

CAPITAL PACIFIC HOLDINGS INC

Form 10-K

May 29, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

- Ⓟ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
- Ⓞ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended February 28, 2003

Commission File Number: 001-09911

Capital Pacific Holdings, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
*(State or other jurisdiction of
incorporation or organization)*

95-2956559
*(IRS Employer
Identification Number)*

**4100 MacArthur Blvd., Suite 200
Newport Beach, California**
(Address of principal executive offices)

92660
(Zip Code)

(Registrant's telephone number, including area code)

(949) 622-8400

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, \$0.10 Par Value

American Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

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 and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

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At May 15, 2003, the aggregate market value of the voting stock held by persons other than the directors, executive officers and principal shareholders filing Schedules 13D of the Registrant was \$6,702,912 as determined by the closing price on the American Stock Exchange. The basis of this calculation does not constitute a determination by the Registrant that all of its principal shareholders, directors and executive officers are affiliates as defined in Rule 405 under the Securities Act of 1933.

At May 15, 2003, there were the following shares outstanding of the Registrant's classes of Common Stock:

Common Stock	12,907,050
Non-Voting Common Stock	2,007,312

Part III incorporates certain information by reference to the Registrant's definitive proxy statement to be filed with the Commission no later than June 28, 2003.

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PART I

Item 1. Business
General

Capital Pacific Holdings, Inc. (CPH, Inc.), together with its subsidiaries (the Company), is a regional homebuilder and developer with operations throughout selected metropolitan areas of California, Texas, Arizona and Colorado. The Company conducts its homebuilding business through its wholly-owned subsidiary Capital Pacific Holdings, LLC (CPH LLC) and through single purpose joint venture entities. Joint venture entities are used principally in circumstances in which a third party provides capital or other financing for a project. In addition to its owned projects, the Company through one of its wholly-owned subsidiaries manages certain homebuilding projects in which it formerly had an equity interest (the Managed Projects). With respect to these Managed Projects, the Company is reimbursed its direct costs and paid a management fee representing an allocation of overhead. CPH, Inc. also conducts certain other activities related to homebuilding, including mortgage brokerage operations, design centers and land development activities, principally through various other subsidiaries and joint ventures. CPH LLC 's principal business activities are to build and sell single-family homes. The Company 's single-family homes are targeted to entry-level, move-up and semi-custom luxury buyers. Since 1975, the Company has built and sold nearly 25,000 homes in the markets it serves. During the fiscal year ended February 28, 2003, the Company (including unconsolidated joint ventures but excluding Managed Projects) closed 1,467 home and lot sales, including 720 homes, at an average home sales price of \$330,000. Revenues for the same period (including unconsolidated joint ventures but excluding Managed Projects) totaled \$268.5 million. Including Managed Projects, revenues totaled \$297.6 million. The Company currently conducts its operations principally under the name Capital Pacific Homes.

Assets owned and under management, including assets owned by unconsolidated joint ventures and Managed Projects, totaled \$513 million at February 28, 2003 in 65 residential properties. At February 28, 2003, CPH, Inc. 's wholly-owned subsidiary, CPH LLC, had \$238 million in assets and a net worth of \$107 million. CPH LLC, the Managed Projects and certain other project-specific entities indemnify CPH, Inc. and its subsidiaries against liabilities arising from the projects owned by such entities.

References to the Company are, unless the context indicates otherwise, also references to CPH LLC, the project-specific joint venture entities and its other subsidiaries. At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by the project-specific entities.

Strategy

The Company 's long-term strategy includes the following key elements:

(1) *Maintaining diversity in its geographic markets.* The Company believes that geographic market diversification is a key element in achieving long-term stability and growth. While the Company has no specific plans to expand outside the California, Texas, Arizona and Colorado markets, it may consider expansion to other markets in the future.

(2) *Diversifying its product.* The Company builds homes targeted for all price segments, from entry-level buyers to the semi-custom luxury market move-up buyers, so that it is able to deliver well-priced homes to a broad segment of its potential customer base. Within Texas, Arizona and Colorado, the Company serves the entry level as well as move-up markets. Within California, the Company has products targeted toward first, second and third time move-up buyers, as well as the million dollar luxury market. This product diversification enables the Company to adapt to changing market conditions.

