M I HOMES INC
Form 10-Q
October 26, 2018

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 September 30, 2018
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES ACT OF 1934
Commission File Number 1-12434

M/I HOMES, INC.
(Exact name of registrant as specified in it charter)

| | |
|---|---|
| Ohio | 31-1210837 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

3 Easton Oval, Suite 500, Columbus, Ohio 43219
(Address of principal executive offices) (Zip Code)
(614) 418-8000
(Registrant's telephone number, including area code)

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

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

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

| | | |
|---|---|---|
| Large accelerated filer | Accelerated filer | X |
| Non-accelerated filer | Smaller reporting company | |
| | Emerging growth company | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. q

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.
Common shares, par value $.01 per share: 27,923,936 shares outstanding as of October 24, 2018.

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M/I HOMES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| (Dollars in thousands, except par values) | September 30, 2018 (unaudited) | December 31, 2017 |
|---|---|---|
| ASSETS: | | |
| Cash, cash equivalents and restricted cash | $ 36,360 | $ 151,703 |
| Mortgage loans held for sale | 115,189 | 171,580 |
| Inventory | 1,751,525 | 1,414,574 |
| Property and equipment - net | 28,691 | 26,816 |
| Investment in joint venture arrangements | 24,568 | 20,525 |
| Deferred income tax asset | 16,925 | 18,438 |
| Goodwill | 16,400 | — |
| Other assets | 68,677 | 61,135 |
| TOTAL ASSETS | $ 2,058,335 | $ 1,864,771 |
| | | |
| LIABILITIES AND SHAREHOLDERS’ EQUITY | | |
| | | |
| LIABILITIES: | | |
| Accounts payable | $ 148,421 | $ 117,233 |
| Customer deposits | 40,448 | 26,378 |
| Other liabilities | 116,651 | 131,534 |
| Community development district obligations | 16,101 | 13,049 |
| Obligation for consolidated inventory not owned | 21,897 | 21,545 |
| Notes payable bank - homebuilding operations | 222,700 | — |
| Notes payable bank - financial services operations | 104,026 | 168,195 |
| Notes payable - other | 8,838 | 10,576 |
| Convertible senior subordinated notes due 2018 - net | — | 86,132 |
| Senior notes due 2021 - net | 297,608 | 296,780 |
| Senior notes due 2025 - net | 246,441 | 246,051 |
| TOTAL LIABILITIES | $ 1,223,131 | $ 1,117,473 |
| | | |
| Commitments and contingencies (Note 6) | — | — |
| | | |
| SHAREHOLDERS’ EQUITY: | | |
| Common shares - $.01 par value; authorized 58,000,000 shares at both September 30, 2018 and December 31, 2017; issued 30,137,141 and 29,508,626 shares at September 30, 2018 and December 31, 2017, respectively | 301 | 295 |
| Additional paid-in capital | 328,511 | 306,483 |
| Retained earnings | 548,585 | 473,329 |
| Treasury shares - at cost - 2,003,778 and 1,651,874 shares at September 30, 2018 and December 31, 2017, respectively | (42,193) | (32,809) |
| TOTAL SHAREHOLDERS’ EQUITY | $ 835,204 | $ 747,298 |
| TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY | $ 2,058,335 | $ 1,864,771 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands, except per share amounts) | 2018 | 2017 | 2018 | 2017 |
| Revenue | $567,842 | $476,423 | $1,563,797 | $1,340,269 |
| Costs and expenses: | | | | |
| Land and housing | 452,029 | 374,673 | 1,250,067 | 1,062,552 |
| General and administrative | 36,897 | 31,337 | 99,514 | 89,209 |
| Selling | 35,054 | 31,136 | 100,708 | 88,666 |
| Acquisition and integration costs | — | — | 1,700 | — |
| Equity in income from joint venture arrangements | (44) | (71) | (268) | (198) |
| Interest | 4,426 | 4,675 | 15,192 | 13,847 |
| Total costs and expenses | 528,362 | 441,750 | 1,466,913 | 1,254,076 |
| Income before income taxes | 39,480 | 34,673 | 96,884 | 86,193 |
| Provision for income taxes | 10,198 | 12,346 | 21,628 | 29,994 |
| Net income | 29,282 | 22,327 | 75,256 | 56,199 |
| Preferred dividends | — | 1,218 | — | 3,656 |
| Excess of fair value over book value of preferred shares subject to redemption | — | 2,257 | — | 2,257 |
| Net income available to common shareholders | $29,282 | $18,852 | $75,256 | $50,286 |
| Earnings per common share: | | | | |
| Basic | $1.03 | $0.74 | $2.65 | $2.00 |
| Diluted | $1.01 | $0.64 | $2.56 | $1.73 |
| Weighted average shares outstanding: | | | | |
| Basic | 28,469 | 25,581 | 28,389 | 25,106 |
| Diluted | 28,906 | 30,675 | 29,511 | 30,539 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

| | Nine Months Ended September 30, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Common Shares | | | | | |
| (Dollars in thousands) | Shares Outstanding | Amount | Additional Paid-in Capital | Retained Earnings | Treasury Shares | Total Shareholders' Equity |
| Balance at December 31, 2017 | 27,856,752 | $ 295 | $306,483 | $473,329 | $(32,809) | $ 747,298 |
| Net income | — | — | — | 75,256 | — | 75,256 |
| Common share issuance for conversion of convertible notes | 628,515 | 6 | 20,303 | — | — | 20,309 |
| Stock options exercised | 24,220 | — | (56) | — | 482 | 426 |
| Stock-based compensation expense | — | — | 3,771 | — | — | 3,771 |
| Repurchase of common shares | (437,490) | — | — | — | (11,085) | (11,085) |
| Deferral of executive and director compensation | — | — | 184 | — | — | 184 |
| Executive and director deferred compensation distributions | 61,366 | — | (2,174) | — | 1,219 | (955) |
| Balance at September 30, 2018 | 28,133,363 | $ 301 | $328,511 | $548,585 | $(42,193) | $ 835,204 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

