AVATAR HOLDINGS INC
Form 10-Q
May 11, 2009

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

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

For the quarterly period ended March 31, 2009

OR

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

Commission File Number 0-7616

AVATAR HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Delaware	**23-1739078**
(State or other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
201 Alhambra Circle, Coral Gables, Florida	**33134**
(Address of Principal Executive Offices)	*(Zip Code)*

Registrant s telephone number, including area code (305) 442-7000

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

8,830,098 shares of Avatar s common stock ($1.00 par value) were outstanding as of April 30, 2009.

AVATAR HOLDINGS INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

AVATAR HOLDINGS INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Unaudited)
(Dollars in thousands)

	March 31, 2009	December 31, 2008
Assets		
Cash and cash equivalents	$ 172,430	$ 175,396
Restricted cash	1,111	1,614
Receivables, net	3,753	3,144
Income tax receivable	21,503	21,503
Land and other inventories	299,980	304,196
Property and equipment, net	52,654	53,485
Poinciana Parkway	15,732	16,043
Investment in and notes receivable from unconsolidated entities	5,808	5,790
Prepaid expenses and other assets	9,639	10,806
Deferred income taxes	2,835	2,835
Total Assets	**$ 585,445**	**$ 594,812**
Liabilities and Stockholders Equity		
Liabilities		
Accounts payable	$ 1,697	$ 1,484
Accrued and other liabilities	9,023	8,677
Amount owed for settlement of 4.50% Note repurchase	6,038	
Customer deposits and deferred revenues	3,694	3,611
Estimated development liability for sold land	20,424	20,468
Notes, mortgage notes and other debt:		
Corporate	68,219	74,950
Real estate	56,086	56,111
Total Liabilities	**165,181**	**165,301**
Commitments and Contingencies		
Stockholders Equity		
Common Stock, par value $1 per share Authorized: 50,000,000 shares Issued: 11,488,259 shares at March 31, 2009 and December 31, 2008	11,488	11,488
Additional paid-in capital	244,396	245,049
Retained earnings	243,317	251,911
	499,201	508,448
	(78,937)	(78,937)

Treasury stock: at cost, 2,658,461 shares at March 31, 2009 and December 31, 2008		
Total Stockholders Equity	420,264	429,511
Total Liabilities and Stockholders Equity	**$ 585,445**	**$ 594,812**

See notes to consolidated financial statements.

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AVATAR HOLDINGS INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the three months ended March 31, 2009 and 2008
(Unaudited)
(Dollars in thousands except per-share amounts)

	Three Months	
	2009	2008
Revenues		
Real estate revenues	$ 13,751	$ 29,395
Interest income	199	1,014
Other	1,397	123
Total revenues	15,347	30,532
Expenses		
Real estate expenses	18,205	26,214
General and administrative expenses	4,667	5,137
Interest expense	1,837	527
Total expenses	24,709	31,878
Equity losses from unconsolidated entities	(62)	(49)
Loss before income taxes	(9,424)	(1,395)
Income tax benefit	830	523
Net loss	$ (8,594)	$ (872)
Basic and Diluted Loss Per Share	$ (0.99)	$ (0.10)

See notes to consolidated financial statements.

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AVATAR HOLDINGS INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
For the three months ended March 31, 2009 and 2008
(Dollars in Thousands)