(3) *Enhancing the Company 's capital base and sources of financial liquidity.* This has been a principal focus of the Company over the past several years. The Company has substantially improved its leverage ratios and reduced its debt costs. In fiscal year 1995, the Company accessed the public debt capital markets through the sale of \$100 million of 12 3/4% Senior Notes (Senior Notes) including 790,000 warrants to purchase common stock (the Offering). The Senior Notes were due May 1, 2002

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and have been fully repurchased or redeemed. During fiscal 2002, the Company repurchased the remaining \$55.6 million of the Senior Notes and its wholly-owned subsidiary, CPH LLC, entered into a senior unsecured revolving credit facility with a maximum commitment of \$125 million, which has since been increased to \$140 million. This has substantially lowered the Company's borrowing costs. Credit facilities in place at February 28, 2003 totaled \$208 million, of which \$120 million was outstanding. In addition, the Company has begun utilizing project level lot development financing to enhance the efficiency of its utilization of its capital and its unsecured credit facility. The Company believes this financing strategy allows orderly growth and greater flexibility to react quickly to changing market conditions. The Company also utilizes joint ventures within its operations as a source of financing and risk management. The Company is also considering additional sources of financing for the purpose of credit diversification and expansion.

(4) *Controlling costs and maintaining operational efficiency.* The Company has job cost, warranty tracking and construction scheduling systems and other quality control processes to control costs and to reduce the effect of certain risks inherent in the homebuilding industry. The Company has made a substantial investment in its information systems. These systems and controls enable the Company to effectively monitor its operations and improve its efficiencies.

(5) *Minimizing inventory risk.* CPH LLC tries to carefully manage its land and inventory risk in a variety of ways. CPH LLC monitors its supply of owned, optioned and controlled land to maintain an adequate pipeline of building lots in each of its markets while avoiding excess land holdings. For its homebuilding projects, CPH LLC generally prefers to purchase entitled land, generally defined as land that has received the majority of the land use approvals necessary for residential development from the appropriate state, county and local governments, typically in parcels of 50 to 250 lots, and makes use of options, seller financing, lot development financing and joint ventures, when available, to reduce its capital commitment on individual projects in order to be in a position to allocate its capital among a larger number of projects and properties. CPH LLC generally tries to limit its speculative building by commencing construction only after some sales have been made and tries to limit the size of each construction phase. CPH LLC generally purchases and holds land in amounts sufficient to support home production and sales over a 24 to 48 month period.

(6) *Land Development.* In certain markets, often in project-specific joint ventures, the Company may purchase unentitled land, with the intention of obtaining the required entitlements and then either selling the unimproved land, developing lots and selling them to other builders or building and selling homes itself. Depending upon the available inventory of entitled land in the Company's markets, the Company's land development activities may vary.

Homebuilding Geographic Markets

At February 28, 2003, the Company, either directly or through joint ventures, including four Managed Projects in which the Company does not have an equity ownership interest, controlled lots in various stages of development with respect to approximately 65 residential projects. The Company is currently selling homes in 29 of these projects. As detailed in Item 7 below, the Company anticipates opening between 8 and 10 net new projects in the current fiscal year. The Company's homes for sale (including Managed Projects) currently range in size from 1,200 to 8,000 square feet and are currently priced from \$109,000 to slightly over \$4,000,000.

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The following table sets forth the estimated number of homes under construction and lots owned, under option and controlled as of February 28, 2003:

**Estimated Number of Housing Units that Could be
Constructed on Land Controlled as of February 28, 2003(a)**

Region	Homes Under Construction(b)	Lots Owned	Lots Under Option(c)	Lots Controlled(d)	Total
California	171	441	57	802	1,471
Managed Projects (California)(e)	38	144			182
Texas	84	543	810	1,085	2,522
Arizona	78	921		905	1,904
Colorado(f)	128	882	39	1,647	2,696
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Total	499	2,931	906	4,439	8,775
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

- (a) Based upon current management estimates, which are subject to change. This table includes the Company's unconsolidated joint ventures. This table also includes the Managed Projects in which the Company's sole economic interest is through management agreements.
- (b) Includes completed model homes.
- (c) Lots under option represent lots under option contracts within existing projects. There can be no assurance that the Company will actually acquire any lots under option.
- (d) Controlled home sites include those properties for which the Company has entered into a variety of contractual relationships including non-binding letters of intent, binding purchase agreements with customary conditions precedent and similar arrangements. There can be no assurance that the Company will actually acquire any such properties.
- (e) This line includes homes and lots in the Managed Projects in which the Company's sole economic interest is through management agreements. These homes and lots are not owned by the Company.
- (f) This table excludes the CPH Banning-Lewis Ranch, LLC property owned by a joint venture which CPH, Inc. manages and in which it has a potential profit participation (after payment of costs, return of capital, and payment of preferred return). This joint venture controls approximately 21,400 acres in Colorado Springs, Colorado as further described in footnote (a) to Joint Ventures below.

