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

FORM 10-Q

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

For the quarterly period ended June 30, 2006

or

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

Commission File Number 1-9977

MERITAGE HOMES CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	**86-0611231** (I.R.S. Employer Identification No.)
17851 North 85th Street, Suite 300 **Scottsdale, Arizona** (Address of Principal Executive Offices)	**85255** (Zip Code)

(480) 609-3330
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☒ **Accelerated Filer ☐** **Non-Accelerated Filer ☐**

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

Common shares outstanding as of August 3, 2006: 26,113,716.

MERITAGE HOMES CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2006

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	June 30, 2006	December 31, 2005
Assets:		
Real estate	$ 1,548,822	$ 1,392,267
Cash and cash equivalents	47,465	65,812
Deposits on real estate under option or contract	172,636	167,040
Receivables	59,664	60,745
Goodwill	129,940	130,222
Intangibles, net	14,075	14,029
Property and equipment, net	41,639	36,239
Prepaid expenses and other assets	26,791	16,289
Investments in unconsolidated entities	87,320	88,714
Total assets	$ 2,128,352	$ 1,971,357
Liabilities:		
Accounts payable	$ 132,213	$ 140,789
Accrued liabilities	253,465	290,275
Home sale deposits	68,075	76,299
Deferred tax liability, net	19,295	20,865
Loans payable and other borrowings	243,013	112,398
Senior notes	478,553	479,726
Total liabilities	1,194,614	1,120,352
Stockholders' Equity:		
Common stock, par value $0.01. Authorized 125,000,000 shares at June 30, 2006, and 50,000,000 shares at December 31, 2005; issued and outstanding 33,865,684 and 33,112,358 shares at June 30, 2006 and December 31, 2005, respectively	338	331
Additional paid-in capital	326,147	296,804
Deferred stock compensation	(1,920)	—
Retained earnings	794,039	637,248
Treasury stock at cost, 7,791,068 and 5,935,068 shares at June 30, 2006 and December 31, 2005, respectively	(184,866)	(83,378)
Total stockholders' equity	933,738	851,005
Total liabilities and stockholders' equity	$ 2,128,352	$ 1,971,357

See accompanying notes to condensed consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Home closing revenue	$ 902,851	$ 651,783	$ 1,749,225	$ 1,202,730
Land closing revenue	11,809	1,788	12,706	2,009
Total closing revenue	914,660	653,571	1,761,931	1,204,739
Cost of home closings	(683,384)	(499,080)	(1,315,695)	(930,702)
Cost of land closings	(10,658)	(1,326)	(11,577)	(1,538)
Total cost of closings	(694,042)	(500,406)	(1,327,272)	(932,240)
Home closing gross profit	219,467	152,703	433,530	272,028
Land closing gross profit	1,151	462	1,129	471
Total closing gross profit	220,618	153,165	434,659	272,499
Commissions and other sales costs	(52,849)	(35,869)	(100,876)	(67,340)
General and administrative expenses	(51,344)	(26,672)	(94,066)	(50,635)
Earnings from unconsolidated entities, net	5,251	2,053	10,839	6,514
Other income, net	3,474	2,316	5,385	3,956
Loss on extinguishment of debt	—	(197)	—	(31,477)
Earnings before provision for income taxes	125,150	94,796	255,941	133,517
Provision for income taxes	(48,095)	(35,557)	(99,150)	(50,082)
Net earnings	$ 77,055	$ 59,239	$ 156,791	$ 83,435
Earnings per common share:				
Basic	$ 2.90	$ 2.19	$ 5.85	$ 3.13
Diluted	$ 2.82	$ 2.05	$ 5.68	$ 2.92
Weighted average number of shares:				
Basic	26,609	27,110	26,792	26,664
Diluted	27,362	28,906	27,619	28,545

See accompanying notes to condensed consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net earnings	$ 156,791	$ 83,435
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	10,177	8,024
Write-off of senior note issuance cost	—	4,977
Write-off of deposits and land acquisition costs	7,295	—
Decrease in deferred tax liability	(2,013)	—
Stock-based compensation	7,329	—
Excess tax benefit from stock-based compensation	(10,121)	—
Tax benefit from stock option exercises	—	8,168
Equity in earnings from unconsolidated entities	(10,839)	(6,514)
Distributions of earnings from unconsolidated entities	7,836	6,934
Changes in assets and liabilities, net of effect of acquisitions:		
Increase in real estate	(163,203)	(250,249)
Increase in deposits on real estate under option or contract	(7,864)	(16,451)
Increase in receivables and prepaid expenses and other assets	(6,933)	(2,562)
(Decrease) increase in accounts payable and accrued liabilities	(34,193)	70,822
(Decrease) increase in home sale deposits	(8,224)	15,238
Net cash used in operating activities	(53,962)	(78,178)
Cash flows from investing activities:		
Investments in unconsolidated entities	(17,270)	(29,890)
Distributions of capital from unconsolidated entities	15,357	10,789
Cash paid for acquisitions	—	(66,220)
Purchases of property and equipment	(16,356)	(11,009)
Proceeds from sales of property and equipment	212	446
Net cash used in investing activities	(18,057)	(95,884)
Cash flows from financing activities:		
Net borrowings under line of credit agreement	135,000	37,600
Proceeds from loans payable and other borrowings, net	855	—
Repayments of loans payable and other borrowings, net	—	(10,162)
Proceeds from issuance of senior notes, net	—	343,836
Purchases of treasury stock	(101,488)	—
Payments of senior notes	(1,254)	(285,472)

Proceeds from sale of common stock, net	—	69,699
Excess tax benefit from stock-based compensation	10,121	—
Proceeds from stock option exercises	10,438	4,789
Net cash provided by financing activities	53,672	160,290
Net decrease in cash and cash equivalents	(18,347)	(13,772)
Cash and cash equivalents at beginning of period	65,812	47,876
Cash and cash equivalents at end of period	$ 47,465	$ 34,104

See supplemental disclosures of cash flow information at Note 11.

See accompanying notes to condensed consolidated financial statements

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

Organization. We are a leading designer and builder of single-family homes in the growth regions of the southern and western United States, based on the number of home closings. We offer a variety of homes that are designed to appeal to a wide range of homebuyers, including first-time, move-up, luxury and active adult buyers. We have operations in 14 metropolitan areas in Arizona, Texas, California, Nevada, Colorado and Florida. Meritage Homes Corporation was incorporated in 1988 as a real estate investment trust in the State of Maryland. In 1996 and 1997, through a merger and acquisition, we acquired the homebuilding operations of our predecessor companies having operations in Arizona and Texas. We currently focus exclusively on homebuilding and related activities and no longer operate as a real estate investment trust. At June 30, 2006, we were actively selling homes in 204 communities, with base prices ranging from $109,000 to $1,220,000.

Basis of Presentation. The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles and include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, the "Company"). In management's opinion, the data reflects all adjustments, consisting of only normal recurring adjustments, necessary to fairly present our financial position and results of operations for the periods presented. Intercompany balances and transactions have been eliminated in consolidation and certain prior year amounts have been reclassified to conform to our current year financial statement presentation. These financial statements should be read in conjunction with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2005.

The Company designs, constructs and sells a wide range of homes designed to meet the specific needs of each of its markets. Because each of our homebuilding regions has similar economic characteristics, housing products and classes of prospective buyers, each homebuilding region has been aggregated into a single homebuilding segment.

Common Stock Repurchase. In August 2004, the Board of Directors approved a stock repurchase program authorizing the expenditure of up to $50 million to repurchase shares of our common stock. This program was completed in February 2006, with the repurchase of 601,000 shares at an average price of $59.21.

In February 2006, the Board of Directors approved a new stock repurchase program authorizing the expenditure of up to $100 million to repurchase shares of our common stock. There is no stated expiration date for this program but we will purchase shares subject to applicable securities law and at times and in amounts as management deems appropriate. In March 2006, we repurchased 255,000 shares at an average price of $53.77 under this program. In June 2006, we repurchased 1,000,000 shares from John R. Landon, our former Co-CEO and Co-Chairman, for $52.19 a share (see Note 12 - Other Events). At June 30, 2006, we had approximately $34.1 million available to repurchase additional shares under this program.

Off-Balance Sheet Arrangements. We often acquire finished building lots from various development entities pursuant to option and purchase agreements. The purchase price typically approximates the market price at the date the contract is executed. We believe this lot acquisition strategy reduces the financial requirements and risks associated with direct land ownership and land development. Under these option and purchase agreements, we are usually required to make deposits in the form of cash or letters of credit, which may be forfeited if we fail to perform under the applicable agreements. As of June 30, 2006, we had entered into option and purchase agreements with an aggregate purchase price of approximately $2.8 billion and had made deposits of approximately $172.6 million in the form of cash and approximately $75.0 million in letters of credit.

We participate in homebuilding and land development joint ventures from time to time as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base. Our participation in joint ventures is an increasingly important part of our business model and we expect it to continue to increase in the future. We and/or our joint venture partners occasionally provide limited repayment guarantees on a pro rata basis on debt of certain unconsolidated land acquisition and development joint ventures. At June 30, 2006, our share of these limited pro rata repayment guarantees was $32.2 million.

In addition, we and/or our joint venture partners occasionally provide guarantees that are only applicable if and when the joint venture directly, or indirectly through agreement with its joint venture partners or other third parties, causes the joint venture to voluntarily file a bankruptcy or similar liquidation or reorganization action or take other actions that are fraudulent or improper (commonly referred to as "bad boy guarantees"). These types of guarantees typically are on a pro rata basis and are designed to protect the respective secured lender's remedies with respect to its mortgage or other secured lien on the joint

venture's underlying property. To date, no such guarantees have been invoked and we believe it is unlikely that such a guarantee would be invoked in the future as it would require us to voluntarily take actions that would generally be disadvantageous to the joint venture and to us. At June 30, 2006, we had outstanding guarantees of this type totaling approximately $63.9 million. By definition, these guarantees, unless invoked as described above, are not considered guarantees or indebtedness under our revolving credit facility or senior note indentures.

We and our joint venture partners are also typically obligated to the project lenders to complete land development improvements if the joint venture does not perform the required development. Provided we and the other joint venture partners are in compliance with these completion obligations, the project lenders are generally obligated to fund these improvements through any financing commitments available under the applicable joint venture development and construction loans. In addition, we and our joint venture partners have from time to time provided unsecured environmental indemnities to joint venture project lenders. In some instances, our exposure under these indemnities is limited. These indemnities generally obligate us to reimburse the project lenders only for claims related to environmental matters for which such lenders are

held responsible. As part of our project acquisition due diligence process to determine potential environmental risks, we generally obtain, or the joint venture entity generally obtains, an independent environmental review from outside consultants.

Additionally, we and our joint venture partners sometimes agree to indemnify third party surety providers with respect to performance bonds issued on behalf of certain of our joint ventures. If a joint venture does not perform its obligations, the surety bond could be called. If these surety bonds are called and the joint venture fails to reimburse the surety, we and our joint venture partners would be obligated to indemnify the surety. These surety indemnity arrangements are generally joint and several obligations with our other joint venture partners. As of June 30, 2006, we had approximately $40.1 million of surety bonds outstanding subject to these indemnity arrangements. None of these bonds have been called to date and we believe it is unlikely that any of these bonds will be called.

We also obtain letters of credit and performance, maintenance and other bonds in support of our related obligations with respect to the development of our projects. The amount of these obligations outstanding at any time varies depending on the stage and level of our development activities. In the event the letters of credit or bonds are drawn upon, we would be obligated to reimburse the issuer of the letter of credit or bond. At June 30, 2006, we had approximately $31.7 million in outstanding letters of credit and $255.1 million in performance bonds for such purposes. We believe it is unlikely that any of these letters of credit or bonds will be drawn upon.

