New Home Co Inc.
Form 10-Q
November 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014 or

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

For the transition period from ______to ______

Commission File Number 001-36283

The New Home Company Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	27-0560089
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

85 Enterprise, Suite 450
Aliso Viejo, California 92656
(Address of principal executive offices) (Zip Code)
Registrant’s telephone number, including area code (949) 382-7800

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 ý 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 ý 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 ¨	Non-accelerated filer (Do not check if smaller reporting company) ý	Smaller reporting company ¨	Accelerated filer ¨

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

Registrant’s shares of common stock outstanding as of November 7, 2014: 16,448,750

THE NEW HOME COMPANY INC.
FORM 10-Q
INDEX

Insert Title Here

PART I – FINANCIAL INFORMATION
Item 1. Financial Statements

THE NEW HOME COMPANY INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2014 (unaudited)	December 31, 2013
Assets		
Cash and cash equivalents	$59,944,071	$9,541,361
Restricted cash	1,042,280	130,215
Contracts and accounts receivable	9,626,408	7,178,241
Due from affiliates	507,350	558,421
Real estate inventories	126,174,097	45,350,479
Investment in unconsolidated joint ventures	55,942,515	32,269,546
Property and equipment, net of accumulated depreciation	1,082,552	481,506
Other assets	5,685,999	3,439,527
Total assets	$260,005,272	$98,949,296
Liabilities and equity		
Accounts payable	$18,684,739	$8,687,702
Accrued expenses and other liabilities	3,244,665	6,851,162
Notes payable	94,297,509	17,883,338
Total liabilities	116,226,913	33,422,202
Commitments and contingencies (Note 10)	—	—
Equity:		
Stockholders' equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, no shares outstanding	—	—
Common stock, $0.01 par value, 500,000,000 shares authorized, 16,448,750 shares issued and outstanding as of September 30, 2014	164,488	—
Additional paid-in capital	142,858,709	—
Retained deficit	(875,089)	—
Total The New Home Company Inc. stockholders' equity	142,148,108	—
Members’ equity	—	64,355,719
Noncontrolling interest in subsidiary	1,630,251	1,171,375
Total equity	143,778,359	65,527,094
Total liabilities and equity	$260,005,272	$98,949,296

See accompanying notes to the unaudited condensed consolidated financial statements.

THE NEW HOME COMPANY INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
Home sales	$8,196,683	$11,515,947	$22,854,625	$24,735,081
Fee building, including management fees from unconsolidated joint ventures of $2,199,198, $1,902,346 $5,523,998 and $4,373,734, respectively	20,408,030	9,655,331	53,817,385	33,689,862
	28,604,713	21,171,278	76,672,010	58,424,943
Expenses:				
Cost of homes sales	6,922,087	9,561,856	18,821,857	20,386,325
Cost of fee building	19,389,081	7,876,798	51,863,827	30,663,898
Abandoned project costs	62,099	166,132	161,887	489,395
Selling and marketing	971,214	528,920	2,187,767	1,272,575
General and administrative	3,148,326	1,858,908	8,028,183	4,122,348
	30,492,807	19,992,614	81,063,521	56,934,541
Equity in net income of unconsolidated joint ventures	50,098	1,037,579	994,826	1,689,659
Guaranty fee income	—	28,391	18,927	85,173
Other income (expense), net	16,835	(7,997)	28,819	(33,790)
(Loss) income before taxes	(1,821,161)	2,236,637	(3,348,939)	3,231,444
Benefit of (provision for) taxes	556,305	(133,476)	2,575,454	(315,313)
Net (loss) income	(1,264,856)	2,103,161	(773,485)	2,916,131
Net loss attributable to noncontrolling interests	205,901	—	240,386	—
Net (loss) income attributable to The New Home Company Inc.	$(1,058,955)	$2,103,161	$(533,099)	$2,916,131
(Loss) earnings per share attributable to The New Home Company Inc.				
Basic	$(0.06)	$0.24	$(0.03)	$0.38
Diluted	$(0.06)	$0.24	$(0.03)	$0.38
Weighted average shares outstanding:				
Basic	16,448,750	8,636,250	15,696,435	7,667,424
Diluted	16,448,750	8,636,250	15,696,435	7,667,424

See accompanying notes to the unaudited condensed consolidated financial statements.

4

THE NEW HOME COMPANY INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF EQUITY

	Stockholders' Equity							
	Number of Common Shares	Common Stock	Additional Paid-in Capital	Retained Deficit	Total Stockholders' Equity	Members' Equity	Noncontrolling Interest in Subsidiary	Total Equity
Balance at December 31, 2013	—	$—	$—	$—	$—	$64,355,719	$1,171,375	$65,527,094
Net (loss) income	—	—	—	(875,089)	(875,089)	341,990	(240,386)	(773,485
Noncontrolling interest contribution	—	—	—	—	—	—	751,262	751,262
Noncontrolling interest distribution	—	—	—	—	—	—	(52,000)	(52,000
Equity-based compensation expense	—	—	1,490,380	—	1,490,380	316,667	—	1,807,047
Conversion of members' equity into common stock	8,636,250	86,363	64,928,013	—	65,014,376	(65,014,376)	—	—
Issuance of common stock, net of issuance costs	8,984,375	89,844	87,710,178	—	87,800,022	—	—	87,800,022
Repurchase of common stock	(1,171,875)	(11,719)	(11,976,562)	—	(11,988,281)	—	—	(11,988,281
Deductible transaction costs from IPO	—	—	694,000	—	694,000	—	—	694,000
Additional contribution of deferred tax assets	—	—	12,700	—	12,700	—	—	12,700
Balance at September 30, 2014	16,448,750	$164,488	$142,858,709	$(875,089)	$142,148,108	$—	$1,630,251	$143,778,35

See accompanying notes to the unaudited condensed consolidated financial statements.

THE NEW HOME COMPANY INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine months ended September 30, 2014	2013
Operating activities:		
Net (loss) income	$(773,485)	$2,916,131
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Deferred taxes	(1,387,098)	—
Amortization of equity based compensation	1,807,047	356,250
Distributions of earnings from unconsolidated joint ventures	784,176	2,370,392
Equity in net income of unconsolidated joint ventures	(994,826)	(1,689,659)
Depreciation	244,616	144,006
Abandoned project costs	161,887	489,395
Net changes in operating assets and liabilities:		
Restricted cash	(912,065)	9,600
Contracts and accounts receivable	(2,448,167)	1,574,010
Due from affiliates	51,071	(566,029)
Real estate inventories	(65,124,535)	(17,533,987)
Other assets	(152,674)	(2,614,537)
Accounts payable	9,997,037	(936,240)
Accrued expenses and other liabilities	(3,606,497)	1,588,741
Net cash used in operating activities	(62,353,513)	(13,891,927)
Investing activities:		
Purchases of property and equipment	(845,662)	(296,724)
Contributions to unconsolidated joint ventures	(24,645,041)	(17,184,352)
Distributions of equity from unconsolidated joint ventures	3,073,014	8,979,636
Net cash used in investing activities	(22,417,689)	(8,501,440)
Financing activities:		
Net proceeds from issuance of common stock	87,800,022	—
Repurchase of common stock	(11,988,281)	—
Cash contributions from members	—	21,600,000
Cash distribution to noncontrolling interest in subsidiary	(52,000)	—
Proceeds from issuance of unsecured notes to members	—	1,055,000
Repayments of unsecured notes to members	—	(2,055,000)
Borrowings from notes payable	90,949,122	13,883,569
Repayments of notes payable	(31,534,951)	(13,630,294)
Net cash provided by financing activities	135,173,912	20,853,275
Net increase (decrease) in cash and cash equivalents	50,402,710	(1,540,092)
Cash and cash equivalents – beginning of period	9,541,361	6,007,928
Cash and cash equivalents – end of period	$59,944,071	$4,467,836
Supplemental disclosures of cash flow information		
Interest paid, net of amounts capitalized	$—	$—
Taxes paid	$1,470,000	$216,522
Supplemental disclosures of non-cash transactions		
Purchase of real estate with note payable to land seller	$17,000,000	$—
Contribution of real estate to unconsolidated joint ventures	$1,890,292	$8,290,002
Contribution of real estate from noncontrolling interest in subsidiary	$751,262	$—
Deductible transaction costs from IPO	$694,000	$—
Additional contribution of deferred tax assets	$12,700	$—

See accompanying notes to the unaudited condensed consolidated financial statements.

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization

The New Home Company Inc. (the “Company”), a Delaware Corporation, and its subsidiaries are primarily engaged in all aspects of residential real estate development, including acquiring land and designing, constructing and selling homes located in California.

Initial Public Offering

The Company completed its initial public offering ("IPO") on January 30, 2014. In preparation for the IPO, the Company reorganized from a Delaware limited liability company ("LLC") into a Delaware corporation, issuing 8,636,250 shares of common stock to the former members of the LLC in the Company's formation transactions, and changed its name to The New Home Company Inc. As a result of the IPO, the Company issued and sold 8,984,375 shares of common stock (including 1,171,875 shares sold pursuant to the underwriter's exercise of their option to purchase additional shares from the Company) at the public offering price of $11.00 per share. In accordance with the terms of the IPO, with net proceeds received from the underwriters exercise of their option to purchase additional shares, the Company repurchased 1,171,875 shares of its common stock issued to a member of the LLC in connection with the Company's formation transactions. The Company received proceeds of $75.8 million, net of the underwriting discount, offering expenses and the repurchase of shares. Upon the close of the IPO and as of September 30, 2014, the Company had 16,448,750 common shares outstanding.

Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts have been eliminated upon consolidation.

The accompanying unaudited condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013. The accompanying unaudited condensed financial statements include all adjustments (consisting of normal recurring entries) necessary for the fair presentation of our results for the interim period presented. Results for the interim period are not necessarily indicative of the results to be expected for the full year.

Unless the context otherwise requires, the terms “we”, “us”, “our” and “the Company” refer to the Company.

Reclassifications
Certain reclassifications have been made to prior year amounts to conform to the current year presentation.
Use of Estimates

The preparation of the Company’s consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the accompanying consolidated financial statements and notes. Accordingly, actual results could differ materially from these estimates.

Segment Reporting

Accounting Standards Codification ("ASC") 280, "Segment Reporting" (“ASC 280”) established standards for the manner in which public enterprises report information about operating segments. In accordance with ASC 280, we have determined that our homebuilding division and our fee building division are our operating segments. Corporate is a non-operating segment.

Cash and Cash Equivalents and Concentration of Credit Risk

We define cash and cash equivalents as cash on hand, demand deposits with financial institutions, and short term liquid investments with an initial maturity date of less than three months. The Company’s cash balances exceed federally insurable limits. The Company monitors the cash balances in its operating accounts and adjusts the cash balances as appropriate; however, these cash balances could be impacted if the underlying financial institutions fail or are subject to other adverse conditions in the financial markets. To date, the Company has not experienced a loss or lack of access to cash in its operating accounts.

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Restricted Cash

Restricted cash of $1.0 million and $0.1 million as of September 30, 2014 and December 31, 2013, respectively, is held in accounts for payments of subcontractor costs incurred in connection with various fee building projects.

Real Estate Inventories and Cost of Sales

We capitalize pre-acquisition, land, development and other allocated costs, including interest, during development and home construction. Pre-acquisition costs, including non-refundable land deposits, are expensed to abandoned project costs when we determine continuation of the respective project is not probable. During the three months ended September 30, 2014 and 2013, the Company reduced its real estate inventory balance by $62,099 and $166,132 respectively, for projects no longer being pursued. During the nine months ended September 30, 2014 and 2013, the Company reduced its real estate inventory balance by $161,887 and $489,395 respectively, for projects no longer being pursued. The associated expense is reflected as abandoned project costs in the accompanying consolidated statements of operations.

Land, development and other common costs are typically allocated to real estate inventories using a methodology that approximates the relative-sales-value method. Home construction costs per production phase are recorded using the specific identification method. Cost of sales for homes closed includes the allocation of construction costs of each home and all applicable land acquisition, land development and related common costs (both incurred and estimated to be incurred) based upon the relative-sales-value of the home within each project. Changes to estimated total development costs subsequent to initial home closings in a project are generally allocated on a relative-sales-value method to remaining homes in the project. Inventory is stated at cost, unless the carrying amount is determined not to be recoverable, in which case inventory is written down to fair value. We review our real estate assets at each project on a periodic basis or whenever indicators of impairment exist. Real estate assets include projects actively selling and projects under development or held for future development. Indicators of impairment include, but are not limited to, significant decreases in local housing market values and selling prices of comparable homes, significant decreases in gross margins and sales absorption rates, costs in excess of budget, and actual or projected cash flow losses.

If there are indicators of impairment, we perform a detailed budget and cash flow review of the applicable real estate inventories to determine whether the estimated remaining undiscounted future cash flows of the project are more or less than the asset’s carrying value. If the undiscounted cash flows are more than the asset’s carrying value, no impairment adjustment is required. However, if the undiscounted cash flows are less than the asset’s carrying value, the asset is deemed impaired and is written down to fair value.