	2009	2008
OPERATING ACTIVITIES		
Net loss	$ (8,594)	$ (872)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,386	1,627
Amortization of stock-based compensation	475	690
Impairment of land and other inventories	430	
Impairment of the Poinciana Parkway	318	
Gain from repurchase of 4.50% Notes	(1,365)	
Return of earnings from an unconsolidated entity	(57)	(67)
Equity losses from unconsolidated entities	62	49
Deferred income taxes	(830)	(329)
Excess income tax benefit from exercise of stock options and restricted stock units		(20)
Changes in operating assets and liabilities:		
Restricted cash	503	(520)
Receivables, net	(609)	(2,800)
Land and other inventories	3,950	(3,930)
Prepaid expenses and other assets	1,104	935
Accounts payable and accrued and other liabilities	310	(1,622)
Customer deposits and deferred revenues	83	1,076
NET CASH USED IN OPERATING ACTIVITIES	(2,834)	(5,783)
INVESTING ACTIVITIES		
Investment in property and equipment	(77)	(817)
Investment in Poinciana Parkway	(7)	(11,210)
Investment in unconsolidated entities	(23)	(14)
NET CASH USED IN INVESTING ACTIVITIES	(107)	(12,041)
FINANCING ACTIVITIES		
Principal payments of real estate borrowings	(25)	(15,765)
Proceeds from exercise of stock options		250
Excess income tax benefit from exercise of stock options and restricted stock units		20
Payment of withholding taxes related to restricted stock units withheld		(52)
NET CASH USED IN FINANCING ACTIVITIES	(25)	(15,547)
DECREASE IN CASH AND CASH EQUIVALENTS	(2,966)	(33,371)
Cash and cash equivalents at beginning of period	175,396	192,258
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 172,430	$ 158,887

See notes to consolidated financial statements.

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AVATAR HOLDINGS INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
March 31, 2009
(Dollars in thousands except share and per share data)

Basis of Financial Statement Presentation and Summary of Significant Accounting Policies

The accompanying consolidated financial statements include the accounts of Avatar Holdings Inc. and all subsidiaries, partnerships and other entities in which Avatar Holdings Inc. (Avatar , we , us or our) has a controlling interest. Our investments in unconsolidated joint ventures in which we have less than a controlling interest are accounted for using the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated balance sheets as of March 31, 2009 and December 31, 2008, and the related consolidated statements of operations for the three months ended March 31, 2009 and 2008 and the consolidated statements of cash flows for the three months ended March 31, 2009 and 2008 have been prepared in accordance with United States generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statement presentation. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. Interim results are not necessarily indicative of results for a full year.

The preparation of the consolidated financial statements in accordance with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates. Due to Avatar s normal operating cycle being in excess of one year, we present unclassified balance sheets.

The consolidated balance sheet as of December 31, 2008 was derived from audited consolidated financial statements included in our 2008 Annual Report on Form 10-K as adjusted for the retrospective application of FSP No. 14-1 discussed below, but does not include all disclosures required by United States generally accepted accounting principles. These consolidated financial statements should be read in conjunction with our December 31, 2008 audited consolidated financial statements included in our 2008 Annual Report on Form 10-K and the notes to the consolidated financial statements included therein.

Reclassifications

Certain 2008 financial statement items have been reclassified to conform to the 2009 presentation.

Adoption of New Accounting Pronouncement

In May 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. APB No. 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP No. 14-1). FSP No. 14-1 applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement of the conversion option. FSP No. 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer s nonconvertible debt borrowing rate. FSP No. 14-1 requires bifurcation of the instrument into a debt component that is initially recorded at fair value and an equity component. The difference between the fair value of the debt component and the initial proceeds from issuance of the instrument is recorded as a component of equity. In addition, transaction costs incurred directly related to the issuance of convertible debt instruments are allocated to the liability and equity components in proportion to the allocation of proceeds and accounted for as debt issuance costs and equity issuance costs, respectively. The excess

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Adoption of New Accounting Pronouncement continued

of the principal amount of the liability component over its carrying amount and the debt issuance costs are amortized to interest cost using the interest method over the expected life of a similar liability that does not have an associated equity component. The equity component is not subsequently re-valued as long as it continues to qualify for equity treatment. FSP No. 14-1 must be applied retrospectively to previously issued convertible instruments that may be settled in cash, as well as prospectively to newly issued instruments. FSP No. 14-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. This FSP was effective January 1, 2009 for us.

On March 30, 2004, we issued $120,000 aggregate principal amount of 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes). Each $1 in principal amount of the 4.50% Notes is convertible, at the option of the holder, at a conversion price of $52.63, or 19.0006 shares of our common stock. In lieu of delivery of shares of our common stock upon conversion, we have the right to deliver cash or common stock or a combination thereof, at our option. The 4.50% Notes are subject to the provisions of FSP No. 14-1.

