Comstock Homebuilding Companies, Inc.
Form 10-Q
August 14, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2009

¨ **Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from ________ to ________

Commission File Number 1-32375

Comstock Homebuilding Companies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-1164345**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

11465 Sunset Hills Road

5^{th} Floor

Reston, Virginia 20190

(703) 883-1700

(Address including zip code, and telephone number,

including area code, of principal executive offices)

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 x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ¨ NO ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

As of August 14, 2009, 15,211,499 shares of the Class A common stock, par value $.01 per share, and 2,733,500 shares of Class B common stock, par value $0.01, of the Registrant were outstanding.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

FORM 10-Q

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)

	June 30, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 1,043	$ 5,977
Restricted cash	3,878	3,859
Real estate held for development and sale	98,409	129,542
Inventory not owned - variable interest entities		19,250
Property, plant and equipment, net	457	830
Other assets	1,542	1,402
TOTAL ASSETS	$ 105,329	$ 160,860
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable and accrued liabilities	$ 9,501	$ 8,232
Obligations related to inventory not owned		19,050
Notes payable - secured by real estate	77,151	90,086
Notes payable - unsecured	18,252	12,743
TOTAL LIABILITIES	104,904	130,111
Commitments and contingencies (Note 9)		
SHAREHOLDERS EQUITY		
Class A common stock, $0.01 par value, 77,266,500 shares authorized, 15,608,438 and 15,608,438 issued and outstanding, respectively	156	156
Class B common stock, $0.01 par value, 2,733,500 shares authorized, 2,733,500 issued and outstanding	27	27
Additional paid-in capital	157,121	157,058
Treasury stock, at cost (391,400 Class A common stock)	(2,439)	(2,439)
Accumulated deficit	(154,663)	(124,277)
TOTAL COMSTOCK HOMEBUILDING COMPANIES, INC SHAREHOLDERS EQUITY	202	30,525
Noncontrolling interest	223	223
TOTAL EQUITY	425	30,749
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 105,329	$ 160,860

The accompanying notes are an integral part of these consolidated financial statements.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenues				
Revenue - homebuilding	$ 2,136	$ 11,435	$ 6,862	$ 27,375
Revenue - other	829	568	1,626	1,004
Total revenue	2,965	12,003	8,488	28,379
Expenses				
Cost of sales - homebuilding	1,935	10,260	6,080	24,200
Cost of sales - other	541	293	950	713
Impairments and write-offs	22,938	13,746	22,938	14,577
Selling, general and administrative	2,188	4,079	4,354	7,473
Interest, real estate taxes and indirect costs related to inactive projects	1,554	657	3,354	1,416
Operating loss	(26,191)	(17,032)	(29,188)	(20,001)
Gain on troubled debt restructuring				(8,325)
Other (income) loss, net	1,552	(413)	1,199	(1,598)
Total pre tax loss	(27,743)	(16,619)	(30,387)	(10,078)
Income taxes expense			1	
Net (loss) income	(27,743)	(16,619)	(30,388)	(10,078)
Net (loss) income attributable to noncontrolling interest		(1)		(3)
Net (loss) income attributable to Comstock Homebuilding Companies, Inc	$ (27,743)	$ (16,618)	$ (30,388)	$ (10,075)
Basic loss per share	$ (1.58)	$ (1.00)	$ (1.73)	$ (0.61)
Basic weighted average shares outstanding	17,554	16,541	17,554	16,502
Diluted loss per share	$ (1.58)	$ (1.00)	$ (1.73)	$ (0.61)
Diluted weighted average shares outstanding	17,554	16,541	17,554	16,502

The accompanying notes are an integral part of these consolidated financial statements.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands, except per share data)

	Six Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net loss	$ (30,388)	$ (10,078)
Adjustment to reconcile net loss to net cash provided by operating activities		
Amortization and depreciation	373	355
Impairments and write-offs	22,938	14,577
Gain on troubled debt restructuring		(8,325)
Gain on trade payable settlements	(333)	
Board of directors compensation		100
Amortization of stock compensation	64	49
Changes in operating assets and liabilities:		
Restricted cash	(19)	585
Receivables		252
Due from related parties		1
Real estate held for development and sale	4,881	3,062
Other assets	60	19,241
Accounts payable and accrued liabilities	3,268	(11,439)
Net cash provided by operating activities	844	8,379
Cash flows from financing activities:		
Proceeds from notes payable	310	23,617
Payments on notes payable	(6,088)	(28,887)
Proceeds from shares issued under employee stock purchase plan		8
Net cash used in financing activities	(5,778)	(5,262)
Net (decrease) increase in cash and cash equivalents	(4,934)	3,117
Cash and cash equivalents, beginning of period	5,977	6,822
Cash and cash equivalents, end of period	$ 1,043	$ 9,939
Supplemental disclosure for non-cash activity:		
Interest incurred but not paid in cash	$ 1,667	$ 290
Warrants issued in connection with troubled debt restructuring	$	$ 720
Reduction in real estate held for development and sale in connection with foreclosure of Mathis Gates properties	$ 3,314	$
Reduction of notes payable in connection with foreclosure of Mathis Gates properties	$ 3,314	$
Deconsolidation of variable interest inventory and related debt	$ 19,050	$

The accompanying notes are an integral part of these consolidated financial statements.