Intangibles, net. Intangible assets consist primarily of non-compete agreements, tradenames and home plan designs acquired in connection with our February 2005 acquisition of Colonial Homes and our September 2005 acquisition of Greater Homes. These intangible assets were valued at the acquisition dates utilizing accepted valuation procedures. The non-compete agreements, tradenames and home plan designs are being amortized over their estimated useful lives. The cost and accumulated amortization of our intangible assets was $11.5 million and $3.3 million, respectively, at June 30, 2006. In the first six months of 2006, amortization expense was $1.5 million. Amortization expense is expected to be approximately $1.4 million in the remaining six months of 2006 and $2.8, $2.3, $1.2 and $0.5 million per year in 2007, 2008, 2009 and 2010, respectively.

Additionally, in accordance with SOP 98-1"Accounting for Costs of Computer Software Developed or Obtained for Internal Use", we have capitalized software costs at June 30, 2006 of $5.9 million, net of accumulated amortization of $3.8 million. In the first six months of 2006, amortization expense was approximately $1.3 million related to the capitalized software costs and is expected to be approximately $1.7 million for the remaining six months of 2006 and $1.8, $0.7, $0.7, $0.7 and $0.3 million in 2007, 2008, 2009, 2010 and 2011, respectively.

Accrued Liabilities. Accrued liabilities consists of the following (in thousands):

	June 30, 2006	December 31, 2005
Accruals related to real estate development and construction activities	$ 141,697	$ 135,953
Payroll and other benefits	54,932	51,382
Accrued taxes	—	48,941
Warranty reserves	26,494	25,168
Other accruals	30,342	28,831
Total	$ 253,465	$ 290,275

Warranty Reserves. As is customary in the homebuilding industry, we have obligations related to post-construction warranties and defect claims for homes closed. We have established reserves for these obligations based on historical data and trends with respect to similar product types and geographic areas. Warranty reserves are included in accrued liabilities on the accompanying condensed consolidated balance sheets. Additions to warranty reserves are included in cost of sales within the accompanying condensed consolidated statements of earnings. We periodically review the adequacy of our warranty reserves, and believe they are sufficient to cover potential costs for materials and labor related to post-construction warranties and defects. A summary of changes in our warranty reserves follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Balance, beginning of period	$ 26,229	$ 16,300	$ 25,168	$ 14,967
Additions to reserve	5,165	3,656	10,393	7,202
Warranty claims and expenses	(4,900)	(2,738)	(9,067)	(4,951)
Balance, end of period	$ 26,494	$ 17,218	$ 26,494	$ 17,218

Recently Issued Accounting Pronouncements. In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48,*Accounting for Uncertainty in Income Taxes*, an interpretation of FASB No. 109 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Earlier application of the provisions of FIN 48 is encouraged if the enterprise has not yet issued financial statements, including interim financial statements, in the period this interpretation is adopted. We are currently evaluating the impact of the adoption of FIN 48 on our results of operations and statement of financial position.

Reference is made to Note 9 regarding our adoption of SFAS No. 123R, "*Share-based Payment.*"

NOTE 2 - REAL ESTATE AND CAPITALIZED INTEREST

Real estate consists of the following (in thousands):

	June 30, 2006	December 31, 2005
Homes under contract under construction	$ 809,951	$ 815,925
Finished home sites and home sites under development	440,614	370,921
Unsold homes, completed and under construction	192,223	116,088
Model homes	67,883	45,060
Model home lease program	34,096	39,336
Land held for development	4,055	3,473
Real estate not owned	—	1,464
	$ 1,548,822	$ 1,392,267

Subject to sufficient qualifying assets, we capitalize all development period interest costs incurred in connection with the development and construction of real estate. Capitalized interest is allocated to real estate when incurred and charged to cost of home closings when the related property is delivered. Certain information regarding

capitalized interest follows (in thousands):

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Capitalized interest, beginning of period	$ 24,753	$ 21,902	$ 23,939	$ 19,701
Interest incurred and capitalized	12,600	9,710	24,175	19,839
Amortization to cost of home closings	(9,518)	(9,583)	(20,279)	(17,511)
Capitalized interest, end of period	$ 27,835	$ 22,029	$ 27,835	$ 22,029

NOTE 3 - VARIABLE INTEREST ENTITIES AND CONSOLIDATED REAL ESTATE NOT OWNED

FASB Interpretation No. 46 (revised December 2003), "*Consolidation of Variable Interest Entities*" ("FIN 46R") requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a

majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Prior to the issuance of FIN 46R, entities were generally consolidated by an enterprise when it had a controlling financial interest through ownership of a majority voting interest in the entity.

Under FIN 46R, a variable interest entity, or VIE, is created when (i) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, (ii) equity holders either (a) lack direct or indirect ability to make decisions about the entity, (b) are not obligated to absorb expected losses of the entity, or (c) do not have the right to receive expected residual returns of the entity or (iii) the equity of investors as a group are considered to lack the direct or indirect ability to make decisions about the entity if (x) the voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity, their rights to receive the expected residual returns of the entity, or both, and (y) substantially all of the entity's activities either involve or are conducted on behalf of an investor that has disproportionately fewer voting rights.

Based on the provisions of FIN 46R, we have concluded that when we enter into an option or purchase agreement to acquire land or lots from an entity and pay a non-refundable deposit, a VIE is created because we are deemed to have provided subordinated financial support, which refers to variable interests that will absorb some or all of an entity's expected losses if they occur. For each VIE created, we compute expected losses and residual returns based on the probability of future cash flows as outlined in FIN 46R. If we are deemed to be the primary beneficiary of the VIE, because we are obligated to absorb the majority of the expected losses, receive the majority of the residual returns, or both, we will consolidate the VIE in our consolidated financial statements. Not all of our purchase and option agreements are determined to be VIEs.

We have applied FIN 46R by developing a methodology to determine whether or not we are the primary beneficiary of the VIE. Part of this methodology requires the use of estimates in assigning probabilities to various future cash flow possibilities relative to changes in the fair value and changes in the development costs associated with the property. Although we believe that our accounting policy properly identifies our primary beneficiary status with these VIEs, changes in the probability estimates could produce different conclusions regarding our primary beneficiary status.

We generally do not have any ownership interest in the VIEs that hold the lots and land under option or contract, and accordingly, we generally do not have legal or other access to the VIE's books or records. Therefore, it is not possible for us to compel the VIEs to provide financial or other data to us in performing our primary beneficiary evaluation. Accordingly, this lack of information from the VIEs may result in our evaluation being conducted primarily based on management's judgments and estimates.

In most cases, creditors of the entities with which we have option agreements have no recourse against us and the maximum exposure to loss in our option agreements is limited to our option deposit. Often, we are at risk for items over budget related to land development on property we have under option. In these cases, we have contracted to complete development at a fixed cost on behalf of the land owner. Some of our option deposits may be refundable if certain contractual conditions are not performed by the party selling the lots to us. At June 30, 2006, we had no specific performance options, as none of our option agreements require us to purchase lots.

The table below presents a summary of our lots under option or contract at June 30, 2006 (dollars in thousands):

	Number of Lots	Purchase Price	Option/Earnest Money Deposits: Cash	Option/Earnest Money Deposits: Letters of Credit
Option contracts not recorded on balance sheet — non-refundable deposits (1)	32,516	$ 2,047,780	$ 141,844	$ 74,467
Purchase contracts not recorded on balance sheet — non-refundable deposits (1)	13,508	493,244	29,178	484
Purchase contracts not recorded on balance sheet — refundable deposits (2)	6,102	242,630	1,614	—
Total lots under option or contract not recorded on balance sheet	52,126	$ 2,783,654	$ 172,636	$ 74,951

Notes: Our options to purchase lots remain effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the applicable agreement. The pre-established number of lots typically is structured to approximate our expected rate of home orders, although as demand slows, in some instances starts may fall below the pre-established minimum number. This could force us to purchase lots in advance of corresponding sales, re-negotiate the takedown schedule, or discontinue lot purchases and forfeit the related non-refundable option deposit.

(1) Deposits are non-refundable except if certain contractual conditions are not performed by the selling party.
(2) Deposits are refundable at our sole discretion. Includes 5,135 lots under contract for which we have not completed our due diligence process.

NOTE 4 - INVESTMENTS IN UNCONSOLIDATED ENTITIES

We participate in homebuilding and land development joint ventures from time to time as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base. For the periods presented, we do not have controlling financial interests in these unconsolidated entities. Our joint venture partners generally are other homebuilders, land sellers or other real estate investors. We also enter into mortgage and title business joint ventures from time to time. These unconsolidated entities follow accounting principles generally accepted in the United States of America and we generally share in their profits and losses in accordance with our ownership interests.

For land development joint ventures, we and, in some cases our joint venture partners, usually receive an option or other similar arrangement to purchase portions of the land held by the joint venture. Option prices are generally negotiated prices that approximate market value when we enter into the option contract. For homebuilding and land development joint ventures, our share of the joint venture earnings relating to lots we purchase from the joint ventures is deferred until homes are delivered by us and title passes to a homebuyer. At such time, we allocate our joint venture earnings to the land acquired by us as a reduction in the basis of the property.

We and/or our joint venture partners occasionally provide limited repayment guarantees on a pro rata basis on the debt of certain unconsolidated land acquisition and development joint ventures. At June 30, 2006, our share of these limited pro rata repayment guarantees was approximately $32.2 million.

In addition, we and/or our joint venture partners occasionally provide guarantees that are only applicable if and when the joint venture directly, or indirectly through agreement with its joint venture partners or other third parties, causes the joint venture to voluntarily file a bankruptcy or similar liquidation or reorganization action or take other actions that are fraudulent or improper (commonly referred to as "bad boy guarantees"). These types of guarantees typically are on a pro rata basis and are designed to protect the respective secured lender's remedies with respect to its mortgage or other secured lien on the joint venture's underlying property. To date, no such guarantees have been invoked and we believe it is unlikely that such a guarantee would be invoked in the future as it would require us to voluntarily take actions that would generally be disadvantageous to the joint venture and to us. At June 30, 2006, we had outstanding guarantees of this type totaling approximately $63.9 million. By definition, these guarantees, unless invoked as described above, are not considered

guarantees or indebtedness under our revolving credit facility or senior note indentures.

Summarized condensed financial information related to unconsolidated joint ventures that are accounted for using the equity method was as follows (in thousands):

	June 30, 2006	December 31, 2005
Assets:		
Cash	$ 16,567	$ 10,337
Real estate	625,733	524,775
Other assets	21,440	22,373
Total assets	$ 663,740	$ 557,485
Liabilities and equity:		
Accounts payable and other liabilities	$ 50,612	$ 32,244
Notes and mortgages payable	416,072	299,498
Equity of:		
Meritage	69,898	72,362
Others	127,158	153,381
Total liabilities and equity	$ 663,740	$ 557,485

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues	$ 18,804	$ 52,868	$ 45,932	$ 83,535
Costs and expenses	(8,437)	(38,546)	(17,664)	(59,376)
Net earnings of unconsolidated entities	$ 10,367	$ 14,322	28,268	24,159
Meritage's share of pre-tax earnings (1)	$ 5,251	$ 3,137	$ 11,530	$ 7,598

(1) Our share of pre-tax earnings is recorded in "Earnings from unconsolidated entities, net" on our consolidated statements of earnings. Our share of pre-tax earnings excludes joint venture earnings related to lots we purchased from the joint ventures. Those earnings are deferred until homes are delivered by us and title passes to a homebuyer.