When estimating undiscounted cash flows of a project, we make various assumptions, including: (i) expected sales prices and sales incentives to be offered, including the number of homes available, pricing and incentives being offered by us or other builders in other projects, and future sales price adjustments based on market and economic trends; (ii) expected sales pace and cancellation rates based on local housing market conditions, competition and historical trends; (iii) costs expended to date and expected to be incurred including, but not limited to, land and land development costs, home construction costs, interest costs, indirect construction and overhead costs, and selling and marketing costs; (iv) alternative product offerings that may be offered that could have an impact on sales pace, sales price and/or building costs; and (v) alternative uses for the property.

Many assumptions are interdependent and a change in one may require a corresponding change to other assumptions. For example, increasing or decreasing sales absorption rates has a direct impact on the estimated per unit sales price of a home, the level of time sensitive costs (such as indirect construction, overhead and carrying costs), and selling and marketing costs (such as model maintenance costs and advertising costs). Depending on the underlying objective of the project, assumptions could have a significant impact on the projected cash flow analysis. For example, if our objective is to preserve operating margins, our cash flow analysis will be different than if the objective is to increase sales. These objectives may vary significantly from project to project and over time. If assets are considered impaired, impairment is determined by the amount the asset's carrying value exceeds its fair value. Fair value is determined based on estimated future cash flows discounted for inherent risks associated with real estate assets. These discounted cash flows are impacted by expected risk based on estimated land development; construction and delivery timelines; market risk of price erosion; uncertainty of development or construction cost increases; and other risks specific to the asset or market conditions where the asset is located when assessment is made. These factors are specific to each project and may vary among projects. For the three and nine months ended September 30, 2014 and 2013, no impairment adjustments relating to homebuilding real estate inventories were recorded.

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Capitalization of Interest

We follow the practice of capitalizing interest to inventories owned during the period of development and to investments in unconsolidated joint ventures in accordance with ASC 835, "Interest" (“ASC 835”). Homebuilding interest capitalized as a component of cost of real estate inventories is included in cost of home sales as related homes or lots are sold. Interest capitalized to investment in unconsolidated joint ventures is included as a reduction of income from or increase in loss from unconsolidated joint ventures when the related homes or lots are sold to third parties. To the extent our debt exceeds our qualified assets as defined in ASC 835, we expense a portion of the interest incurred by us. Qualified assets represent projects that are actively selling or under development as well as investments in unconsolidated joint ventures accounted for under the equity method until such equity investees begin their principal operations.

Revenue Recognition

Home Sales and Profit Recognition

In accordance with ASC 360, "Property, Plant, and Equipment", revenues from home sales and other real estate sales are recorded and a profit is recognized when the respective homes are closed. Home sales and other real estate sales are closed when all conditions of escrow are met, including delivery of the home or other real estate asset, title passage, appropriate consideration is received and collection of associated receivables, if any, is reasonably assured. Sales incentives are a reduction of revenues when the respective home is closed. When it is determined that the earnings process is not complete, the sale and the related profit are deferred for recognition in future periods. The profit we record is based on the calculation of cost of sales, which is dependent on our allocation of costs, as described in more detail above in the section entitled “Real Estate Inventories and Cost of Sales.”

Fee Building

The Company enters into fee building agreements to provide services whereby it will build homes on behalf of independent third-party property owners. The independent third-party property owner funds all project costs incurred by the Company to build and sell the homes. The Company primarily enters into cost plus fee contracts where it charges independent third-party property owners for all direct and indirect costs plus a negotiated management fee. For these types of contracts, the Company recognizes revenue based on the actual total costs it has expended plus the applicable management fee. The management fee is typically a fixed fee based on a percentage of the cost or home sales revenue of the project depending on the terms of the agreement with the independent third-party property owner. In accordance with ASC 605, "Revenue Recognition" ("ASC 605"), revenues from fee building services are recognized over a cost-to-cost approach in applying the percentage-of-completion method. Under this approach, revenue is earned in proportion to total costs incurred, divided by total costs expected to be incurred. The total estimated cost plus the management fee represents the total contract value. The Company recognizes revenue based on the actual labor and other direct costs incurred, plus the portion of the management fee it has earned to date. In the course of providing its services, the Company routinely subcontracts for services and incurs other direct costs on behalf of its clients. These costs are passed through to clients and, in accordance with industry practice and GAAP, are included in the Company’s revenue and cost of revenue. Under certain agreements, the Company is eligible to receive additional incentive compensation as certain financial thresholds defined in the agreement are achieved. The Company recognizes revenue for any incentive compensation when such financial thresholds are probable of being met and such compensation is deemed to be collectible, generally at the date the amount is communicated to us by the independent third-party property owner.

The Company also enters into fee building and management contracts with third parties and its unconsolidated joint ventures where it provides construction supervision services, as well as sales and marketing services, and does not bear financial risks for any services provided. In accordance with ASC 605, revenues from these services are recognized over a proportional performance method or completed performance method. Under this approach, revenue is earned as services are provided in proportion to total services expected to be provided to the client or on a straight line basis if the pattern of performance cannot be determined while costs are recognized as incurred. Revenue recognition for any portion of the fees earned from these services that are contingent upon a financial threshold or specific event is deferred until the threshold is achieved or the event occurs.

The Company's fee building revenues have historically been concentrated in a small number of customers. For the three and nine months ended September 30, 2014, one customer comprised 89% and 85% of fee building revenue, respectively. For the three and nine months ended September 30, 2013, one customer comprised 71%, and 81% of fee building revenue, respectively. At September 30, 2014 two customers comprised 95% of contracts and accounts receivables. At December 31, 2013 one customer comprised 82% of contracts and accounts receivables.

Variable Interest Entities

The Company accounts for variable interest entities in accordance with ASC 810, "Consolidation" (“ASC 810”). Under ASC 810, a variable interest entity (“VIE”) is created when: (a) the equity investment at risk in the entity is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by other parties, including the equity holders; (b) the entity’s equity holders as a group either (i) lack the direct or indirect ability to make decisions about the entity, (ii) are not obligated to absorb expected losses of the entity or (iii) do not have the right to receive expected residual returns of the entity; or (c) the entity’s equity holders have voting rights that are not proportionate to their economic interests, and the activities of the entity involve or are conducted on behalf of the equity holder with disproportionately few voting rights. If an entity is deemed to be a VIE pursuant to ASC 810, the enterprise that has both (i) the power to direct the activities of a VIE that most significantly impact the entity’s economic performance and (ii) the obligation to absorb the expected losses of the entity or right to receive benefits from the entity that could be potentially significant to the VIE is considered the primary beneficiary and must consolidate the VIE.

Under ASC 810, a non-refundable deposit paid to an entity may be deemed to be a variable interest that will absorb some or all of the entity’s expected losses if they occur. Our land purchase and lot option deposits generally represent our maximum exposure to the land seller if we elect not to purchase the optioned property. In some instances, we may also expend funds for due diligence, development and construction activities with respect to optioned land prior to takedown. Such costs are classified as real estate inventories, which we would have to write off should we not exercise the option. Therefore, whenever we enter into a land option or purchase contract with an entity and make a non-refundable deposit, a VIE may have been created.

As of September 30, 2014 and December 31, 2013, the Company was not required to consolidate any VIEs. In accordance with ASC 810, we perform ongoing reassessments of whether we are the primary beneficiary of a VIE.

Noncontrolling Interest

During 2013, the Company entered into a joint venture agreement with a third-party property owner. In accordance with ASC 810, the Company analyzed this arrangement and determined that it was not a variable interest entity; however, the Company determined it was required to consolidate the joint venture as it is the managing member with the powers to direct the major decisions of the entity. As of September 30, 2014 and December 31, 2013, the third-party investor had made contributions of $1.6 million and $1.2 million, net of losses and distributions.

Investments in Unconsolidated Joint Ventures

We first analyze our homebuilding and land development joint ventures to determine if they are variable interest entities under the provisions of ASC 810 (as discussed above) when determining whether the entity should be consolidated. If we conclude that our homebuilding and land development joint ventures are not variable interest entities, then, in accordance with the provisions of ASC 810, limited partnerships or similar entities must be further evaluated under the presumption that the general partner, or the managing member in the case of a limited liability company, is deemed to have a controlling interest and therefore must consolidate the entity unless the limited partners or non-managing members have: (1) the ability, either by a single limited partner or through a simple majority vote, to dissolve or liquidate the entity, or kick-out the managing member/general partner without cause, or (2) substantive participatory rights that are exercised in the ordinary course of business. Under the provisions of ASC 810, we may be required to consolidate certain investments in which we hold a general partner or managing member interest.

As of September 30, 2014 and December 31, 2013, the Company concluded that some of its joint ventures were variable interest entities. The Company concluded that it was not the primary beneficiary of the variable interest entities and accounted for these entities under the equity method of accounting.

As of September 30, 2014, our estimated future capital contributions to unconsolidated joint ventures was $27.3 million. Under the joint venture operating agreements, future capital contributions are determined based on the operating budgets and needs of the joint venture, which will likely vary throughout the life of each joint venture based on the circumstances unique to the project. In addition to required contributions, the Company selectively provides guaranties for debt held by certain of its unconsolidated joint ventures. Such guarantees facilitated the financing of our joint ventures' development projects and arose in the ordinary course of business. As of September 30, 2014 and December 31, 2013, our unconsolidated joint ventures had outstanding debt secured by financial guaranties of $104.8 million and $39.1 million, respectively, of which 12.1% and 11.5% respectively, was guaranteed by the Company. The guarantees will remain in place through the repayment of the notes, which mature at various dates through 2017. Payments under the guarantees are triggered by events of default, as defined in the various credit facilities. As of September 30, 2014, there were no events of default that would require payments under the guarantees.

Investments in our unconsolidated joint ventures are accounted for under the equity method of accounting. Under the equity method, we recognize our proportionate share of earnings and losses generated by the joint venture upon the delivery of lots or homes to third parties. Our proportionate share of intra-entity profits and losses are eliminated until the related asset has been sold by the unconsolidated joint venture to third parties. Our ownership interests in our unconsolidated joint ventures vary, but are generally less than or equal to 50%.

We review real estate inventory held by our unconsolidated joint ventures for impairment, consistent with our real estate inventories. We also review our investments in unconsolidated joint ventures for evidence of other-than-temporary declines in value. To the extent we deem any portion of our investment in unconsolidated joint ventures as not recoverable, we impair our investment accordingly. For the three and nine months ended September 30, 2014 and 2013, no impairments related to investment in unconsolidated joint ventures were recorded.

Selling and Marketing Expense

Selling and marketing costs incurred to sell real estate projects are capitalized if they are reasonably expected to be recovered from the sale of the project or from incidental operations, and are incurred for tangible assets that are used directly through the selling period to aid in the sale of the project or services that have been performed to obtain regulatory approval of sales. All other selling and marketing costs are expensed in the period incurred.

Warranty Reserves

We offer warranties on our homes that generally cover various defects in workmanship or materials, or to cover structural construction defects for one-year periods. Estimated future direct warranty costs are accrued and charged to cost of sales in the period when the related homebuilding revenues are recognized. Amounts are accrued based upon the Company’s historical rates. Due to the Company’s limited history related to homebuilding sales, the Company also considers the historical experience of its peers in determining the amount of its warranty reserve. In addition, the Company receives warranty payments from its clients for certain of its fee building projects where it has the contractual risk of construction. These payments are recorded as warranty reserve accruals. Indirect warranty overhead salaries and related costs are charged to the reserve in the period incurred. We assess the adequacy of our warranty accrual on a quarterly basis and adjust the amounts recorded if necessary. Our warranty accrual is included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

Contracts and Accounts Receivable

Contracts and accounts receivable primarily represent the fees earned but not collected and reimbursable project costs incurred in connection with fee building agreements. The Company periodically evaluates the collectability of its contracts receivable, and, if it is determined that a receivable might not be fully collectible, an allowance is recorded for the amount deemed uncollectible. This allowance for doubtful accounts is estimated based on management’s evaluation of the contracts involved and the financial condition of its clients. Factors considered in evaluations include, but are not limited to:

- client type;

- historical contract performance;
- historical collection and delinquency trends;
- client credit worthiness; and
- general economic conditions.

As of September 30, 2014 and December 31, 2013, no allowance was recorded related to contracts and accounts receivable.

Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives ranging from three to five years. Leasehold improvements are stated at cost and are amortized using the straight-line method over the shorter of either their estimated useful lives or the probable term of the lease.

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Income Taxes

Income taxes are accounted for in accordance with ASC 740, "Income Taxes" ("ASC 740"). As a result of the conversion from an LLC to a taxable entity in connection with the Company's IPO, the Company recognized a cumulative net deferred tax asset of $1.4 million during the three months ended March 31, 2014 related to the difference between the financial statement basis and tax basis of the assets and liabilities as of January 30, 2014. Subsequent to the conversion, the consolidated provision for, or benefit from, income taxes are calculated using the asset and liability method, under which deferred tax assets and liabilities are recorded based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.
Deferred tax assets are evaluated on a quarterly basis to determine if adjustments to the valuation allowance are required. In accordance with ASC 740, we assess whether a valuation allowance should be established based on the consideration of all available evidence using a "more likely than not" standard with respect to whether deferred tax assets will be realized. The ultimate realization of deferred tax assets depends primarily on the generation of future taxable income during the periods in which the differences become deductible. The value of our deferred tax assets will depend on applicable income tax rates. Judgment is required in determining the future tax consequences of events that have been recognized in our consolidated financial statements and/or tax returns. Differences between anticipated and actual outcomes of these future tax consequences could have a material impact on our consolidated financial statements.
ASC 740 defines the methodology for recognizing the benefits of uncertain tax return positions as well as guidance regarding the measurement of the resulting tax benefits. These provisions require an enterprise to recognize the financial statement effects of a tax position when it is more likely than not (defined as a likelihood of more than 50%), based on the technical merits, that the position will be sustained upon examination. In addition, these provisions provide guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The evaluation of whether a tax position meets the more-likely-than-not recognition threshold requires a substantial degree of judgment by management based on the individual facts and circumstances. Actual results could differ from estimates.

