense	1,835	1,398
Deferred income tax expense	9,190	3,721
Deferred tax asset valuation allowances	(120,836)	(3,721)
Other	—	50
Change in assets and liabilities:		
Cash held in escrow	148	(37)
Inventory	(142,642)	(71,236)
Other assets	(2,443)	(4,030)
Accounts payable	38,114	23,016
Customer deposits	4,679	6,604
Accrued compensation	1,767	1,667
Other liabilities	9,840	11,303
Net cash used in operating activities	(40,436)	(16,321)
INVESTING ACTIVITIES:		
Change in restricted cash	(7,274)	32,391
Purchase of property and equipment	(1,654)	(858)
Return of capital from unconsolidated joint ventures	1,522	—
Acquisition, net of cash acquired	—	(4,707)
Investment in unconsolidated joint ventures	(25,496)	(949)
Net cash (used in) provided by investing activities	(32,902)	25,877
FINANCING ACTIVITIES:		
Repayment of senior notes, including transaction costs	—	(41,443)
Net proceeds from issuance of senior notes	—	29,700
Proceeds from issuance of convertible senior subordinated notes due 2018	86,250	—
Proceeds from issuance of convertible senior subordinated notes due 2017	—	57,500
Repayments of bank borrowings - net	(12,343)	2,234
	(2,979)	4,968

(Principal repayments of) proceeds from notes payable-other and CDD bond obligations

Dividends paid on preferred shares	(2,438)	—
Net proceeds from issuance of common shares	54,617		42,085
Redemption of preferred shares	(50,352)	—
Debt issue costs	(5,463)	(5,843
Proceeds from exercise of stock options	2,640		1,215
Excess tax deficiency from stock-based payment arrangements	383		—
Net cash provided by financing activities	70,315		90,416
Net (decrease) increase in cash and cash equivalents	(3,023)	99,972
Cash and cash equivalents balance at beginning of period	145,498		59,793
Cash and cash equivalents balance at end of period	\$142,475		\$159,765

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the year for:

Interest — net of amount capitalized	\$4,977		\$5,442
Income taxes	\$679		\$280

NON-CASH TRANSACTIONS DURING THE PERIOD:

Community development district infrastructure	\$(1,215)	\$(995
Consolidated inventory not owned	\$(17,529)	\$3,608
Distribution of single-family lots from unconsolidated joint ventures	\$1,912		\$—

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, 2012 (the “2012 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 joint ventures, 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 2012 Form 10-K, as the same may be updated from time to time in our subsequent filings with the SEC.

Reclassifications

The Company reclassified certain amounts presented in the Supplemental Condensed Consolidating Balance Sheet for the period ended December 31, 2012 and the Supplemental Condensed Consolidating Statement of Cash Flows for the nine months ended September 30, 2012 included in Note 13. The Company believes these reclassifications are immaterial to the supplemental condensed consolidating financial statements which are presented as supplemental information. These reclassifications do not affect the Company's consolidated financial statements for either period.

Impact of New Accounting Standards

In January 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-01: Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities (“ASU 2013-01”). ASU 2013-01 amended ASU 2011-11 and will enhance disclosures required by the United States Generally Accepted Accounting Principles (“U.S. GAAP”) by requiring additional information about financial and derivative instruments that are either (1) offset in accordance with Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with Section 210-20-45 or Section 815-10-45. We are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and for interim periods within those annual periods. The Company adopted this standard on January 1, 2013, and the adoption did not have a material impact on its Unaudited Condensed Consolidated Financial Statements.

In April 2013, the FASB issued ASU No. 2013-04: Liabilities (“ASU 2013-04”), which provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. ASU 2013-04 is effective for us beginning January 1, 2014. The Company does not anticipate the adoption of this guidance will have a material impact on its Unaudited Condensed Consolidated Financial Statements or disclosures.

In July 2013, the FASB issued ASU No. 2013-11: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (“ASU 2013-11”). The amendments in ASU 2013-11 are intended to end inconsistent practices regarding the presentation of unrecognized tax benefits on the balance sheet. An entity will be required to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss (“NOL”) or tax credit carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. An entity is required to apply the amendments prospectively for annual reporting periods

beginning after December 15, 2013, and for interim periods within those annual periods. Early adoption and retrospective application are permitted. The Company does not anticipate the adoption of this guidance will have a material impact on its Unaudited Condensed Consolidated Financial Statements or disclosures.

NOTE 2. 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. 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 trading or 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 generally sells 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 company 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.

Interest Rate Lock 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. Uncommitted IRLCs are considered derivative instruments and are fair value adjusted, with the resulting gain or loss recorded in current earnings.

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.