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

1. ORGANIZATION AND BASIS OF PRESENTATION

Comstock Companies, Inc. (the Company) was incorporated on May 24, 2004 as a Delaware corporation. On June 30, 2004, the Company changed its name to Comstock Homebuilding Companies, Inc.

On December 17, 2004, as a result of completing its initial public offering (IPO) of its Class A common stock, the Company acquired 100% of the outstanding capital stock of Comstock Holding Company, Inc. and subsidiaries (Comstock Holdings) by merger, which followed a consolidation that took place immediately prior to the closing of the IPO (the Consolidation). The Consolidation was effected through the mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries and Comstock Service Corp., Inc. and subsidiaries (Comstock Service) with and into Comstock Holdings. Pursuant to the terms of the merger agreement, shares of Comstock Holdings were canceled and replaced by 4,333 and 2,734 shares Class A and B common stock of the Company, respectively. Both Class A and B common stock shares bear the same economic rights. However, for voting purposes, Class A stock holders are entitled to one vote for each share held while Class B stock holders are entitled to fifteen votes for each share held.

The mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries with and into Comstock Holdings (collectively the Comstock Companies or Predecessor) and the Company s acquisition of Comstock Holdings was accounted for using the Comstock Companies historical carrying values of accounting as these mergers were not deemed to be substantive exchanges. The merger of Comstock Service was accounted for using the purchase method of accounting as this was deemed to be a substantive exchange due to the disparity in ownership.

The Company s Class A common stock is traded on the NASDAQ Global market (NASDAQ) under the symbol CHCI and has no public trading history prior to December 17, 2004. In January 2008 the Company was notified by NASDAQ that it was not in compliance with requirements related to its listing on the NASDAQ Global Market. The Company was granted 180 days to regain compliance. On July 9, 2008 the Company was notified that it had not regained compliance and was going to be delisted from the NASDAQ Global Market. The Company requested a hearing on September 4, 2008 to appeal this decision and seek an additional extension. On October 24, 2008 the Company received a notice from NASDAQ indicating that the NASDAQ Listing Qualifications Panel had granted the Company s request for continued listing. The notice from NASDAQ indicated that continued listing was subject to: 1) the Company evidencing a closing bid price of $1.00 or more for a minimum of ten consecutive trading days on or before April 9, 2009, and 2) the Company evidencing a minimum market value of publicly held shares of $5,000 on or before May 10, 2009. In January 2009 and again in March 2009 NASDAQ suspended compliance obligations with respect to these rules. Our deadlines for compliance are now estimated to be August 24, 2009 for the market value of publicly held shares requirement and October 28, 2009 for the bid price requirement.

The Company develops, builds and markets single-family homes, townhouses and condominiums in the Washington D.C., Raleigh, North Carolina and Atlanta, Georgia metropolitan markets. The Company also provides certain management and administrative support services to certain related parties.

The homebuilding industry is cyclical and significantly affected by changes in national and local economic, business and other conditions. During 2006, new home sales in our markets began to slow and that trend has continued to worsen. In response to these conditions, the Company has significantly reduced selling, general and administrative expenses in an effort to align its cost structure with the current level of sales activity, slowed land acquisition, halted land development and construction activities (except where required for near term sales). The Company has also offered for sale various developed lots and land parcels that the Company believes are not needed based on carrying costs and anticipated absorption rates. Additional reductions may be required as the downturn is expected to continue throughout 2009.

Liquidity Developments

During 2008 and continuing into 2009 the banking and credit markets experienced severe disruption as a result of a collapse in the sub-prime and securitized debt markets. As a result, commercial banks and other unregulated lenders have experienced a liquidity crisis which has made funding for real estate investment extremely difficult to secure. This tightening of the credit markets presents substantial risk to our ability to secure financing for our operations, construction and land development efforts. In addition, this disruption is affecting our customers ability to secure mortgage financing for the purchase of our homes. This limitation on available credit continues to have a negative effect on our sales and revenue in 2009 which undermines our ability to generate enough cash to fund our operations, meet our obligations and survive as a going concern. This continuing erosion of our liquidity could result in our need to seek bankruptcy protections either for certain subsidiary entities or for the Company as a whole.

Under normal market conditions it is customary for lenders in our industry to renew and extend debt obligations until a project or collection of projects is completed provided the obligations are kept current. This is no longer the case in our industry. Liquidity constraints among banks have limited their ability to renew loan facilities. As recently reported, and as further discussed in Note 14, several of the Company s loan facilities have matured with no extensions available. At June 30, 2009 the Company and its subsidiaries had $19.8 million of cash obligations to debt which had either already matured or have payment obligations during the remainder of 2009. The Company is the guarantor of $79.1 million of debt, including that of subsidiaries. As a result, any significant failure to negotiate renewals and extensions to its debt obligations would severely compromise the Company s liquidity and would jeopardize the Company s ability to satisfy its capital requirements. This inability to meet our capital requirements could result in our need to seek bankruptcy protections either for certain subsidiary entities or the for Company as a whole.