On January 1, 2009, we adopted FSP No. 14-1. Upon adoption, we determined that the fair value of the debt component of the 4.50% Notes at the time of issuance in 2004 was $101,400. The fair value of the debt component was calculated using a market interest rate of 7.5% for similar debt without a conversion option and a maturity date of April 1, 2011 which is the first date that holders of the 4.50% Notes can require us to repurchase the 4.50% Notes. The difference between the $120,000 principal amount of the 4.50% Notes and the fair value amount of $101,400 is the discount amount of $18,600. This discount is treated as a reduction in the carrying amount of the 4.50% Notes and a corresponding increase in Additional Paid-In Capital. The discount as well as the related debt issuance costs (which are classified as Prepaid Expenses) are amortized from the issuance date in 2004 through April 1, 2011. These adjustments resulted in the retrospective modification of the December 31, 2008 balance sheet line items Prepaid Expenses and Notes, Mortgage Notes and Other Debt (Corporate). The amortization of the discount and debt issuance costs pursuant to FSP No. 14-1 resulted in the increase in interest expense incurred, causing an increase in the carrying values of Land and Other Inventories and the Poinciana Parkway due to additional capitalized interest expense in accordance with SFAS No. 34, *Capitalization of Interest Cost* . Furthermore, for all periods presented the statement of operations was restated to reflect an increase in Real Estate Expenses due to additional capitalized interest from the adoption of FSP No. 14-1 which is expensed as cost of sales as well as additional interest expense that was not eligible for capitalization. (See further discussion of the 4.50% Notes under the caption Notes, Mortgage Notes and Other Debt.)

Upon retrospective application, the adoption of FSP No. 14-1 resulted in a decrease of $5,888 in retained earnings at December 31, 2008, comprised of non-cash interest expense of $5,189 for the years 2004-2008 and reductions in cumulative non-cash gains of $699 related to repurchases and the partial conversion of the 4.50% Notes during 2007 and 2008. The following table presents the December 31, 2008 balance sheet line items affected, as adjusted and as originally reported:

	As Originally Reported	As Adjusted	Effect of Change
Land and other inventories	$ 299,621	$304,196	$ 4,575
Poinciana Parkway	$ 15,310	$ 16,043	$ 733
Prepaid expenses and other assets	$ 12,162	$ 10,806	$ (1,356)
Notes, mortgage notes and other debt (Corporate)	$ 78,880	$ 74,950	$ (3,930)
Additional paid-in capital	$ 231,279	$245,049	$13,770
Retained earnings	$ 257,799	$251,911	$ (5,888)

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Adoption of New Accounting Pronouncement continued

The following table presents the three months ended March 31, 2008 statement of operations line items affected, as adjusted and as originally reported:

	Three Months		
	As Originally Reported	As Adjusted	Effect of Change
Real estate expenses	$25,870	$26,214	$ 344
Interest expense	$ 357	$ 527	$ 170
Loss before income taxes	$ (881)	$ (1,395)	$ (514)
Income tax benefit	$ 325	$ 523	$ 198
Net loss	$ (556)	$ (872)	$ (316)
Basic and diluted loss per share	$ (0.07)	$ (0.10)	$ (0.03)

Land and Other Inventories:

Land and Other Inventories are stated at cost unless the asset is determined to be impaired, in which case the asset would be written down to its fair value. Land and Other Inventories include expenditures for land acquisition, construction, land development and direct and allocated costs. Land and Other Inventories owned and constructed by us also include interest cost capitalized until development and construction is substantially completed. Land and development costs, construction and direct and allocated costs are assigned to components of Land and Other Inventories based on specific identification or other allocation methods based upon United States generally accepted accounting principles.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144), we carry Land and Other Inventories at the lower of the carrying amount or fair value. Each reporting period, we review our Land and Other Inventories for indicators of impairment.

For assets held and used, if indicators are present, we perform an impairment test in which the asset is reviewed for impairment by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset s carrying value, the carrying value is written down to its estimated fair value. Generally, fair value is determined by discounting the estimated cash flows at a rate commensurate with the inherent risks associated with the asset and related estimated cash flow streams. Assumptions and estimates used in the determination of the estimated future cash flows are based on expectations of future operations and economic conditions and certain factors described below. Changes to these assumptions could significantly affect the estimates of future cash flows which could affect the potential for future impairments. Due to the uncertainties of the estimation process, actual results could differ significantly from such estimates.