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The table below summarizes the residential developments in process in the Company's geographic markets:

Projects and Units in Process as of February 28, 2003(a)

Region	Number of Projects Held for Development(b)	Number of Projects in Sales Stage(c)	Total Units Planned(d)	Units Closed in Prior Years	Units Closed in FY 2003	Units Remaining at 2/28/03(d)
California	18	5	1,527	487	371	669
Managed Projects (California)	4	2	217	14	21	182
Texas	12	8	2,964	1,061	466	1,437
Arizona	12	5	1,518	187	332	999
Colorado(e)	19	9	1,557	210	298	1,049
Total	65	29	7,783	1,959	1,488	4,336

- (a) This table includes the Company's unconsolidated joint ventures. This table also includes the Managed Projects in which the Company's sole economic interest is through management agreements.
- (b) The number of projects held for development includes projects with houses in the planning, development, construction and sales stages.
- (c) The number of projects in the sales stage includes projects where the sales office has opened, reservations are being taken or sales contracts are being executed.
- (d) Includes units under construction, in backlog and lots under option in projects owned by the Company or the Managed Projects.
- (e) Excludes the CPH Banning-Lewis Ranch, LLC property described in footnote (a) to Joint Ventures below.

Joint Ventures

The Company conducts its operations as either wholly-owned projects or through joint ventures in which the joint venture partner typically provides more than a majority of the capital and/or financing required for the project. The Company has utilized joint ventures in order to increase access to sources of capital, financing and land. The Company expects to continue to utilize joint ventures in the future on a selective basis, taking into account other available sources of financing, project risk and the potential return to the Company. The use of joint ventures may vary in the future in order to enable the Company to control an adequate supply of lots while minimizing capital commitments. The Company typically is required to fund a small percentage of the capital requirements of each joint venture, which amount is included in investments in and advances to unconsolidated joint ventures in the Company's consolidated balance sheets.

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At February 28, 2003, the Company's consolidated subsidiaries, unconsolidated joint ventures and Managed Projects, were as follows:

	<u>Total Units Planned</u>	<u>Units Closed in FY 2003</u>	<u>Units Remaining at 2/28/03</u>
Consolidated Subsidiaries			
CPH Newport Coast, LLC Orange County, CA	97	22	2
CPH Yucaipa I, LLC Riverside County, CA	100	69	1
CPH Dysart Ranch, LLC Maricopa County, AZ	293		293
	<u>490</u>	<u>91</u>	<u>296</u>
Unconsolidated Joint Ventures			
LB/L-CPH Longmont, LLC Boulder County, CO	448	14	434
LB/L-CPH Providence, LLC Riverside County, CA	98	45	
LB/L-CPH Laguna Street, LLC Santa Barbara County, CA	14		14
CPH Daily Ranch, L.P. Ventura County, CA	262	18	244
CPH Sierra Peak, L.P. Riverside County, CA	90		90
CPH Banning-Lewis Ranch, LLC El Paso County, CO(a)	(a)		(a)
	<u>912</u>	<u>77</u>	<u>782</u>
Managed Projects(b)			
Makallon RPV Associates, LLC Los Angeles County, CA	79	16	49
Makallon Dana Point, LLC Orange County, CA	44	5	39
Makallon Resorts I, LLC Orange County, CA(c)	94		94
	<u>217</u>	<u>21</u>	<u>182</u>
	<u>1,619</u>	<u>189</u>	<u>1,260</u>

(a) The phasing for this project is currently being determined. The joint venture owns approximately 21,400 acres of entitled land in Colorado Springs, Colorado, which is currently zoned for a potential density of approximately 76,000 residential units and 48 million square feet of commercial, industrial and office space. Based upon a variety of factors, including without limitation economic conditions and the availability of city services and utilities and government actions, the achievable density may vary.

(b) Previously unconsolidated joint ventures. The Company's sole economic interest in the Managed Projects is through management agreements.

(c) Includes two residential projects.