In response to changing conditions in the banking industry the Company retained external consultants in the second quarter of 2008 to act as a financial advisor to the Company in exploring debt restructuring and alternatives for raising additional capital for the Company. In connection with the exploration of available debt restructuring alternatives, the Company then elected to cease making certain scheduled interest and/or principal curtailment payments while it attempted to negotiate modifications or other satisfactory resolutions from its lenders. During 2008 the Company reported several loan covenant violations and notices of default from several of its lenders. As discussed further in Note 14, these violations and notices led to foreclosures of certain assets and have resulted in certain guarantee enforcement actions being initiated against the Company where no foreclosures have taken place. Many of the Company s loan facilities contain Material Adverse Effect clauses which, if invoked, could create an event of default under those loans. In the event certain of the Company s loans were deemed to be in default as a result of a Material Adverse Effect, the Company s ability to meet its cash flow and debt obligations would be compromised. During the fourth quarter of 2008 the Company discontinued its relationship with its external advisory consultants. The Company has continued to negotiate with its lenders into 2009 and has continued to report default notices and debt restructurings as they occur. The Company may experience additional foreclosure actions in the future as a result of the continuing distress in the real estate and credit markets. The Company cannot at this time provide any assurances that it will be successful in its continuing efforts to work with its lenders on loan modifications. This inability to renegotiate debt could result in our need to seek bankruptcy protections either for certain subsidiary entities or for the Company as a whole.

We require capital to operate, to post deposits on new deals, to purchase and develop land, to construct homes, to fund related carrying costs and overhead and to fund various advertising and marketing programs to generate sales. These expenditures include payroll, community engineering, entitlement, architecture, advertising, utilities and interest as well as the construction costs of our homes and related community amenities. Our current operations and inventory of home sites will require substantial capital to develop and construct. Our overall borrowing capacity is constrained by various loan covenants. There is no assurance either that we will return to compliance in the future or that our lenders will continue to refrain from exercising their rights related to our covenant violations. In the event our banks discontinue funding, accelerate the maturities of their facilities, refuse to waive future covenant defaults or refuse to renew the facilities at maturity we could experience an unrecoverable liquidity crisis in the future. We can make no assurances that cash advances available under our credit facilities, refinancing of existing underleveraged projects or access to public debt and equity markets will provide us with sufficient capital to meet our existing and expected operating capital needs in 2009. If we fail to meet our cash flow requirements we may be required to seek bankruptcy protection or to liquidate.

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At June 30, 2009 we had $1.0 million in unrestricted cash and $3.9 million in restricted cash. Included in our restricted cash balance, to which we have no access, is a $3.0 million deposit with an insurance provider as security for future claims. Our access to working capital is very limited and our debt service obligations and operating costs for 2009 exceed our current cash reserves. If we are unable to identify new sources of liquidity and/or successfully modify our existing facilities, we will likely deplete our cash reserves and be forced to file for bankruptcy protection. There can be no assurances that in that event we would be able to reorganize through bankruptcy, and we might be forced into a trustee managed liquidation of our assets.

2. REAL ESTATE HELD FOR DEVELOPMENT AND SALE

Real estate held for development and sale includes land, land development costs, interest and other construction costs. Land held for development is stated at cost, or when circumstances or events indicate that the land is impaired, at estimated fair value. Real estate held for sale is carried at the lower of cost or market. Land, land development and indirect land development costs are accumulated by specific project and allocated to various lots or housing units within that project using specific identification and allocation based upon the relative sales value, unit or area methods. Direct construction costs are assigned to housing units based on specific identification. Construction costs primarily include direct construction costs and capitalized field overhead. Other costs are comprised of prepaid local government fees and capitalized interest and real estate taxes. Selling costs are expensed as incurred.

Estimated fair value is based on comparable sales of real estate in the normal course of business under existing and anticipated market conditions. The evaluation takes into consideration the current status of the property, various restrictions, carrying costs, costs of disposition and any other circumstances, which may affect fair value including management s plans for the property. Due to the large acreage of certain land holdings, disposition in the normal course of business is expected to extend over a number of years. A write-down to estimated fair value is recorded when the net carrying value of the property exceeds its estimated undiscounted future cash flows. These evaluations are made on a property-by-property basis as seen fit by management whenever events or changes in circumstances indicate that the net book value may not be recoverable.

Deteriorating market conditions, turmoil in the credit markets and increased price competition have continued to negatively impact the Company during 2008 and into the second quarter of 2009 resulting in reduced sales prices, increased customer concessions, reduced gross margins and extended estimates for project completion dates. The Company evaluates its projects on a quarterly basis to determine if recorded carrying amounts are recoverable. This quarter, the Company evaluated all 26 of its projects for impairment and the evaluation resulted in impairment charges of $22,938 across nineteen projects as compared to impairment charges of $13,746 across sixteen projects for the three months ended June 30, 2008. The remaining book value of the properties impaired during the three months ended June 30, 2009 was $51,098. As a result of this analysis, the Company believes that book value approximates fair value for all of its projects except for one with a carrying value of $40,740.