For assets held for sale (such as completed speculative housing inventory), if indicators are present, we perform an impairment test in which the asset is reviewed for impairment by comparing the fair value (estimated sales prices) less cost to sell the asset to its carrying value. If such fair value less cost to sell is less than the asset s carrying value, the carrying value is written down to its estimated fair value less cost to sell.

Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) — continued

Land and Other Inventories — continued

We evaluate our Land and Other Inventories for impairment on a quarterly basis. During the first quarter of 2009, our impairment assessment resulted in impairment charges of $430 for housing communities relating to homes completed or under construction. Our evaluation of land developed and/or held for future development or sale did not result in impairment charges during the first quarter of 2009. As of March 31, 2009, other than the Land and Other Inventories that we determined to be impaired, we had no long-lived assets that had undiscounted cash flows within 25% of their carrying values.

The impairment charges during the fourth quarter of 2008 and first quarter of 2009 reflect the housing market conditions, including a significant oversupply of homes available for sale, tight credit standards, high foreclosure activity and significant competition. We have experienced difficulty in selling homes at a profit causing us to reduce prices to achieve desired sales levels. Contribution margins are defined as house sales prices less direct production costs including closing costs and commissions. During the fourth quarter of 2008 and first quarter of 2009, most of our sales contracts have been signed at selling prices that have resulted or will result in losses upon closing when factoring in operating costs such as sales and marketing and divisional overhead. During the first quarter of 2009, we recorded impairment charges of $430 for housing communities relating to homes completed or under construction. The following significant trends were utilized in the evaluation of our land and other inventories for impairment:

- The average price on sales closed from primary residential homebuilding operations has decreased approximately 34% from $323 in 2006 to $213 during the first quarter of 2009. Our average sales price on sales contracts entered into during the first quarter of 2009 declined to approximately $178 as compared to $250 during the fourth quarter of 2008. Additionally, the average contribution margin on closings from primary residential homebuilding operations has declined from approximately 34% in 2006 to approximately 8% during the first quarter of 2009.

- The average price on sales closed from active adult homebuilding operations has decreased approximately 14% from $298 in 2006 to $256 during the first quarter of 2009. Our average sales price on sales contracts entered into during the first quarter of 2009 declined to approximately $188 as compared to $210 during the fourth quarter of 2008. Additionally, the average contribution margin on closings from active adult homebuilding operations has declined from approximately 33% in 2006 to approximately 19% during the first quarter of 2009.

Land and Other Inventories that are subject to a review for indicators of impairment include our: (i) housing communities (primary residential, including scattered lots, and active adult) and (ii) land developed and/or held for future development or sale. A discussion of the factors that impact our impairment assessment for these categories follows:

Housing communities: Activities include the development of active adult and primary residential communities and the operation of amenities. The operating results and losses generated from active adult and primary residential communities during the three months ended March 31, 2009 and 2008 include operating expenses relating to the operation of our amenity operations in our communities as well as divisional overhead not associated with specific communities.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Land and Other Inventories continued

Our active adult and primary residential communities are generally large master-planned communities in central Florida and in southeast Arizona. Many of these communities are long term projects on land we have owned for many years. In reviewing each of our communities, we determine if potential impairment indicators exist by reviewing actual contribution margins on homes closed in recent months, projected contribution margins on homes in backlog, projected contribution margins on speculative homes, average selling prices, sales activities and local market conditions. If indicators are present, the asset is reviewed for impairment. In determining estimated future cash flows for purposes of the impairment test, the estimated future cash flows are significantly impacted by specific community factors such as: (i) sales absorption rates; (ii) estimated sales prices and sales incentives; and (iii) estimated cost of home construction, estimated land development costs, interest costs, indirect construction and overhead costs, and selling and marketing costs. In addition, our estimated future cash flows are also impacted by general economic and local market conditions, competition from other homebuilders, foreclosures and depressed home sales in the areas in which we build and sell homes, product desirability in our local markets and the buyers ability to obtain mortgage financing. Build-out of our active adult and primary residential communities on average is in excess of ten and five years, respectively. Our current assumptions are based on current activity and recent trends at our active adult and primary residential communities. There are a significant number of assumptions with respect to each analysis. Many of these assumptions extend over a significant number of years. The substantial number of variables to these assumptions could significantly affect the potential for future impairments.