At June 30, 2006 and December 31, 2005, our investments in unconsolidated entities includes $1.5 million related to the difference between the amounts at which our investments are carried and the amount of underlying equity in net assets. These amounts are amortized to equity of earnings of unconsolidated entities over the life of the respective joint ventures, which offsets their related earnings. We amortized approximately $1.1 million to our equity of the joint venture earnings in the second quarter of 2005 and approximately $0.7 million and $1.1 million in the first six months of 2006 and 2005, respectively. We had no such amortization in the second quarter of 2006.

In addition to joint ventures accounted for under the equity method summarized in the above table, at June 30, 2006, and December 31, 2005, our investments in unconsolidated entities included joint ventures recorded under the cost method. These joint ventures were formed to acquire large parcels of land, to perform off-site development work and to sell lots to the joint venture members and other third parties. As of June 30, 2006, and December 31, 2005, our investments in unconsolidated entities recorded under the cost method were $15.9 and $14.9 million, respectively. As of June 30, 2006, we have not recorded any income or distributions from these joint ventures.

NOTE 5 - LOANS PAYABLE AND OTHER BORROWINGS

Loans payable consists of the following (in thousands):

	June 30, 2006	December 31, 2005
$850 million unsecured revolving credit facility maturing May 2010 with extension provisions, and interest payable monthly approximating LIBOR (approximately 5.50% at June 30, 2006) plus 1.7% or Prime (approximately 8.25% at June 30, 2006)	$ 207,600	$ 72,600
Model home lease program, with interest in the form of lease payments payable monthly approximating 7.71% at June 30, 2006	34,096	39,336
Other borrowings, acquisition and development financing	1,317	462
Total loans payable and other borrowings	$ 243,013	$ 112,398

We have determined that the construction costs and related debt associated with certain model homes that are owned and leased to us by others and that we use to market our communities are required to be included on our balance sheet. We do not legally own these model homes, but we are reimbursed by the owner for our construction costs and we have the right, but not the obligation, to purchase these homes. Although we have no legal obligation to repay any amounts received from the third-party owner, such amounts are recorded as debt and are typically deemed repaid when we simultaneously exercise our option to purchase the model home and sell it to a third-party home buyer. Should we elect not to exercise our rights to purchase these model homes, the model home costs and related debt under the model lease program will be eliminated upon the termination of the lease, which is generally between one and three years from the origination of the lease.

On May 16, 2006, we amended and restated our senior unsecured revolving credit facility. Under the First Amended and Restated Credit Agreement with Guaranty Bank, as administrative agent, and a number of other financial institutions (the "New Credit Agreement"), our credit facility was increased from $600 million to $800 million, and the term was extended from May 2009 to May 2010. The maximum borrowings under the New Credit Agreement are based on the amount of qualifying borrowing base assets (generally real estate assets), limited to the facility size. In addition, the New Credit Agreement includes an accordion feature that will allow Meritage to request from time to time an increase of up to $250 million in the maximum borrowing commitment. Each member of the lending group may elect to participate or not participate in any request we make to increase the maximum borrowing commitment. In addition, any increase in the borrowing capacity pursuant to this accordion feature is subject to certain terms and conditions, including the absence of an event of default. On June 30, 2006, we exercised a portion of the accordion feature under the New Credit Agreement to increase our borrowing capacity by $50 million to $850 million and amended the New Credit Agreement to make certain other minor changes.

NOTE 6 - SENIOR NOTES

Senior notes consist of the following (in thousands):

	June 30, 2006	December 31, 2005
6.25% senior notes due 2015. At June 30, 2006, and December 31, 2005, there was approximately $1.5 and $1.6 million, respectively, in unamortized discount.	$ 348,484	$ 348,396
7.0% senior notes due 2014. At both June 30, 2006, and December 31, 2005, there was approximately $0.1 million in unamortized premium	130,069	130,074
9.75% senior notes due 2011.	—	1,256
	$ 478,553	$ 479,726

In March 2005, we used a portion of the proceeds from the $350 million sale of our 6.25% senior notes to repurchase pursuant to a tender offer and consent solicitation approximately $276.8 million of our outstanding 9.75% senior notes due 2011. In connection with this tender offer and repurchase, we reported a one-time pre-tax charge of approximately $31.5 million for premiums, commissions and expenses associated with the tender offer and the write-off of existing offering costs associated with the 9.75% senior notes, net of the accretion of existing note premiums on the 9.75% senior notes. Later during 2005, we repurchased an additional $2 million of our 9.75% senior notes. During the second quarter of 2006, we repurchased the remaining $1.2 million of our outstanding 9.75% senior notes.

The New Credit Agreement and indentures for the 7% senior notes due 2014 and the 6.25% senior notes due 2015 contain covenants that require maintenance of certain levels of tangible net worth and compliance with certain minimum financial ratios, place limitations on the payment of dividends and redemptions of equity, and limit the incurrence of additional indebtedness, asset dispositions, mergers, certain investments and creations of liens, among other items. As of and for the quarter ended June 30, 2006, we were in compliance with these covenants. After considering our most restrictive bank covenants, our borrowing availability under the New Credit Agreement was approximately $496.0 million at June 30, 2006 as determined by borrowing base limitations defined by our agreement with the lending banks. The New Credit Agreement and indentures relating to our senior notes restrict our ability to pay dividends, and at June 30, 2006, our maximum permitted amount available to pay dividends was $337.0 million.

Obligations to pay principal and interest on the New Credit Agreement and senior notes are guaranteed by all of our subsidiaries (collectively, the Guarantor Subsidiaries), each of which is directly or indirectly 100% owned by Meritage Homes Corporation. Such guarantees are full and unconditional, and joint and several. We do not provide separate financial statements of the Guarantor Subsidiaries because Meritage (the parent company) has no independent assets or operations, the guarantees are full and unconditional and joint and several and there are no non-guarantor subsidiaries. There are no significant restrictions on the ability of Meritage or any Guarantor Subsidiary to obtain funds from their respective subsidiaries, as applicable, by dividend or loan.

NOTE 7 - ACQUISITIONS AND GOODWILL

Greater Homes Acquisition. In September 2005 we purchased all of the outstanding stock of Greater Homes, Inc. ("Greater Homes"), a builder of single-family homes in Orlando, Florida. The purchase price was approximately $86.2 million in cash, including the repayment of existing debt of approximately $27.7 million. The results of Greater Homes' operations have been included in our financial statements since September 1, 2005, the effective date of the acquisition. Assets and liabilities were recorded at their estimated fair market value at the date of acquisition, and are subject to change when we finalize our analysis.

Colonial Homes Acquisition. In February 2005 we purchased the homebuilding and related assets of Colonial Homes of Florida ("Colonial Homes"), which operates primarily in the Ft. Myers/Naples area. The purchase price was approximately $66.2 million in cash. The results of Colonial Homes' operations have been included in our consolidated financial statements as of the effective date of acquisition, February 1, 2005.

Goodwill. Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the assets acquired. The acquisitions of Colonial Homes and Greater Homes were recorded using the purchase method of accounting. The purchase price for each was allocated based on estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition. The excess purchase price over the fair value of the net assets acquired of $27.9 and $10.1 million for Colonial Homes and Greater Homes, respectively, was recorded as goodwill.

The changes in the carrying amount of goodwill for the six months ended June 30, 2006, follow (in thousands):

Balance at December 31, 2005	$ 130,222
Tax benefit of amortization of excess tax basis	(282)
Balance at June 30, 2006	$ 129,940

Under the guidelines contained in SFAS No. 142, "*Goodwill and Other Intangible Assets*," in the first quarter of 2006 management performed its annual assessment of goodwill and determined that no impairment existed.

NOTE 8 - EARNINGS PER SHARE

Basic and diluted earnings per common share are presented in conformity with SFAS No. 128, "*Earnings Per Share.*" The following table presents the calculation of basic and diluted earnings per common share (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Basic weighted average number of shares outstanding	26,609	27,110	26,792	26,664
Effect of dilutive securities:				
Stock options and restricted stock	753	1,796	827	1,881
Diluted weighted average shares outstanding	27,362	28,906	27,619	28,545
Net earnings	$ 77,055	$ 59,239	$ 156,791	$ 83,435
Basic earnings per share	$ 2.90	$ 2.19	$ 5.85	$ 3.13
Diluted earnings per share	$ 2.82	$ 2.05	$ 5.68	$ 2.92
Antidilutive stock options not included in the calculation of diluted earnings per share	760	—	679	—

NOTE 9 - STOCK-BASED COMPENSATION

In the first quarter of 2006, we adopted Statement SFAS 123R, *Share-Based Payment* ("SFAS 123R"), which revises SFAS 123, *Accounting for Stock-Based Compensation*. Prior to 2006, we accounted for stock awards granted to employees under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees, and Related Interpretations*. As a result, in periods prior to fiscal year 2006, no compensation expense was recognized for stock options granted to employees because we did not grant stock options with exercise prices below the market price of the underlying stock on the date of the grant.

SFAS 123R applies to new awards and to awards modified, repurchased or cancelled after the required effective date, as well as to the unvested portion of awards outstanding as of the required effective date. We use the Black-Scholes model to value new stock option grants under SFAS 123R. We have applied the "modified prospective method" for existing grants, which requires us to value stock options prior to our adoption of SFAS 123R under the fair value method and expense the unvested portion over the remaining vesting period. SFAS 123R also requires us to estimate forfeitures in calculating the expense related to stock-based compensation and to reflect the benefits of tax deductions in excess of recognized compensation expense as both a financing inflow and an operating cash outflow upon adoption.

We have two stock compensation plans, the Meritage Stock Option Plan, which was adopted in 1997 and has been amended from time to time (the "1997 Plan"), and the 2006 Stock Incentive Plan (the "2006 Plan" and together with the 1997 Plan, the "Plans"). The Plans, which were approved by our stockholders, are administered by our Board of Directors. The provisions of the Plans are generally consistent with the exception that the 2006 Plan allows for the grant of stock appreciation rights, restricted stock awards, performance share awards and performance-based awards in addition to the non-qualified and incentive stock options allowed under the 1997 Plan. The Plans authorize awards to officers, key employees, non-employee directors and consultants for up to 6,600,000 shares of common stock, of which 729,207 shares remain available for grant at June 30, 2006. We believe that such awards provide a means of performance-based compensation to attract and retain qualified employees and better align the interests of our employees with those of our stockholders. Generally, option awards are granted with an exercise price equal to the market price of Meritage stock at the date of grant, a five-year ratable vesting period and a seven-year contractual term.

The following table illustrates the effect on net income and earnings per share for the three and six months ended June 30, 2005, as if our stock-based compensation had been determined based on the fair value at the grant dates for awards made prior to 2006, under the Plans and consistent with SFAS 123R (in thousands, except per share amounts):

		Three Months Ended	Six Months Ended
		June 30, 2005	
Net earnings	As reported	$ 59,239	$ 83,435
	Deduct (1)	(1,989)	(3,355)
	Pro forma	$ 57,250	$ 80,080
Basic earnings per share	As reported	$ 2.19	$ 3.13
	Pro forma	$ 2.11	$ 3.00
Diluted earnings per share	As reported	$ 2.05	$ 2.92
	Pro forma	$ 1.98	$ 2.81

(1) Total stock-based compensation expense determined using the fair value method for awards, net of related tax effects.

The pro forma results above are not intended to be indicative of, or a projection of, future results.

The fair values of option awards are estimated using a Black-Scholes option pricing model that uses the assumptions noted in the following table. Beginning January 1, 2006, expected volatilities are based on a combination of implied volatilities from traded options on our stock and historical volatility of our stock. Expected term, which represents the period of time that options granted are expected to be outstanding, is estimated using historical data. Groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve.