Stock-Based Compensation

We account for share-based awards in accordance with ASC 718, "Compensation – Stock Compensation" ("ASC 718"). ASC 718 requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. ASC 718 requires all entities to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans.

Recently Issued Accounting Standards

The Company qualifies as an "emerging growth company" pursuant to the provisions of the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, enacted on April 5, 2012. Section 102 of the JOBS Act provides that an "emerging growth company" can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended, for complying with new or revised accounting standards. As previously disclosed, the Company has chosen, irrevocably, to "opt out" of such extended transition period, and as a result, will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies.

In May 2014, the Financial Accounting Standards Board ("FASB") and International Accounting Standards Board issued their converged standard on revenue recognition, Accounting Standards Update ("ASU") 2014-09, “Revenue from Contracts with Customers” ("ASU 2014-09"). This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. The Company will need to apply the new guidance to determine whether revenue should be recognized over time or at a point in time. This standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2016, with no early adoption permitted, and the Company can choose to apply this standard retrospectively for each prior reporting period presented or retrospectively with the cumulative effect of initially applying the standard recognized at the date of the initial application in retained earnings. The Company is in the process of evaluating the effects of ASU 2014-09 on its revenue recognition.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (“ASU 2014-12”), which requires

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation - Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The amendments in ASU 2014-12 are effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted. Our adoption of ASU 2014-12 is not expected to have a material effect on our condensed consolidated financial statements or disclosures.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern, ("ASU 2014-15"), which requires management to perform interim and annual assessments on whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year of the date the financial statements are issued and to provide related disclosures, if required. The amendments in ASU 2014-15 are effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted. Our adoption of ASU 2014-15 is not expected to have a material effect on our condensed consolidated financial statements or disclosures.

2. Computation of (Loss) Earnings Per Share

Basic and diluted (loss) earnings per share for the nine months ended September 30, 2014 and 2013 and the three months ended September 30, 2013 give effect to the conversion of the Company's members' equity into common stock on January 30, 2014 as though the conversion had occurred as of the beginning of the reporting period or the original date of issuance, if later. The number of shares converted was based on the actual IPO price of $11.00 per share.

For the three and nine months ended September 30, 2014, there were no differences between the number of common shares used for the basic and diluted earnings per share computations as the Company incurred a net loss. For the three and nine months ended September 30, 2014, the Company excluded 50,603 and 31,933 shares of restricted stock, respectively, and 872,279 and 779,844 stock options, respectively, from diluted loss per share that would have been included if the Company had been in a net income position because the inclusion of such restricted shares and options would be anti-dilutive.

The following table sets forth the components used in the computation of basic and diluted earnings per share for the three months ended September 30, 2014 and 2013 and the nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net (loss) income attributable to The New Home Company Inc.	$(1,058,955)	$2,103,161	$(533,099)	$2,916,131
Denominator:				
Basic weighted-average shares outstanding	16,448,750	8,636,250	15,696,435	7,667,424
Effect of dilutive shares:				
Unvested restricted stock units	—	—	—	—
Diluted weighted-average shares outstanding	16,448,750	8,636,250	15,696,435	7,667,424
Basic (loss) earnings per share attributable to The New Home Company Inc.	$(0.06)	$0.24	$(0.03)	$0.38
Diluted (loss) earnings per share attributable to The New Home Company Inc.	$(0.06)	$0.24	$(0.03)	$0.38

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Contracts and Accounts Receivable

Contracts and accounts receivable consist of the following:

	September 30, 2014	December 31, 2013
Contracts receivable:		
Costs incurred on fee building projects	$51,863,827	$42,317,737
Estimated earnings	1,953,558	5,247,768
	53,817,385	47,565,505
Less: amounts collected during the period	(44,715,471)	(40,945,938)
	$9,101,914	$6,619,567
Contracts receivable:		
Billed	$106,576	$230,642
Unbilled	8,995,338	6,388,925
	9,101,914	6,619,567
Other receivables:		
Escrow receivables	451,336	436,862
Other receivables	73,158	121,812
	$9,626,408	$7,178,241

Billed contracts receivable represent amounts billed to clients that have yet to be collected. Unbilled contracts receivable represents the contract revenue recognized but not yet billable pursuant to contract terms or administratively not invoiced. All unbilled receivables as of September 30, 2014 and December 31, 2013 are expected to be billed and collected within twelve months. Accounts payable at September 30, 2014 and December 31, 2013 includes $8.6 million and $6.1 million, respectively, related to costs incurred under the Company’s fee building contracts.

4. Real Estate Inventories and Capitalized Interest

Real estate inventories are summarized as follows:

	September 30, 2014	December 31, 2013
Deposits and pre-acquisition costs	$4,778,223	$4,912,563
Land held and land under development	56,317,048	29,063,591
Homes completed or under construction	47,297,498	10,221,069
Model homes	17,781,328	1,153,256
	$126,174,097	$45,350,479

All of our deposits and pre-acquisition costs are non-refundable, except for $800,000 and $50,000 as of September 30, 2014 and December 31, 2013 respectively.

Model homes, homes completed, and homes under construction include all costs associated with home construction, including land, development, indirects, permits, materials and labor. Land held and land under development includes costs incurred during site development such as land, development, indirects, and permits.

14

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Interest is capitalized to inventory during development and other qualifying activities. Interest capitalized as cost of inventory is included in cost of sales as related homes are closed. For the three and nine months ended September 30, 2014 and 2013 interest incurred, capitalized and expensed was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Interest incurred	$533,799	$281,048	$1,079,144	$813,694
Interest capitalized	(533,799)	(281,048)	(1,079,144)	(813,694)
Interest expensed	$—	$—	$—	$—
Capitalized interest in beginning inventory	$1,494,546	$836,509	$1,003,390	$493,486
Interest capitalized as a cost of inventory	533,799	281,048	1,079,144	813,694
Interest previously capitalized as cost of inventory, included in cost of sales	(64,080)	(157,949)	(118,269)	(347,572)
Capitalized interest in ending inventory	$1,964,265	$959,608	$1,964,265	$959,608

5. Unconsolidated Joint Ventures

As of September 30, 2014 and December 31, 2013, the Company had ownership interests in twelve and eleven, respectively, unconsolidated joint ventures with ownership percentages ranging from 5% to 35%. The combined balance sheets for our unconsolidated joint ventures accounted for under the equity method are as follows:

	September 30, 2014	December 31, 2013
Cash and cash equivalents	$25,333,641	$15,292,035
Restricted cash	10,810,074	4,357,945
Real estate inventories	409,960,041	266,316,859
Other assets	4,487,162	1,723,429
Total assets	$450,590,918	$287,690,268
Accounts payable and accrued liabilities	$34,437,494	$15,064,068
Notes payable	134,180,072	68,594,343
Total liabilities	168,617,566	83,658,411
The Company's equity	55,942,515	32,269,546
Other partners' equity	226,030,837	171,762,311
Total equity	281,973,352	204,031,857
Total liabilities and equity	$450,590,918	$287,690,268

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed combined statements of operations for our unconsolidated joint ventures accounted for under the equity method are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues	$35,719,714	$39,382,319	$88,166,393	$105,001,748
Cost of sales	29,326,370	28,482,738	69,489,511	76,741,526
Gross profit	6,393,344	10,899,581	18,676,882	28,260,222
Operating expenses	3,969,653	3,488,563	11,114,149	8,491,620
Net income of unconsolidated joint ventures	$2,423,691	$7,411,018	$7,562,733	$19,768,602
Equity in net income of unconsolidated joint ventures reflected in the accompanying consolidated statements of operations	$50,098	$1,037,579	$994,826	$1,689,659

The Company has entered into agreements with its unconsolidated joint ventures to provide management services related to the underlying projects (collectively referred to as the “Management Agreements”). Pursuant to the Management Agreements, the Company receives a management fee based on each project’s revenues from its unconsolidated joint ventures. For the three and nine months ended September 30, 2014 and 2013, the Company earned $2.2 million, $1.9 million, $5.5 million, and $4.4 million, respectively, in management fees, which have been recorded as fee building revenues in the accompanying consolidated statements of operations.

6. Other Assets

Other assets consist of the following:

	September 30, 2014	December 31, 2013
Deferred tax asset	$1,399,798	$—
Income tax receivable	1,882,356	—
Prepaid income taxes	1,349,685	—
Prepaid loan fees	307,197	—
Prepaid expenses	711,712	101,809
Other assets	35,251	87,718
Offering costs	—	3,250,000
	$5,685,999	$3,439,527

As a result of the conversion from an LLC to a taxable entity in connection with the Company's IPO, the Company recognized a cumulative net deferred tax asset of $1.4 million during the first quarter of 2014 related to the difference between the financial statement basis and tax basis of the assets and liabilities as of January 30, 2014 (See Note 13).

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7. Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consist of the following:

	September 30, 2014	December 31, 2013
Warranty reserve	$1,215,815	$1,074,298
Employee benefits	706,550	659,978
Accrued payroll	673,453	1,007,591
Accrued interest	193,333	86,496
Completion reserve	294,828	471,870
Incentive compensation	—	1,770,230
Accrued professional fees	25,000	1,403,183
Income taxes payable	—	120,315
Deferred fees from unconsolidated joint ventures	—	111,583
Other accrued expenses	135,686	145,618
	$3,244,665	$6,851,162

During 2013, the Company elected to institute a fully discretionary employee incentive compensation plan to various non-executive employees. The accrual at December 31, 2013 was $1.8 million. As of September 30, 2014, there is no accrual for incentive compensation.

Completion reserves relate to liabilities for completed subcontractor work on closed homes for which invoices have not been remitted as of the balance sheet date.

Changes in our warranty accrual are detailed in the table set forth below:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Beginning warranty liability for homebuilding projects	$916,259	$592,026	$810,088	$464,449
Warranty provision for homebuilding projects	82,218	115,982	229,387	249,226
Warranty payments for homebuilding projects	(31,853)	(3,876)	(72,851)	(9,543)
Ending warranty liability for homebuilding projects	966,624	704,132	966,624	704,132
Beginning warranty liability for fee building projects	257,492	277,372	264,210	295,391
Warranty efforts for fee building projects	(8,301)	(9,371)	(15,019)	(27,390)
Ending warranty liability for fee building projects	249,191	268,001	249,191	268,001
Total ending warranty liability	$1,215,815	$972,133	$1,215,815	$972,133

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. Notes Payable

Notes payable consisted of the following:

	September 30, 2014	December 31, 2013
Senior unsecured revolving credit facility	$81,418,407	$—
Secured revolving credit facility	—	8,215,720
Note payable with land seller	9,500,000	9,500,000
Construction loans	3,379,102	167,618
	$94,297,509	$17,883,338

On June 26, 2014, the Company entered into a senior unsecured revolving credit facility (the "Unsecured Facility") with a bank to borrow up to $125.0 million, limited by borrowing base provisions and financial covenants. Any outstanding principal is due upon maturity, which is June 26, 2017, with the potential for a one-year extension of the term of the loan, subject to specified conditions and the payment of an extension fee. The Company may repay advances at any time without premium or penalty. Interest is payable monthly and is charged at a rate of 1-month LIBOR plus a margin ranging from 2.25% to 3.00% depending on the Company’s leverage ratio as calculated at the end of each fiscal quarter. As of September 30, 2014, the availability under the facility was $43.6 million and the interest rate was 2.40%. In connection with the agreement, the Company is required to maintain certain financial covenants, including (i) a minimum tangible net worth, as defined; (ii) leverage ratios, as defined; (iii) a minimum liquidity covenant; (iv) a minimum fixed charge coverage ratio based on EBITDA to interest incurred; and (v) from and after January 1, 2015, a speculative unit limitation. As of September 30, 2014, the Company was in compliance with all financial covenants.

On September 26, 2013, the Company entered into a secured revolving credit facility with a bank to borrow up to $30.0 million. The secured revolving credit facility was repaid in full with proceeds from the Unsecured Facility. Prior to repayment, the secured revolving credit facility bore interest at a rate of 1-month LIBOR plus a margin ranging from 3.25% to 4.25%, depending on leverage ratios.

In March 2014, the Company acquired real estate with a purchase price of $21.5 million. Concurrent with the acquisition, it entered into a $17.0 million note with the land seller, secured by real estate, which bore interest at 1.0% per annum. The note matured on June 30, 2014 and was repaid in full. In 2012, the Company entered into a $9.5 million note with a land seller, secured by real estate, which bears interest at 7.0% per annum. The note matures on February 15, 2015 and requires certain mandatory pay downs totaling $1.0 million based on the occurrence of certain project-related events. Interest is payable monthly and the remaining principal is due at maturity.