Land Acquisition

For typical residential developments, CPH LLC tries to purchase and hold land in amounts sufficient to support home production and sales over a 24 to 48 month period. CPH LLC also tries to maintain additional supplies of land through options and other means. CPH LLC typically does not acquire and hold land for speculative investment, but on several occasions has sold some or all of the lots in a project simultaneously with the acquisition of such lots by CPH LLC.

CPH LLC typically considers numerous factors when analyzing the suitability of land for acquisition and development including, but not limited to, proximity to existing developed areas; population growth patterns; availability of existing community services (i.e., utilities, schools

and transportation); employment growth rates; anticipated absorption rates for new housing; and the estimated cost of development.

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CPH LLC tries to avoid speculative building by constraining project phase sizes, and entitlement risks by acquiring entitled land when practicable and acquiring lots through the use of options, development agreements and joint ventures with lot owners, when available on favorable terms. Additionally, by forming joint ventures with various sources of capital, the Company has been able to obtain access to additional capital and construction financing to expand the number of lots the Company controls and to spread project risk.

Due to increased competition and in some markets a declining supply of favorably priced lots, the Company continues to consider opportunities to purchase unentitled land, re-entitle land, and acquire larger positions in land tracts than can practically be utilized by the Company's homebuilding operations. Where possible and appropriate, the Company will seek outside capital and pursue such activities through joint ventures. In general, and particularly within CPH LLC, all such activities are closely related to CPH LLC's homebuilding activities.

Product Design

The Company has received numerous industry design awards for its homes and developments. The Company has been featured in several nationally known periodicals, on network television and in various international publications. The Company's homes are noted for their innovative design, attention to detail and quality construction. By emphasizing the right product designs, the Company has also been able to build brand loyalty while attempting to reduce warranty costs. In many markets, resales of the Company's homes include the Company's name as a sign of quality construction and design.

The Company contracts with a number of outside architects, designers, engineers, consultants and subcontractors. The Company believes that the use of third parties for the production of the final design, engineering and construction reduces its costs, increases design innovation and quality, and reduces risks. The Company has a large number of plans which it has used in various projects and can be re-used in new projects with appropriate modifications as necessary. The Company offers options and upgrades to provide its homebuilders with opportunities to augment their home to fit their lifestyle, the extent of which varies depending upon the project. However, structural and other changes which impact the build time of the home are typically limited.

The Company creates architectural variety within its projects by offering numerous models, floor plans, and exterior styles in an effort to enhance home values by creating diversified neighborhood looks within its projects. Generally, the Company selects the exterior finishes of its homes subject to necessary architectural approvals. The Company offers homebuyers the opportunity to engage interior design consultants to personalize the interior of their homes. Such services are offered at an additional cost to buyers through third parties contracted with by the Company, or the services may be provided through the homebuyer's own consultants.

Development and Construction

The Company typically acts as the general contractor for the construction of its projects and the Managed Projects. Typically, all construction work for the Company is performed by subcontractors. The Company's consultants and employees coordinate the construction of each project and the activities of subcontractors and suppliers, and subject their work to quality and cost controls and compliance with zoning and building codes. Subcontractors typically are retained on a phase-by-phase basis to complete construction at a fixed price. Agreements with the Company's subcontractors are generally entered into after competitive bidding on a project-by-project basis. The Company has established relationships with a large number of subcontractors and is not dependent to any material degree upon the services of any one subcontractor. Decreasing availability of insurance coverage for subcontractors as well as, in California, the effects of increased Worker's Compensation insurance rates may have an adverse effect in the availability of qualified subcontractors.

The Company typically develops its residential projects in several phases generally averaging approximately 10 to 15 homes per phase. The Company determines the number of homes to be built in the first phase and the appropriate price range. The first phase of home construction is typically relatively small to reduce risk while the Company measures consumer demand. Construction generally does not begin until some sales have

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occurred, except for construction of model homes and in some cases the first few additional homes. Subsequent phases are generally not started until 50% to 75% of the homes in the previous phase have been sold. Sales prices in the second phase are then adjusted to reflect market demand as evidenced by sales experience in the first phase. With each subsequent phase, the Company continues to accumulate data which enables the Company to make decisions on the pricing, timing and size of subsequent phases. Although the time required to complete a phase varies from development to development depending on the above factors and the build time which in turn varies generally with the size and complexity of the home, the Company typically completes construction of a phase within one of its California developments in approximately six to ten months for larger homes and four to five months for smaller homes and within its Texas, Arizona and Colorado developments within three to five months. The Company is continuously developing and refining its production practices in order to reduce cycle time within the construction process.