For projects where the Company expects to continue sales, these impairment evaluations are based on discounted cash flow models. Discounted cash flow models are dependent upon several subjective factors, primarily estimated average sales prices, estimated sales pace, and the selection of an appropriate discount rate. While current market conditions make the selection of a timeframe for sales in a community challenging, the Company has generally assumed sales prices equal to or less than current prices and the remaining lives of the communities were estimated to be one to two years. These assumptions are often interrelated as price reductions can generally be assumed to increase the sales pace. In addition, the Company must select what it believes is an appropriate discount rate based on current market cost of capital and returns expectations. The Company has used its best judgment in determining an appropriate discount rate based on anecdotal information it has received from marketing its deals for sale in recent months. The Company has elected to use a rate of 17% in its discounted cash flow model, which is consistent with the discount rate used in prior periods as the Company s cost of capital has not changed significantly. While the selection of a 17% discount rate was subjective in nature, the Company believes it is an appropriate rate in the current market. The estimates of sales prices, sales pace, and discount rates used by the Company are based on the best information available at the time the estimates were made.

For projects where the Company expects to sell the remaining lots in bulk or convey the remaining lots to a lender where the loans have matured, the fair value is determined based on offers received from third parties, comparable sales transactions, and/or cash flow valuation techniques.

If the project meets the criteria of held for sale in accordance with SFAS 144, the project is valued at the lower of cost or fair value less estimated selling costs. At June 30, 2009, the Company had three projects with a carrying value of $45,240 that met these criteria.

At March 31, 2009 Mathis Partners, LLC, a wholly owned subsidiary of the Company had approximately $5,100 of principal, accrued interest and fees outstanding to the Federal Deposit Insurance Corporation (FDIC) relating to the Company s Gates at Luberon project. This loan matured in November 2007. Haven Trust Bank, the originating lender and its participating lenders were unwilling to grant an extension on terms the Company felt were reasonable so this loan remains unpaid and unmodified. Haven Trust Bank initiated foreclosure proceedings and the

Company protected the equity in the project by seeking bankruptcy protection for the entity which owns Gates at Luberon. The Company elected not to submit a plan of reorganization to the court by September 30, 2008 which resulted in Haven Trust filing a motion to lift the court imposed stay of foreclosure. In December 2008 Haven Trust Bank was closed by the FDIC and its loan portfolio was taken over by the FDIC. Litigation with respect to Haven Trust s guarantee action against Comstock was stayed with the court while the FDIC determined its intended course of action. Cornerstone Bank, one of Haven Trust s participating lenders, assumed control of the loan and reinstated the guarantee and foreclosure actions. In June 2009, Cornerstone Bank foreclosed on 25 of 28 Gates of Luberon lots that collateralized the loan. The Company had been engaged in discussions with Cornerstone Bank regarding a friendly foreclosure agreement regarding all 28 lots and the related debt. However, since no friendly foreclosure agreement was consummated at June 30, 2009, the $3,314 estimated fair value of the 25 foreclosed lots was reclassified from real estate held for development and sale and charged to the $5,100 debt balance outstanding to Cornerstone Bank. After this reclass, and an impairment charge of $1,000, the June 30, 2009 statement of financial position includes the three Gates of Luberon lots not foreclosed upon valued at approximately $135 in real estate held for development and sale and net debt to Cornerstone Bank of approximately $1,786.

If market conditions continue to deteriorate, additional adverse changes to these estimates in future periods could result in further material impairment amounts to be recorded. In addition, and from time to time, the Company will write-off deposits it has made for options on land that it has decided not to purchase. These deposits and any related capitalized pre-acquisition feasibility or project costs are written off at the earlier of the option expiration or the decision to terminate the option.

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The following table summarizes impairment charges and write-offs for the three and six months ended:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Impairments	$ 22,938	$ 13,740	$ 22,938	$ 14,568
Write-offs		6		9
	$ 22,938	$ 13,746	$ 22,938	$ 14,577

After impairments and write-offs, real estate held for development and sale consists of the following:

	June 30, 2009	December 31, 2008
Land and land development costs	$ 36,504	$ 51,421
Cost of construction (including capitalized interest and real estate taxes)	61,905	78,121
	$ 98,409	$ 129,542

3. CONSOLIDATION OF VARIABLE INTEREST ENTITIES

The Company typically acquires land for development at market prices from various entities under fixed price purchase agreements. The purchase agreements require deposits that may be forfeited if the Company fails to perform under the agreements. The deposits required under the purchase agreements are in the form of cash or letters of credit in varying amounts. The Company may, at its option, choose for any reason and at any time not to perform under these purchase agreements by delivering notice of its intent not to acquire the land under contract. The Company s sole legal obligation and economic loss for failure to perform under these purchase agreements is typically limited to the amount of the deposit pursuant to the liquidated damages provision contained within the purchase agreement. As a result, none of the creditors of any of the entities with which the Company enters into forward fixed price purchase agreements have recourse to the general credit of the Company.