In May 2014, the Company entered into two construction loans with a bank related to model and production homes for a specific project. The loans are secured by real estate and bear interest at the bank's prime rate plus 2.0%, or 5.25% at September 30, 2014. The total commitment under the construction loans is $9.5 million. As of September 30, 2014, the Company had $6.1 million available to borrow under the construction loans. The loans mature on November 27, 2016. Interest is payable monthly with all unpaid principal and interest due at maturity. As of December 31, 2013, the Company had one construction loan related to model homes, which was repaid during the first quarter of 2014 and the remaining commitment was closed.

9. Fair Value Disclosures

ASC 820, "Fair Value Measurements and Disclosures," defines fair value as the price that would be received for selling an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date and requires assets and liabilities carried at fair value to be classified and disclosed in the following three categories:

- Level 1 – Quoted prices for identical instruments in active markets
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are inactive; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets at measurement date
- Level 3 – Valuations derived from techniques where one or more significant inputs or significant value drivers are unobservable in active markets at measurement date

Fair Value of Financial Instruments

The accompanying consolidated balance sheets include the following financial instruments: cash and cash equivalents, restricted cash, contracts and accounts receivable, due from affiliates, accounts payable, accrued expenses and other liabilities, and notes payable.

The Company considers the carrying value of cash and cash equivalents, restricted cash, contracts and accounts receivable, accounts payable, and accrued expenses and other liabilities to approximate the fair value of these financial instruments based on the short duration between origination of the instruments and their expected realization. The fair value of amounts due from affiliates is not determinable due to the related party nature of such amounts. As of September 30, 2014 and December 31, 2013, the fair value of the Company's notes payable was $94.3 million and $17.9 million, respectively, compared to the carrying value of $94.3 million and $17.9 million, respectively. The Company has determined that its notes payable are classified as Level 3 within the fair value hierarchy.

Non-Recurring Fair Value Adjustments

Nonfinancial assets and liabilities include items such as inventory and long lived assets that are measured at cost when acquired and adjusted for impairment to fair value, if deemed necessary. During the three and nine months ended September 30, 2014 and 2013, the Company did not record any fair value adjustments to those nonfinancial assets and liabilities remeasured at fair value on a nonrecurring basis.

10. Commitments and Contingencies

The Company is a defendant in various lawsuits related to its normal course of business. We are also subject to local, state and federal laws and regulations related to land development activities, house construction standards, sales practices, employment practices and environmental protection. As a result, we are subject to periodic examinations or inquiry by agencies administering these laws and regulations.

We record a reserve for potential legal claims and regulatory matters when they are probable of occurring and a potential loss is reasonably estimable. We accrue for these matters based on facts and circumstances specific to each matter and revise these estimates when necessary.

In view of the inherent difficulty of predicting outcomes of legal claims and related contingencies, we generally cannot predict their ultimate resolution, related timing or eventual loss. If our evaluations indicate loss contingencies that could be material are not probable, but are reasonably possible, we will disclose their nature with an estimate of possible range of losses or a statement that such loss is not reasonably estimable. At September 30, 2014 and December 31, 2013, the Company did not have any accruals for asserted or unasserted matters.

As an owner and developer of real estate, the Company is subject to various environmental laws of federal, state and local governments. The Company is not aware of any environmental liability that could have a material adverse effect on its financial condition or results of operations. However, changes in applicable environmental laws and regulations, the uses and conditions of real estate in the vicinity of the Company’s real estate and other environmental conditions of which the Company is unaware with respect to the real estate could result in future environmental liabilities.

We obtain surety bonds in the normal course of business to ensure completion of certain infrastructure improvements of our projects. At September 30, 2014 and December 31, 2013, the Company had outstanding surety bonds totaling $19.2 million and $2.7 million, respectively. The beneficiaries of the bonds are various municipalities and other organizations. In the unlikely event that any such surety bond issued by a third party is called because the required improvements are not completed, the Company could be obligated to reimburse the issuer of the bond.

11. Related Party Transactions

During the three and nine months ended September 30, 2014 and the three and nine months ended 2013, the Company incurred construction-related costs on behalf of its unconsolidated joint ventures totaling $1.9 million, $5.6 million, $1.3 million, and $3.4 million, respectively. As of September 30, 2014 and December 31, 2013, $0.2 million and $0.3

million, respectively, are included in due from affiliates in the accompanying consolidated balance sheets.

The Company has entered into agreements with its unconsolidated joint ventures to provide management services related to the underlying projects. Pursuant to the Management Agreements, the Company receives a management fee based on each project's revenues. During the three and nine months ended September 30, 2014 and the three and nine months ended September 30, 2013 , the Company earned $2.2 million, $5.5 million, $1.9 million and $4.4 million, respectively, in management fees, which have been recorded as fee building revenue in the accompanying consolidated statements of

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

operations. As of September 30, 2014 and December 31, 2013, $0.3 million and $0.2 million, respectively, related to management fees are included in due from affiliates in the accompanying consolidated balance sheets.

The Company has entered into loan guaranties on behalf of certain of its unconsolidated joint ventures in order to secure performance under the loans and maintain certain loan-to-value ratios. The Company has also entered into agreements with its partners in each of the unconsolidated joint ventures whereby the Company and the partners are apportioned liability under the guaranties according to their respective capital interest. In addition, the agreements provide the Company, to the extent the partner has an unpaid liability under the guaranties, the right to receive distributions from the unconsolidated joint venture that would otherwise be made to the partner. The loans underlying the guaranties comprise acquisition and development loans, construction revolvers and model loans, and the guaranties remain in force until the loans are satisfied, which is expected to occur over a period between March 2015 and March 2017. Due to the nature of the loans, the outstanding balance at any given time is subject to a number of factors including the status of site improvements, the mix of horizontal and vertical development underway, the timing of phase build outs, and the period necessary to complete the escrow process for homebuyers. With respect to guaranties regarding specific performance, the Company is not generally subject to financial liability, but is only required to complete the project with funds provided by the beneficiary of the guaranty. As of September 30, 2014 and December 31, 2013, $104.8 million and $39.1 million, respectively, was outstanding under the loans, of which 12.1% and 11.5%, respectively was guaranteed by the Company. In connection with providing the loan guaranties, the Company recognized $0 and $18,927, during the three and nine months ended September 30, 2014, respectively, and $28,391, and $85,173 during the three and nine months ended September 30, 2013, respectively, as guaranty fee income in the accompanying consolidated statements of operations. As of September 30, 2014 and December 31, 2013, $0 and $85,172, respectively, were included in due from affiliates related to guaranty fee income.

Berchtold Capital Partners, an entity owned by Mr. Michael Berchtold, one of the Company's non-employee directors, served as an advisor to the Company, providing general advice and guidance in connection with the Company's IPO, as well as assisting with the selection of the members of the Company's board of directors, the selection of and interacting with the Company's compensation consultant and advising the executives and board of managers regarding governance and compensation matters. The Company paid Berchtold Capital Partners $562,500 for these services, including $500,000 upon completion of our IPO. Amounts paid to Berchtold are included in offering expenses and were offset against the proceeds of our IPO.

As of September 30, 2014, the Company had investments in certain unconsolidated joint ventures totaling $19.2 million. Certain members of the Company's board of directors are affiliated with entities that also had an investment in these joint ventures and are owners of more than 10% of the outstanding common stock of the Company.

12. Stock-Based Compensation

On August 18, 2010, the Company granted equity based units to certain members of management valued on the date of grant at $1.9 million with a four year vesting period. Recipients of the equity based units have the right to receive certain distributions, if any, from the Company following return of capital to its equity members. The share based units vested upon completion of the IPO, and the remaining unrecognized compensation expense of $316,667 was recognized during the first quarter of 2014, and is included in general and administrative expense in the accompanying consolidated statement of operations.

The 2014 Long-Term Incentive Plan (“2014 Incentive Plan”), was adopted by our board of directors in January 2014. The 2014 Incentive Plan provides for the grant of equity-based awards, including options to purchase shares of common stock, stock appreciation rights, restricted and unrestricted stock awards, restricted stock units and performance awards. The 2014 Incentive Plan will automatically expire on the tenth anniversary of its effective date. Our board of directors may terminate or amend the 2014 Incentive Plan at any time, subject to any requirement of stockholder approval required by applicable law, rule or regulation and provided that the rights of a holder of an outstanding award may not be impaired without the consent of the holder.

The number of shares of our common stock that may be issued under the 2014 Incentive Plan is 1,644,875 shares. To the extent that shares of the Company's common stock subject to an outstanding option, stock appreciation right, stock award or performance award granted under the 2014 Incentive Plan or any predecessor plan are not issued or delivered by reason of the expiration, termination, cancellation or forfeiture of such award or the settlement of such award in cash, then such shares of common stock generally shall again be available under the 2014 Incentive Plan.

The Company has issued stock option and restricted stock unit awards under the 2014 Incentive Plan. The exercise price of stock-based awards may not be less than the market value of the Company's common stock on the date of grant. The fair value for stock options is established at the date of grant using the Black-Scholes model for time-based vesting awards. The

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Company's stock option and restricted stock awards typically vest over a one to three year period and expire ten years from the date of grant.

A summary of the Company's common stock option activity as of and for the nine months ended September 30, 2014 is presented below:

	Options Outstanding	
	Number of Shares	Weighted-Average Exercise Price per share
Options outstanding at December 31, 2013	—	—
Options granted	872,683	$11.00
Options forfeited	(3,096)	$11.00
Options outstanding at September 30, 2014	869,587	$11.00
Options exercisable at September 30, 2014	—	—

A summary of the Company's restricted stock units as of and for the nine months ended September 30, 2014 is presented below:

	Restricted Stock Units Outstanding	
	Number of Shares	Weighted-Average Grant-Date Fair Value per Share
Balance outstanding at December 31, 2013	—	—
Restricted stock units granted	118,937	$11.34
Restricted stock units forfeited	(4,424)	$11.00
Balance outstanding at September 30, 2014	114,513	$11.36

The expense related to the Company's stock-based compensation programs, included in general and administrative expense in the accompanying consolidated statements of operations, was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Expense related to:				
Equity based incentive units	$—	$118,750	$316,667	$356,250
Stock options	319,129	—	854,301	—
Restricted stock units	240,300	—	636,079	—
	$559,429	$118,750	$1,807,047	$356,250

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table presents details of the assumptions used to calculate the weighted-average grant date fair value of common stock options granted by the Company:

	Nine months ended September 30, 2014	
Expected term (in years)	4.3	
Expected volatility	49.0	%
Risk-free interest rate	1.2	%
Expected dividends	—	
Weighted-average grant date fair value per share	$4.43	

Our restricted stock awards are valued based on the closing price of our common stock on the date of grant. At September 30, 2014, the amount of unearned stock-based compensation currently estimated to be expensed through 2017 related to unvested common stock options and restricted stock units is $3.7 million, net of estimated forfeitures. The weighted-average period over which the unearned stock-based compensation is expected to be recognized is 2.2 years. If there are any modifications or cancellations of the underlying unvested awards, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

13. Income Taxes

The Company accounts for income taxes in accordance with ASC 740, which requires an asset and liability approach for measuring deferred taxes based on temporary differences between the financial statements and tax bases of assets and liabilities existing at each balance sheet date using enacted tax rates for the years in which taxes are expected to be paid or recovered.

As discussed in Note 1, during 2013 and for the first 30 calendar days of 2014, the Company was a Delaware LLC which was treated as partnership for income tax purposes and was subject to certain minimal taxes and fees; however, income taxes on taxable income or losses realized by the Company were the obligation of the members.

On January 30, 2014, the Company completed its IPO and reorganized from a Delaware LLC into a Delaware corporation. For the three and nine months ended September 30, 2014, the Company recorded a tax benefit of $0.6 million and $2.6 million, respectively. The effective tax rate for the nine months ended September 30, 2014 differs from the 35% statutory tax rate due to the recognition of a tax benefit of $1.4 million in the first quarter of 2014 for cumulative net deferred tax assets resulting from the Company's conversion to a taxable entity. The net deferred tax asset primarily relates to differences between the financial statement basis and tax basis for investments in unconsolidated joint ventures, accrued warranties and accrued benefits. Additionally, the effective tax rate for the nine months ended September 30, 2014 was reduced by the exclusion of pre-conversion earnings from taxable income during the first quarter of 2014, and the tax benefit of production activities, partially offset by state income taxes. The effective tax rate for the three months ended September 30, 2014 differs from the statutory tax rate due to the tax benefit of production activities, partially offset by state income taxes.

The Company has concluded that there were no significant uncertain tax positions requiring recognition in its financial statements, nor has the Company been assessed interest or penalties by any major tax jurisdictions related to any open tax periods.

14. Segment Information

The Company’s operations are organized into two reportable segments: homebuilding and fee building. In accordance with ASC 280, in determining the most appropriate reportable segments, we considered similar economic and other characteristics, including product types, average selling prices, gross profits, production processes, suppliers, subcontractors, regulatory environments, land acquisition results, and underlying demand and supply.