Sales and Marketing

The Company typically builds, furnishes and landscapes model homes for each residential project and maintains on-site sales offices, which are usually open seven days a week once a project fully opens. The Company generally sells all of its homes through Company sales representatives who typically work from the sales offices located either at the model homes or at sales centers used in each subdivision. When appropriate, the Company also uses listing and cooperative brokers to sell its homes.

The Company generally opens an on-site sales office before the construction of the model homes is completed. This on-site sales office is utilized to commence the sales process to potential customers. The sales center is later generally moved to one of the model homes. Potential homebuyers may reserve a home by submitting a refundable deposit (a reservation deposit) usually ranging from \$500 to \$20,000 and executing a reservation document. The Company then conducts preliminary research concerning the credit status of the potential homebuyer in order to pre-qualify the homebuyer. Once the prospective homebuyer has been pre-qualified and there is a strong indication that the homebuyer will qualify for a mortgage (although final loan approval is still pending), the homebuyer must then convert the reservation deposit to an earnest money deposit and complete a purchase contract for the purchase of their home. The Company attempts to keep its contract cancellation rate low by attempting to pre-qualify prospective homebuyers and by allowing homebuyers to customize their homes at an early point in the purchase process. When home purchase contracts are canceled, the Company seeks to identify alternate homebuyers.

The Company makes extensive use of advertising and promotional resources, including newspaper and magazine advertisements, brochures, direct mail and the placement of strategically located signboards and occasionally places radio and television advertisements. Because the Company usually offers multiple projects within a market area, it is able to utilize regional advertising that highlights all of the Company's projects within that same market area.

The Company utilizes the Internet through its website address, www.capitalpacifichomes.com, and through participation in a builder-sponsored web joint venture to augment its advertising and promotional activities.

The Company provides flooring and other amenities and upgrades to its homebuyers through various contracted facilities.

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The following table shows new home and lot deliveries, net new orders and average sales prices for each of the last three fiscal years for each of the Company's residential operations, including unconsolidated joint ventures but excluding Managed Projects:

	Year Ended		
	February 28, 2001	February 28, 2002	February 28, 2003
New homes delivered:			
California	68	101	196
Texas	426	305	178
Nevada	231	69	
Arizona	240	172	171
Colorado	198	139	112
	<hr/>	<hr/>	<hr/>
Subtotal	1,163	786	657
Unconsolidated Joint Ventures (California)	46	53	63
	<hr/>	<hr/>	<hr/>
Total homes delivered	1,209	839	720
Lots delivered	990	295	747
	<hr/>	<hr/>	<hr/>
Total homes and lots delivered	2,199	1,134	1,467
	<hr/>	<hr/>	<hr/>
Net new orders	1,155	782	869
	<hr/>	<hr/>	<hr/>
Average sales price for homes delivered:			
California (excluding unconsolidated joint ventures)	\$ 1,518,000	\$ 1,193,000	\$ 587,000
California (including unconsolidated joint ventures)	1,458,000	880,000	559,000
Texas	203,000	260,000	247,000
Nevada	211,000	238,000	
Arizona	159,000	152,000	149,000
Colorado	212,000	237,000	237,000
Combined (excluding unconsolidated joint ventures)	274,000	350,000	331,000
Combined (including unconsolidated joint ventures)	315,000	346,000	330,000

Backlog and Inventory

The Company typically pre-sells homes prior to and during construction through home purchase contracts requiring earnest money deposits or through reservation documents requiring reservation deposits. Generally, reservation deposits are refundable, but home purchase contracts are not cancelable unless the customer is unable to sell their existing home, qualify for financing or under certain other circumstances. A home sale is placed in backlog status upon execution of such a contract and receipt of an earnest money deposit and is removed when such contracts are canceled as described above or the home purchase escrow is closed.

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The following table shows backlog in units and dollars at the end of each of the last three fiscal years for each of the Company's residential operations, including unconsolidated joint ventures. Backlog and selling communities data does not include Managed Projects.

	Ending Backlog					
	February 28, 2001		February 28, 2002		February 28, 2003	
	Units	(\$000s)	Units	(\$000s)	Units	(\$000s)
California	71	\$69,900	63	\$47,200	118	\$42,500
Texas	265	68,800	64	18,500	61	13,100
Nevada	45	11,400				
Arizona	56	8,500	33	4,400	62	11,600
Colorado	75	15,000	34	4,200	55	12,400
Total	512		n			