The Company also does not share in an allocation of either the profit earned or loss incurred by any of these entities with which the Company has fixed price purchase agreements. The Company has concluded that whenever it options land or lots from an entity and pays a significant non-refundable deposit as described above, a variable interest entity is created under the provisions of Financial Accounting Standards Board (FASB) issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46-R). This is because the Company has been deemed to have provided subordinated financial support, which creates a variable interest which limits the equity holder s returns and may absorb some or all of an entity s expected theoretical losses if they occur. The Company, therefore, examines the entities with which it has fixed price purchase agreements for possible consolidation by the Company under FIN 46-R. This requires the Company to compute expected losses and expected residual returns based on the probability of future cash flows as outlined in FIN 46-R. This calculation requires substantial management judgments and estimates. In addition, because the Company does not have any contractual or ownership interests in the entities with which it contracts to buy the land, the Company does not have the ability to compel these development entities to provide financial or other data to assist the Company in the performance of the primary beneficiary evaluation.

On July 7, 2009 the Company reached a settlement agreement with Belmont Bay, LC in a dispute related to the fixed price purchase agreement regarding Phase II of Beacon Park. Under the terms of the settlement agreement, the Company forfeits its $200 deposit and is released from debt owed to Belmont Bay, LC of approximately $1,797. As a result of this settlement agreement, the Company is not asserting its contractual rights under the option contract, which has expired. Therefore the Company is no longer the primary beneficiary and has deconsolidated the entity from its consolidated balance sheet at June 30, 2009. The effect of the deconsolidation was the removal of $19,250 in Inventory not owned-variable interest entities with a corresponding reduction of $19,050 (net of land deposits paid of $200) to Obligations related to inventory not owned. Creditors, if any, of this deconsolidated variable interest entity have no recourse against the Company relating to this purchase contract.

4. WARRANTY RESERVE

Warranty reserves for houses settled are established to cover potential costs for materials and labor with regard to warranty-type claims expected to arise during the one-year warranty period provided by the Company or within the five-year statutorily mandated structural warranty period. Since the Company subcontracts its homebuilding work, subcontractors are required to provide the Company with an indemnity and a certificate of insurance prior to receiving payments for their work. Claims relating to workmanship and materials are generally the primary responsibility of the subcontractors and product manufacturers. The warranty reserve is established at the time of closing, and is calculated based upon historical warranty cost experience and current business factors. Variables used in the calculation of the reserve, as well as the adequacy of the reserve based on the number of homes still under warranty, are reviewed on a periodic basis. Warranty claims are directly charged to the reserve as they arise. The following table is a summary of warranty reserve activity which is included in accounts payable and accrued liabilities:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Balance at beginning period	$ 931	$ 1,531	$ 1,031	$ 1,537
Additions	14	36	38	216
Releases and/or charges incurred	(117)	(238)	(241)	(424)
Balance at end of period	$ 828	$ 1,329	$ 828	$ 1,329

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COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

5. CAPITALIZED INTEREST AND REAL ESTATE TAXES

Interest and real estate taxes incurred relating to the development of lots and parcels are capitalized to real estate held for development and sale during the active development period, which generally commences when borrowings are used to acquire real estate assets and ends when the properties are substantially complete or the property becomes inactive which means that development and construction activities have been suspended indefinitely. Interest is capitalized based on the interest rate applicable to specific borrowings or the weighted average of the rates applicable to other borrowings during the period. Interest and real estate taxes capitalized to real estate held for development and sale are expensed as a component of cost of sales as related units are sold. The following table is a summary of interest incurred and capitalized and interest expensed as units are settled:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Total interest incurred and capitalized	$	$ 1,686	$ 12	$ 4,360
Interest expensed as a component of cost of sales	$ 321	$ 995	$ 891	$ 2,120

During the six months ended June 30, 2009 the majority of the Company s projects in Washington, DC and Atlanta, GA were determined to be inactive for accounting purposes as they were either substantially complete or management elected to suspend construction activities indefinitely. When a project becomes inactive, its interest, real estate taxes and indirect production overhead costs are no longer capitalized but rather expensed in the period in which they are incurred. Following is a breakdown of the interest, real estate taxes and indirect costs related to inactive projects reported on the consolidated statement of operations related to the inactivation of certain real estate projects held for development and sale:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Total interest incurred and expensed for inactive projects	$ 1,057	$ 478	$ 2,291	$ 1,080
Total real estate taxes incurred and expensed for inactive projects	309	179	602	336
Total production overhead incurred and expensed for inactive projects	187		461	
	$ 1,554	$ 657	$ 3,354	$ 1,416

6. LOSS PER SHARE

The following weighted average shares and share equivalents are used to calculate basic and diluted earnings (loss) per share for the three and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Basic loss per share				
Net loss	$ (27,743)	$ (16,618)	$ (30,388)	$ (10,075)

Basic weighted-average shares outstanding	17,554	16,541	17,554	16,502
Per share amounts	$ (1.58)	$ (1.00)	$ (1.73)	$ (0.61)
Dilutive loss per share				
Net loss	$ (27,743)	$ (16,618)	$ (30,388)	$ (10,075)
Basic weighted-average shares outstanding	17,554	16,541	17,554	16,502
Stock options and restricted stock grants				
Dilutive weighted-average shares outstanding	17,554	16,541	17,554	16,502
Per share amounts	$ (1.58)	$ (1.00)	$ (1.73)	$ (0.61)

As a result of net losses during the three and six months ended June 30, 2009 and 2008, respectively, stock grant issuances were excluded from the computation of dilutive earnings per share because their inclusion would have been anti-dilutive. Options and warrants issued during these periods were also excluded due to the options and warrants having an exercise price greater than the average market price of the common shares.