	Six Months Ended June 30,	
	2006	2005
Expected volatility	46 – 48%	52%

Expected dividends	0%	0%
Expected term (in years)	4.80 – 5.85	7
Risk-free interest rate	5.04 – 5.05%	4.43%
Weighted average grant date fair value of options granted	$ 25.63	$ 34.44

A summary of option activity under the Plans as of June 30, 2006, and changes during the six months then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2006	2,799,282	$ 27.90		
Granted	587,000	$ 53.99		
Exercised	(753,326)	$ 13.86		
Forfeited or expired	(173,800)	$ 31.67		
Outstanding at June 30, 2006	2,459,156	$ 38.16	4.81	$ 33,432
Exercisable at June 30, 2006	874,654	$ 25.76	3.26	$ 20,554

A summary of the status of the Company's restricted stock as of June 30, 2006 is presented below:

Restricted Stock	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	—	$ —
Granted	34,886	57.33
Vested	—	—
Forfeited	—	—
Nonvested at June 30, 2006	34,886	$ 57.33

The total intrinsic value of options exercised during the three and six months ended June 30, 2006 was $16.3 million and $31.3 million, respectively, and $15.8 million and $28.5 million during the three and six months ended June 30, 2005, respectively. The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the stock option.

As of June 30, 2006, we had $37.2 million of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the Plans that will be recognized on a straight-line basis over the remaining vesting periods. That cost is expected to be recognized over a weighted-average period of 3.42 years. For the three and six months ended June 30, 2006, our total stock-based compensation expense was $4.7 million ($3.3 million net of tax) and $7.3 million ($5.3 million net of tax), respectively. Stock compensation expense net of tax for the three months ended June 30, 2006 was $0.12 per basic and diluted share. Stock compensation expense for the six months ended June 30, 2006 was $0.19 per basic share and $0.20 per diluted share.

Cash received from option exercises under the Plans for the three and six months ended June 30, 2006, was $8.0 million and $10.4 million, respectively, and $3.3 million and $4.8 million for the three and six months ended June 30, 2005, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled $5.1 million and $10.1 million for the three and six months ended June 30, 2006, respectively, and $5.5 million and $8.2 million for the three and six months ended June 30, 2005, respectively.

NOTE 10 - INCOME TAXES

Components of the provision for income taxes are (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Federal	$ 41,614	$ 30,813	$ 85,995	$ 43,393
State	6,481	4,744	13,155	6,689
Total	$ 48,095	$ 35,557	$ 99,150	$ 50,082

NOTE 11 - SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The February 2005 acquisition of Colonial Homes resulted in the following changes in assets and liabilities (in thousands):

	June 30, 2005
Increase in real estate	$ (47,592)
Increase in deposits on real estate under option or contract	(1,343)
Increase in receivables and other assets	(1,065)
Increase in goodwill	(22,111)
Increase in intangibles	(2,763)
Increase in property and equipment	(327)
Increase in accounts payable and accrued liabilities	3,758
Increase in home sale deposits	5,223
Net cash paid for acquisition	$ (66,220)

The following presents certain supplemental cash flow information (in thousands):

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Cash paid during the period for:		
Interest	$ 22,072	$ 14,510
Income taxes	$ 150,515	$ 52,463
Non-cash distributions from unconsolidated entities	$ 4,011	$ 19,863

NOTE 12 — OTHER EVENTS

On May 17, 2006, John R. Landon, the Company's Co-CEO, resigned. In connection with Mr. Landon's departure, both his employment and change of control agreement terminated (other than certain provisions in the Employment Agreement that survive termination). Under the terms of the Employment Agreement, subject to his compliance with certain restrictive covenants and other requirements therein, Mr. Landon is entitled to a payment of $10,000,000, payable in equal monthly installments over the course of 24 months, and acceleration of all outstanding stock options that were granted to him after the effective date of the employment agreement, which was July 1, 2003. During the quarter ended June 30, 2006, the Company expensed approximately $10.0 million related to the obligations owed to Mr. Landon pursuant to the terms of his employment agreement and also recorded stock-based compensation expense of approximately $2.3 million related to the accelerated vesting of certain of his outstanding stock options. On June 12, 2006, the Company entered into a Stock Purchase Agreement with Mr. Landon, pursuant to which the Company acquired 1,000,000 shares of the Company's common stock from Mr. Landon at a price of $52.19 per share, or an aggregate purchase price of $52.2 million.

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

Overview

We are a leading designer and builder of single-family homes in the growth regions of the western and southern United States based on the number of home closings. We focus on providing a broad range of first-time, move-up, active adult and luxury homes to our targeted customer base. We believe that population, job and income growth, as well as the favorable migration characteristics in our markets, provide us opportunities for long-term growth. At June 30, 2006, we were actively selling homes in 204 communities, with base prices ranging from $109,000 to $1,220,000.

Total home closing revenue was $902.9 million for the three months ended June 30, 2006, increasing 39% from $651.8 million for the same period last year. Net earnings for the second quarter of 2006 increased 30% to $77.1 million from $59.2 million in the same period last year. Net earnings for the six months ended June 30, 2005, included a bond refinancing charge related to a series of refinancing transactions that resulted in a charge of $31.5 million, which reduced after-tax net earnings by $19.7 million. Excluding this charge, net earnings for the six months ended June 30, 2006 increased 52% compared to the same period last year.

During the second quarter of 2006, our pre-tax earnings were reduced by approximately $19.0 million due to severance and other employee-related departure costs of approximately $11.7 million, as well as an additional $7.3 million in real estate write-offs to reduce the carrying amount of certain projects to fair value and for write-offs of option deposits for projects we no longer believe are economically viable.

Our strong second quarter 2006 revenue and net income are the result of closing orders taken mostly during the robust housing markets in 2005. As a result of these market conditions, we benefited from pricing power, which resulted in our home closing gross margin for the second quarter of 2006 increasing to 24.3% from 23.4% in the same period last year. We began experiencing slowdowns in our northern California markets in the fourth quarter of 2005, which continued through the second quarter of 2006. Beginning in the first quarter of 2006 and continuing through the second quarter, our Arizona, Nevada and Florida markets have also experienced moderating demand as these markets pull back from a record-setting environment in 2004 and 2005, resulting in a decline in orders in these higher-margin markets, while demand in Texas remained strong. This change has caused a significant shift in the mix of home orders during the first six months of 2006, with a higher percentage coming from Texas, where we historically achieve a lower margin than in many of our markets that are currently softening. Based on these conditions, we expect our home closing gross margins to trend lower in the remainder of 2006 and throughout 2007.

It is also our expectation that sales in our markets that experienced robust sales activity in 2005 will continue to moderate, and we expect the home order rate to decrease in 2006 and beyond from the levels achieved in 2005. At June 30, 2006, our backlog of approximately $2.0 billion decreased by 10% compared to March 31, 2006, and 8% at June 30, 2005, as a result of decreasing sales orders. In the second quarter of 2006, our cancellation rate on sales orders increased to approximately 32% from 22% in the same period a year ago, and from 28% at March 31, 2006, which has resulted in an increase in the percentage of unsold homes recorded on our balance sheet. Consequently, we are using various incentive and discount offerings to reduce the number of unsold homes in inventory. We believe our experiences are consistent with the overall trends in the homebuilding industry. Looking beyond 2006, based on current market conditions, we do not believe we will sustain the revenue growth rates that we achieved during the last several years and we expect our 2007 revenue and earnings to be somewhat lower compared to anticipated 2006 results.

Critical Accounting Policies

We have established various accounting policies that govern the application of accounting principles generally accepted in the United States of America in the preparation and presentation of our consolidated financial statements. Our significant policies are described in Note 1 of the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005. Certain of these policies involve significant judgments, assumptions and estimates by management that may have a material impact on the carrying value of certain assets and liabilities, and revenue and costs.

We are subject to uncertainties such as the impact of future events, economic, environmental and political factors and changes in our business environment; therefore, actual results could differ from these estimates. Accordingly, the accounting estimates used in the preparation of our financial statements will change as new events occur, as more experience is acquired, as additional information is obtained or as our operating environment changes. Such changes in estimates and refinements in estimation methodologies are reflected in our reported results of operations and, if material, the effects of these changes are disclosed in the notes to the consolidated financial statements. The judgments, assumptions and estimates we use and believe to be critical to our business are based on historical experience, knowledge of the accounts and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we have made, actual results may differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations.

The accounting policies that we deem most critical to us, and that involve the most difficult, subjective or complex judgments, include:

Real Estate

Real estate is stated at cost, which includes direct construction costs for homes, development period interest and certain common costs that benefit the entire community. We assess these assets for recoverability whenever events or circumstances change indicating that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by comparing the carrying amount of an asset to its fair value less cost to sell. If the fair value of an asset is less than its carrying amount (less costs to sell), an impairment loss is recognized.

Goodwill

We review the carrying value of goodwill annually or whenever events or circumstances change that indicate that the carrying amount is not recoverable. In evaluating impairment, we base our estimates of fair value on an analysis of selected business acquisitions in the homebuilding industry provided to us by an independent third party. Such evaluations for impairment are significantly impacted by the amount a buyer is willing to pay in the current market for a like business. Our reporting units are determined in accordance with SFAS 142, "*Goodwill and Other Intangible Assets*," which defines a reporting unit as an operating segment or one level below an operating segment.

Warranty Reserves

Warranty reserves are included in other liabilities in the consolidated balance sheets. We record a reserve covering our anticipated warranty costs for each home closed. We review the adequacy of warranty reserves based on historical experience and our estimate of the costs to remediate the claims, and adjust these provisions accordingly. Factors that affect our warranty liability include the number of homes sold, historical and anticipated rates of warranty claims, and cost per claim.

Off-Balance Sheet Arrangements

We invest in entities that acquire and develop land for sale to us in connection with our homebuilding operations or for sale to third parties. Our partners generally are unrelated homebuilders, land sellers and financial or other strategic partners.

Most of the unconsolidated entities through which we acquire and develop land are accounted for by the equity method of accounting because such arrangements do not meet the criteria for consolidation set forth in FASB Interpretation No. 46 (revised December 2003), "*Consolidation of Variable Interest Entities*" ("FIN 46R"). We record our investments in these entities in our consolidated balance sheets as "Investments in unconsolidated entities" and our pro rata share of the entities' earnings or losses in our consolidated statements of earnings as "Earnings from unconsolidated entities, net." See Note 4 in the accompanying financial statements for additional information related to our investments in unconsolidated entities.

We also enter into option or purchase agreements to acquire land or lots from entities, for which we generally pay non-refundable deposits. We analyze these agreements under FIN 46R to determine whether we are the primary beneficiary of the VIE created as result of these agreements using a model developed by management. If we are deemed to be the primary beneficiary of the VIE because we are obligated to absorb the majority of the expected losses, receive the majority of the residual returns, or both, we will consolidate the VIE in our consolidated financial statements. See Note 3 in the accompanying financial statements for additional information related to our off-balance sheet arrangements.

Results of Operations

The following discussion and analysis of financial condition and results of operations is based on our consolidated unaudited financial statements at and for the three and six months ended June 30, 2006 and 2005. All balances and transactions between us and our subsidiaries have been eliminated. In management's opinion, the data reflects all adjustments, consisting of only normal recurring adjustments, necessary to fairly present our financial position and results of operations for the periods presented. The results of operations for any interim period are not necessarily indicative of results expected for a full fiscal year.