Declines in contribution margins below those realized from our current sales prices and estimations could result in future impairment losses in one or more of our housing communities.

Land developed and/or held for future development or sale: Our land developed and/or held for future development or sale represents land holdings for the potential development of future active adult and/or primary residential communities. We anticipate these future communities will be large master-planned communities similar to our current active adult and/or primary residential communities including scattered lots. For land developed and/or held for future development or sale, indicators of potential impairment include changes in use, changes in local market conditions, declines in the selling prices of similar assets and increases in costs. If indicators are present, the asset is reviewed for impairment. In determining estimated future cash flows for purposes of the impairment test, the estimated future cash flows are significantly impacted by specific community factors such as: (i) sales absorption rates; (ii) estimated sales prices and sales incentives; and (iii) estimated costs of home construction, estimated land and land development costs, interest costs, indirect construction and overhead costs, and selling and marketing costs. In addition, our estimated future cash flows are also impacted by general economic and local market conditions, competition from other homebuilders, foreclosures and depressed home sales in the areas where we own land for future development, product desirability in our local markets and the buyers ability to obtain mortgage financing. Factors that we consider in determining the appropriateness of moving forward with land development or whether to write-off the related amounts capitalized include: our current inventory levels, local market economic conditions, availability of adequate resources and the estimated future net cash flows to be generated from the project. Build-out of our land held for future development on average is in excess of five years. There are a significant number of assumptions with respect to each analysis. Many of these assumptions extend over a significant number of years. The substantial number of variables to these assumptions could significantly affect the potential for future impairments.

Declines in market values below those realized from our current sales prices and estimations could result in future impairment.

Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Land and Other Inventories continued

Land and other inventories consist of the following:

	March 31, 2009	December 31, 2008
Land developed and in process of development	$153,677	$ 153,623
Land held for future development or sale	96,054	96,054
Homes completed or under construction	49,624	53,817
Other	625	702
	$299,980	$ 304,196

During the three months ended March 31, 2009, pre-tax profits from sales of commercial, industrial and other land were $1,778 on revenues of $1,825. For the three months ended March 31, 2009, pre-tax profits from commercial and industrial land were $1,758 on aggregate revenues of $1,785. For the three months ended March 31, 2009, pre-tax profits from other land sales were $20 on aggregate revenues of $40.

During the three months ended March 31, 2008, we realized pre-tax profits of $7,070 on revenues of $7,428 from commercial, industrial and other land sales. For the three months ended March 31, 2008, pre-tax profits from commercial and industrial land were $1,182 on aggregate revenues of $1,428. On March 31, 2008, we closed on the sale of the stock of one of our wholly-owned subsidiaries, the sole asset of which was land leased to a third party that generated revenues to Avatar of approximately $600 per annum. Since this is substantially a sale of real estate, this sale is classified for financial statement purposes as a sale of other land resulting in pre-tax profits of $5,888 on aggregate revenues of $6,000.

See Financial Information Relating to Reportable Segments below.

Property and Equipment

Property and Equipment are stated at cost and depreciation is computed by the straight-line method over the following estimated useful lives of the assets: land improvements 10 to 25 years; buildings and improvements 8 to 39 years; and machinery, equipment and fixtures 3 to 7 years. Maintenance and operating expenses of equipment utilized in the development of land are capitalized as land inventory cost. Repairs and maintenance are expensed as incurred.

Property and Equipment includes the cost of amenities owned by us. Property and Equipment placed in service is depreciated by the straight-line method over the useful lives of the assets when these assets are placed in service. The cost of amenities includes expenditures for land acquisition, construction, land development and direct and allocated costs. Property and Equipment owned and constructed by us also include interest cost incurred during development and construction.