M/I HOMES, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended September 30, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| OPERATING ACTIVITIES: | | |
| Net income | $75,256 | $56,199 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Equity in income from joint venture arrangements | (268) | (198) |
| Mortgage loan originations | (828,400) | (732,587) |
| Proceeds from the sale of mortgage loans | 884,725 | 798,946 |
| Fair value adjustment of mortgage loans held for sale | 66 | (4,326) |
| Capitalization of originated mortgage servicing rights | (3,649) | (3,873) |
| Amortization of mortgage servicing rights | 580 | 789 |
| Depreciation | 8,064 | 7,078 |
| Amortization of debt discount and debt issue costs | 2,110 | 2,632 |
| Stock-based compensation expense | 3,771 | 4,034 |
| Deferred income tax expense | 1,513 | 1,306 |
| Change in assets and liabilities: | | |
| Inventory | (221,279) | (212,660) |
| Other assets | (6,447) | 4,763 |
| Accounts payable | 20,660 | 17,386 |
| Customer deposits | 9,914 | 8,427 |
| Accrued compensation | (10,199) | (9,341) |
| Other liabilities | (10,312) | (4,600) |
| Net cash used in operating activities | (73,895) | (66,025) |
| | | |
| INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (5,866) | (6,017) |
| Return of capital from joint venture arrangements | 676 | 1,833 |
| Acquisition | (100,960) | — |
| Investment in joint venture arrangements | (20,487) | (8,439) |
| Net proceeds from sale of mortgage servicing rights | 5,111 | 7,558 |
| Net cash used in investing activities | (121,526) | (5,065) |
| | | |
| FINANCING ACTIVITIES: | | |
| Repayment of convertible senior subordinated notes due 2018 | (65,941) | — |
| Net proceeds from issuance of senior notes | — | 250,000 |
| Proceeds from bank borrowings - homebuilding operations | 519,900 | 366,500 |
| Repayment of bank borrowings - homebuilding operations | (297,200) | (406,800) |
| Net repayment of bank borrowings - financial services operations | (64,169) | (61,620) |
| Principal repayment of notes payable - other and community development district bond obligations | (1,738) | (2,358) |
| Dividends paid on preferred shares | — | (3,656) |
| Repurchases of common shares | (11,085) | — |
| Debt issue costs | (115) | (6,572) |
| Proceeds from exercise of stock options | 426 | 4,791 |
| Net cash provided by financing activities | 80,078 | 140,285 |
| Net (decrease) increase in cash, cash equivalents and restricted cash | (115,343) | 69,195 |

| | | |
|---|---|---|
| Cash, cash equivalents and restricted cash balance at beginning of period | 151,703 | 34,441 |
| Cash, cash equivalents and restricted cash balance at end of period | $36,360 | $103,636 |
| | | |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the year for: | | |
| Interest — net of amount capitalized | $21,833 | $15,386 |
| Income taxes | $17,784 | $27,702 |
| | | |
| NON-CASH TRANSACTIONS DURING THE PERIOD: | | |
| Community development district infrastructure | $3,052 | $4,822 |
| Consolidated inventory not owned | $352 | $14,675 |
| Distribution of single-family lots from joint venture arrangements | $16,036 | $11,839 |
| Common stock issued for conversion of convertible notes | $20,309 | $57,500 |
| Reclassification of preferred shares subject to redemption | $— | $50,420 |

See Notes to Unaudited Condensed Consolidated Financial Statements.

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M/I HOMES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements (the “financial statements”) of M/I Homes, Inc. and its subsidiaries (the “Company”) and notes thereto have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial information. The financial statements include the accounts of the Company. All intercompany transactions have been eliminated. Results for the interim period are not necessarily indicative of results for a full year. In the opinion of management, the accompanying financial statements reflect all adjustments (all of which are normal and recurring in nature) necessary for a fair presentation of financial results for the interim periods presented. These financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Form 10-K”).

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during that period. Actual results could differ from these estimates and have a significant impact on the financial condition and results of operations and cash flows. With regard to the Company, estimates and assumptions are inherent in calculations relating to valuation of inventory and investment in unconsolidated joint ventures, property and equipment depreciation, valuation of derivative financial instruments, accounts payable on inventory, accruals for costs to complete inventory, accruals for warranty claims, accruals for self-insured general liability claims, litigation, accruals for health care and workers’ compensation, accruals for guaranteed or indemnified loans, stock-based compensation expense, income taxes, and contingencies. Items that could have a significant impact on these estimates and assumptions include the risks and uncertainties listed in “Item 1A. Risk Factors” in Part I of our 2017 Form 10-K and “Item 1A. Risk Factors” in Part II of this Quarterly Report on Form 10-Q, as the same may be updated from time to time in our subsequent filings with the SEC.

Significant Accounting Policies

We believe that there have been no significant changes to our significant accounting policies during the quarter ended September 30, 2018 as compared to those disclosed in our 2017 Form 10-K, other than the changes described below.
Revenue Recognition.  On January 1, 2018, we adopted ASC 606, Revenue from Contracts from Customers (“ASC 606”), using the modified retrospective transition method, which includes a cumulative catch-up in retained earnings on the initial date of adoption for existing contracts (those that are not completed) as of, and new contracts after, January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC 605, Revenue Recognition (“ASC 605”).  We did not have any material adjustments to our 2018 results under ASC 606.
Revenue from the sale of a home and revenue from the sale of land to third parties is recognized in the financial statements on the date of closing (point in time) if delivery has occurred, title has passed, all performance obligations have been met (please see definition of performance obligations below), and control of the home or land is transferred to the buyer in an amount that reflects the consideration we expect to be entitled to in exchange for the home or land.
We recognize the majority of the revenue associated with our mortgage loan operations when the mortgage loans are sold and/or related servicing rights are sold to third party investors or retained and managed under a third party subservice arrangement. The revenue recognized is reduced by the fair value of the related guarantee provided to the investor. The fair value of the guarantee is recognized in revenue when the Company is released from its obligation under the guarantee (note that guarantees are excluded from the scope of ASC 606). We recognize financial services revenue associated with our title operations as homes are delivered, closing services are rendered, and title policies are

issued, all of which generally occur simultaneously as each home is delivered. All of the underwriting risk associated with title insurance policies is transferred to third-party insurers.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. All of our contracts to sell homes have a single performance obligation as the promise to transfer the home is not separately identifiable from other promises in the contract and, therefore, not distinct. Our third party land contracts may include multiple performance obligations; however, revenue expected to be recognized in any future year related to remaining performance obligations, excluding revenue pertaining to contracts that have an original expected duration of one year or less, is not material.

We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within general, selling and administrative expenses as part of our sales and marketing expenses. We do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less.

The following table presents our revenues disaggregated by geography:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2018 [a] | 2017 | 2018 | 2017 |
| Midwest homebuilding | $236,803 | $180,488 | $622,325 | $495,379 |
| Southern homebuilding | 221,044 | 176,502 | 649,014 | 504,647 |
| Mid-Atlantic homebuilding | 97,802 | 107,670 | 253,363 | 302,305 |
| Financial services [b] | 12,193 | 11,763 | 39,095 | 37,938 |
| Total revenue | $567,842 | $476,423 | $1,563,797 | $1,340,269 |

(a) As noted above, prior period amounts have not been adjusted under the cumulative catch-up transition method.

(b) Revenues include $0.2 million and $1.2 million related to hedging losses for the three months ended September 30, 2018 and 2017. Revenues include $3.0 million and $1.3 million related to hedging gains for the nine months ended September 30, 2018 and 2017, respectively. Hedging gains (losses) do not represent revenues recognized from contracts with customers.