Mortgage Loans Held for Sale. Mortgage loans held for sale consists primarily of single-family residential loans collateralized by the underlying property. Generally, all of the mortgage loans and related servicing rights are sold to third-party investors shortly after origination. 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 FMBSs are classified and accounted for as non-designated derivative instruments, with gains and losses recorded in current earnings.

The table below shows the notional amounts of our financial instruments at September 30, 2013 and December 31, 2012:

Description of financial instrument (in thousands)	September 30, 2013	December 31, 2012
Best efforts contracts and related committed IRLCs	\$4,417	\$1,184
Uncommitted IRLCs	79,594	25,854
FMBSs related to uncommitted IRLCs	80,000	26,000
Best efforts contracts and related mortgage loans held for sale	3,025	25,441
FMBSs related to mortgage loans held for sale	55,000	44,000
Mortgage loans held for sale covered by FMBSs	54,720	44,524

The table below shows the level and measurement of assets and liabilities measured on a recurring basis at September 30, 2013 and December 31, 2012:

Description of Financial Instrument (in thousands)	Fair Value Measurements September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mortgage loans held for sale	\$60,388	\$—	\$60,388	\$—
Forward sales of mortgage-backed securities	(1,971)	—	(1,971)	—
Interest rate lock commitments	942	—	942	—
Best-efforts contracts	(179)	—	(179)	—
Total	\$59,180	\$—	\$59,180	\$—

Description of Financial Instrument (in thousands)	Fair Value Measurements December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mortgage loans held for sale	\$71,121	\$—	\$71,121	\$—
Forward sales of mortgage-backed securities	253	—	253	—
Interest rate lock commitments	1	—	1	—
Best-efforts contracts	(3)	—	(3)	—
Total	\$71,372	\$—	\$71,372	\$—

The following table sets forth the amount of (loss) gain recognized, within our revenue in the Unaudited Condensed Consolidated Statements of Operations, on assets and liabilities measured on a recurring basis for the three and nine months ended September 30, 2013 and 2012:

Description (in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Mortgage loans held for sale	\$3,365	\$328	\$1,782	\$431
Forward sales of mortgage-backed securities	(5,262)	(838)	(2,224)	(925)
Interest rate lock commitments	1,677	341	941	328
Best-efforts contracts	(193)	(84)	(176)	(77)
Total (loss) gain recognized	\$(413)	\$(253)	\$323	\$(243)

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 (except for mortgage loans held for sale which is disclosed as a separate line item):

Description of Derivatives	Asset Derivatives September 30, 2013		Liability Derivatives September 30, 2013	
	Balance Sheet Location	Fair Value (in thousands)	Balance Sheet Location	Fair Value (in thousands)
Forward sales of mortgage-backed securities	Other assets	\$—	Other liabilities	\$1,971
Interest rate lock commitments	Other assets	942	Other liabilities	—
Best-efforts contracts	Other assets	—	Other liabilities	179
Total fair value measurements		\$942		\$2,150
Description of Derivatives	Asset Derivatives December 31, 2012		Liability Derivatives December 31, 2012	
	Balance Sheet Location	Fair Value (in thousands)	Balance Sheet Location	Fair Value (in thousands)
Forward sales of mortgage-backed securities	Other assets	\$253	Other liabilities	\$—
Interest rate lock commitments	Other assets	1	Other liabilities	—
Best-efforts contracts	Other assets	—	Other liabilities	3
Total fair value measurements		\$254		\$3

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, the value of the land itself as well as any results from third party appraisals. 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 the review of all of these factors, we identify communities whose carrying values may exceed their estimated undiscounted future cash flows and run a test for recoverability. 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 and/or changes in management's intentions with respect to the inventory 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 listed 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 or a reduction in base house costs. 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.

As of September 30, 2013, our projections generally assume a gradual improvement in market conditions over time. If communities are not recoverable based on estimated future undiscounted cash flows, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. The fair value of a community is estimated by discounting management's cash flow projections using an appropriate risk-adjusted interest rate. As of September 30, 2013, we utilized discount rates ranging from 13% to 16% in our valuations. The discount rate used in determining each asset's estimated fair value reflects the inherent risks associated with the related estimated cash flow stream, as well as current risk-free rates available in the market and estimated market risk premiums. For example, construction in progress inventory, which is closer to completion, will generally require a lower discount rate than land under development in communities consisting of multiple phases spanning several years of development.

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. We believe 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 and management's most current assessment of sales pace.

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, assuming no increase in weighted average sales price in 2013, a 4% increase in 2014 and 2015, and a 2% increase in 2016 and beyond.

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. The Company anticipates no increase in assumed weighted average costs in 2013, a 4% increase in 2014 and 2015, and a 2% increase in 2016 and beyond.

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 the 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, land under development, or lots 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 asset's current carrying value, the asset is written down to its estimated fair value less costs to sell.