Each reporting period, we review our Property and Equipment for indicators of impairment in accordance with SFAS No. 144. For our amenities, which are located within our housing communities, indicators of potential impairment are similar to those of our housing communities (described above) as these factors may impact our ability to generate revenues at our amenities or cause the cost to construct to increase. In addition, we factor in the collectibility and potential delinquency of the fees due for our amenities. As of March 31, 2009 and December 31, 2008, no impairments existed for Property and Equipment.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Poinciana Parkway

In December 2006, we entered into agreements with Osceola County, Florida and Polk County, Florida for us to develop and construct at our cost a 9.66 mile four-lane road in Osceola and Polk Counties, to be known as the Poinciana Parkway (the Poinciana Parkway). The Poinciana Parkway is to include a 4.15 mile segment to be operated as a private toll road. Except for the toll road, the Poinciana Parkway will be owned, maintained and operated by the Counties upon completion. We have acquired right-of-way and federal and state environmental permits necessary to construct the Poinciana Parkway. In July 2008 and August 2008, we entered into amended and restated agreements with Osceola County and Polk County, pursuant to which construction is to be commenced by February 14, 2011. Construction was to be completed by December 31, 2011 subject to extension for Force Majeure. We have notified the Counties that the completion date has been extended to August 31, 2012 due to Force Majeure related to the economic downturn. We advised the Counties that the current economic downturn has resulted in our inability to: (i) conclude negotiations with potential investors; or (ii) obtain financing for the construction of the Poinciana Parkway.

In January 2009, Osceola County listed the Poinciana Parkway as a County project on its Osceola County Transportation Improvement Projects list in order to apply for federal funds to build the road. Osceola County and Avatar are discussing how to restructure our agreements regarding the Poinciana Parkway so that (i) the County can take over the ownership, development and construction of the Poinciana Parkway and (ii) Avatar can recover some or all of its investment in the road from toll revenue. Any such agreements reached will not be effective unless sufficient federal funds become available to construct the Poinciana Parkway.

Our estimate of the right-of-way acquisition, development and construction costs for the Poinciana Parkway approximates $175,000 to $200,000. However, no assurance of the ultimate costs can be given at this stage. As of March 31, 2009, approximately $46,600 has been expended. During fiscal year 2008 we recorded impairment charges of $30,228 associated with the Poinciana Parkway.

For the Poinciana Parkway, indicators of impairment are general economic conditions, rate of population growth and estimated change in traffic levels. If indicators are present, we perform an impairment test in which the asset is reviewed for impairment by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset s carrying value, the carrying value is written down to its estimated fair value. In determining estimated future cash flows for purposes of the impairment test, we incorporate current market assumptions based on general economic conditions such as anticipated estimated revenues and estimated costs. These assumptions can significantly affect our estimates of future cash flows.

We reviewed the recoverability of the carrying value of the Poinciana Parkway as of March 31, 2009 in accordance with SFAS No. 144. Based on our review, we determined the estimated future undiscounted cash flows of the Poinciana Parkway were less than its carrying value. Therefore, we have reduced the carrying value of the Poinciana Parkway as of March 31, 2009 to the estimated fair value of $15,732 and recognized an impairment loss of $318 for the three months ended March 31, 2009 which is due to the cumulative additional capitalized interest allocated to the Poinciana Parkway upon adoption of FSP No. 14-1. In addition, non-capitalizable expenditures of $341 related to the Poinciana Parkway were expensed during the three months ended March 31, 2009.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Notes, Mortgage Notes and Other Debt

On March 30, 2004, we issued $120,000 aggregate principal amount of 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes) in a private offering. Interest is payable semiannually on April 1 and October 1. The 4.50% Notes are senior, unsecured obligations and rank equal in right of payment to all of our existing and future unsecured and senior indebtedness. However, the 4.50% Notes are effectively subordinated to all of our existing and future secured debt to the extent of the collateral securing such indebtedness, and to all existing and future liabilities of our subsidiaries.