The data provided below presents operating and financial data regarding our homebuilding activities (dollars in thousands):

Home Closing Revenue

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Total				
Dollars	$ 902,851	$ 651,783	$ 1,749,225	$ 1,202,730
Homes closed	2,722	2,095	5,250	3,882
Average sales price	$ 331.7	$ 311.1	$ 333.2	$ 309.8
Texas				
Dollars	$ 252,386	$ 184,229	$ 471,470	$ 340,184
Homes closed	1,075	856	2,027	1,573
Average sales price	$ 234.8	$ 215.2	$ 232.6	$ 216.3
Arizona				
Dollars	$ 290,124	$ 194,108	$ 515,983	$ 348,063
Homes closed	888	745	1,624	1,344
Average sales price	$ 326.7	$ 260.5	$ 317.7	$ 259.0
California				
Dollars	$ 208,111	$ 228,412	$ 454,994	$ 422,899
Homes closed	361	379	784	724
Average sales price	$ 576.5	$ 602.7	$ 580.3	$ 584.1
Nevada				
Dollars	$ 69,106	$ 25,493	$ 143,262	$ 56,682
Homes closed	172	66	361	154
Average sales price	$ 401.8	$ 386.3	$ 396.8	$ 368.1

Florida (1)				
Dollars	$ 69,486	$ 19,541	$ 143,788	$ 34,902
Homes closed	189	49	401	87
Average sales price	$ 367.7	$ 398.8	$ 358.6	$ 401.2
Colorado				
Dollars	$ 13,638	n/a	$ 19,728	n/a
Homes closed	37	n/a	53	n/a
Average sales price	$ 368.6	n/a	$ 372.2	n/a

(1) Results for Florida for the three and six months ended June 30, 2005, do not include Greater Homes, which was acquired in September 2005, and only include Colonial Homes since acquisition in February 2005.

Home closing revenue for the quarter ended June 30, 2006 increased 39% to $902.9 million from $651.8 million at the same time period a year ago as a result of a 30% increase in homes closed to 2,722. The home closing increase is primarily due to strong demand that drove order activity and pricing power during the last half of 2005. Our 7% increase in average selling prices to $331,700 is the result of a higher percentage of closings came from Nevada and Florida, where average selling prices are considerably higher than the company average, more than offsetting decreases in the average sales price in California. In Texas, we closed 1,075 homes, an increase of 26% compared to the same period last year, with a 37% increase in home closing revenue to $252.4 million from $184.2 million. Home closing revenue in Arizona increased 49% to $290.1 million due to strong pricing power when those home orders were taken. In Florida, we posted large increases in both the number of homes closed and home closing revenue primarily due to our September 2005 acquisition of Greater Homes in Orlando and the maturing of our start-up operation in Orlando. Due to the softening of demand for our homes in California, which began in the fourth quarter of 2005, our home closing revenue and number of homes closed have decreased compared to the same period a year ago. Based on the trends previously discussed, we expect that during the remainder of 2006 and continuing into 2007, we will experience a shift in the mix of home closings that will result in lower average sales prices resulting from a greater percentage of closings in Texas, which is our lowest-priced market, and a lower percentage of closings in higher-priced markets, such as California, Nevada and Florida.

Home Orders

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Total				
Dollars	$ 694,360	$ 1,005,611	$ 1,526,978	$ 1,886,957
Homes ordered	2,116	2,931	4,706	5,570
Average sales price	$ 328.1	$ 343.1	$ 324.5	$ 338.8
Texas				
Dollars	$ 293,439	$ 243,490	$ 608,586	$ 456,091
Homes ordered	1,170	1,067	2,482	2,040
Average sales price	$ 250.8	$ 228.2	$ 245.2	$ 223.6
Arizona				
Dollars	$ 165,475	$ 313,146	$ 425,285	$ 585,995
Homes ordered	457	973	1,190	1,898
Average sales price	$ 362.1	$ 321.8	$ 357.4	$ 308.7
California				
Dollars	$ 161,857	$ 320,027	$ 299,213	$ 608,233
Homes ordered	291	563	528	1,037
Average sales price	$ 556.2	$ 568.4	$ 566.7	$ 586.5
Nevada				
Dollars	$ 33,241	$ 80,788	$ 82,649	$ 127,644
Homes ordered	82	221	211	350
Average sales price	$ 405.4	$ 365.6	$ 391.7	$ 364.7
Florida (1)				
Dollars	$ 32,696	$ 45,138	$ 86,599	$ 105,972
Homes ordered	94	99	231	237
Average sales price	$ 347.8	$ 455.9	$ 374.9	$ 447.1
Colorado				
Dollars	$ 7,652	$ 3,022	$ 24,646	$ 3,022
Homes ordered	22	8	64	8
Average sales price	$ 347.8	$ 377.8	$ 385.1	$ 377.8

(1) Results for Florida for the three and six months ended June 30, 2005, do not include Greater Homes, which was acquired in September 2005, and only include Colonial Homes since acquisition in February 2005.

Home orders for any period represent the aggregate sales price of all homes ordered by customers, net of cancellations. We do not include orders contingent upon the sale of a customer's existing home as a sales contract until the contingency is removed. In many of our markets, demand has softened compared to the pace experienced throughout 2005 and much of 2004. Home orders declined by 28% to 2,116 homes during the quarter ended June 30, 2006 with a value of $694.4 million, a decrease of 31% compared to the same quarter a year ago. Our actively selling community count increased 25% to 204 at June 30, 2006, over the same period a year ago, helping to offset some of the softening in demand in many of our key markets. During the second quarter of 2006, our Arizona, California, Nevada and Florida markets have experienced softer market conditions due to decreasing demand from investors and speculative buyers, higher inventory levels of unsold homes and homebuyers electing to defer purchase decisions in this transitional market. This decrease in demand has also led to higher cancellation rates than we have historically experienced, and as a result, spec homes inventory has increased in many of our communities. Our cancellation rate for the quarter ended June 30, 2006 increased to 32% from 22% at the same time period a year ago, and from 28% at March 31, 2006. In response to these market conditions, we have increased incentives to home buyers in many of these markets. Partially offsetting these trends, our Texas market continues to show strength with home orders increasing 21% in value quarter-over-quarter to $293.4 million compared to $243.5 million on a 10% increase in homes sold. The Texas markets continue to enjoy favorable overall economic conditions and relative affordability of housing. Beginning in the second quarter of 2006, our shift in mix of homes sold with an increased percentage in Texas and decreased percentage in the markets that are experiencing softening demand.

Order Backlog

	At June 30,	
	2006	2005
Total		
Dollars	$ 1,959,353	$ 2,135,024
Homes in backlog	5,849	6,463
Average sales price	$ 335.0	$ 330.3
Texas		
Dollars	$ 646,581	$ 428,997
Homes in backlog	2,628	1,952
Average sales price	$ 246.0	$ 219.8
Arizona		
Dollars	$ 748,004	$ 775,319
Homes in backlog	1,993	2,545
Average sales price	$ 375.3	$ 304.6
California		
Dollars	$ 265,183	$ 576,605
Homes in backlog	457	1,008
Average sales price	$ 580.3	$ 572.0
Nevada		
Dollars	$ 65,787	$ 150,165
Homes in backlog	199	433
Average sales price	$ 330.6	$ 346.8
Florida (1)		
Dollars	$ 217,058	$ 200,916
Homes in backlog	529	517
Average sales price	$ 410.3	$ 388.6
Colorado		
Dollars	$ 16,740	$ 3,022
Homes in backlog	43	8
Average sales price	$ 389.3	$ 377.8

(1) Florida amounts at June 30, 2005, do not include Greater Homes, which was acquired in September 2005.

Our backlog represents net sales contracts that have not closed. Our June 30, 2006 backlog value was $2.0 billion representing 5,849 homes. These amounts declined 8% and 10%, respectively, compared to a year ago, consistent with softening overall order trends in our California, Nevada and Arizona markets that have been partially offset by strength in Texas. In Texas, a strong underlying economy and relative affordability of housing continue to fuel growth as evidenced by a 51% increase in backlog value in the Texas market, while California, Nevada and Arizona backlog values decreased 54%, 56% and 4%, respectively. The number of units in our Texas backlog increased by 35%, while in California, Nevada and Arizona decreased 55%, 54% and 22% respectively. We experienced positive growth in backlog value, units and average price in both Florida and Colorado as the startup operations in both states continue to mature and, with respect to Florida, we benefited from the 2005 acquisitions of Colonial Homes and Greater Homes.

Other Operating Information (dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Home Closing Gross Profit				
Dollars	$ 219,467	$ 152,703	$ 433,530	$ 272,028
Percent of home closing revenue	24.3%	23.4%	24.8%	22.6%
Commissions and Other Sales Costs				
Dollars	$ 52,849	$ 35,869	$ 100,876	$ 67,340
Percent of home closing revenue	5.9%	5.5%	5.8%	5.6%
General and Administrative Costs				
Dollars	$ 51,344	$ 26,672	$ 94,066	$ 50,635
Percent of total revenue	5.6%	4.1%	5.3%	4.2%
Income Taxes				
Dollars	$ 48,095	$ 35,557	$ 99,150	$ 50,082
Percent of earnings before income taxes	38.4%	37.5%	38.7%	37.5%

Home Closing Gross Profit

Home closing gross profit represents home closing revenue less cost of home closings. Cost of home closings include land and lot development costs, direct home construction costs, an allocation of common community costs (such as model complex costs, common community and recreation areas and landscaping, and architectural, legal and zoning costs), interest, sales tax, impact fees, warranty, construction overhead and closing costs. Home closing gross profit percentages for the three and six months ended June 30, 2006 increased to 24.3% and 24.8%, respectively from 23.4% and 22.6%, respectively for the three and six months ended June 30, 2005. These increases were primarily due to pricing power driven by stronger market conditions in the later half of 2005, when these homes were sold, and our ability to effectively manage our land and construction costs. Home closing gross profit for the three months ended June 30, 2006 was reduced by $7.3 million related to the write-off of $4.5 million of land acquisition and development costs and $2.8 million of option deposits. These write-offs were the result of the Company's review of the fair value of its real estate assets and the decision that the acquisition of certain properties under contract was no longer economically viable. Excluding these write-offs, home closing gross profit percentages for the three and six months ended June 30, 2006 would have been 25.1% and 25.2%, respectively. In the future, we believe that as prices moderate in certain key markets and a greater mix of our sales come from markets with lower margins, such as Texas, our margins will trend lower from the historically high levels experienced during the last two years. In addition, during the second quarter of 2006, we have increased the number, type and amount of incentives we offer in those markets that have experienced softening demand.

The impact of these incentives is reflected in the decline in home closing gross profit percentage from 25.3% in the first quarter of 2006 to 24.3% in the second quarter of 2006. The types of incentives we offer vary from market to market, community to community and model to model and may include a discount on home price, free or discounted upgrades and options, and the payment of a portion of the buyer's closing costs. Increasing incentives can also be expected to have an adverse effect on our gross and net margins over the next several quarters.

Commissions and Other Sales Costs

Commissions and other sales costs, such as advertising and sales office expenses, as a percentage of home closing revenue, increased to 5.9% and 5.8%, respectively for the three and six months ended June 30, 2006 from 5.5% and 5.6%, respectively for the three and six months ended June 30, 2005. These increases are the result of a larger percentage of our homes being sold with the participation of outside commissioned sales agents, which results in additional commission costs.

General and Administrative Costs

General and administrative expenses represent corporate and divisional overhead expenses such as salaries and bonuses, occupancy, insurance and travel expenses. General and administrative expenses as a percentage of total revenue increased to 5.6% and 5.3%, respectively for the three and six months ended June 30, 2006 from 4.1% and 4.2%, respectively

for the three and six months ended June 30, 2005. During the three months ended June 30, 2006, we recorded expenses of $11.7 million related to the departure of our former Co-CEO and severance costs related to adjusting our staffing levels in the markets that are experiencing softening demand. This amount is composed of $11.7 million of severance expense and $2.3 million of stock-based compensation expense related to the accelerated vesting of certain options granted to our former Co-CEO, which is partially offset by a $2.3 million reduction to 2006 compensation related accruals to reflect these departures. There was an additional $2.4 million and $5.0 million, respectively, of stock based compensation in the three and six months ended June 30, 2006 due to the implementation of Statement of Financial Accounting Standards ("SFAS") 123R, Share-Based Payment ("SFAS 123R") for which there are no comparable amounts in 2005. Excluding the impact of these items, selling general and administrative expenses as a percentage of total revenue for the three and six months ended June 30, 2006 would have been 4.1% and 4.4%, respectively, which are relatively consistent with the same periods last year.