The following table presents our revenues disaggregated by revenue source:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 [a] | 2017 | 2018 | 2017 |
| Housing | $554,820 | $459,342 | $1,518,278 | $1,289,893 |
| Land sales | 829 | 5,318 | 6,424 | 12,438 |
| Financial services [b] | 12,193 | 11,763 | 39,095 | 37,938 |
| Total revenue | $567,842 | $476,423 | $1,563,797 | $1,340,269 |

(a) As noted above, prior period amounts have not been adjusted under the cumulative catch-up transition method.

(b) Revenues include $0.2 million and $1.2 million related to hedging losses for the three months ended September 30, 2018 and 2017. Revenues include $3.0 million and $1.3 million related to hedging gains for the nine months ended September 30, 2018 and 2017, respectively. Hedging gains (losses) do not represent revenues recognized from contracts with customers.

Goodwill. Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired and liabilities assumed in business combinations. Because the purchase price allocation is subject to change within a measurement period of up to one year from the acquisition date pursuant to ASC 805, in connection with the Company’s acquisition of the homebuilding assets and operations of Pinnacle Homes in Detroit, Michigan, the Company recorded a provisional amount of goodwill of approximately $16.4 million as of September 30, 2018, which is included as Goodwill in our Unaudited Condensed Consolidated Balance Sheets. This provisional amount was based on the estimated fair values of the acquired assets and assumed liabilities at the date of the acquisition in accordance with ASC 350, Intangibles, Goodwill and Other (“ASC 350”). Please see Note 7 to the Company’s financial statements for further discussion.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment, which eliminates Step 2 from the goodwill impairment test in order to simplify the subsequent measurement of goodwill. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. As a result of this ASU, the Company will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 is effective beginning January 1, 2020, with early adoption permitted, and applied prospectively. The Company elected to early adopt this ASU effective for the current reporting period in its impairment testing and analyses. The adoption of ASU 2017-04 on January 1, 2018 did not have an impact on the Company's consolidated financial statements and disclosures as it will perform its annual goodwill impairment analysis during the fourth quarter of 2018 (as no indicators for impairment existed at September 30, 2018).

In accordance with ASC 350, the Company analyzes goodwill for impairment on an annual basis (or more often if indicators of impairment exist). The Company performs a qualitative assessment to determine whether the existence of events or circumstances leads to a determination that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. When performing a qualitative assessment, the Company evaluates qualitative factors such as (1) macroeconomic conditions, such as a deterioration in general economic conditions; (2) industry and market considerations such as deterioration in the environment in which the entity operates; (3) cost factors such as increases in raw materials and labor costs; and (4) overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings, to determine if it is more-likely-than-not that the fair value of the reporting unit is less than its carrying amount. If the qualitative assessment indicates that it is more-likely-than-not that the fair value of the reporting unit is less than its carrying amount, then a quantitative assessment is performed to determine the reporting unit's fair value. If the reporting unit's carrying value exceeds its fair value, then an impairment loss is recognized for the amount of the excess of the carrying amount over the reporting unit's fair value.

The evaluation of goodwill for possible impairment includes estimating fair value using one or a combination of valuation techniques, such as discounted cash flows. These valuations require the Company to make estimates and assumptions regarding future operating results, cash flows, changes in capital expenditures, selling prices, profitability, and the cost of capital. Although the Company believes its assumptions and estimates are reasonable, deviations from the assumptions and estimates could produce a materially different result.

Recently Adopted Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which provides guidance for revenue recognition. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets and supersedes the revenue recognition requirements in ASC 605 and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, "Revenue Recognition-Construction-Type and Production-Type Contracts." ASU 2014-09's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under today's guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which delayed the effective date of ASU 2014-09 by one year. ASU 2014-09, as amended, is effective for public companies for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period.

Subsequent to the issuance of ASU 2014-09, the FASB has issued several ASUs, such as ASU 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, and ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients. These ASUs do not change the core principle of the guidance stated in ASU 2014-09. Instead, these amendments are intended to clarify and improve the operability of certain topics addressed by ASU 2014-09. These additional ASUs have the same effective date and transition requirements as ASU 2014-09, as amended.

We adopted the standard, and the subsequently issued standards mentioned above, on January 1, 2018 using the modified retrospective transition method, which includes a cumulative catch-up in retained earnings on the initial date of adoption for existing contracts (those that are not completed) as of, and new contracts after, January 1, 2018. The adoption did not have a material impact on our consolidated financial statements. The amount and timing of our housing and land revenue remained substantially unchanged, and we did not have significant changes to our business processes, systems, or internal controls as a result of adopting the standard. The Company has developed the additional expanded disclosures required (please see our Significant Accounting Policies section above); however, the adoption did not have a material impact on its consolidated results of operations, financial position and cash flows.

In February 2017, the FASB issued ASU 2017-05, Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for

Partial Sales of Nonfinancial Assets (“ASU 2017-05”). ASU 2017-05 is intended to clarify the scope of the original guidance within Subtopic 610-20 that was issued in connection with ASU 2014-09, which provides guidance for recognizing gains and losses from the transfer of nonfinancial assets in contracts with noncustomers. ASU 2017-05 additionally added guidance for partial sales of nonfinancial assets. ASU 2017-05 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. We were required to adopt ASU 2017-05 concurrent with the adoption of ASU 2014-09. The adoption of ASU 2017-05 did not have a material impact on the Company’s consolidated financial statements and disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 provides guidance on how certain cash receipts and cash payments are to be presented and classified in the statement of cash flows. For public entities, ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The adoption of ASU 2016-15

did not modify the Company's current disclosures within the condensed consolidated statement of cash flows and did not have any impact on the Company’s consolidated financial statements and disclosures.
In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (“ASU 2017-01”), which provides a more robust framework for determining whether transactions should be accounted for as acquisitions (or dispositions) of assets or businesses. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company adopted the standard on January 1, 2018. The adoption of ASU 2017-01 did not have an impact on the Company’s consolidated financial statements and disclosures as the Company’s acquisition during the first quarter of 2018 met all requirements to be accounted for as a business acquisition.
Impact of New Accounting Standards
In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”). ASU 2016-02 will require organizations that lease assets - referred to as “lessees” - to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under ASU 2016-02, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Lessor accounting remains substantially similar to current GAAP. In addition, disclosures of leasing activities will be expanded to include qualitative and specific quantitative information. For public entities, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. ASU 2016-02 mandates a modified retrospective transition method. The Company continues to evaluate the potential impact the adoption of ASU 2016-02 will have on the Company’s consolidated financial statements and disclosures; however, because a large majority of our leases are for office space, which we have determined will be treated as operating leases under ASU 2016-02, we anticipate recording a right-of-use asset and related lease liability for these leases, but do not expect our expense recognition pattern to change.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities (“ASU 2017-08”), which shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public entities, ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company does not believe the adoption of ASU 2017-08 will have a material impact on the Company’s consolidated financial statements and disclosures.