Our quarterly assessments reflect management's best estimates. Due to the inherent uncertainties in management's estimates and uncertainties related to our operations and our industry as a whole, we are unable to determine at this time if and to what extent continuing future impairments will occur. Additionally, due to the volume of possible outcomes that can be generated from changes in the various model inputs for each community, we do not believe it is possible to create a sensitivity analysis that can provide meaningful information for the users of our financial statements.

Variable Interest Entities. In order to minimize our investment and risk of land exposure in a single location, we have periodically partnered with other land developers or homebuilders to share in the land investment and development of a property through joint ownership and development agreements, joint ventures, and other similar arrangements. During the nine month period ended September 30, 2013, we increased our total investment in such joint venture arrangements from December 31, 2012 by \$22.4 million primarily due to a joint investment with another builder in a land development in our Southern region.

For joint venture arrangements where a special purpose entity is established to own the property, we generally enter into limited liability company or similar arrangements ("LLCs") with the other partners. The Company's ownership in these LLCs as of September 30, 2013 ranged from 25% to 61%. These entities typically engage in land development activities for the purpose of distributing or selling developed lots to the Company and its partners in the LLC. With respect to our investments in these LLCs, we are required, under ASC 810-10, Consolidation ("ASC 810-10"), to evaluate whether or not such entities should be consolidated into our financial statements. We initially perform these evaluations when each new entity is created and upon any events that require reconsideration of the entity. In order to determine if we should consolidate an LLC, we determine (1) if the LLC is a Variable Interest Entity ("VIE") and (2) if we are the primary beneficiary of the entity. To determine whether we are the primary beneficiary of an entity, we consider whether we have the ability to control the activities of the VIE that most significantly impact its economic performance. This analysis considers, among other things, whether we have the ability to determine the budget and

scope of land development work, if any; the ability to control financing decisions for the VIE; the ability to acquire additional land into the VIE or dispose of land in the VIE not under contract with M/I Homes; and the ability to change or amend the existing option contract with the VIE. If it is determined we are not able to control such activities, we are not considered the primary beneficiary of the VIE.

As of September 30, 2013, we have determined that one of the LLCs in which we have an interest meets the requirements of a VIE due to a lack of equity at risk in the entity. However, we have determined that we do not have substantive control over any of these entities, including our VIE, as we do not have the ability to control the activities that most significantly impact their economic performance. As a result, none of these LLCs are required to be consolidated into our financial statements and the entities are instead recorded in Investment in Unconsolidated Joint Ventures on our Unaudited Condensed Consolidated Balance Sheets.

We enter into option or purchase agreements to acquire land or lots, for which we generally pay non-refundable deposits. We also analyze these agreements under ASC 810-10 to determine whether we are the primary beneficiary of the VIE, if applicable, using

an analysis similar to that described above. If we are deemed to be the primary beneficiary of the VIE, we will consolidate the VIE in our consolidated financial statements. In cases where we are the primary beneficiary, even though we do not have title to such land, we are required to consolidate these purchase/option agreements and reflect such assets and liabilities as Consolidated Inventory not Owned in our Unaudited Condensed Consolidated Balance Sheets.

Investment In Unconsolidated Joint Ventures. We use the equity method of accounting for investments in unconsolidated joint ventures over which we exercise significant influence but do not have a controlling interest. Under the equity method, our share of the unconsolidated joint ventures' earnings or loss, if any, is included in our statement of operations. We evaluate our investments in unconsolidated joint ventures for impairment at least quarterly as described below.

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 joint venture, the timing of distribution of lots to the Company from the unconsolidated joint venture, 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 joint ventures, the Company evaluates the projected cash flows associated with each unconsolidated joint venture. As of September 30, 2013, the Company used a discount rate of 16% in determining the fair value of investments in unconsolidated joint ventures. 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 joint venture for a period of time sufficient to allow for any anticipated recovery in market value. We believe that the Company's maximum exposure related to its investment in these unconsolidated joint ventures as of September 30, 2013 is the amount invested of \$34.1 million (in addition to a \$2.5 million note due to the Company from one of the unconsolidated joint ventures), although we expect to invest further amounts in these unconsolidated joint ventures as development of the properties progresses. Included in the Company's investment in unconsolidated joint ventures at September 30, 2013 and December 31, 2012 were \$0.7 million and \$0.8 million of capitalized interest and other costs, respectively.

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; however, due to the passage of time, change in market conditions, and/or changes in management's intentions with respect to the inventory, a change in assumptions could result and impairment could occur.

The table below summarizes the Company's assets measured on a non-recurring basis as of and for the three and nine months ended September 30, 2013 and 2012:

Description (in thousands)	Hierarchy	Three Months Ended September 30,		Nine Months Ended September 30,	
		2013	2012 (2)	2013	2012 (2)
Adjusted basis of inventory (1)	Level 3	\$1,975	\$2,108	\$3,876	\$2,350
Impairments		2,136	1,309	4,237	1,876
Initial basis of inventory (1)		\$4,111	\$3,417	\$8,113	\$4,226

The fair values in the table above represent only assets whose carrying values were adjusted in the respective period.