The reportable segments follow the same accounting policies as our consolidated financial statements described in Note 1. Operational results of each reportable segment are not necessarily indicative of the results that would have been achieved had the reportable segment been an independent, stand-alone entity during the periods presented. Financial information relating to reportable segments was as follows:

THE NEW HOME COMPANY INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues				
Homebuilding	$8,196,683	$11,515,947	$22,854,625	$24,735,081
Fee building	20,408,030	9,655,331	53,817,385	33,689,862
Total	$28,604,713	$21,171,278	$76,672,010	$58,424,943
Gross profit				
Homebuilding	$1,274,596	$1,954,091	$4,032,768	$4,348,756
Fee building	1,018,949	1,778,533	1,953,558	3,025,964
Total	$2,293,545	$3,732,624	$5,986,326	$7,374,720
			September 30, 2014	December 31, 2013
Assets				
Homebuilding			$249,281,070	$91,519,281
Fee building			10,724,202	7,430,015
Total			$260,005,272	$98,949,296

15. Pro Forma Net (Loss) Income and (Loss) Earnings per Share

The pro forma amounts reflect the income tax provision as if the Company was a taxable corporation as of the beginning of the period, and assume the Company filed a consolidated tax return for the periods presented. Accordingly, the historical net income from the Company's sole taxable subsidiary would have been offset by losses from other entities, resulting in the elimination of income tax expense recorded for the three and nine months ended September 30, 2013.

For the three and nine months ended September 30, 2014, the pro forma tax provision assumes the Company's taxable income for the year would have included pre-tax income earned between January 1, 2014 and January 30, 2014, prior to the conversion to a taxable corporation. In addition, a net deferred income tax asset of $1.4 million was recognized as a result of the conversion to a taxable entity during the first quarter of 2014. However, the pro forma results exclude the effect of the conversion adjustment because of its nonrecurring nature.

Basic and diluted earnings per share and pro forma basic and diluted earnings per share give effect to the conversion of the Company's members' equity into common stock on January 30, 2014 as though the conversion had occurred as of the beginning of the reporting period or the original date of issuance, if later. See Note 2.

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
(Loss) income before taxes	$(1,821,161)	$2,236,637	$(3,348,939)	$3,231,444
Pro forma income tax benefit (provision) to reflect the conversion to a C Corporation	655,007	(1,000)	1,231,623	(3,000)
Pro forma net (loss) income	(1,166,154)	2,235,637	(2,117,316)	3,228,444
Net loss attributable to noncontrolling interests	205,901	—	240,386	—
Pro forma net (loss) income attributable to The New Home Company Inc.	$(960,253)	$2,235,637	$(1,876,930)	$3,228,444
	$(0.06)	$0.26	$(0.12)	$0.42

Pro forma basic (loss) earnings per share attributable to The New Home Company Inc.				
Pro forma diluted (loss) earnings per share attributable to The New Home Company Inc.	$(0.06)	$0.26	$(0.12)	$0.42

16. Subsequent Events

On October 3, 2014, TNHC-HW Foster City LLC, one of the Company's unconsolidated joint ventures, acquired approximately 404 lots in Foster City, California for $30.0 million. The seller carried back a portion of the purchase price in the form of a $21.0 million promissory note that is secured by the acquired property, bears interest at the rate of 5.0% per annum, and matures in 2015.

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

CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

Various statements contained in this quarterly report on Form 10-Q, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements. These forward-looking statements may include projections and estimates concerning the timing and success of specific projects and our future production, revenues, income and capital spending. Our forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "intend," "anticipate," "potentia "goal" or other words that convey the uncertainty of future events or outcomes. The forward-looking statements in this report speak only as of the date of this report, and we disclaim any obligation to update these statements unless required by law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. The following factors, among others, may cause our actual results, performance or achievements to differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements:

- economic changes either nationally or in the markets in which we operate, including declines in employment, volatility of mortgage interest rates and inflation;
- continued or increased downturn in the homebuilding industry;
- continued volatility and uncertainty in the credit markets and broader financial markets;
- our future operating results and financial condition;
- our business operations;
- changes in our business and investment strategy;
- availability of land to acquire and our ability to acquire such land on favorable terms or at all;
- availability, terms and deployment of capital;
- continued or increased disruption in the availability of mortgage financing or the number of foreclosures in the market;
- shortages of or increased prices for labor, land or raw materials used in housing construction;
- delays in land development or home construction resulting from adverse weather conditions or other events outside our control;
- issues concerning our joint venture partnerships;
- the cost and availability of insurance and surety bonds;
- changes in, or the failure or inability to comply with, governmental laws and regulations;
- the timing of receipt of regulatory approvals and the opening of projects;
- the degree and nature of our competition;
- our leverage and debt service obligations; and
- availability of qualified personnel and our ability to retain our key personnel.

Unless the context otherwise requires, the terms "we", "us", "our" and "the Company" refer to The New Home Company Inc. and its consolidated subsidiaries. The following discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and related notes thereto contained elsewhere in this report. The information contained in this quarterly report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our securities. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the year ended December 31, 2013 and subsequent reports on

Form 10-Q and Form 8-K, which discuss our business in greater detail. The section entitled “Risk Factors” set forth in Item 1A of our Annual Report on Form 10-K, and similar disclosures in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks, in addition to the information in this report and in our other filings with the SEC, before deciding to invest in, or maintain your investment in, our common stock.

Consolidated Financial Data

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
Home sales	$8,196,683	$11,515,947	$22,854,625	$24,735,081
Fee building, including management fees from unconsolidated joint ventures of $2,199,198, $1,902,346 $5,523,998 and $4,373,734, respectively	20,408,030	9,655,331	53,817,385	33,689,862
	28,604,713	21,171,278	76,672,010	58,424,943
Expenses:				
Cost of homes sales	6,922,087	9,561,856	18,821,857	20,386,325
Cost of fee building	19,389,081	7,876,798	51,863,827	30,663,898
Abandoned project costs	62,099	166,132	161,887	489,395
Selling and marketing	971,214	528,920	2,187,767	1,272,575
General and administrative	3,148,326	1,858,908	8,028,183	4,122,348
	30,492,807	19,992,614	81,063,521	56,934,541
Equity in net income of unconsolidated joint ventures	50,098	1,037,579	994,826	1,689,659
Guaranty fee income	—	28,391	18,927	85,173
Other income (expense), net	16,835	(7,997)	28,819	(33,790)
(Loss) income before taxes	(1,821,161)	2,236,637	(3,348,939)	3,231,444
Benefit of (provision for) taxes	556,305	(133,476)	2,575,454	(315,313)
Net (loss) income	(1,264,856)	2,103,161	(773,485)	2,916,131
Net loss attributable to noncontrolling interests	205,901	—	240,386	—
Net (loss) income attributable to The New Home Company Inc.	$(1,058,955)	$2,103,161	$(533,099)	$2,916,131

Results of Operations

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

Net New Home Orders and Backlog

	Three Months Ended September 30,		Increase (Decrease)	
	2014	2013	Amount	%
Net new home orders	27	22	5	23%
Cancellation rate	21%	29%	(8)%	(28)%
Average selling communities	4.0	2.8	1.2	43%
Selling communities at end of period	4	3	1	33%
Backlog (dollar value)	$91,061,000	$20,030,000	$71,031,000	355%
Backlog (homes)	42	32	10	31%
Average sales price of backlog	$2,168,000	$626,000	$1,542,000	246%

Net new home orders for the three months ended September 30, 2014 increased 23% to 27, compared to 22 during the same period in 2013. Our overall “absorption rate” (the rate at which home orders are contracted, net of cancellations) for the three months ended September 30, 2014 was 6.8 per average selling community (2.3 monthly), compared to 7.9 per average selling community (2.8 monthly) during the same period in 2013.

Our cancellation rate of buyers who contracted to buy a home, but did not close escrow (as a percentage of overall orders), was approximately 21% for the three months ended September 30, 2014 as compared to 29% for the same period in 2013. Our average number of selling communities increased by 1.2 for the three months ended September 30, 2014 compared to the same period in 2013.

Backlog reflects the number of homes, net of actual cancellations, for which we have entered into a sales contract with a customer, but for which we have not yet delivered the home. Backlog has not been reduced to reflect our historical cancellation rate. Homes in backlog are generally closed within three to seven months, although we may experience cancellations of sales contracts prior to closing. The number of homes in backlog as of September 30, 2014 compared to September 30, 2013 increased 31% as a result of increased net new home orders and a decrease of new home deliveries. The dollar value of backlog increased $71,031,000, or 355%, as of September 30, 2014 compared to September 30, 2013 primarily due to the opening of two new communities in Irvine, California with average sales prices of $2.0 million and $2.8 million.

Home Sales Revenue and New Homes Delivered

	Three Months Ended September 30,		Increase (Decrease)	
	2014	2013	Amount	%
New homes delivered	10	25	(15)	(60)%
Home sales revenue	$8,196,683	$11,515,947	$(3,319,264)	(29)%
Average sales price of homes delivered	$820,000	$461,000	$359,000	78%

New home deliveries decreased by 15, or 60%, during the three months ended September 30, 2014 compared to the same period in 2013. The decrease in new home deliveries was primarily due to the closeout of one community in Sacramento, California.

During the three months ended September 30, 2014, home sales revenue decreased by $3.3 million, or 29%, from the same period in 2013 primarily due to a decrease in new home deliveries, offset partially by an increase in the average sales price of homes delivered in the Sacramento, California community noted above.

Homebuilding

	Three Months Ended September 30,			
	2014	%	2013	%
Home sales revenue	$8,196,683	100.0%	$11,515,947	100.0%
Cost of home sales	6,922,087	84.4%	9,561,856	83.0%
Homebuilding gross margin	1,274,596	15.6%	1,954,091	17.0%
Add: interest in cost of home sales	64,080	0.8%	157,949	1.4%
Adjusted homebuilding gross margin(1)	$1,338,676	16.4%	$2,112,040	18.4%
Homebuilding gross margin percentage	15.6%		17.0%	
Adjusted homebuilding gross margin percentage(1)	16.4%		18.4%	

(1) Non-GAAP financial measure (as discussed below).

Homebuilding gross margin represents home sales revenue less cost of home sales. Our homebuilding gross margin decreased to 15.6% for the three months ended September 30, 2014 as compared to 17.0% for the same period in 2013. During the three months ended September 30, 2014, one community in Sacramento, California delivered its final home and another community in Sacramento, California is nearing completion. An increase in incentives related to those communities was the primary reason homebuilding gross margin decreased.

Excluding interest in cost of home sales, adjusted homebuilding gross margin percentage was 16.4% for the three months ended September 30, 2014, compared to 18.4% for the same period in 2013. Adjusted homebuilding gross margin is a non-GAAP financial measure. We believe that by adding interest in cost of home sales back to homebuilding gross margin, investors are able to assess the performance of our homebuilding business excluding our interest cost, allowing a focus on the performance of the underlying homebuilding operations. We believe this information is meaningful as it isolates the impact that leverage has on homebuilding gross margin and permits investors to make better comparisons with our competitors who adjust gross margins in a similar fashion. See the table above reconciling this non-GAAP financial measure to homebuilding gross margin, the nearest GAAP equivalent.

Fee Building

	Three Months Ended September 30,					
	2014	%		2013	%	
Fee building revenues	$20,408,030	100.0	%	$9,655,331	100.0	%
Cost of fee building	19,389,081	95.0	%	7,876,798	81.6	%
Fee building gross margin	$1,018,949	5.0	%	$1,778,533	18.4	%

As of September 30, 2014 and 2013, we had ten and seven, respectively, fee building agreements with independent third-party land owners and twelve and ten, respectively, construction management agreements with our unconsolidated joint ventures to provide construction management services. Fee building revenue increased to $20.4 million for the three months ended September 30, 2014 compared to $9.7 million for the same period during 2013. The increase in fee building revenue and cost is due to the increase in number of fee building agreements and increased construction activity during the three months ended September 30, 2014 and the increase in management fees from our unconsolidated joint ventures.

We collect management fees from our unconsolidated joint ventures over the life of the project and these fees increase as homes are delivered. Management fees were $2.2 million and $1.9 million for the three months ended September 30, 2014 and 2013, respectively, and are included in fee building revenues.

Cost of fee building increased to $19.4 million for the three months ended September 30, 2014 compared to $7.9 million for the same period during 2013. Cost of fee building includes overhead expenses that are attributable to the fee building projects and direct labor, subcontractor costs and other indirect project costs that are reimbursed by the independent third-party land owner. The amount of reimbursable labor, subcontractor and indirect project costs are primarily driven by the pace at which the land owner has us execute its development plan.

The amount of overhead expenses included in cost of fee building were $2.0 million and $0.8 million for the three months ending September 30, 2014 and 2013, respectively. The increase in revenue from fee building agreements and the related increase in overhead expenses was the primary reason fee building gross margin percentage decreased to 5.0% from 18.4% for the three months ended September 30, 2014 and 2013, respectively.

Abandoned Project Costs

Pre-acquisition costs, which consist primarily of due diligence costs for specific projects, are expensed to abandoned project costs when we determine continuation of the respective project is not probable. During the three months ended September 30, 2014, abandoned project costs decreased to $62,099 from $166,132 for the three months ended September 30, 2013, primarily due to the success of our project investigation activity.