Income Taxes

The increase in the effective tax rate to 38.4% and 38.7% for the three and six months ended June 30, 2006 from 37.5% in the same time periods a year ago is primarily attributable to non-deductible executive incentive compensation and the impact of incentive stock options under SFAS 123R, which was implemented at the beginning of 2006. These increases were partially offset by the deduction related to qualified production activities provided by the American Jobs Creation Act of 2004.

Stock-Based Compensation

In the first quarter of 2006, we adopted SFAS 123R, which revises SFAS 123. Prior to 2006, we accounted for stock awards granted to employees under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employee, and Related Interpretations*. As a result, no compensation expense was recognized for stock options granted to employees because we did not grant stock options with exercise prices below the market price of the underlying stock on the date of the grant.

SFAS 123R applies to new awards and to awards modified, repurchased or cancelled after the required effective date, as well as to the unvested portion of awards outstanding as of the required effective date. We use the Black-Scholes model to value new stock option grants under SFAS 123R, applying the "modified prospective method" for existing grants which requires us to value stock options prior to our adoption of SFAS 123R under the fair value method and expense the unvested portion over the remaining vesting period. SFAS 123R also requires us to estimate forfeitures in calculating the expense related to stock-based compensation and to reflect the benefits of tax deductions in excess of recognized compensation expense as both a financing inflow and an operating cash outflow upon adoption.

As of June 30, 2006, we had $37.2 million of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the Plans that will be recognized on a straight-line basis over the remaining vesting periods. That cost is expected to be recognized over a weighted-average period of 3.42 years. For the three and six months ended June 30, 2006, our total stock-based compensation expense was $4.7 million ($3.3 million net of tax) and $7.3 million ($5.3 million net of tax), respectively. Stock compensation expense net of tax for the three months ended June 30, 2006, was $0.12 per basic and diluted share. Stock compensation expense for the six months ended June 30, 2006, was $0.19 per basic share and $0.20 per diluted share.

Cash received from option exercises under the Plans for the three and six months ended June 30, 2006, was $8.0 million and $10.4 million, respectively, and $3.3 million and $4.8 million for the three and six months ended June 30, 2005, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled $5.1 million and $10.1 million for the three and six months ended June 30, 2006, respectively, and $5.5 million and $8.2 million for the three and six months ended June 30, 2005, respectively.

Liquidity and Capital Resources

Our principal uses of capital for the three months ended June 30, 2006 were operating expenses, land and property purchases, lot development, home construction, income taxes, investments in joint ventures, repurchases of our common stock and the payment of various liabilities. We use a combination of borrowings and funds generated by operations to meet our short-term working capital requirements.

Cash flows for each of our communities depend on the status of the development cycle, and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, plat and other approvals, and construction of model homes, roads, utilities, general landscaping and other amenities. Because these costs are capitalized, income reported for financial statement purposes during those early stages may significantly exceed cash flow. In the later stages of development, future cash flows may significantly exceed earnings reported for financial statement purposes, as cost of closings includes charges for substantial amounts of previously expended costs.

We enter into various options and purchase contracts for land in the normal course of business. Currently, none of these agreements require us to purchase lots. Generally, our options to purchase lots remain effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the respective agreement. The pre-established number is typically structured to approximate our expected rate of home construction starts, although as demand slows, in some instances starts may fall below the pre-established minimum number. This could force us to purchase lots in advance of corresponding sales, re-negotiate the takedown

schedule, or discontinue lot purchases and forfeit the related non-refundable option deposit. At June 30, 2006, our total option and purchase contracts had purchase prices in the aggregate of approximately $2.8 billion, on which we had made deposits of approximately $172.6 million in cash along with approximately $75.0 million in letters of credit. Additional information regarding our purchase agreements and related deposits is presented in Note 3 - Variable Interest Entities and Consolidated Real Estate Not Owned in the accompanying consolidated financial statements.

At June 30, 2006, there was approximately $207.6 million outstanding under our senior unsecured revolving credit facility and approximately $108.5 million was outstanding in letters of credit that collateralize our obligations under various land purchase, land development and other contracts. In addition, we had approximately $295.2 million in surety and performance bonds outstanding at June 30, 2006. After considering our most restrictive bank covenants and borrowing base limitations, the remaining balance of the bank credit facility of approximately $496.0 million is available for us to borrow.

On May 16, 2006, we amended and restated our senior unsecured revolving credit facility. Under the New Credit Agreement, our credit facility was increased from $600 million to $800 million, and the term was extended from May 2009 to May 2010. On June 30, 2006, we amended our New Credit Agreement to increase our borrowing capacity under the Credit Agreement by $50 million and to make certain other minor changes. The total borrowing capacity of the credit facility is now $850 million. The increase in capacity was made pursuant to an accordion feature contained in the Credit Agreement.

At June 30, 2006, the aggregate principal amount of our outstanding 7% senior notes due 2014 totaled approximately $130.1 million, which includes unamortized premiums of approximately $0.1 million, and the aggregate principal amount of our outstanding 6.25% senior notes due 2015 totaled approximately $348.5 million, which includes unamortized discounts of approximately $1.5 million. During the second quarter of 2006, we repurchased the remaining $1.2 million of our outstanding 9.75% senior notes.

We believe that our current borrowing capacity, cash on hand and anticipated net cash flows from operations are and will be sufficient to meet liquidity needs for the foreseeable future. We believe our future cash needs will include funds for the completion of projects that are underway, the acquisition of land and property for new projects, the maintenance of our day-to-day operations, repurchases of common stock and the acquisition or start-up of additional homebuilding operations, should the opportunities arise. There is no assurance, however, that future cash flows will be sufficient to meet future capital needs. The amount and types of indebtedness that we incur may be limited by the terms of the indentures governing our senior notes and by the terms of the credit agreement governing our senior unsecured credit facility.

Off-Balance Sheet Arrangements

Reference is made to Notes 1, 3 and 4 in the accompanying Notes to consolidated financial statements included in this Quarterly Report on Form 10-Q. These notes discuss our off-balance sheet arrangements with respect to land acquisition contracts and option agreements, and land development joint ventures, including the nature and amounts of financial obligations relating to these items. In addition, these notes discuss the nature and amounts of certain types of commitments that arise in connection with the ordinary course of our land development and homebuilding operations, including commitments of land development joint ventures for which we might be obligated.

Seasonality

We historically have closed more homes in the second half of the fiscal year than in the first half, due in part to the slightly seasonal nature of the market for our move-up and semi-custom luxury products. We expect this seasonal trend to continue, although it may vary if our operations continue to expand.

Special Note of Caution Regarding Forward-Looking Statements

In passing the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Congress encouraged public companies to make "forward-looking statements" by creating a safe-harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify both our written and oral forward-looking statements for protection under the PSLRA.

The words "believe," "expect," "anticipate," "forecast," "plan," "estimate," and "project" and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. All statements we make other than statements of historical fact are forward-looking statements within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Exchange Act. Forward-looking statements on this Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, include statements concerning: the demand for and the pricing of our homes; our expectations about trends in gross and net margins, spec home inventories, incentives, cancellations, sales orders, sales prices, mix of sales across our different geographic areas; the growth potential of the markets we operate in; our acquisition strategy; demographic and other trends related to specific markets and the homebuilding industry in general and our ability to capitalize on them; the future supply of housing inventory in our markets and the homebuilding industry in general; our expectation that existing guarantees, letters of credit and performance and surety bonds will not be drawn on; the adequacy of our insurance coverage and warranty reserves; the expected outcome of legal proceedings against us; the sufficiency of our capital resources to support our operations and growth strategy; our ability and willingness to acquire land under option or contract; the benefits of our lot acquisition strategy; the impact of changes in interest rates on our outstanding debt; our expected amortization expense in future periods; the impact of recently issued accounting pronouncements; seasonal trends and the future impact of deferred tax assets or liabilities. Such statements are subject to significant risks and uncertainties.

Important factors currently known to management that could cause actual results to differ materially from those in forward-looking statements, and that could negatively affect our business are discussed in our Annual Report on Form 10-K for the year ended December 31, 2005, under the heading "Risk Factors" and under the heading "Risk Factors" in Part II, Item 1A in this Quarterly Report on Form 10-Q, the contents of each of which are incorporated by reference herein.

Forward-looking statements express expectations of future events. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions concerning future events and they are subject to numerous known and unknown risks and uncertainties that could cause actual events or results to differ materially from those projected. Due to these inherent uncertainties, the investment community is urged not to place undue reliance on forward-looking statements. In addition, we undertake no obligations to update or revise forward-looking statements to reflect changed assumptions, the occurrence of anticipated events or changes to projections over time. As a result of these and other factors, our stock and note prices may fluctuate dramatically.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk primarily related to potential adverse changes in interest rates on our revolving credit facility. The interest rate for this facility fluctuates with the prime and Eurodollar lending rates. As of June 30, 2006, we had approximately $207.6 million drawn under our senior revolving credit facility that is subject to changes in interest rates. We do not enter into, or intend to enter into, derivative financial instruments for trading or speculative purposes.

Our fixed rate debt is made up primarily of our $130 million in principal of our 7% senior notes and $350 million in principal of our 6.25% senior notes. Except in limited circumstances, we do not have an obligation to prepay our fixed-rate debt prior to maturity and, as a result, interest rate risk and changes in fair value should not have a significant impact on fixed rate of borrowings until we would be required to refinance such debt.

Our operations are interest rate sensitive. As overall housing demand is adversely affected by increases in interest rates, a significant increase in mortgage interest

rates may negatively affect the ability of homebuyers to secure adequate

financing. Higher interest rates could adversely affect our revenues, gross margins and net earnings and would also increase our variable rate borrowing costs.

Item 4. Controls and Procedures

In order to ensure that the information we must disclose in our filings with the Securities and Exchange Commission ("SEC") is recorded, processed, summarized and reported on a timely basis, we have developed and implemented disclosure controls and procedures. Our management with the participation of our chief executive officer and chief financial officer has reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exhange Act"), as of the end of the period covered by this Form 10-Q (the "Evaluation Date"). Based on such evaluation, management has concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective in ensuring that information that is required to be disclosed in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

During the fiscal quarter covered by this Form 10-Q, there have not been any changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various routine legal proceedings incidental to our business, some of which are covered by insurance. Most of these matters relate to correction of home construction defects and general customer claims. With respect to the majority of pending litigation matters, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to these matters are not considered probable. We believe that none of these matters will have a material adverse impact upon our consolidated financial condition, results of operations or cash flows.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005 and the factors discussed below which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K and below are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

The following risk factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005, are being updated.

Dependence on Key Personnel. Our success largely depends on the continuing services of certain key employees, including our Chief Executive Officer, Steve J. Hilton, and our ability to attract and retain qualified personnel. We have an employment agreement with Mr. Hilton, but we do not have employment agreements with certain other key employees. We believe that Mr. Hilton possesses valuable industry knowledge, experience and leadership abilities that would be difficult in the short term to replicate. In addition, Mr. Hilton has cultivated key contacts and relationships with important participants in the land acquisition process in our various communities across the country. The loss of the services of key employees could harm our operations and business plans.