- (2) The carrying values for these assets may have subsequently increased or decreased from the fair value reported due to activities that have occurred since the measurement date.

Financial Instruments

Counterparty Credit Risk. To reduce the risk associated with 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, 2013 and December 31, 2012. 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).

(In thousands)	September 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash, cash equivalents and restricted cash	\$ 158,281	\$ 158,281	\$ 154,178	\$ 154,178
Mortgage loans held for sale	60,388	60,388	71,121	71,121
Split dollar life insurance policies	176	174	710	678
Notes receivable	3,312	3,180	8,787	7,460
Commitments to extend real estate loans	942	942	1	1
Forward sales of mortgage-backed securities	—	—	253	253
Liabilities:				
Notes payable - banks	55,614	55,614	67,957	67,957
Notes payable - other	8,126	8,137	11,105	11,148
Convertible senior subordinated notes due 2017	57,500	65,406	57,500	74,175
Convertible senior subordinated notes due 2018	86,250	87,328	—	—
Senior notes due 2018	227,970	246,675	227,670	250,700
Best-efforts contracts for committed IRLCs and mortgage loans held for sale	179	179	3	3
Forward sales of mortgage-backed securities	1,971	1,971	—	—
Off-Balance Sheet Financial Instruments:				
Letters of credit	—	659	—	493

The following methods and assumptions were used by the Company in estimating its fair value disclosures of financial instruments at September 30, 2013 and December 31, 2012:

Cash, Cash Equivalents and Restricted Cash. The carrying amounts of these items approximate fair value because they are short-term by nature.

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, 2017 Convertible Senior Subordinated Notes, 2018 Convertible Senior Subordinated Notes and 2018 Senior Notes. The fair value of these financial instruments was determined based upon market quotes at September 30, 2013 and December 31, 2012. 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.

Split Dollar Life Insurance Policies 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. During the third quarter of 2013, the balance of our split dollar life insurance policies decreased by \$0.5 million due to the surrender of a policy (and termination of the related split-dollar agreement) by an officer.

Notes Payable - Banks. The interest rate available to the Company in the third quarter of 2013 fluctuated with the Alternate Base Rate or the Eurodollar Rate (for the Company's new \$200 million unsecured revolving credit facility (the "Credit Facility")) or LIBOR (for M/I Financial Corp.'s \$100 million secured mortgage warehousing agreement as amended and restated on March 29, 2013 (the "MIF Mortgage Warehousing Agreement")) and for M/I Financial's \$15

million mortgage repurchase agreement dated November 13, 2012, as amended (the "MIF Mortgage Repurchase Facility")), and thus their carrying value is a reasonable estimate of fair value. During the second quarter of 2013, M/I Financial exercised the accordion feature under the MIF Mortgage Warehousing Agreement to increase the maximum borrowing availability amount thereunder by \$20.0 million to \$100.0 million.

Notes Payable - Other. 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 \$29.4 million and \$25.7 million represent potential commitments at September 30, 2013 and December 31, 2012, 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 3. Inventory

A summary of the Company's inventory as of September 30, 2013 and December 31, 2012 is as follows:

(In thousands)	September 30, 2013	December 31, 2012
Single-family lots, land and land development costs	\$283,455	\$257,397
Land held for sale	6,899	8,442
Homes under construction	331,969	221,432
Model homes and furnishings - at cost (less accumulated depreciation: September 30, 2013 - \$5,242; December 31, 2012 - \$4,883)	35,664	37,080
Community development district infrastructure	3,418	4,634
Land purchase deposits	13,355	8,727
Consolidated inventory not owned	1,576	19,105
Total inventory	\$676,336	\$556,817

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 include homes that are in various stages of construction. As of September 30, 2013 and December 31, 2012, we had 822 homes (with a carrying value of \$110.0 million) and 649 homes (with a carrying value of \$89.8 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. Refer to Note 2 of our Unaudited Condensed Consolidated Financial Statements 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.

NOTE 4. 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, 2013 and 2012 is as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Impairment of operating communities:				
Midwest	\$481	\$—	\$481	\$10
Southern	—	—	—	—
Mid-Atlantic	—	—	—	—
Total impairment of operating communities (a)	\$481	\$—	\$481	\$10
Impairment of future communities:				
Midwest	\$1,655	\$1,309	\$2,465	\$1,771
Southern	—	—	—	—
Mid-Atlantic	—	—	—	—
Total impairment of future communities (a)	\$1,655	\$1,309	\$2,465	\$1,771
Impairment of land held for sale:				
Midwest	\$—	\$—	\$1,291	\$95
Southern				