In January 2018, the FASB issued ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842 (“ASU 2018-01”), which provides an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current lease guidance in Topic 840. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 beginning at the date the entity adopts Topic 842; otherwise, an entity should evaluate all existing or expired land easements in connection with the adoption of the new lease requirements in Topic 842 to assess whether they meet the definition of a lease. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in ASU 2016-02. This ASU is not expected to have a significant impact on the Company's expected impact of the adoption of ASU 2016-02 (discussed above) or its consolidated financial statements and disclosures.

In March 2018, the FASB issued ASU 2018-05, which amends Income Taxes (Topic 740) by incorporating the Securities and Exchange Commission’s (“SEC”) Staff Accounting Bulletin 118 (“SAB 118”) issued on December 22, 2017. SAB 118 provides guidance on accounting for the effects of the Tax Cuts and Jobs Act of 2017 (the “Tax Act”). We recognized the income tax effects of the Tax Act in our 2017 financial statements in accordance with SAB 118. Please see Note 10 to our financial statements for additional disclosures.

In July 2018, the FASB issued ASU 2018-09, Codification Improvements (“ASU 2018-09”). ASU 2018-09 amends a variety of topics in the FASB’s Accounting Standards Codification. The transition and effective date of the guidance are based on the facts and circumstances of each amendment. Some of the amendments in ASU 2018-09 do not require transition guidance and were effective upon issuance of ASU 2018-09. However, many of the amendments include transition guidance with effective dates for annual periods beginning after December 15, 2018. The Company does not believe the adoption of ASU 2018-09 will have a material impact on the Company’s consolidated financial statements and disclosures.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases. This ASU includes certain clarifications to address potential narrow-scope implementation issues which we are incorporating into our assessment and adoption of ASU 2016-02. The amendments in this ASU are effective in the same time-frame as ASU 2016-02 as discussed above.

In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements. This ASU allows entities to not recast comparative periods in transition to ASC 842 and instead report the comparative periods presented in the period of adoption under ASC 840. The ASU also includes a practical expedient for lessors to not separate the lease and non-lease components of a contract. The amendments in this ASU are effective in the same time-frame as ASU 2016-02 as discussed above. We are incorporating this ASU into our assessment and adoption of ASU 2016-02.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement (“ASU 2018-13”). This ASU modifies the disclosure requirements for fair value measurements. This ASU removes the requirement to disclose (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels, and (3) the valuation processes for Level 3 fair value measurements. ASU 2018-13 requires disclosure of changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For all entities, ASU 2018-13 is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. We are currently evaluating the effect that this guidance will have on our consolidated financial statements and disclosures.

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force) (“ASU 2018-15”). This ASU requires entities that are customers in cloud computing arrangements to defer implementation costs if they would be capitalized by the entity in software licensing arrangements under the internal-use software guidance. The guidance may be applied retrospectively or prospectively to implementation costs incurred after the date of adoption. For public entities, ASU 2018-15 is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. We are currently evaluating the effect that this guidance will have on our consolidated financial statements and disclosures.

NOTE 2. Inventory and Capitalized Interest

Inventory

Inventory is recorded at cost, unless events and circumstances indicate that the carrying value of the land is impaired, at which point the inventory is written down to fair value (please see Note 4 to our financial statements for additional details relating to our procedures for evaluating our inventories for impairment). Inventory includes the costs of land acquisition, land development and home construction, capitalized interest, real estate taxes, direct overhead costs incurred during development and home construction, and common costs that benefit the entire community, less impairments, if any.

A summary of the Company’s inventory as of September 30, 2018 and December 31, 2017 is as follows:

| (In thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Single-family lots, land and land development costs | $ 754,322 | $ 687,260 |
| Land held for sale | 14,312 | 6,491 |
| Homes under construction | 831,129 | 579,051 |
| Model homes and furnishings - at cost (less accumulated depreciation: September 30, 2018 - $14,194; December 31, 2017 - $12,715) | 81,642 | 74,622 |
| Community development district infrastructure | 16,101 | 13,049 |
| Land purchase deposits | 32,122 | 32,556 |
| Consolidated inventory not owned | 21,897 | 21,545 |
| Total inventory | $ 1,751,525 | $ 1,414,574 |

Single-family lots, land and land development costs include raw land that the Company has purchased to develop into lots, costs incurred to develop the raw land into lots, and lots for which development has been completed, but which have not yet been used to start construction of a home.

Homes under construction include homes that are in various stages of construction. As of September 30, 2018 and December 31, 2017, we had 1,436 homes (with a carrying value of $296.4 million) and 1,134 homes (with a carrying value of $242.7 million), respectively, included in homes under construction that were not subject to a sales contract.

Model homes and furnishings include homes that are under construction or have been completed and are being used as sales models. The amount also includes the net book value of furnishings included in our model homes. Depreciation on model home furnishings is recorded using an accelerated method over the estimated useful life of the assets, which is typically three years.

We own lots in certain communities in Florida that have Community Development Districts ("CDDs"). The Company records a liability for the estimated developer obligations that are probable and estimable and user fees that are required to be paid or transferred at the time the parcel or unit is sold to an end user. The Company reduces this liability at the time of closing and the transfer of the property. The Company recorded a $16.1 million and $13.0 million liability related to these CDD bond obligations as of September 30, 2018 and December 31, 2017, respectively, along with the related inventory infrastructure.

Land purchase deposits include both refundable and non-refundable amounts paid to third party sellers relating to the purchase of land. On an ongoing basis, the Company evaluates the land option agreements relating to the land purchase deposits. In the period during which the Company makes the decision not to proceed with the purchase of land under an agreement, the Company expenses any deposits and accumulated pre-acquisition costs relating to such agreement.

Capitalized Interest

The Company capitalizes interest during land development and home construction. Capitalized interest is charged to land and housing costs and expensed as the related inventory is delivered to a third party. The summary of capitalized interest for the three and nine months ended September 30, 2018 and 2017 is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2018 | 2017 |
| Capitalized interest, beginning of period | $19,252 | $16,465 | $17,169 | $16,012 |
| Interest capitalized to inventory | 8,047 | 6,178 | 21,197 | 15,240 |
| Capitalized interest charged to land and housing costs and expenses | (6,278 ) | (4,988 ) | (17,345 ) | (13,597 ) |
| Capitalized interest, end of period | $21,021 | $17,655 | $21,021 | $17,655 |
| | | | | |
| Interest incurred | $12,473 | $10,853 | $36,389 | $29,087 |

NOTE 3. Investment in Joint Venture Arrangements

Investment in Joint Venture Arrangements

In order to minimize our investment and risk of land exposure in a single location, we have periodically partnered with other land developers or homebuilders to share in the land investment and development of a property through joint ownership and development agreements, joint ventures, and other similar arrangements. During the nine-month period ended September 30, 2018, we increased our total investment in such joint venture arrangements by $4.1 million from $20.5 million at December 31, 2017 to $24.6 million at September 30, 2018, which was driven primarily by our cash contributions to our unconsolidated joint ventures during the first nine months of 2018 of $20.5 million, offset, in part, by our increased lot distributions from unconsolidated joint ventures of $16.0 million. We believe that the Company's maximum exposure related to its investment in these joint venture arrangements as of September 30, 2018 is the amount invested of $24.6 million, which is reported as Investment in Joint Venture Arrangements on our Unaudited Condensed Consolidated Balance Sheets, although we expect to invest further amounts in these joint venture arrangements as development of the properties progresses.