Comprehensive income

For the three and six months ended June 30, 2009 and 2008, comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying consolidated financial statements.

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7. INCOME TAX

Income taxes are accounted for under the asset and liability method in accordance with SFAS 109 *Accounting for Income Taxes*. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on the deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company is projecting a tax loss for the twelve months ended December 31, 2009. Therefore, an effective tax rate of zero was assumed in calculating the current income tax expense at June 30, 2009. This results in a zero current income tax expense for the three and six months ended June 30, 2009.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. At December 31, 2007, the Company recorded valuation allowances for certain tax attributes and other deferred tax assets. At this time, sufficient uncertainty exists regarding the future realization of these deferred tax assets through future taxable income or carry back opportunities. If in the future the Company believes that it is more likely than not that these deferred tax benefits will be realized, the valuation allowances will be reversed. With a full valuation allowance, any change in the deferred tax asset or liability is fully offset by a corresponding change in the valuation allowance. This results in a zero deferred tax benefit or expense for the three and six months ended June 30, 2009.

We adopted the provisions of FIN 48 as of January 1, 2007. As a result of this adoption, the Company recorded a benefit to the opening accumulated deficit in the amount of $1,663. The Company recognizes interest accrued related to unrecognized tax benefits in interest expense. Penalties, if incurred, would be recognized as a component of general and administrative expense. At June 30, 2009, the Company had gross unrecognized tax benefits of $77, which was fully reserved. The reserve was limited to interest on the net timing difference. The unrecognized tax benefits of $77 at June 30, 2009, would not reduce the Company annual effective tax rate if recognized. The Company has accrued interest and recorded a liability of $77 related to these unrecognized tax benefits during 2009. The Company does not expect the unrecognized tax benefits to change significantly over the next 12 months.

The Company files U.S. and state income tax returns in jurisdictions with varying statutes of limitations. The 2004 through 2008 tax years generally remain subject to examination by federal and most state tax authorities.

8. STOCK REPURCHASE PROGRAM

In February 2006 the Company s Board of Directors authorized the Company to purchase up to 1,000 shares of the Company s Class A common stock in the open market or in privately negotiated transactions. The authorization did not include a specified time period in which the shares repurchase would remain in effect. During the twelve months ended December 31, 2006, the Company repurchased an aggregate of 391 shares of Class A common stock for a total of $2,439 or $6.23 per share. There were no shares repurchased in 2007, 2008 or during the six months ended June 30, 2009. The Company has no immediate plans to repurchase any additional shares under the existing authorization.

9. COMMITMENTS AND CONTINGENCIES

Litigation

In April, 2008, a wholly owned subsidiary of the Company, Mathis Partners, LLC (Mathis Partners) received notice from Haven Trust Bank (Lender) that it filed a collection action against the Company pursuant to a guaranty agreement entered into by the Company for the outstanding balance of the indebtedness owed for the Gates of Luberon project in Atlanta, Georgia. In January 2009, prior to any substantive action taking place in the lawsuit, the Lender failed and was taken over by the Federal Deposit Insurance Corporation (FDIC). The FDIC sought a stay in the guaranty action through April of 2009. Cornerstone Bank, one of the banks to whom Haven Trust participated the loan has assumed control of the collection process and has reinstated the foreclosure and guarantee actions. Foreclosure of a portion of the Property took place on June 2, 2009, at which time a bid was made on the Property by Cornerstone Bank for approximately $1,275. Cornerstone Bank has sought the Court s confirmation of the foreclosure sale, to which the Company and Mathis Partners intends to object. The confirmation of the foreclosure sale, and the Company s objection, is scheduled to be heard in September 2009.

On or about June 10, 2009, a judgment of $1,502 was entered against Comstock Homes of Atlanta, LLC, a subsidiary of the Company, as a result of an uncontested breach of contract claim related to a discontinued development project in the Atlanta area. A liability for this judgment has been recorded as of June 30, 2009.