Equity in Net Income of Unconsolidated Joint Ventures

As of September 30, 2014 and 2013, we had ownership interests in twelve and ten, respectively, unconsolidated joint ventures. We own economic interests in our unconsolidated joint ventures, which include our capital interests that range from 5% to 35% plus, in each case, a share of the distributions from the joint ventures in excess of our capital interest. These economic interests vary among our joint ventures. The unconsolidated joint ventures produced $2.4 million and $7.4 million in net income during the three months ended September 30, 2014 and 2013, respectively. Our equity in net income from unconsolidated joint ventures was $0.1 million for the three months ended September 30, 2014, compared to $1.0 million for the same period in 2013. The decrease in our equity in net income from unconsolidated joint ventures was primarily due to a decrease in net income produced by the unconsolidated joint ventures, which was due to a change in community mix resulting in (i) a reduction in home sales revenue from the unconsolidated joint ventures actively closing homes, (ii) a reduction in homebuilding gross margin, and (iii) increased operating costs, primarily marketing related during the 2014 period, as the unconsolidated joint ventures prepared to bring new communities to market.

The following sets forth supplemental operational and financial information about our unconsolidated joint ventures. Such information is not included in our financial data for GAAP purposes, but is recognized in our results as a component of equity in net income of unconsolidated joint ventures. This data is included for informational purposes only.

	Three Months Ended September 30,		Increase (Decrease)	
	2014	2013	Amount	%
Unconsolidated Joint Ventures—Net New Home Orders, Backlog, Revenues and Deliveries				
Net new home orders	79	47	32	68 %
Cancellation rate	10 %	4 %	6 %	150 %
Average selling communities	8.3	2.5	5.8	232 %
Selling communities at end of period	10	4	6	150 %
Backlog (dollar value)	$189,069,000	$93,529,000	$95,540,000	102 %
Backlog (homes)	147	91	56	62 %
Average sales price of backlog	$1,286,000	$1,028,000	$258,000	25 %
New homes delivered	72	26	46	177 %
Home sales revenue	$35,719,714	$39,382,319	$(3,662,605)	(9)%
Average sales price of homes delivered	$496,000	$1,515,000	$(1,019,000)	(67)%

Net new home orders from unconsolidated joint ventures increased to 79 from 47, or 68%, for the three months ended September 30, 2014 and 2013, respectively, primarily due to an increase in the number of average selling communities. The absorption rate for unconsolidated joint ventures for the three months ended September 30, 2014 was 9.5 per average selling community (3.3 monthly), compared to 18.8 per average selling community (5.9 monthly) during the same period in 2013.

The cancellation rate of unconsolidated joint venture projects was approximately 10% for the three months ended September 30, 2014 as compared to 4% for the same period in 2013. The number of homes in backlog from unconsolidated joint ventures as of September 30, 2014 increased by 56 from September 30, 2013 primarily due to the 68% increase in net new home orders, offset partially by an increase in new home deliveries. The dollar value of backlog as of September 30, 2014 compared to September 30, 2013 increased due to the increase in the number of homes in backlog and the average sales price of backlog. The average sales price of backlog increased by $258,000 primarily due to a change in product mix.

New homes delivered from unconsolidated joint ventures increased to 72 from 26, or 177%, for the three months ended September 30, 2014 and 2013, respectively, primarily due to an increase in net new home orders and community count. Home sales revenue from unconsolidated joint ventures decreased to $35.7 million from $39.4 million, or 9%, during the three months ended September 30, 2014 and 2013, respectively, primarily due to the decrease in average sales price of homes delivered. The average sales price of homes delivered decreased during the three months ended September 30, 2014 compared to the same period in 2013 primarily due to deliveries of lower priced homes, including below market rate homes in certain communities.

	Three Months Ended September 30,			
	2014	%	2013	%
Unconsolidated Joint Ventures—Homebuilding				
Unconsolidated joint ventures home sales revenue	$35,719,714	100.0 %	$39,382,319	100.0 %
Cost of unconsolidated joint ventures home sales	29,326,370	82.1 %	28,482,738	72.3 %
Unconsolidated joint ventures gross margin	6,393,344	17.9 %	10,899,581	27.7 %
Add: interest in cost of unconsolidated joint venture home sales	442,609	1.2 %	965,338	2.5 %
	$6,835,953	19.1 %	$11,864,919	30.2 %

Adjusted unconsolidated joint ventures home sales gross margin [1]				
Unconsolidated joint ventures home sales gross margin percentage	17.9	%	27.7	%
Adjusted unconsolidated joint ventures home sales gross margin percentage [1]	19.1	%	30.2	%

[1] Non-GAAP financial measure (as discussed below).

29

Excluding interest in cost of home sales, adjusted unconsolidated joint ventures home sales gross margin percentage was 19.1% for the three months ended September 30, 2014 compared to 30.2% for the same period in 2013. Adjusted unconsolidated joint ventures home sales gross margin is a non-GAAP financial measure. We believe that by adding interest in cost of unconsolidated joint venture home sales back to unconsolidated joint ventures gross margin, investors are able to assess the performance of our unconsolidated joint ventures excluding interest cost, allowing a focus on the performance of the underlying unconsolidated joint venture homebuilding operations. We believe this information is meaningful as it isolates the impact that leverage has on unconsolidated joint venture homebuilding gross margin and permits investors to make better comparisons with our competitors who adjust gross margins in a similar fashion. See the table above reconciling this non-GAAP financial measure to unconsolidated joint venture homebuilding gross margin, the nearest GAAP equivalent.

The table below summarizes lots owned and controlled by our unconsolidated joint ventures as of the dates presented:

	September 30,		Increase (Decrease)		
	2014	2013	Amount	%	
Unconsolidated Joint Ventures—Lots Owned and Controlled					
Lots owned	2,431	1,761	670	38	%
Lots controlled [1]	1,869	1,279	590	46	%
Total	4,300	3,040	1,260	41	%

[1] Consists of lots that are under purchase and sale agreements.

Selling, General and Administrative Expense

	Three Months Ended September 30,		As a Percentage of Home Sales Revenue			
	2014	2013	2014		2013	
Selling and marketing expenses	$971,214	$528,920	11.8	%	4.6	%
General and administrative expenses (“G&A”)	3,148,326	1,858,908	38.4	%	16.1	%
Total selling, marketing and G&A	$4,119,540	$2,387,828	50.2	%	20.7	%

Selling and marketing expenses incurred during the three months ended September 30, 2014 increased to 11.8% of home sales revenue compared to 4.6% for the same period in 2013. The increase in selling and marketing expense during the three months ended September 30, 2014 as compared to the same period in 2013 was primarily due to an increase in selling and marketing costs related to three new communities which opened towards the end of the second quarter of 2014. These communities will begin delivering homes in the fourth quarter of 2014.

During the three months ended September 30, 2014, G&A expenses increased to $3.1 million from $1.9 million for the same period in 2013. The increase was primarily attributable to (i) an increase of $0.4 million in stock-based compensation due to new option and restricted share unit awards granted during the first quarter of 2014, (ii) an increase in personnel as a result of the increase in, and level of activity of our projects, and (iii) an increase in outside services, professional fees and board of director costs related to public company requirements, and other costs incurred to support our growth. G&A expenses as a percentage of home sales revenue increased to 38.4% for the three months ended September 30, 2014 from 16.1% for the three months ended September 30, 2013.

Guaranty Fee Income

During the three months ended September 30, 2014 and 2013, we recognized $0 and $28,391 respectively in guaranty fee income from one of our unconsolidated joint ventures for certain loan guaranties provided over a 12-month period by us on behalf of the unconsolidated joint venture, which ended during the first quarter of 2014.

Other Income (Expense), Net

Other income (expense), net, increased slightly during the three months ended September 30, 2014 due to interest earned on our cash balances, compared to the same period in 2013.

Benefit of (Provision for) Taxes

During 2013 and for the first 30 calendar days of 2014, we were a Delaware LLC which was treated as a partnership for income tax purposes and was subject to certain minimal taxes and fees; however, income taxes on taxable income or losses realized by us were the obligation of the members. Federal and state taxes provided during 2013 and the first 30 calendar days of 2014 relate to a subsidiary that is treated as a C Corporation.

On January 30, 2014, the Company completed its IPO and reorganized from a Delaware LLC into a Delaware corporation. For the three months ended September 30, 2014, the Company recorded a tax benefit of $0.6 million. The effective tax rate for the three months ended September 30, 2014 differs from the 35% statutory tax rate due to the tax benefit of production activities, partially offset by state income taxes.

Net (Loss) Income

As a result of the foregoing factors, we generated a net loss during the three months ended September 30, 2014 of $1.1 million compared to net income of $2.1 million during the same period in 2013.

Interest Incurred

Interest, which was incurred principally to finance land acquisition, land development and home construction, totaled $0.5 million and $0.3 million for the three months ended September 30, 2014 and 2013, respectively, all of which was capitalized to real estate inventory. Interest incurred during the three months ended September 30, 2014 compared to the three months ended September 30, 2013 increased slightly as a result of a higher average outstanding notes payable balance, offset partially by a decrease in the weighted average interest rate.

Lots Owned and Controlled

	September 30,		Increase (Decrease)	
	2014	2013	Amount	%
Lots Owned				
Southern California	107	170	(63)	(37)%
Northern California	244	159	85	53%
Total	351	329	22	7%
Lots Controlled [1]				
Southern California	622	303	319	105%
Northern California	90	194	(104)	(54)%
Fee Building Projects [2]	1,161	887	274	31%
Total	1,873	1,384	489	35%
Total Lots Owned and Controlled	2,224	1,713	511	30%

(1) Includes 712 and 497 lots as of September 30, 2014 and 2013, respectively, that are under purchase contracts.
(2) Subject to agreements with property owners.

31

Results of Operations

Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

Net New Home Orders

	Nine Months Ended September 30,		Increase (Decrease)	
	2014	2013	Amount	%
Net new home orders	60	66	(6)	(9)%
Cancellation rate	13%	16%	(3)%	(19)%
Average selling communities	3.2	4.0	(0.8)	(20)%

Net new home orders for the nine months ended September 30, 2014 decreased 9% to 60, compared to 66 during the same period in 2013. Our overall "absorption rate" (the rate at which home orders are contracted, net of cancellations) for the nine months ended September 30, 2014 was 18.8 per average selling community (2.1 monthly), compared to 16.5 per average selling community (2.4 monthly) during the same period in 2013.

Our cancellation rate of buyers who contracted to buy a home, but did not close escrow (as a percentage of overall orders), was approximately 13% for the nine months ended September 30, 2014 as compared to 16% for the same period in 2013. Our average number of selling communities decreased by 0.8 for the nine months ended September 30, 2014 compared to the same period in 2013.

Home Sales Revenue and New Homes Delivered

	Nine Months Ended September 30,		Increase (Decrease)	
	2014	2013	Amount	%
New homes delivered	33	59	(26)	(44)%
Home sales revenue	$22,854,625	$24,735,081	$(1,880,456)	(8)%
Average sales price of homes delivered	$693,000	$419,000	$274,000	65%

New home deliveries decreased by 26, or 44%, during the nine months ended September 30, 2014 compared to the same period in 2013. The decrease in new home deliveries was primarily due to the closeout of one community in Sacramento, California.

During the nine months ended September 30, 2014, home sales revenue decreased by $1.9 million, or 8%, from the same period in 2013 due to a decrease in the number of new homes delivered, offset partially by an increase in the average sales price of homes delivered. The increase in average sales price of homes delivered was due to a change in product mix.

Homebuilding

	Nine months ended September 30,			
	2014	%	2013	%
Home sales revenue	$22,854,625	100.0%	$24,735,081	100.0%
Cost of home sales	18,821,857	82.4%	20,386,325	82.4%
Homebuilding gross margin	4,032,768	17.6%	4,348,756	17.6%
Add: interest in cost of home sales	118,269	0.5%	347,572	1.4%
Adjusted homebuilding gross margin[1]	$4,151,037	18.1%	$4,696,328	19.0%
Homebuilding gross margin percentage	17.6%		17.6%	
Adjusted homebuilding gross margin percentage[1]	18.1%		19.0%	

[1] Non-GAAP financial measure (as discussed below).

Homebuilding gross margin represents home sales revenue less cost of home sales. Our homebuilding gross margin remained consistent at 17.6% for the nine months ended September 30, 2014 as compared to the same period in 2013. Excluding interest in cost of home sales, adjusted homebuilding gross margin percentage was 18.1% for the nine months ended September 30, 2014, compared to 19.0% for the same period in 2013. Adjusted homebuilding gross margin is a non-GAAP financial measure. We believe that by adding interest in cost of home sales back to homebuilding gross margin, investors are able to assess the performance of our homebuilding business excluding our interest cost, allowing a focus on the performance of the underlying homebuilding operations. We believe this information is meaningful as it isolates the impact that leverage has on homebuilding gross margin and permits investors to make better comparisons with our competitors who adjust gross margins in a similar fashion. See the table above reconciling this non-GAAP financial measure to homebuilding gross margin, the nearest GAAP equivalent.

Fee Building

	Nine months ended September 30,					
	2014	%		2013	%	
Fee building revenues	$53,817,385	100.0	%	$33,689,862	100.0	%
Cost of fee building	51,863,827	96.4	%	30,663,898	91.0	%
Fee building gross margin	$1,953,558	3.6	%	$3,025,964	9.0	%

As of September 30, 2014 and 2013, we had ten and seven, respectively, fee building agreements with independent third-party land owners and twelve and ten, respectively, construction management agreements with our unconsolidated joint ventures to provide construction management services. Fee building revenue increased to $53.8 million for the nine months ended September 30, 2014 compared to $33.7 million for the same period during 2013. The increase in fee building revenue and cost is due to the increase in number of fee building agreements and construction activity during the nine months ended September 30, 2014 and the increase in management fees from unconsolidated joint ventures.