We use the equity method of accounting for investments in unconsolidated joint ventures over which we exercise significant influence but do not have a controlling interest. Under the equity method, our share of the unconsolidated joint ventures' earnings or loss, if any, is included in our consolidated statement of income. The Company assesses its investments in unconsolidated joint ventures for recoverability on a quarterly basis. Please see Note 4 to our financial statements for additional details relating to our procedures for evaluating our investments for impairment.

For joint venture arrangements where a special purpose entity is established to own the property, we generally enter into limited liability company or similar arrangements ("LLCs") with the other partners. The Company's ownership in these LLCs as of both September 30, 2018 and December 31, 2017 ranged from 25% to 97%. These entities typically engage in land development activities for the purpose of distributing or selling developed lots to the Company and its partners in the LLC.

Variable Interest Entities

With respect to our investments in these LLCs, we are required, under ASC 810-10, Consolidation (“ASC 810”), to evaluate whether or not such entities should be consolidated into our consolidated financial statements. We initially perform these evaluations when each new entity is created and upon any events that require reconsideration of the entity. Please see Note 1, “Summary of

Significant Accounting Policies - Variable Interest Entities" in the Company's 2017 Form 10-K for additional information regarding the Company's methodology for evaluating entities for consolidation.

Land Option Agreements

In the ordinary course of business, the Company enters into land option or purchase agreements for which we generally pay non-refundable deposits. Pursuant to these land option agreements, the Company provides a deposit to the seller as consideration for the right to purchase land at different times in the future, usually at predetermined prices. In accordance with ASC 810, we analyze our land option or purchase agreements to determine whether the corresponding land sellers are variable interest entities ("VIEs") and, if so, whether we are the primary beneficiary, as further described in Note 1, "Summary of Significant Accounting Policies - Land Option Agreements" in the Company's 2017 Form 10-K. If we are deemed to be the primary beneficiary of the VIE, we will consolidate the VIE in our consolidated financial statements and reflect such assets and liabilities in our Consolidated Inventory not Owned in our Unaudited Condensed Consolidated Balance Sheets. At both September 30, 2018 and December 31, 2017, we concluded that we were not the primary beneficiary of any VIEs from which we are purchasing land under option or purchase agreements.

NOTE 4. Fair Value Measurements

There are three measurement input levels for determining fair value: Level 1, Level 2, and Level 3. Fair values determined by Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

Assets Measured on a Recurring Basis

The Company measures both mortgage loans held for sale and interest rate lock commitments ("IRLCs") at fair value. Fair value measurement results in a better presentation of the changes in fair values of the loans and the derivative instruments used to economically hedge them.

In the normal course of business, our financial services segment enters into contractual commitments to extend credit to buyers of single-family homes with fixed expiration dates. The commitments become effective when the borrowers "lock-in" a specified interest rate within established time frames. Market risk arises if interest rates move adversely between the time of the "lock-in" of rates by the borrower and the sale date of the loan to an investor. To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into optional or mandatory delivery forward sale contracts to sell whole loans and mortgage-backed securities to broker/dealers. The forward sale contracts lock in an interest rate and price for the sale of loans similar to the specific rate lock commitments. The Company does not engage in speculative trading or derivative activities. Both the rate lock commitments to borrowers and the forward sale contracts to broker/dealers or investors are undesignated derivatives, and accordingly, are marked to fair value through earnings. Changes in fair value measurements are included in earnings in the accompanying statements of income.

The fair value of mortgage loans held for sale is estimated based primarily on published prices for mortgage-backed securities with similar characteristics. To calculate the effects of interest rate movements, the Company utilizes applicable published mortgage-backed security prices, and multiplies the price movement between the rate lock date and the balance sheet date by the notional loan commitment amount. The Company sells loans on a servicing released or servicing retained basis, and receives servicing compensation. Thus, the value of the servicing rights included in the fair value measurement is based upon contractual terms with investors and depends on the loan type. The Company applies a fallout rate to IRLCs when measuring the fair value of rate lock commitments. Fallout is defined as locked loan commitments for which the Company does not close a mortgage loan and is based on management's judgment and company experience.

The fair value of the Company's forward sales contracts to broker/dealers solely considers the market price movement of the same type of security between the trade date and the balance sheet date. The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

Interest Rate Lock Commitments. IRLCs are extended to certain home-buying customers who have applied for a mortgage loan and meet certain defined credit and underwriting criteria. Typically, the IRLCs will have a term of less than six months; however, in certain markets, the term could extend to nine months.

Some IRLCs are committed to a specific third party investor through the use of whole loan delivery commitments matching the exact terms of the IRLC loan. Uncommitted IRLCs are considered derivative instruments and are fair value adjusted, with the resulting gain or loss recorded in current earnings.

Forward Sales of Mortgage-Backed Securities. Forward sales of mortgage-backed securities (“FMBSs”) are used to protect uncommitted IRLC loans against the risk of changes in interest rates between the lock date and the funding date. FMBSs related to uncommitted IRLCs are classified and accounted for as non-designated derivative instruments and are recorded at fair value, with gains and losses recorded in current earnings.

Mortgage Loans Held for Sale. Mortgage loans held for sale consists primarily of single-family residential loans collateralized by the underlying property. Generally, all of the mortgage loans and related servicing rights are sold to third-party investors shortly after origination. During the period between when a loan is closed and when it is sold to an investor, the interest rate risk is covered through the use of a whole loan contract or by FMBSs.