Homebuilding Industry Factors. The homebuilding industry is cyclical and is significantly affected by changes in economic and other conditions such as employment levels, availability of financing, interest rates, and consumer confidence. These factors can negatively affect demand for and cost of our homes. We are also subject to various risks, many of which are outside of our control, including delays in construction schedules, cost overruns, changes in governmental regulations (such as no- or slow-growth initiatives), increases in real estate taxes and other local government fees, and raw materials and labor costs.

We are also subject to the potential for significant variability and fluctuations in the cost and availability of real estate. Although historically we have generally developed parcels ranging from 100 to 300 lots, in order to achieve and maintain an adequate inventory of lots, we are now acquiring larger parcels, in many cases with a joint venture partner. Write-downs of our real estate or write-offs of purchase and option contract deposits could occur if market conditions deteriorate and these write-downs or write-offs could be material in amount.

Performance and Surety Bonds; Performance Guarantees; Letters of Credit. In the ordinary course of our business, we obtain letters of credit and performance, maintenance and other bonds in support of our related obligations with respect to the development of our projects. With respect to our joint ventures, we and our joint venture partners are typically obligated to complete land development improvements if the joint venture does not perform the required development. In addition, we and our joint venture partners sometimes agree to indemnify third party surety providers with respect to performance bonds issued on behalf of certain of our joint ventures. In the event the letters of credit or bonds are drawn upon, we, and in the case of a joint venture, our joint venture partners, would be obligated to reimburse the surety or other issuer of the letter of credit or bond if the obligations the bond or guarantee secures are not performed by us (or the joint venture). If one or more bonds, letters of credit or other guarantees were drawn upon or otherwise invoked, our obligations could be significant, individually or in the aggregate, which could have a material adverse effect on our financial position or results of operations. We cannot guarantee that such events will not occur or that such obligations will not be invoked.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities:

The following table summarizes our purchases of our own equity securities during the three months ended June 30, 2006:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans of Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
April 1-30, 2006	—	—	—	$ 86,289,605
May 1-31, 2006	—	—	—	$ 86,289,605
June 1-30, 2006	1,000,000	$ 52.19	1,000,000	$ 34,099,605
Total	1,000,000	$ 52.19	1,000,000	$ 34,099,605

In November 2004, we announced that the Board of Directors had approved a new stock buyback program, authorizing the expenditure of up to $50 million to repurchase shares of our common stock. The program was completed in February 2006, with the repurchase of 601,000 shares at an average price of $59.21.

On February 21, 2006, we announced that the Board of Directors approved a new stock repurchase program, authorizing the expenditure of up to $100 million to repurchase shares of our common stock. There is no stated expiration date for this program. In March 2006, we repurchased 255,000 shares at an average price of $53.77 under this program. In June 2006, we repurchased 1,000,000 shares from John R. Landon, our former Co-CEO and Co-Chairman, for $52.19 per share. As of June 30, 2006, we had approximately $34.1 million available to repurchase shares under this program.

Item 4. Submission of Matters to a Vote of Security Holders

Our Annual Meeting of Stockholders was held on May 17, 2006. At the Annual Meeting, the stockholders elected Steven J. Hilton, Raymond Oppel, William G. Campbell and Richard T. Burke Sr. to serve as Directors for a two-year term. John R. Landon, Robert G. Sarver, Peter L. Ax and Gerald W. Haddock continued as Directors after the meeting.

Stockholders holding 25,770,905 shares of 96.8% of the outstanding shares were present in person or by proxy at the Annual Meeting. The tabulation with respect to each nominee for director follows:

	Votes For	Votes Against or Withheld
Steven J. Hilton	23,756,653	2,014,252
Raymond Oppel	23,276,437	2,494,468
William G. Campbell (1)	23,674,400	2,096,505
Richard T. Burke, Sr.	23,785,039	1,985,866

(1) William G. Campbell resigned his position as a member of the Board of Directors, effective June 14, 2006.

Also, at the Annual Meeting, our stockholders approved an increase in the Company's authorized shares of common stock from 50,000,000 to 125,000,000, the 2006 Stock Incentive Plan, the 2006 Annual Incentive Plan and the ratification of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year. The results of the vote were as follows:

	Votes For	Votes Against	Votes Abstain	Broker Non-Vote
Increase of Authorized Shares	19,080,142	6,686,443	4,320	—
2006 Stock Incentive Plan	13,410,493	7,917,531	11,839	4,431,042
2006 Annual Incentive Plan	19,356,316	1,971,363	12,184	4,431,042
Ratified the selection of Deloitte & Touche	25,707,381	59,144	4,379	—

Item 6. Exhibits

Exhibit Number	Description	Page or Method of Filing
3.1	Restated Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3 of Form 8-K dated June 20, 2002
3.1.1	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.1 of Form 8-K dated September 15, 2004
3.1.2	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix A of the Company's Definitive 2006 Proxy Statement
3.2	Amended and Restated Bylaws of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.3 of Form S-3 Registration Statement No. 333-58793
10.1	First Amended and Restated Credit Agreement	Incorporated by reference to Exhibit 10.1 of Form 8-K dated May 18, 2006
10.2	Meritage Homes Corporation 2006 Stock Incentive Plan	Incorporated by reference to Exhibit 4.1 of Form S-8 Registration Statement No. 333-134637
10.3	Form of Restricted Stock Agreement	Incorporated by reference to Exhibit 4.2 of Form S-8 Registration Statement No. 333-134637

10.4	Form of Non-Qualified Stock Option Agreement	Incorporated by reference to Exhibit 4.3 of Form S-8 Registration Statement No. 333-134637
10.5	Form of Incentive Stock Option Agreement	Incorporated by reference to Exhibit 4.4 of Form S-8 Registration Statement No. 333-134637
10.6	Form of Stock Appreciation Rights Agreement	Incorporated by reference to Exhibit 4.5 of Form S-8 Registration Statement No. 333-134637
10.7	Stock Purchase Agreement between the Company and John R. Landon	Incorporated by reference to Exhibit 10.1 of Form 8-K dated June 12, 2006
10.8	Settlement Agreement between the Company and John R. Landon	Incorporated by reference to Exhibit 10.2 of Form 8-K dated June 12, 2006
10.9	Cooperation Agreement between the Company and John R. Landon	Incorporated by reference to Exhibit 10.3 of Form 8-K dated June 12, 2006
10.10	First Amendment and Commitment Increase Agreement (re First Amended and Restated Credit Agreement)	Incorporated by reference to Exhibit 10.1 of Form 8-K dated June 30, 2006
31.1	Rule 13a-14(a)/15d-14(a) Certificate of Steven J. Hilton, Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certificate of Larry W. Seay, Chief Financial Officer	Filed herewith
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer	Filed herewith
99.1	Item 1A. Risk Factors contained in Form 10-K for the year ended December 31, 2005	Filed herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized this 8th day of August 2006.

MERITAGE HOMES CORPORATION,
a Maryland Corporation

By /s/ LARRY W. SEAY
Larry W. Seay
Chief Financial Officer and Executive Vice President
(Principal Financial Officer and Duly Authorized Officer)

By /s/ VICKI L. BIGGS
Vicki L. Biggs
Vice President - Corporate Controller
(Principal Accounting Officer)

INDEX OF EXHIBITS

3.1	Restated Articles of Incorporation of Meritage Homes Corporation
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Exhibit 31.1

Rule 13a-14(a)/15d-14(a) CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER

I, Steven J. Hilton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Meritage Homes Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2006

/s/ Steven J. Hilton
Steven J. Hilton
Chief Executive Officer

Exhibit 31.2

Rule 13a-14(a)/15d-14(a) CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Larry W. Seay, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Meritage Homes Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 8, 2006

/s/ Larry W. Seay
Larry W. Seay
Chief Financial Officer

EXHIBIT 32.1

Certification Pursuant to 18 U.S.C. Section 1350,
As adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report on Form 10-Q of Meritage Homes Corporation (the "Company") for the period ending June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we the undersigned certify, to the best of our knowledge, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

MERITAGE HOMES CORPORATION

By: /s/ Steven J. Hilton
Steven J. Hilton
Chairman and Chief Executive Officer

Date: August 8, 2006

By: /s/ Larry W. Seay
Larry W. Seay
Executive Vice President and Chief Financial Officer

Date: August 8, 2006

Item 1A. Risk Factors contained in Form 10-K for the year ended December 31, 2005

Our future operating results and financial condition depend on our ability to successfully design, develop, construct and sell homes that satisfy dynamic customer demand patterns. Inherent in this process are factors that we must successfully manage to achieve favorable future operating results and financial condition. These operating and financial factors, along with many other factors, could affect our business and the price of our common stock and notes. Potential risks and uncertainties that could affect our future operating results and financial condition include the following:

Interest Rates and Mortgage Financing. In general, housing demand is adversely affected by increases in interest rates and the unavailability of mortgage financing. Most of our buyers finance their home purchases through third-party lenders providing mortgage financing. If mortgage interest rates increase and, consequently, the ability of prospective buyers to finance home purchases is adversely affected, home sales, gross margins and cash flow may also be adversely affected and the impact may be material. Long-term interest rates currently remain at low levels; however, rates have increased in the last year from historically low levels and it is impossible to predict future increases or decreases in market interest rates.

Homebuilding activities depend upon the availability and costs of mortgage financing for buyers of homes owned by potential customers, as those customers (move-up buyers) often must sell their residences before they purchase our homes. Mortgage lenders have recently become subject to more intense underwriting standards by the regulatory authorities which oversee them. More stringent underwriting standards could indirectly have a material adverse effect on our business if certain buyers are unable to obtain mortgage financing.

Housing Affordability and Market Conditions. As a participant in the homebuilding industry, we are subject to market forces beyond our control. In general, housing demand is adversely affected by the affordability of housing. In recent periods, the affordability of housing has declined in many of our markets, which could adversely affect the ability of our customers, particularly first-time homebuyers, to afford our product offerings.

In addition, many homebuyers need to sell their existing home in order to purchase a new home from us, and a weakening of the home sale market or a decrease or leveling in home sale prices could adversely affect that ability. Some commentators believe that the prices of homes are inflated and may decline if the demand for homes weakens. A decline in prices for homes could have an adverse effect on our homebuilding business.

Cancellations. Our backlog reflects the number and value of homes for which we have entered into a sales contract with a customer but have not yet delivered the home. Although these sales contracts typically require a cash deposit and do not make the sale contingent on the sale of the customer's existing home, in some cases a customer may cancel the contract and receive a complete or partial refund of the deposit as a result of local laws or as a matter of our business practices. If home prices begin to decline, interest rates increase or there is a national or local economic decline, homebuyers may have an incentive to cancel their contract with us, even where they might be entitled to no refund or only a partial refund. An increase in cancellations could have a material adverse effect on our business.

Future Expansion. We may continue to consider growth or expansion of our operations in our current markets or in other areas of the country. Our expansion into new or existing markets could have a material adverse effect on our cash flows or profitability. The magnitude, timing and nature of any future expansion will depend on a number of factors, including suitable acquisition candidates, the negotiation of acceptable terms, our financial capabilities and general economic and business conditions. New acquisitions may result in the incurrence of additional debt. Acquisitions also involve numerous risks, including difficulties in the assimilation of the acquired company's operations, the incurrence of unanticipated liabilities or expenses, the diversion of management's attention from other business concerns, risks of entering markets in which we have limited or no direct experience and the potential loss of key employees of the acquired company.

Dependence on Subcontractors. We conduct our construction operations only as a general contractor. Virtually all architectural, construction and development work is performed by unaffiliated third-party subcontractors. As a consequence, we depend on the continued availability of and satisfactory performance by these subcontractors for the design and construction of our homes. We cannot assure you that there will be sufficient availability of and satisfactory performance by these unaffiliated third-party subcontractors. In addition, inadequate subcontractor resources could have a material adverse affect on our business.