We collect management fees from our unconsolidated joint ventures over the life of the project and these fees increase as homes are delivered. Management fees were $5.5 million and $4.4 million for the nine months ended September 30, 2014 and 2013, respectively, and are included in fee building revenues.

Cost of fee building increased to $51.9 million for the nine months ended September 30, 2014 compared to $30.7 million for the same period during 2013. Cost of fee building includes overhead expenses that are attributable to the fee building projects and direct labor, subcontractor costs and other indirect project costs that are reimbursed by the independent third-party land owner. The amount of reimbursable labor, subcontractor and indirect project costs are primarily driven by the pace at which the land owner has us execute its development plan.

The amount of overhead expenses included in cost of fee building were $6.2 million and $3.2 million for the nine months ending September 30, 2014 and 2013, respectively. The increase in revenue from fee building agreements and the related increase in overhead expenses was the primary reason fee building gross margin percentage decreased to 3.6% from 9.0% for the nine months ended September 30, 2014 and 2013, respectively.

Abandoned Project Costs

Pre-acquisition costs, which consist primarily of due diligence costs for specific projects, are expensed to abandoned project costs when we determine continuation of the respective project is not probable. During the nine months ended September 30, 2014, abandoned project costs decreased to $0.2 million from $0.5 million for the nine months ended September 30, 2013, primarily due to the success of our project investigation activity.

Equity in Net Income of Unconsolidated Joint Ventures

As of September 30, 2014 and 2013, we had ownership interests in twelve and ten, respectively, unconsolidated joint ventures. We own economic interests in our unconsolidated joint ventures, which include our capital interests that range from 5% to 35% plus, in each case, a share of the distributions from the joint ventures in excess of our capital interest. These economic interests vary among our joint ventures. The unconsolidated joint ventures produced $7.6 million and $19.8 million in net income during the nine months ended September 30, 2014 and 2013, respectively. The net income of our unconsolidated joint ventures decreased due to a change in community mix resulting in (i) a reduction in home sales revenue, (ii) a reduction in homebuilding gross margin, (iii) the income allocation percentages of specific joint ventures, and (iv) increased operating costs during the 2014 period as the unconsolidated joint ventures prepare to bring new communities to market. Our equity in net

33

income from unconsolidated joint ventures was $1.0 million for the nine months ended September 30, 2014, compared to equity in net income of $1.7 million for the same period in 2013.

The following sets forth supplemental operational and financial information about our unconsolidated joint ventures. Such information is not included in our financial data for GAAP purposes, but is recognized in our results as a component of equity in net income of unconsolidated joint ventures. This data is included for informational purposes only.

	Nine Months Ended September 30, 2014	2013	Increase (Decrease) Amount	%
Unconsolidated Joint Ventures—Net New Home Orders, Revenues and Deliveries				
Net new home orders	231	111	120	108 %
Cancellation rate	8 %	6 %	2 %	33 %
Average selling communities	7.7	6.0	1.7	28 %
New homes delivered	146	74	72	97 %
Home sales revenue	$88,166,393	$105,001,748	$(16,835,355)	(16)%
Average sales price of homes delivered	$604,000	$1,419,000	$(815,000)	(57)%

Net new home orders from unconsolidated joint ventures increased to 231 from 111, or 108%, for the nine months ended September 30, 2014 and 2013, respectively, primarily due to an increase in the number of average selling communities. The absorption rate for unconsolidated joint ventures for the nine months ended September 30, 2014 was 30.0 per average selling community (3.3 monthly), compared to 18.5 per average selling community (4.3 monthly) during the same period in 2013.

The cancellation rate of unconsolidated joint venture projects was approximately 8% for the nine months ended September 30, 2014 as compared to 6% for the same period in 2013.

New homes delivered from unconsolidated joint ventures increased to 146 from 74, or 97%, for the nine months ended September 30, 2014 and 2013, respectively, primarily due to an increase in community count. Home sales revenue from unconsolidated joint ventures decreased to $88.2 million from $105.0 million, or 16%, during the nine months ended September 30, 2014 and 2013, respectively, primarily due to the decrease in average sales price of homes delivered resulting from a change in community mix.

	Nine months ended September 30, 2014	%	2013	%
Unconsolidated Joint Ventures—Homebuilding				
Unconsolidated joint ventures home sales revenue	$88,166,393	100.0 %	$105,001,748	100.0 %
Cost of unconsolidated joint ventures home sales	69,489,511	78.8 %	76,741,526	73.1 %
Unconsolidated joint ventures gross margin	18,676,882	21.2 %	28,260,222	26.9 %
Add: interest in cost of unconsolidated joint venture home sales	1,007,730	1.1 %	2,555,686	2.4 %
Adjusted unconsolidated joint ventures home sales gross margin (1)	$19,684,612	22.3 %	$30,815,908	29.3 %
Unconsolidated joint ventures home sales gross margin percentage	21.2 %		26.9 %	
Adjusted unconsolidated joint ventures home sales gross margin percentage (1)	22.3 %		29.3 %	

(1) Non-GAAP financial measure (as discussed below).

Excluding interest in cost of home sales, adjusted unconsolidated joint ventures home sales gross margin percentage was 22.3% for the nine months ended September 30, 2014, compared to 29.3% for the same period in 2013. Adjusted unconsolidated joint ventures home sales gross margin is a non-GAAP financial measure. We believe that by adding interest in cost of unconsolidated joint venture home sales back to unconsolidated joint ventures gross margin, investors are able to assess the performance of our unconsolidated joint ventures excluding interest cost, allowing a focus on the performance of the underlying unconsolidated joint venture homebuilding operations. We believe this information is meaningful as it isolates the impact that leverage has on unconsolidated joint venture homebuilding gross margin and permits investors to make better comparisons with our competitors who adjust gross margins in a similar fashion. See the table above reconciling this non-GAAP financial measure to unconsolidated joint venture homebuilding gross margin, the nearest GAAP equivalent.

Selling, General and Administrative Expense

	Nine Months Ended September 30,		As a Percentage of Home Sales Revenue			
	2014	2013	2014		2013	
Selling and marketing expenses	$2,187,767	$1,272,575	9.6	%	5.1	%
General and administrative expenses (“G&A”)	8,028,183	4,122,348	35.1	%	16.7	%
Total selling, marketing and G&A	$10,215,950	$5,394,923	44.7	%	21.8	%

Selling and marketing expenses incurred during the nine months ended September 30, 2014 increased to 9.6% of home sales revenue compared to 5.1% for the same period in 2013. The increase in selling and marketing expense during the nine months ended September 30, 2014 as compared to the same period in 2013 is primarily due to an increase in the number of sales personnel and marketing costs related to three new communities that opened during the second quarter of 2014 that will begin delivering homes in the fourth quarter of 2014.

During the nine months ended September 30, 2014, G&A expenses increased to $8.0 million from $4.1 million for the same period in 2013. The increase was primarily attributable to (i) an increase of $1.5 million in stock-based compensation due to new option and restricted share unit awards granted during the first quarter of 2014, (ii) an increase in personnel as a result of the increase in, and level of activity of our projects, and (iii) an increase in outside services, professional fees and board of director costs related to public company requirements, and other costs incurred to support our growth. G&A expenses as a percentage of home sales revenue increased to 35.1% for the nine months ended September 30, 2014 from 16.7% for the nine months ended September 30, 2013.

Guaranty Fee Income

During the nine months ended September 30, 2014 and 2013, we recognized $18,927 and $85,173, respectively, in guaranty fee income from one of our unconsolidated joint ventures for certain loan guaranties provided over a 12-month period by us on behalf of the unconsolidated joint venture, which ended during the first quarter of 2014.

Other Income (Expense), Net

Other income (expense), net, increased slightly during the nine months ended September 30, 2014 compared to the same period in 2013 due to interest earned on our cash balances.

Benefit of (Provision for) Taxes

During 2013 and for the first 30 calendar days of 2014, we were a Delaware LLC which was treated as a partnership for income tax purposes and was subject to certain minimal taxes and fees; however, income taxes on taxable income or losses realized by us were the obligation of the members. Federal and state taxes provided during 2013 and the first 30 calendar days of 2014 relate to a subsidiary that is treated as a C Corporation.

On January 30, 2014, the Company completed its IPO and reorganized from a Delaware LLC into a Delaware corporation. For the nine months ended September 30, 2014, the Company recorded a tax benefit of $2.6 million. The effective tax rate for the nine months ended September 30, 2014 differs from the 35% statutory tax rate due to the recognition of a tax benefit of $1.4 million for cumulative net deferred tax assets resulting from the Company's conversion to a taxable entity. The net deferred tax asset primarily relates to differences between the financial statement basis and tax basis for investments in unconsolidated joint ventures, accrued warranties and accrued benefits. Additionally, the tax benefit was increased by the exclusion of pre-conversion earnings from taxable income for the three months ended March 31, 2014, and the tax benefit of production activities, partially offset by state income taxes.

Net (Loss) Income

As a result of the foregoing factors, net loss during the nine months ended September 30, 2014 was $0.5 million compared to net income of $2.9 million during the same period in 2013.

35

Interest Incurred

Interest, which was incurred principally to finance land acquisition, land development and home construction, totaled $1.1 million and $0.8 million for the nine months ended September 30, 2014 and 2013, respectively, all of which was capitalized to real estate inventory. Interest incurred during the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013 increased slightly as a result of a higher average outstanding notes payable balance, offset partially by a decrease in the weighted average interest rate.

Liquidity and Capital Resources

Overview

Our principal uses of capital for the nine months ended September 30, 2014 were land purchases, land development, home construction, investments in unconsolidated joint ventures, operating expenses and the payment of routine liabilities. Our principal source of capital for the nine months ended September 30, 2014 was the sale of shares in our IPO and secondarily, advances from our unsecured credit facility.

Cash flows for each of our communities depend on their stage in the development cycle, and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, entitlements and other approvals, and construction of model homes, roads, utilities, general landscaping and other amenities. Because these costs are a component of our real estate inventories and not recognized in our consolidated statement of operations until a home closes, we incur significant cash outlays prior to our recognition of earnings. In the later stages of community development, cash inflows may significantly exceed earnings reported for financial statement purposes, as the cash outflow associated with home and land construction was previously incurred. From a liquidity standpoint, we and our unconsolidated joint ventures are actively acquiring and developing lots in our markets to increase our lot supply and community count. We focus on strategically located sites, which are located along key transportation corridors in major job centers in our submarkets. As demand for new homes improves and we continue to expand our business, we expect that cash outlays for land purchases and land development will exceed our cash generated by operations. During the nine months ended September 30, 2014, we delivered 33 homes and purchased 77 lots. During the nine months ended September 30, 2013, we delivered 59 homes and purchased 20 lots. During the nine months ended September 30, 2014, our unconsolidated joint ventures delivered 146 homes and purchased 883 lots. During the nine months ended September 30, 2013, our unconsolidated joint ventures delivered 74 homes and purchased 1,076 lots.

We exercise strict controls and believe we have a prudent strategy for company-wide cash management, including those related to cash outlays for land and inventory acquisition, development and investments in unconsolidated joint ventures. We ended the third quarter of 2014 with $59.9 million of cash and cash equivalents, a $50.4 million increase from December 31, 2013, primarily as a result of $75.8 million in net proceeds from our IPO and advances from our unsecured credit facility, partially offset by net real estate inventory expenditures of $65.1 million. We intend to generate cash from the sale of our inventory, net of loan release payments on our notes payable when applicable, but we intend to redeploy the net cash generated from the sale of inventory to acquire and develop strategic and well-positioned lots that represent opportunities to generate future income.

At September 30, 2014 and December 31, 2013, we had $8.6 million and $6.1 million, respectively, in accounts payable that related to costs incurred under our fee building agreements. Funding to pay these amounts is the obligation of the independent third-party land owner, which is funded on a monthly basis. Similarly, contracts and account receivable as of the same dates included $9.1 million and $6.6 million, respectively, related to the payment of the above payables. As of September 30, 2014, we have not experienced any losses from uncollectable contracts and accounts receivable related to our fee building projects.

We intend to employ both debt and equity as part of our ongoing financing strategy, coupled with redeployment of cash flows from continuing operations, to provide us with the financial flexibility to access capital on favorable terms. In that regard, we expect to employ prudent levels of leverage to finance the acquisition and development of our lots and construction of our homes. As of September 30, 2014, we had $144.0 million of aggregate loan commitments, of which $94.3 million was outstanding. We will consider a number of factors when evaluating our level of indebtedness and when making decisions regarding the incurrence of new indebtedness, including the purchase price of assets to be acquired with debt financing, the estimated market value of our assets and the ability of particular assets, and our company as a whole, to generate cash flow to cover the expected debt service. As a means of sustaining our long-term financial health and limiting our exposure to unforeseen dislocations in the debt and financing markets, we currently expect to remain conservatively capitalized. However, our charter does not contain a limitation on the amount of debt we may incur and our board of directors may change our target debt levels at any time without the approval of our stockholders.

We intend to finance future acquisitions and developments with the most advantageous source of capital available to us at the time of the transaction, which may include a combination of common and preferred equity, secured and unsecured corporate level debt, property-level debt and mortgage financing and other public, private or bank debt.