The table below shows the notional amounts of our financial instruments at September 30, 2018 and December 31, 2017:

| Description of Financial Instrument (in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Whole loan contracts and related committed IRLCs | $ 8,163 | $ 2,182 |
| Uncommitted IRLCs | 135,450 | 50,746 |
| FMBSs related to uncommitted IRLCs | 143,000 | 53,000 |
| Whole loan contracts and related mortgage loans held for sale | 11,015 | 80,956 |
| FMBSs related to mortgage loans held for sale | 103,000 | 91,000 |
| Mortgage loans held for sale covered by FMBSs | 103,258 | 90,781 |

The table below shows the level and measurement of assets and liabilities measured on a recurring basis at September 30, 2018 and December 31, 2017:

| Description of Financial Instrument (in thousands) | Fair Value Measurements September 30, 2018 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Mortgage loans held for sale | $ 115,189 | $ — | $ 115,189 | $ — |
| Forward sales of mortgage-backed securities | 1,624 | — | 1,624 | — |
| Interest rate lock commitments | 384 | — | 384 | — |
| Whole loan contracts | 87 | — | 87 | — |
| Total | $ 117,284 | $ — | $ 117,284 | $ — |

| Description of Financial Instrument (in thousands) | Fair Value Measurements December 31, 2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Mortgage loans held for sale | $ 171,580 | $ — | $ 171,580 | $ — |
| Forward sales of mortgage-backed securities | 177 | — | 177 | — |
| Interest rate lock commitments | 271 | — | 271 | — |
| Whole loan contracts | 12 | — | 12 | — |
| Total | $ 172,040 | $ — | $ 172,040 | $ — |

The following table sets forth the amount of gain (loss) recognized, within our revenue in the Unaudited Condensed Consolidated Statements of Income, on assets and liabilities measured on a recurring basis for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| Description (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Mortgage loans held for sale | $(1,383) | $(64) | $(66) | $4,326 |
| Forward sales of mortgage-backed securities | 2,407 | (128) | 1,447 | 241 |
| Interest rate lock commitments | (763) | 22 | 80 | 116 |
| Whole loan contracts | 252 | (41) | 108 | 30 |
| Total gain (loss) recognized | $513 | $(211) | $1,569 | $4,713 |

The following tables set forth the fair value of the Company's derivative instruments and their location within the Unaudited Condensed Consolidated Balance Sheets for the periods indicated (except for mortgage loans held for sale which are disclosed as a separate line item):

| | Asset Derivatives September 30, 2018 | | Liability Derivatives September 30, 2018 | |
|---|---|---|---|---|
| Description of Derivatives | Balance Sheet Location | Fair Value (in thousands) | Balance Sheet Location | Fair Value (in thousands) |
| Forward sales of mortgage-backed securities | Other assets | $ 1,624 | Other liabilities | $ — |
| Interest rate lock commitments | Other assets | 384 | Other liabilities | — |
| Whole loan contracts | Other assets | 87 | Other liabilities | — |
| Total fair value measurements | | $ 2,095 | | $ — |

| | Asset Derivatives December 31, 2017 | | Liability Derivatives December 31, 2017 | |
|---|---|---|---|---|
| Description of Derivatives | Balance Sheet Location | Fair Value (in thousands) | Balance Sheet Location | Fair Value (in thousands) |
| Forward sales of mortgage-backed securities | Other assets | $ 177 | Other liabilities | $ — |
| Interest rate lock commitments | Other assets | 271 | Other liabilities | — |
| Whole loan contracts | Other assets | 12 | Other liabilities | — |
| Total fair value measurements | | $ 460 | | $ — |

Assets Measured on a Non-Recurring Basis

Inventory.  The Company assesses inventory for recoverability on a quarterly basis based on the difference in the carrying value of the inventory and its fair value at the time of the evaluation. Determining the fair value of a community's inventory involves a number of variables, estimates and projections, which are Level 3 measurement inputs. Please see Note 1, "Summary of Significant Accounting Policies - Inventory" in the Company's 2017 Form 10-K for additional information regarding the Company's methodology for determining fair value.

The Company uses significant assumptions to evaluate the recoverability of its inventory, such as estimated average selling price, construction and development costs, absorption rate (reflecting any product mix change strategies implemented or to be implemented), selling strategies, alternative land uses (including disposition of all or a portion of the land owned), or discount rates. Changes in these assumptions could materially impact future cash flow and fair value estimates and may lead the Company to incur additional impairment charges in the future. Our analysis is conducted only if indicators of a decline in value of our inventory exist, which include, among other things, declines in gross margin on sales contracts in backlog or homes that have been delivered, slower than anticipated absorption pace, declines in average sales price or high incentive offers by management to improve absorptions, declines in margins regarding future land sales, or declines in the value of the land itself as a result of third party appraisals. If communities are not recoverable based on the estimated future undiscounted cash flows, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. During the three and nine months ended September 30, 2018 and 2017, the Company did not record any impairment charges on its inventory.

Investment in Unconsolidated Joint Ventures.  We evaluate our investments in unconsolidated joint ventures for impairment on a quarterly basis based on the difference in the investment's carrying value and its fair value at the time of the evaluation. If the Company has determined that the decline in value is other than temporary, the Company would write down the value of the investment to its estimated fair value. Determining the fair value of investments in unconsolidated joint ventures involves a number of variables, estimates and assumptions, which are Level 3 measurement inputs. Please see Note 1, "Summary of Significant Accounting Policies - Investment in Unconsolidated Joint Ventures," in the Company's 2017 Form 10-K for additional information regarding the Company's methodology for determining fair value. Because of the high degree of judgment involved in developing these assumptions, it is possible that changes in these assumptions could materially impact future cash flow and fair value estimates of the investments which may lead the Company to incur additional impairment charges in the future. During the three and nine months ended September 30, 2018 and 2017, the Company did not record any impairment charges on its investments in unconsolidated joint ventures.

Asset Held For Sale. The Company measures assets held for sale at fair value on a nonrecurring basis and records impairment charges when the assets are deemed to be impaired. Assets held for sale are reported at the lower of cost or fair value. Cost to sell are accrued separately. Our home office building in Columbus, Ohio met the held for sale classification criteria for the period ended September 30, 2018 as it was being actively marketed. The carrying value of the building as of September 30, 2018 was $5.6 million. The Company estimated the fair value of the building using the market values for similar properties, and the building

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was considered a Level 2 asset as defined in ASC 820, "Fair Value Measurements." During the three and nine months ended September 30, 2018, the Company did not record any impairment charges on its asset held for sale.

Financial Instruments

Counterparty Credit Risk. To reduce the risk associated with losses that would be recognized if counterparties failed to perform as contracted, the Company limits the entities with whom management can enter into commitments. This risk of accounting loss is the difference between the market rate at the time of non-performance by the counterparty and the rate to which the Company committed.