Each $1 in principal amount of the 4.50% Notes is convertible, at the option of the holder, at a conversion price of $52.63, or 19.0006 shares of our common stock, upon the satisfaction of one of the following conditions: a) during any calendar quarter (but only during such calendar quarter) commencing after June 30, 2004 if the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is more than 120% of the conversion price per share of common stock on such last day; or b) during the five business day period after any five-consecutive-trading-day period in which the trading price per $1 principal amount of the 4.50% Notes for each day of that period was less than 98% of the product of the closing sale price for our common stock for each day of that period and the number of shares of common stock issuable upon conversion of $1 principal amount of the 4.50% Notes, provided that if on the date of any such conversion that is on or after April 1, 2019, the closing sale price of Avatar s common stock is greater than the conversion price, then holders will receive, in lieu of common stock based on the conversion price, cash or common stock or a combination thereof, at our option, with a value equal to the principal amount of the 4.50% Notes plus accrued and unpaid interest, as of the conversion date. The closing price of Avatar s common stock exceeded 120% ($63.156) of the conversion price for 20 trading days out of 30 consecutive trading days as of the last trading day of the fourth quarter of 2006, as of the last trading day of the first quarter of 2007 and as of the last trading day of the second quarter of 2007. Therefore, the 4.50% Notes became convertible for the quarter beginning January 1, 2007, for the quarter beginning April 1, 2007 and for the quarter beginning July 1, 2007. During 2008, the closing price of Avatar s common stock did not exceed 120% ($63.156) of the conversion price for 20 trading days out of 30 consecutive trading days; therefore, the 4.50% Notes were not convertible during 2008 and for the quarter beginning January 1, 2009. During 2007, $200 principal amount of the 4.50% Notes were converted into 3,800 shares of Avatar common stock. During 2007, Avatar repurchased $5,000 principal amount of the 4.50% Notes. During 2008, we repurchased $35,920 principal amount of the 4.50% Notes for approximately $28,112 including accrued interest. On March 30, 2009, we repurchased $7,500 principal amount of the 4.50% Notes for approximately $6,038 including accrued interest. The settlement of this transaction occurred on April 2, 2009. This repurchase resulted during the first quarter of 2009 in a pre-tax gain of approximately $1,365 (which is included in Other Revenues in the consolidated statements of operations for the three months ended March 31, 2009) including the write-off of approximately $63 of deferred finance costs. Following this repurchase, $71,380 principal amount of the 4.50% Notes remain outstanding.

We may, at our option, redeem for cash all or a portion of the 4.50% Notes at any time on or after April 5, 2011. Holders may require us to repurchase the 4.50% Notes for cash on April 1, 2011, April 1, 2014 and April 1, 2019; or in certain circumstances involving a designated event, as defined in the indenture for the 4.50% Notes, holders may require us to purchase all or a portion of their 4.50% Notes. In each case, we will pay a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, if any.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Notes, Mortgage Notes and Other Debt continued

On January 1, 2009, we adopted FSP No. 14-1. As of March 31, 2009 and December 31, 2008, the 4.50% Notes and the equity component associated with FSP No. 14-1 was comprised of the following:

	March 31, 2009	December 31, 2008
4.50% Notes		
Principal amount	$ 71,380	$ 78,880
Unamortized discount	(3,161)	(3,930)
Net carrying amount	$ 68,219	$ 74,950
Equity Component, net of income tax benefit	$ 13,472	$ 13,770

The discount on the liability component of the 4.50% Notes is amortized using the effective interest method based on an effective rate of 7.5%, which is the market interest rate for similar debt without a conversion option on the issuance date. The discount is amortized from the issuance date in 2004 through April 1, 2011, the first date that holders of the 4.50% Notes can require us to repurchase the 4.50% Notes. As of March 31, 2009, the remaining expected life over which the unamortized discount will be recognized is two years. We recognized $485 and $514 in non-cash interest charges related to the amortization of the discount during the three months ended March 31, 2009 and 2008, respectively.

On March 27, 2008, we entered into an Amended and Restated Credit Agreement, by and among our wholly-owned subsidiary, Avatar Properties Inc., as borrower, Wachovia Bank, National Association (as a lender and as administrative agent on behalf of the lenders), and certain financial institutions as lenders (the Amended Unsecured Credit Facility). This agreement amended and restated the Credit Agreement, dated as of September 20, 2005, as amended. The amendment was made in anticipation of not meeting certain covenants and/or conditions in the Credit Agreement.