Operating and Financial Limitations. The indentures for our senior notes and the agreement for our senior unsecured credit facility impose significant operating and financial restrictions on us. These restrictions limit our ability and the ability of our subsidiaries, among other things, to:

- incur additional indebtedness or liens;
- pay dividends or make other distributions;
- repurchase our stock;
- make investments (including investments in joint ventures); or
- consolidate, merge or sell all or substantially all of our assets.

In addition, the indentures for our senior notes and the agreement for our senior unsecured credit facility require us to maintain a minimum consolidated tangible net worth and our credit facility requires us to maintain other specified financial ratios, including the amount and types of land, speculative housing and model homes that we may own at any given time. We cannot assure you that these covenants will not adversely affect our ability to finance our future operations or capital needs or to pursue available business opportunities. A breach of any of these covenants or our inability to maintain the required financial ratios could result in a default in respect of the related indebtedness. If a default occurs, the relevant lenders could elect to declare the indebtedness, together with accrued interest and other fees, to be immediately due and payable.

Increased Investments in Joint Ventures. We participate in numerous land acquisition and development joint ventures with independent third parties, in which we have less than a controlling interest. Our participation in these types of joint ventures has increased over the last couple of years and we expect it to continue to increase in the foreseeable future. These joint ventures provide us with a means of accessing larger parcels and lot positions and help us expand our marketing opportunities and manage our risk profile. However, these joint ventures often acquire parcels of raw land without entitlements and as such are subject to a number of development risks that our business does not face directly. These risks include the risk that anticipated projects could be delayed or terminated because applicable governmental approvals cannot be obtained at reasonable costs, if at all. In addition, the risk of construction and development cost overruns can be greater for a joint venture where it acquires raw land compared to our typical acquisition of entitled lots. These increased development and entitlement risks could have a material adverse effect on our financial position or results of operations if one or more joint venture projects is delayed, cancelled or terminated or we are required, whether contractually or for business reasons, to invest additional funds in the joint venture to facilitate the success of a particular project.

Our joint venture investments are generally very illiquid both because we lack a controlling interest in the ventures and because most of our joint ventures are structured to require super-majority or unanimous approval of the members to sell a substantial portion of the joint venture's assets or for a member to receive a return of its invested capital. Our lack of controlling interest also results in the risk that the joint venture will take actions that we disagree with, or fail to take actions that we desire.

Colonial Homes and Greater Homes Acquisitions. In February and September 2005, we completed the acquisitions of substantially all of the homebuilding operations of Colonial Homes of Ft. Myers/Naples, Florida, and Greater Homes of Orlando, Florida, respectively. The integration of Colonial and Greater Homes into our operations following the acquisitions will involve a number of risks. In particular, the combined companies may experience attrition among management and personnel. The integration process could also disrupt the activities of our current business. The integration of companies requires, among other things, coordination of management,

administrative and other functions. Failure to overcome these challenges or any other problems encountered in connection with the acquisitions of Colonial and Greater Homes could cause our financial condition, results of operations and competitive position to decline. Our integration of the Colonial Homes and Greater Homes acquisitions assumes certain synergies and other benefits. We cannot assure you that unforeseen factors will not offset the intended benefits of the acquisition in whole or in part.

Attached Product and Condominium Offerings. In connection with the acquisition of Colonial, we became involved in the construction and sale of multi-story condominium homes. Prior to this acquisition, our business has typically involved only the construction and sale of single-family homes. The construction and sale of condominium homes involves different construction processes and subcontractors and, to a degree, different customers. In addition, condominium homes typically involve more extensive sales and warranty regulations. Although we now employ most of the Colonial Homes employees that were involved with the Colonial business (including condominium construction and sales), we have little prior experience in the condominium business. In addition, we are expanding into condominium construction and sales in other markets in which we operate and we face similar challenges and risks with such endeavors.

Dependence on Key Personnel. Our success largely depends on the continuing services of certain key employees, including our Co-Chief Executive Officers, John R. Landon and Steven J. Hilton, and our ability to attract and retain qualified personnel. We have employment agreements with Messrs. Landon and Hilton, but we do not have employment agreements with certain other key employees. We believe that Messrs. Landon and Hilton each possess valuable industry knowledge, experience and leadership abilities that would be difficult in the short term to replicate. In addition, Messrs. Landon and Hilton have cultivated key contacts and relationships with important participants in the land acquisition process in our various communities across the country. The loss of the services of key employees could harm our operations and business plans.

Limited Geographic Diversification. We have operations in Texas, Arizona, California, Nevada, Colorado and Florida. Our limited geographic diversification could adversely impact us if the homebuilding business in our current markets should decline, since there may not be a balancing opportunity in a stronger market in other geographic regions.

Increased Insurance Costs. Recently, lawsuits have been filed against builders asserting claims of personal injury and property damage caused by the presence of mold in residential dwellings. Some of these lawsuits have resulted in substantial monetary judgments or settlements. We believe that we have maintained adequate insurance coverage to insure against these types of claims for homes completed before October 1, 2003. Insurance carriers have been excluding from policies of many homebuilders coverage for claims arising from the presence of mold for many builders and, as of October 1, 2003, our insurance policy began excluding mold coverage. If our retentions are not sufficient to protect against these types of claims or if we are unable to obtain adequate insurance coverage, a material adverse effect on our business, financial condition and results of operations could result if we are exposed to claims arising from the presence of mold in the homes that we build.

Natural Disasters. We have significant homebuilding operations in Texas, California and Florida. Some of our markets in Texas and Florida occasionally experience extreme weather conditions such as tornadoes or hurricanes. California has experienced a significant number of earthquakes, wildfires, flooding, landslides and other natural disasters in recent years. We do not insure against some of these risks. These occurrences could damage or destroy some of our homes under construction or our building lots, which may result in losses that exceed our insurance coverage. We could also suffer significant construction delays or substantial fluctuations in the pricing or availability of building materials. Any of these events could cause a decrease in our revenue, cash flows and earnings.

Inflation. We, like other homebuilders, may be adversely affected during periods of high inflation, mainly because of higher land and construction costs. Also, higher mortgage interest rates may significantly affect the affordability of mortgage financing to prospective buyers. Inflation increases our cost of financing, materials and labor and could cause our financial results or growth to decline. We attempt to pass cost increases on to our customers through higher sales prices. Although inflation has not historically had a material adverse effect on our business, recently the cost of some of the materials we use to construct our homes has increased. Sustained increases in material costs would have a material adverse effect on our business if we are unable to increase home sale prices or home sale prices comparably decrease.

Home Warranty Factors. Construction defect and home warranty claims are common in the homebuilding industry and can be costly. While we maintain product liability insurance and generally require our subcontractors and design professionals to indemnify us for liabilities arising from their work, we cannot assure you that these insurance rights and indemnities will be adequate to cover all construction defect and warranty claims for which we may be held liable. For example, we may be responsible for applicable self-insured retentions, which have increased recently, and certain claims may not be covered by insurance or may exceed applicable coverage limits.

Homebuilding Industry Factors. The homebuilding industry is cyclical and is significantly affected by changes in economic and other conditions such as employment levels, availability of financing, interest rates, and consumer confidence. These factors can negatively affect demand for and cost of our homes. We are also subject to various risks, many of which are outside of our control, including delays in construction schedules, cost overruns, changes in governmental regulations (such as no- or slow-growth initiatives), increases in real estate taxes and other local government fees, and raw materials and labor costs.

We are also subject to the potential for significant variability and fluctuations in the cost and availability of real estate. Although historically we have generally developed parcels ranging from 100 to 300 lots, in order to achieve and maintain an adequate inventory of lots, we are beginning to purchase larger parcels, in many cases with a joint venture partner. Write-downs of our real estate could occur if market conditions deteriorate and these write-downs could be material in amount.

Fluctuations in Operating Results. We historically have experienced, and expect to continue to experience, variability in home sales and net earnings on a quarterly basis. As a result of such variability, our historical performance may not be a meaningful indicator of future results. Factors that contribute to this variability include:

- timing of home deliveries and land sales;
- delays in construction schedules due to strikes, adverse weather, acts of God, reduced subcontractor availability and governmental restrictions;
- our ability to acquire additional land or options for additional land on acceptable terms;
- conditions of the real estate market in areas where we operate and of the general economy;
- the cyclical nature of the homebuilding industry, changes in prevailing interest rates and the availability of mortgage financing; and
- costs and availability of materials and labor.

Competition. The homebuilding industry is highly competitive. We compete for sales in each of our markets with national, regional and local developers and homebuilders, existing home resales and, to a lesser extent, condominiums and available rental housing. Some of our competitors have significantly greater financial resources or lower costs than we do. Competition among both small and large residential homebuilders is based on a number of interrelated factors, including location, reputation, amenities, design, quality and price. Competition is expected to continue and become more intense, and there may be new entrants in the markets in which we currently operate and in markets we may enter in the future. If we are unable to successfully compete, our financial results and growth could suffer.

Additional Financing; Limitations. The homebuilding industry is capital intensive and requires significant up-front expenditures to secure land and begin development and construction. Accordingly, we incur substantial indebtedness to finance our homebuilding activities. At December 31, 2005, we had approximately $592.1 million of indebtedness and other borrowings. If we require working capital greater than that provided by operations or available under our credit facility, we may be required to seek additional capital in the form of equity or debt financing from a variety of potential sources, including bank financing and securities offerings. There can be no assurance we would be able to obtain such additional capital on terms acceptable to us, if at all. The level of our indebtedness could have important consequences to our

stockholders, including the following:

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;
- we must use a substantial portion of our cash flow from operations to pay interest and principal on our indebtedness, which reduces the funds available to us for other purposes such as capital expenditures;
- we have a higher level of indebtedness than some of our competitors, which may put us at a competitive disadvantage and reduce our flexibility in planning for, or responding to, changing conditions in our industry, including increased competition; and
- we may be more vulnerable to economic downturns and adverse developments in our business than some of our competitors.

We expect to obtain the money to pay our expenses and to pay the principal and interest on our indebtedness from cash flow from operations. Our ability to meet our expenses thus depends on our future performance, which will be affected by financial, business, economic and other factors. We will not be able to control many of these factors, such as economic conditions in the markets where we operate and pressure from competitors.

We cannot be certain that our cash flow will be sufficient to allow us to pay principal and interest on our debt and meet our other obligations. If we do not have sufficient funds, we may be required to refinance all or part of our existing debt, sell assets or borrow additional funds. We cannot guarantee that we will be able to do so on terms acceptable to us, if at all. In addition, the terms of existing or future debt agreements may restrict us from pursuing any of these alternatives.

Government Regulations; Environmental Conditions. Regulatory requirements could cause us to incur significant liabilities and costs and could restrict our business activities. We are subject to local, state and federal statutes and rules regulating certain developmental matters, as well as building and site design. We are subject to various fees and charges of government authorities designed to defray the cost of providing certain governmental services and improvements. We may be subject to additional costs and delays or may be precluded entirely from building projects because of “no-growth” or “slow-growth” initiatives, building permit ordinances, building moratoriums, or similar government regulations that could be imposed in the future due to health, safety, welfare or environmental concerns. We must also obtain licenses, permits and

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approvals from government agencies to engage in certain activities, the granting or receipt of which are beyond our control and could cause delays in our homebuilding projects.

We are also subject to a variety of local, state and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. Environmental laws or permit restrictions may result in project delays, may cause substantial compliance and other costs and may prohibit or severely restrict development in certain environmentally sensitive regions or geographic areas. Environmental regulations can also have an adverse impact on the availability and price of certain raw materials, such as lumber.

Acts of War. Acts of war or any outbreak or escalation of hostilities between the United States and any foreign power, including the conflict with Iraq, may cause disruption to the economy, our company, our employees and our customers, which could impact our revenue, costs and expenses and financial condition.