The following table presents the carrying amounts and fair values of the Company's financial instruments at September 30, 2018 and December 31, 2017. The objective of the fair value measurement is to estimate the price at which an orderly transaction to sell the asset or transfer the liability would take place between market participants at the measurement date under current market conditions.

| (In thousands) | September 30, 2018 Carrying Amount | September 30, 2018 Fair Value | December 31, 2017 Carrying Amount | December 31, 2017 Fair Value |
|---|---|---|---|---|
| Assets: | | | | |
| Cash, cash equivalents and restricted cash | $36,360 | $36,360 | $151,703 | $151,703 |
| Mortgage loans held for sale | 115,189 | 115,189 | 171,580 | 171,580 |
| Split dollar life insurance policies | 209 | 209 | 209 | 209 |
| Commitments to extend real estate loans | 384 | 384 | 271 | 271 |
| Whole loan contracts for committed IRLCs and mortgage loans held for sale | 87 | 87 | 12 | 12 |
| Forward sales of mortgage-backed securities | 1,624 | 1,624 | 177 | 177 |
| Liabilities: | | | | |
| Notes payable - homebuilding operations | 222,700 | 222,700 | — | — |
| Notes payable - financial services operations | 104,026 | 104,026 | 168,195 | 168,195 |
| Notes payable - other | 8,838 | 8,109 | 10,576 | 9,437 |
| Convertible senior subordinated notes due 2018 (a) | — | — | 86,250 | 93,581 |
| Senior notes due 2021 (a) | 300,000 | 305,250 | 300,000 | 310,875 |
| Senior notes due 2025 (a) | 250,000 | 233,438 | 250,000 | 252,500 |
| Off-Balance Sheet Financial Instruments: | | | | |
| Letters of credit | — | 1,087 | — | 1,083 |

(a) Our senior notes and convertible senior subordinated notes are stated at the principal amount outstanding which does not include the impact of premiums, discounts, and debt issuance costs that are amortized to interest cost over the respective terms of the notes.

The following methods and assumptions were used by the Company in estimating its fair value disclosures of financial instruments at September 30, 2018 and December 31, 2017:

Cash, Cash Equivalents and Restricted Cash. The carrying amounts of these items approximate fair value because they are short-term by nature.

Mortgage Loans Held for Sale, Forward Sales of Mortgage-Backed Securities, Commitments to Extend Real Estate Loans, Whole loan Contracts for Committed IRLCs and Mortgage Loans Held for Sale, Convertible Senior Subordinated Notes due 2018, Senior Notes due 2021 and Senior Notes due 2025. The fair value of these financial instruments was determined based upon market quotes at September 30, 2018 and December 31, 2017. The market quotes used were quoted prices for similar assets or liabilities along with inputs taken from observable market data by correlation. The inputs were adjusted to account for the condition of the asset or liability.

Split Dollar Life Insurance Policy and Notes Receivable. The estimated fair value was determined by calculating the present value of the amounts based on the estimated timing of receipts using discount rates that incorporate management's estimate of risk associated with the corresponding note receivable.

Notes Payable - Homebuilding Operations. The interest rate available to the Company during the quarter ended September 30, 2018 under the Company's $500 million unsecured revolving credit facility, dated July 18, 2013, as amended (the “Credit Facility”), fluctuated daily with the one-month LIBOR rate plus a margin of 250 basis points, and thus the carrying value is a reasonable estimate of fair value. Please see Note 8 to our financial statements for additional information regarding the Credit Facility.

Notes Payable - Financial Services Operations. M/I Financial, LLC (“M/I Financial”) is a party to two credit agreements: (1) a $125 million secured mortgage warehousing agreement (which increases to $160 million during certain periods), as most recently amended on June 22, 2018 (the “MIF Mortgage Warehousing Agreement”); and (2) a $35 million mortgage repurchase agreement, as amended and restated on October 30, 2017 (the “MIF Mortgage Repurchase Facility”). For each of these credit facilities, the interest rate is based on a variable rate index, and thus their carrying value is a reasonable estimate of fair value. The interest rate available to M/I Financial during the third quarter of 2018 fluctuated with LIBOR. Please see Note 8 to our financial statements for additional information regarding the MIF Mortgage Warehousing Agreement and the MIF Mortgage Repurchase Facility.

Notes Payable - Other. The estimated fair value was determined by calculating the present value of the future cash flows using the Company’s current incremental borrowing rate.

Letters of Credit. Letters of credit of $48.8 million and $49.7 million represent potential commitments at September 30, 2018 and December 31, 2017, respectively. The letters of credit generally expire within one or two years. The estimated fair value of letters of credit was determined using fees currently charged for similar agreements.

NOTE 5. Guarantees and Indemnifications

In the ordinary course of business, M/I Financial, a 100%-owned subsidiary of M/I Homes, Inc., enters into agreements that guarantee certain purchasers of its mortgage loans that M/I Financial will repurchase a loan if certain conditions occur, primarily if the mortgagor does not meet the terms of the loan within the first six months after the sale of the loan. Loans totaling approximately $81.9 million and $46.8 million were covered under these guarantees as of September 30, 2018 and December 31, 2017, respectively. The increase in loans covered by these guarantees from December 31, 2017 is a result of a change in the mix of investors and their related purchase terms. A portion of the revenue paid to M/I Financial for providing the guarantees on these loans was deferred at September 30, 2018, and will be recognized in income as M/I Financial is released from its obligation under the guarantees. The risk associated with the guarantees above is offset by the value of the underlying assets.

M/I Financial has received inquiries concerning underwriting matters from purchasers of its loans regarding certain loans totaling approximately $0.6 million and $1.2 million at September 30, 2018 and December 31, 2017, respectively.

M/I Financial has also guaranteed the collectability of certain loans to third party insurers (U.S. Department of Housing and Urban Development and U.S. Veterans Administration) of those loans for periods ranging from five to thirty years. As of September 30, 2018 and December 31, 2017, the total of all loans indemnified to third party insurers relating to the above agreements was $1.0 million and $1.3 million, respectively. The maximum potential amount of future payments is equal to the outstanding loan value less the value of the underlying asset plus administrative costs incurred related to foreclosure on the loans, should this event occur.

The Company recorded a liability relating to the guarantees described above totaling $0.6 million and $0.8 million at September 30, 2018 and December 31, 2017, respectively, which is management’s best estimate of the Company’s liability.

NOTE 6. Commitments and Contingencies

Warranty

We use subcontractors for nearly all aspects of home construction. Although our subcontractors are generally required to repair and replace any product or labor defects, we are, during applicable warranty periods, ultimately responsible to the homeowner for making such repairs. As such, we record warranty reserves to cover our exposure to the costs for materials and labor not expected to be covered by our subcontractors to the extent they relate to warranty-type claims. Warranty reserves are established by charging cost of sales and crediting a warranty reserve for each home delivered. Warranty reserves are recorded for warranties under our Home Builder’s Limited Warranty (“HBLW”), and our 30-year (offered on all homes sold after April 25, 1998 and on or before December 1, 2015 in all of our markets except our Texas markets), 15-year (offered on all homes sold after December 1, 2015 in all of our markets except our Texas markets) or 10-year (offered on all homes sold in our Texas markets) transferable structural warranty in Other Liabilities on the Company’s Unaudited Condensed Consolidated Balance Sheets.