On July 3, 2008, the Company and Comstock Belmont Bay 8&9, L.C. (the Subsidiary) were served with a complaint by Belmont Bay, LC (Seller) to enforce payment of a purchase money promissory note (Purchase Note) that matured on March 24, 2007, made by the Subsidiary and guaranteed by the Company with respect to our Beacon Park I Condominium (the Project). Demand was made for $1,993, plus accrued interest, costs and attorney fees. The Company and Subsidiary filed answers to the action and the Subsidiary filed a counterclaim against the Seller as a result of its various breaches of the purchase contract that gave rise to the Purchase Note. On July 30, 2008, the Company and Subsidiary received notice of an additional complaint filed by Seller for breach of the purchase contract and on August 6, 2008, the Subsidiary was served with a third complaint by Seller and the master associations for the Belmont Bay development seeking injunctive relief to prohibit the Subsidiary from selling the Project. The Seller and master associations also joined together to file a lis pendens against the Project in October 2008 to notice the third complaint. As discussed in Note 3, on or about July 8, 2009, the parties executed a Settlement Agreement and Final Orders were entered in the cases, dismissing the cases with prejudice. As part of the Settlement Agreement, the obligations under the Purchase Note and guaranty were released, subject to satisfaction of certain conditions set forth in the Settlement Agreement.

On July 29, 2008, Balfour Beatty Construction, LLC, successor in interest to Centex Construction (Balfour), the general contractor for a subsidiary of the Company, filed liens totaling approximately $552 at The Eclipse on Center Park Condominium project (Project) in connection with its claim for amounts allegedly owed under the Project contract documents. In September 2008, the Company s subsidiary filed suit against Balfour to invalidate the liens and for its actual and liquidated damages in the approximate amount of $13,800 due to construction delays and additional costs incurred by the Company s subsidiary with respect to the Project. In October 2008, Balfour filed counterclaims in the approximate amount of $4,000. Subsequent to an expedited hearing filed by the Company s subsidiary to determine the validity of the liens that was ultimately heard in February, 2009, we received an order of the court in April, 2009 invalidating the liens. A trial is scheduled to begin September 8, 2009. The lender for the Company s subsidiary had not issued a default notice with respect to the liens but an adverse judgment with respect to the litigation could be considered an event of default under the KeyBank loan associated with the Project.

The Company and/or its subsidiaries have also been named as a party defendant in legal actions arising from our other business operations that on an aggregate basis would be deemed material if decided against the Company and/or its subsidiaries for the full amounts claimed. Although the Company would not be liable in all instances for judgments against its subsidiaries, we cannot accurately predict the amount of any liability that could be imposed upon the Company with respect to legal actions currently pending against the Company or its subsidiaries.

Further, it is anticipated that in the future that the Company or its subsidiaries will be named as a defendant in additional legal actions arising from our past business activities. Although we cannot accurately predict the amount of any liability that could be imposed upon the Company with respect to legal actions that may be brought against the Company in the future, it is anticipated that any such liability would likely have a material adverse effect on our financial position, operating results or cash flows.

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Letters of credit and performance bonds

The Company has commitments as a result of contracts entered into with certain third parties to meet certain performance criteria as outlined in such contracts. The Company is required to issue letters of credit and performance bonds to these third parties as a way of ensuring that such commitments entered into are met by the Company. At August 1, 2009 the Company has issued $976 in letters of credit and $7,463 in performance and payment bonds to these third parties. No amounts have been drawn against these letters of credit and performance bonds.

10. RELATED PARTY TRANSACTIONS

The Company entered into a lease agreement for its corporate headquarters at 11465 Sunset Hills Road, Reston, Virginia with Comstock Asset Management, L.C., (CAM) an entity wholly owned by Christopher Clemente. In October 2007, the lease agreement was amended decreasing the total square footage from 24.1 to 17.1 and extending the term to four years through September 2011. For the three months ended June 30, 2009 and 2008, total payments made under this lease agreement were $116 and $137, respectively. During the six months ended June 30, 2009 and 2008 total payments were $257 and $285, respectively. During the second quarter of 2009, the Company began deferring a portion of its monthly rent payment to CAM as well as deferring a portion of the base salary payments to executive officers Chris Clemente and Greg Benson. As a result of its liquidity constraints, the Company expects to further reduce its office lease obligation to CAM.

On February 26, 2009 Comstock Homes of Washington, L.C., a wholly owned subsidiary of Comstock Homebuilding Companies, Inc. concurrently entered into a Fourth Amendment to Sub-Lease Agreement and a Services Agreement with CAM. Under the terms of the lease Amendment, CAM released Comstock Homes of Washington from its lease obligation with respect to 1.4 square feet of space at its headquarters in Reston, Virginia. In consideration of the release Comstock Homes of Washington agreed to pay a $50 termination fee to CAM which is payable at a rate of $5 per month for ten months. After the amendment, Comstock Homes of Washington had 15.8 square feet remaining under its sub-lease with CAM with annual rent of $502. Under the terms of the Services Agreement, Comstock Homes of Washington agreed to provide project management and leasing services to CAM for a term of ten months at a rate of $5 per month.

During 2003, the Predecessor entered into agreements with I-Connect, L.C., a company in which Investors Management, LLC, an entity wholly owned by Gregory Benson, holds a 25% interest, for information technology and website consulting services and the right to use certain customized enterprise software developed with input from the Company. The intellectual property rights associated with the software solution developed by I-Connect, along with any improvements made thereto by the Company, remain the property of I-Connect. For three months ended June 30, 2009 and 2008, the Company paid $25 and $50, respectively. During the six months ended June 30, 2009 and 2008, the Company paid $45 and $164, respectively, to I-Connect.