The U.S. housing market continues to improve from the cyclical low points reached during the 2008-2009 national recession. In 2011, early signs of a recovery began to materialize in many markets around the country as a result of an improving macroeconomic backdrop and excellent housing affordability. Historically, strong housing markets have been associated with great affordability, a healthy domestic economy, positive demographic trends such as population growth and household formation, falling mortgage rates, increases in renters that qualify as homebuyers and locally based dynamics such as housing demand relative to housing supply. Many of the markets in which we operate are exhibiting most of these positive characteristics.

Land Acquisition Notes

During 2012, we entered into a note with a land seller, secured by real estate, which bears interest at 7.0% per annum. The note provides for a commitment of $9.5 million all of which had been funded as of September 30, 2014. The note matures on February 15, 2015 and requires certain mandatory pay downs totaling $1.0 million based on the occurrence of certain project-related events. Interest is payable monthly and the remaining principal is due at maturity. In March 2014, we acquired real estate with a purchase price of $21.5 million. Concurrent with this transaction we entered into a $17.0 million note with the land seller, secured by real estate, which bore interest at 1.0% per annum. The note matured on June 30, 2014 and was repaid in full.

Secured Revolving Construction Notes

In May 2014, we entered into two secured revolving construction loans with a bank related to model and production homes for a specific project. The loans are secured by real estate and bear interest at the bank's prime rate plus 2.0%, or 5.25% at September 30, 2014. The total commitment under the construction loans is $9.5 million, with funding and repayment requirements based on the project development and sales cycle. As of September 30, 2014, we had $6.1 million available to borrow under the revolving construction loans. The loans mature on November 27, 2016. Interest is payable monthly, with all unpaid principal and interest due at maturity.

Senior Unsecured Revolving Credit Facility

As of September 30, 2014, we were party to a senior unsecured revolving credit facility ("Credit Facility") which has a maximum commitment of $125.0 million and matures on June 26, 2017. We may borrow under our Credit Facility in the ordinary course of business for general corporate purposes. Interest on the Credit Facility is paid monthly at a rate of the one-month LIBOR plus a margin ranging from 2.25% to 3.00% depending on our leverage ratio as calculated at the end of each fiscal quarter. As of September 30, 2014, the outstanding principal balance was $81.4 million, the interest rate was 2.40% per annum, and we had $43.6 million of availability under the Credit Facility.

Covenant Compliance

Under our revolving credit facility, we are required to comply with certain financial covenants, including but not limited to those set forth in the table below:

Financial Covenant	Actual at September 30, 2014	Covenant Requirement at September 30, 2014
Unencumbered Liquid Assets	$59,944,071	$5,000,000
EBITDA to Interest Incurred	2.0 : 1.0	> 1.5 : 1.0
Tangible Net Worth	$141,640,758	$106,813,000
Leverage Ratio	30%	< 75%
Adjusted Leverage Ratio	67%	< 125%

As of September 30, 2014 and December 31, 2013, we were in compliance with all financial covenants.

We believe that our leverage ratios provide useful information to the users of our financial statements regarding our financial position and cash and debt management. The ratio of debt-to-capital and the ratio of net debt-to-capital are calculated as follows:

	September 30, 2014		December 31, 2013	
Notes payable	$94,297,509		$17,883,338	
Equity, exclusive of non-controlling interest	142,148,108		64,355,719	
Total capital	$236,445,617		$82,239,057	
Ratio of debt-to-capital [(1)]	39.9	%	21.7	%
Notes payable	$94,297,509		$17,883,338	
Less: cash, cash equivalents and restricted cash	60,986,351		9,671,576	
Net debt	33,311,158		8,211,762	
Equity, exclusive of non-controlling interest	142,148,108		64,355,719	
Total capital	$175,459,266		$72,567,481	
Ratio of net debt-to-capital [(2)]	19.0	%	11.3	%

(1) The ratio of debt-to-capital is computed as the quotient obtained by dividing notes payable by the sum of total notes payable plus equity, exclusive of non-controlling interest.

(2) The ratio of net debt-to-capital is computed as the quotient obtained by dividing net debt (which is notes payable less cash to the extent necessary to reduce the debt balance to zero) by total capital, exclusive of non-controlling interest. The most directly comparable GAAP financial measure is the ratio of debt-to-capital. We believe the ratio of net debt-to-capital is a relevant financial measure for investors to understand the leverage employed in our operations and as an indicator of our ability to obtain financing. We believe that by deducting our cash from our notes payable, we provide a measure of our indebtedness that takes into account our cash liquidity. We believe this provides useful information as the ratio of debt-to-capital does not take into account our liquidity and we believe that the ratio net of cash provides supplemental information by which our financial position may be considered. Investors may also find this to be helpful when comparing our leverage to the leverage of our competitors that present similar information. See the table above reconciling this non-GAAP financial measure to the ratio of debt-to-capital.

Cash Flows — Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

For the nine months ended September 30, 2014 as compared to the nine months ended September 30, 2013, the comparison of cash flows is as follows:

- Net cash used in operating activities was $62.4 million in the 2014 period versus $13.9 million in the 2013 period. The change was primarily a result of an increase in cash outflows for real estate inventories to $65.1 million in the 2014 period compared to $17.5 million in the 2013 period. The increase in real estate inventories resulted primarily from the acquisition of 77 lots and increased development activity at the Company's existing projects.
- Net cash used in investing activities was $22.4 million in the 2014 period compared to $8.5 million in the 2013 period. During the nine months ended September 30, 2014, our net contributions to unconsolidated joint ventures increased to $21.6 million compared to $8.2 million during the nine months ended September 30, 2013 and was the primary reason net cash used in investing activities increased.
- Net cash provided by financing activities was $135.2 million in the 2014 period versus $20.9 million in the 2013 period. The change was primarily a result of the receipt of proceeds of our IPO of $75.8 million, net of the underwriting discount and offering expenses, compared to contributions from members of $21.6 million in the 2013 period. In addition, net borrowings of notes payable were $59.4 million during the 2014 period versus $0.7 million during the 2013 period.

As of September 30, 2013, our unrestricted cash balance was $59.9 million. In January 2014, we completed an IPO of our common stock and received proceeds of $75.8 million, net of the underwriting discount and offering expenses.

We intend to use the proceeds for the acquisition of land, including the land described under "Off-Balance Sheet Arrangements and Contractual Obligations" and for development, home construction, investment in joint ventures and other related purposes.
Based on the foregoing, we believe we have sufficient cash and sources of financing for at least the next twelve months.

Off-Balance Sheet Arrangements and Contractual Obligations

In the ordinary course of business, we enter into land option contracts in order to procure lots for the construction of our homes. We are subject to customary obligations associated with entering into contracts for the purchase of land and improved lots. These purchase contracts typically require a cash deposit and the purchase of properties under these contracts is generally contingent upon satisfaction of certain requirements by the sellers, including obtaining applicable property and development entitlements. We also utilize option contracts with land sellers as a method of acquiring land in staged takedowns, to help us manage the financial and market risk associated with land holdings, and to reduce the use of funds from our corporate financing sources. Option contracts generally require a non-refundable deposit for the right to acquire lots over a specified period of time at pre-determined prices. We generally have the right at our discretion to terminate our obligations under both purchase contracts and option contracts by forfeiting our cash deposit with no further financial responsibility to the land seller. As of September 30, 2014, we had $2.1 million of non-refundable cash deposits and $0.8 million of refundable cash deposits pertaining to land option contracts and purchase contracts with an aggregate remaining purchase price of $270.3 million (net of deposits).

Our utilization of land option contracts is dependent on, among other things, the availability of land sellers willing to enter into option arrangements, the availability of capital to financial intermediaries to finance the development of optioned lots, general housing market conditions, and local market dynamics. Options may be more difficult to procure from land sellers in strong housing markets and are more prevalent in certain geographic regions.

As of September 30, 2014, the outstanding principal balance of our Credit Facility was $81.4 million, the interest rate was 2.40% per annum and we had approximately $43.6 million of availability. As of September 30, 2014, the outstanding principal balance of our secured revolving construction loans was $3.4 million, the interest rate was 5.25% per annum and we had approximately $6.1 million of availability under the construction loans.

We expect that the obligations under our Credit Facility and other loan agreements generally will be satisfied in the ordinary course of business and in accordance with applicable contractual terms.

Off-Balance Sheet Arrangements

As of September 30, 2014, we held membership interests in twelve unconsolidated joint ventures. We were a party to four loan-to-value maintenance agreements related to unconsolidated joint ventures as of September 30, 2014. The following table reflects certain financial and other information related to our unconsolidated joint ventures as of September 30, 2014 (in thousands):

Joint Venture Name	Year Formed	Location	September 30, 2014 Total Joint Venture Assets	Debt [1]	Equity	Debt-to-Total Capitalization		Loan-to-Value Maintenance Agreement	Future Capital Commitment [2]
			(Dollars in 000's)						
LR8 Investors, LLC	2010	Irvine, Orange County	$5,478	$—	$2,041	—	%	N/A	$ —
Larkspur Land 8 Investors, LLC	2011	Larkspur, Marin County	54,942	24,514	26,361	48	%	Yes	—
TNHC-HW San Jose LLC	2012	San Jose, Santa Clara County	78,346	29,005	44,473	39	%	Yes	683
TNHC-TCN Santa Clarita LP [3]	2012	Valencia, Los Angeles County	40,865	11,701	23,810	33	%	Yes	—
TNHC Newport LLC[3]	2013	Newport Beach, Orange County	103,563	46,125	49,723	48	%	Yes	4
Encore McKinley Village LLC [4]	2013	Sacramento, Sacramento County	21,798	2,835	17,150	14	%	No	3,115
TNHC San Juan LLC	2013	San Juan Capistrano, Orange County	21,328	—	20,611	—	%	N/A	2,785
TNHC Russell Ranch LLC [3] [4]	2013	Folsom, Sacramento County	35,615	20,000	15,376	57	%	No	15,379
TNHC-HW Foster City LLC	2013	Foster City, San Mateo County	10,889	—	8,833	—	%	N/A	1,958
Calabasas Village LP[3]	2013	Calabasas, Los Angeles County	23,458	—	22,748	—	%	N/A	503
TNHC-HW Cannery LLC	2013	Davis, Yolo County	43,933	—	40,691	—	%	N/A	364
Arantine Hills Holdings LP [3]	2014	Corona, Riverside County	10,376	—	10,156	—	%	N/A	2,500
Total Unconsolidated Joint Ventures			$450,591	$134,180	$281,973	32	%		$ 27,291

(1) Scheduled maturities of the unconsolidated joint venture debt as of September 30, 2014 are as follows: $24.5 million matures in 2015, $70.4 million matures in 2016, $36.4 million matures in 2017 and $2.8 million matures in

2019.

(2) Future capital commitment represents our proportionate share of estimated future contributions to the respective unconsolidated joint ventures as of September 30, 2014. Actual contributions may differ materially.

(3) Certain members of the Company's board of directors are affiliated with entities that have an investment in these joint ventures.

(4) The debt associated with this joint venture consists of a land seller note.

As of September 30, 2014, the unconsolidated joint ventures were in compliance with their respective loan covenants, where applicable, and we did not make any loan-to-value maintenance related payments during the three and nine months ended September 30, 2014.

Inflation

Our homebuilding and fee building segments can be adversely impacted by inflation, primarily from higher land, financing, labor, material and construction costs. In addition, inflation can lead to higher mortgage rates, which can significantly affect the affordability of mortgage financing to homebuyers. While we attempt to pass on cost increases to customers through increased prices, when weak housing market conditions exist, we are often unable to offset cost increases with higher selling prices.

Seasonality

Historically, the homebuilding industry experiences seasonal fluctuations in quarterly operating results and capital requirements. We typically experience the highest new home order activity in spring and summer, although this activity is also highly dependent on the number of active selling communities, timing of new community openings and other market factors. Since it typically takes four to six months to construct a new home, we deliver more homes in the second half of the year as spring and summer home orders convert to home deliveries. Because of this seasonality, home starts, construction costs and related cash outflows have historically been highest in the second and third quarters, and the majority of cash receipts from home deliveries occur during the second half of the year. We expect this seasonal pattern to continue over the long-term, although it may be affected by volatility in the homebuilding industry.

Description of Completed Projects and Communities under Development

Our homebuilding projects usually take approximately 24 to 36 months to complete from the initiation of homebuilding activity. The following table presents project information relating to each of our markets as of September 30, 2014 and includes information for all completed projects from our inception and current projects under development where we are building and selling homes for our own account or for our unconsolidated joint ventures, all completed projects from our inception and current projects under development where we are acting as a fee builder.

County, Project, City	Year of First Delivery (1)	Total Number of Homes to Be Built at Completion(2)	Cumulative homes Delivered as of September 30, 2014	Lots as of September 30, 2014 (3)	Backlog at September 30, 2014 (4)	Homes delivered for the nine months ended September 30, 2014	Sales Range (in 000's)(5)
Company Projects							
Southern California							
Los Angeles County:							
Canyon Oaks, Calabasas	2016	69	—	69	—	—	\$1,000 - \$1,400
Orange County:							
Four Quartets, Irvine	2011	13	13	—	—	—	\$372 - \$554
Stonetree Manor, Irvine	2011	15	15	—	—	—	\$635 - \$732