The principal changes effected by the Amended Unsecured Credit Facility included:

- a reduction in the amount of the facility from $125,000 to $100,000 (the facility is expandable up to $150,000, subject to certain conditions and lender approval);

- an approval for us to obtain financing for the Poinciana Parkway of up to $140,000, subject to certain conditions;

- modifications to certain covenants including: (i) reducing the minimum adjusted EBITDA/Debt Service ratio (as defined) from 2.75 to 2.0, and providing for an alternative requirement of maintaining a maximum leverage ratio and minimum liquidity level if the minimum adjusted EBITDA/Debt Service ratio cannot be maintained; (ii) reducing the Leverage Ratio (as defined) from 2.0 to 1.75, and allowing us to net unrestricted cash in excess of $35,000 against outstanding debt in determining total liabilities; and (iii) amending our covenant regarding speculative homes and models whereby if we maintain a Leverage Ratio (as defined) of 1.0 or less, we have no financial covenant as to the number of speculative homes and models we can maintain; however, if our Leverage Ratio exceeds 1.0, the number of speculative homes and models cannot exceed 35% of unit closings for the trailing twelve month period; and

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Notes, Mortgage Notes and Other Debt continued

an increased pricing of the facility as follows: (i) the LIBOR Margin is increased from a range of 1.75% to 2.25% to a range of 2.0% to 2.75%, and depending on our EBITDA/Debt Service ratio, our rate on outstanding borrowings could be increased up to an additional 50 basis points; (ii) our fee for outstanding letters of credit increased from 1% to 50 basis points below our LIBOR Margin; and (iii) our unused fee changed from 25 basis points to a range of 25 basis points to 50 basis points, depending on our usage.

In accordance with EITF 98-14: *Debtor s Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements,* the reduction in the amount of the borrowing capacity from $125,000 to $100,000 required us to write-off approximately $85 of deferred finance costs during the first quarter of 2008. In connection with the Amended Unsecured Credit Facility, we incurred and capitalized fees of $655. This fee along with unamortized deferred finance costs will be amortized through the maturity date of September 20, 2010.

The Amended Unsecured Credit Facility includes a $50,000 sublimit for the issuance of standby letters of credit. The maturity date of the Amended Unsecured Credit Facility remained unchanged, as September 20, 2010. As of March 31, 2009, we had borrowings of approximately $55,975 outstanding under the Amended Unsecured Credit Facility and had letters of credit totaling $22,938 of which $21,456 were financial/maintenance letters of credit and $1,482 was a performance letter of credit. Under the Amended Unsecured Credit Facility, performance letters of credit do not count against our availability for borrowing. The maturity date of the Amended Unsecured Credit Facility is September 20, 2010.

On November 7, 2008, Franklin Bank SSB, one of the participating financial institutions in the Amended Unsecured Credit Facility, was closed by the Texas Department of Savings and Mortgage Lending and the Federal Deposit Insurance Corporation (FDIC) was named receiver. Franklin Bank is a 20% participant in the Amended Unsecured Credit Facility. During December 2008, we requested funding from Franklin Bank which we did not receive. Therefore, it is our assumption that Franklin Bank will no longer participate in our Amended Unsecured Credit Facility, and our availability is approximately $2,568 as of March 31, 2009. Our borrowing rate under the Amended Unsecured Credit Facility was 3.0% as of March 31, 2009.

Also on March 27, 2008, in connection with the Amended Unsecured Credit Facility, Avatar Holdings Inc., as guarantor, entered into a Second Restated Guaranty Agreement with Wachovia Bank, National Association (as administrative agent and lender), in favor of certain financial institutions as lenders (Second Restated Guaranty Agreement). This agreement amended and restated the Restated Guaranty Agreement, dated as of October 21, 2005. Payments of all amounts due under the Amended Unsecured Credit Facility are guaranteed by Avatar Holdings Inc. pursuant to the Restated Guaranty Agreement dated as of October 21, 2005.

Under the terms of the Amended Unsecured Credit Facility, we are required, among other things, to maintain a Minimum Tangible Net Worth (as defined) and certain financial c