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11. SEGMENT REPORTING

Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131) establishes standards for the manner in which companies report information about operating segments. The Company determined it provides one single type of business activity, homebuilding, which operates in multiple geographic or economic environments. In addition, as a result of the Company s acquisitions in Georgia and North Carolina, which became fully integrated in the fourth quarter of 2006, the Company modified how it analyzes its business during the fourth quarter of 2006. The Company had, in years prior to 2009, determined that its homebuilding operations primarily involved three reportable geographic segments: Washington DC Metropolitan Area, Raleigh, North Carolina, and Atlanta, Georgia. Based on reduced activity in the Atlanta market, the Company elected to consolidate the Raleigh and Atlanta segments into the Southeast region segment, effective January 1, 2009. As such, the three and six months ended June 30, 2008 have been restated for presentation purposes only. The aggregation criteria are based on the similar economic characteristics of the projects located in each of these regions. The table below summarizes revenue and income (loss) before income taxes for each of the Company s geographic segments (amounts in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues:				
Washington DC Metropolitan Area	$ 2,606	$ 6,252	$ 7,562	$ 12,751
Southeast region	359	5,751	926	15,628
Total revenue	$ 2,965	$ 12,003	$ 8,488	$ 28,379
Segment operating gain (loss)				
Washington DC Metropolitan Area	$ (16,365)	$ (6,492)	$ (17,464)	$ (7,032)
Southeast region	(8,365)	(8,184)	(8,519)	(9,360)
Total segment operating loss	(24,730)	(14,676)	(25,983)	(16,392)
Corporate expenses unallocated	(1,461)	(2,356)	(3,205)	(3,610)
Total operating loss	(26,191)	(17,032)	(29,188)	(20,002)
Other income (loss)	1,552	413	1,199	9,924
Loss before income taxes	$ (27,743)	$ (16,619)	$ (30,387)	$ (10,078)

The table below summarizes impairments and write-offs by segment. These expenses are included in the segment operating income (loss) as reflected in the table above.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Washington DC Metropolitan Area	$ 15,351	$ 6,132	$ 15,351	$ 6,141
Southeast region	7,587	7,614	7,587	8,436

	$ 22,938	$ 13,746	$ 22,938	$ 14,577

The table below summarizes total assets for the Company s segments as of:

	June 30, 2008	December 31, 2008
Washington DC Metropolitan Area	$ 76,672	$ 116,483
Southeast region	23,919	34,925
Corporate	4,738	9,452
Total assets	$ 105,329	$ 160,860

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12. TROUBLED DEBT RESTRUCTURING

On March 14, 2008, the Company executed an option to restructure its $30,000 senior unsecured note. In connection therewith, the Company made a $6,000 principal payment to the noteholder and executed an amended and restated indenture with the noteholder with a new principal balance of $9,000 and a revised term of 5 years. The Company also issued the noteholder a warrant to purchase 1,500 shares of Class A common stock at $0.70 per share. In exchange the noteholder agreed to cancel $15,000 of the original outstanding principal balance.

This transaction has been accounted for as a troubled debt restructuring modification of terms pursuant to Statement of Financial Accounting Standards No. 15, *Accounting by Debtors and Creditors of Troubled Debt Restructurings* (SFAS 15). Under SFAS 15, the amended and restated indenture was recorded at its principal amount plus the total estimated future interest payments of $13,438.

Calculated in accordance with SFAS 15, the gain resulting from the execution of the amended and restated indenture was determined as follows:

Cash paid (including prepayment of interest through December 31, 2008)	$ 6,651
Issuance of warrants, at fair value	720
Amended and restated indenture, principal plus future interest payments	13,438
Transaction costs	172
Total consideration	20,981
Amount outstanding under original indenture	(30,000)
Interest accrued under original indenture	(599)
Unamortized loan fees	1,293
Gain on troubled debt restructuring	$ (8,325)

13. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through August 14, 2009, which is the date these financial statements were issued. Except for the event set forth below, no material subsequent events occurred between June 30, 2009 and August 14, 2009.

On July 8, 2009, the Company executed a settlement agreement with an unsecured lender to resolve all outstanding issues and to compromise and settle all outstanding claims against one another, including its $1,664 unsecured purchase money note plus interest due. In connection therewith, the Company agreed to forfeit their $200 land option deposit and the unsecured lender agreed to release the Company s from liability under the $1,664 deferred purchase money note and interest accrued. This transaction will be recognized in the 2009 third quarter and will be accounted for as a transfer of assets in full settlement of debt pursuant to SFAS 15. Under SFAS 15, the Company will recognize a gain of approximately $1,500 measured by the excess of the carrying amount of the debt and interest settled over the forfeited deposit.

On July 30, 2009 the Company conveyed thirty-three single family lots at our Providence community for approximately $715. Had it not been able to execute this sale, it is likely that the Company would not have been able to meet its cashflow obligations and would have been forced to seek bankruptcy protection.

14. CREDIT FACILITIES

The Company has outstanding borrowings with various financial institutions and other lenders which have been used to finance the acquisition, development and construction of real estate property.