The warranty reserves for the HBLW are established as a percentage of average sales price and adjusted based on historical payment patterns determined, generally, by geographic area and recent trends. Factors that are given consideration in determining the HBLW reserves include: (1) the historical range of amounts paid per average sales price on a home; (2) type and mix of amenity packages added to the home; (3) any warranty expenditures not considered to be normal and recurring; (4) timing of payments; (5) improvements in quality of construction expected to impact future warranty expenditures; and (6) conditions that may affect certain projects and require a different percentage of average sales price for those specific projects. Changes in estimates for warranties occur due to changes in the historical payment experience and differences between the actual payment pattern

experienced during the period and the historical payment pattern used in our evaluation of the warranty reserve balance at the end of each quarter. Actual future warranty costs could differ from our current estimated amount.
Our warranty reserves for our transferable structural warranty programs are established on a per-unit basis. While the structural warranty reserve is recorded as each house is delivered, the sufficiency of the structural warranty per unit charge and total reserve is re-evaluated on an annual basis, with the assistance of an actuary, using our own historical data and trends, industry-wide historical data and trends, and other project specific factors. The reserves are also evaluated quarterly and adjusted if we encounter activity that is inconsistent with the historical experience used in the annual analysis. These reserves are subject to variability due to uncertainties regarding structural defect claims for products we build, the markets in which we build, claim settlement history, insurance and legal interpretations, among other factors.
While we believe that our warranty reserves are sufficient to cover our projected costs, there can be no assurances that historical data and trends will accurately predict our actual warranty costs.
A summary of warranty activity for the three and nine months ended September 30, 2018 and 2017 is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2018 | 2017 |
| Warranty reserves, beginning of period | $23,279 | $30,303 | $26,133 | $27,732 |
| Warranty expense on homes delivered during the period | 3,353 | 2,882 | 9,195 | 8,094 |
| Changes in estimates for pre-existing warranties | 417 | 92 | 882 | 1,154 |
| Charges related to stucco-related claims [(a)] | — | — | — | 8,500 |
| Settlements made during the period | (4,508 ) | (6,209 ) | (13,669 ) | (18,412 ) |
| Warranty reserves, end of period | $22,541 | $27,068 | $22,541 | $27,068 |

(a) Estimated stucco-related repair costs, as described below, have been included in warranty accruals.
We have received claims related to stucco installation from homeowners in certain of our communities in our Tampa and Orlando, Florida markets and have been named as a defendant in legal proceedings initiated by certain of such homeowners. These claims primarily relate to homes built prior to 2014 which have second story elevations with frame construction.
During 2015, 2016 and 2017, we recorded an aggregate total of $28.4 million of warranty charges for stucco-related repair costs for (1) homes in our Florida communities that we had identified as needing repair but had not yet completed the repair and (2) estimated repair costs for homes in our Florida communities that we had not yet identified as needing repair but that may require repair in the future.
We did not record any additional warranty charges for stucco-related repair costs during the third quarter of 2018 or the nine months ended September 30, 2018. The remaining reserve for both known repair costs and an estimate of future costs of stucco-related repairs at September 30, 2018 included within our warranty reserve was $5.6 million. We believe that this amount is sufficient to cover both known and estimated future repair costs as of September 30, 2018.
Our review of the stucco-related issues in our Florida communities is ongoing. Our estimate of future costs of stucco-related repairs is based on our judgment, various assumptions and internal data. Due to the degree of judgment and the potential for variability in our underlying assumptions and data, as we obtain additional information, we may revise our estimate, including to reflect additional estimated future stucco-related repairs costs, which revision could be material.
We also are continuing to investigate the extent to which we may be able to recover a portion of our stucco repair and claims handling costs from other sources, including our direct insurers, the subcontractors involved with the construction of the homes and their insurers. As of September 30, 2018, we are unable to estimate an amount, if any, that we believe is probable to be recovered from these sources and, accordingly, we have not recorded a receivable for estimated recoveries nor included an estimated amount of recoveries in determining our warranty reserves.

Performance Bonds and Letters of Credit

At September 30, 2018, the Company had outstanding approximately $205.9 million of completion bonds and standby letters of credit, some of which were issued to various local governmental entities that expire at various times through September 2026. Included in this total are: (1) $150.3 million of performance and maintenance bonds and $38.2 million of performance letters of credit that serve as completion bonds for land development work in progress; (2) $10.6 million of financial letters of credit, of which $10.1 million represent deposits on land and lot purchase agreements; and (3) $6.8 million of financial bonds.

Land Option Contracts and Other Similar Contracts

At September 30, 2018, the Company also had options and contingent purchase agreements to acquire land and developed lots with an aggregate purchase price of approximately $699.9 million. Purchase of properties under these agreements is contingent upon satisfaction of certain requirements by the Company and the sellers.

Legal Matters

In addition to the legal proceedings related to stucco, the Company and certain of its subsidiaries have been named as defendants in certain other legal proceedings which are incidental to our business. While management currently believes that the ultimate resolution of these other legal proceedings, individually and in the aggregate, will not have a material effect on the Company's financial position, results of operations and cash flows, such legal proceedings are subject to inherent uncertainties. The Company has recorded a liability to provide for the anticipated costs, including legal defense costs, associated with the resolution of these other legal proceedings. However, the possibility exists that the costs to resolve these legal proceedings could differ from the recorded estimates and, therefore, have a material effect on the Company's net income for the periods in which they are resolved. At September 30, 2018 and December 31, 2017, we had $0.2 million and $0.4 million reserved for legal expenses, respectively.

NOTE 7. Acquisition and Goodwill

Acquisition

In March 2018, we entered the Detroit, Michigan market through the acquisition of the homebuilding assets and operations of Pinnacle Homes. The purchase price was $101.0 million. The results of Pinnacle Homes operations have been included in our financial statements since March 1, 2018, the effective date of the acquisition. As a result of the transaction, we recorded a provisional $16.4 million of goodwill (all of which is tax deductible) which relates to expected synergies from establishing a market presence in Detroit, the experience and knowledge of the acquired workforce and the capital-efficient operating structure of the business acquired. The remaining basis of $84.6 million is almost entirely comprised of the fair value of the acquired inventory with an insignificant amount attributable to other assets and liabilities. In accordance with ASC 805-10, Business Combinations ("ASC 805"), we will update such balances, if necessary, upon further verification of the fair values on certain other assets, more relevant history on profitability of backlog, and further understanding of the cost to complete activities, if any, on purchased communities.

Goodwill

Goodwill represents the excess of the purchase price paid over the fair value of the net assets acquired and liabilities assumed in business combinations. Because the purchase price allocation is subject to change within a measurement period of up to one year from the acquisition date pursuant to ASC 805, in connection with the Company's acquisition of the homebuilding assets and operations of Pinnacle Homes in Detroit, Michigan described above, the Company recorded a provisional amount of goodwill of approximately $16.4 million as of September 30, 2018, which is included as Goodwill in our Unaudited Condensed Consolidated Balance Sheets. This provisional amount was based on the estimated fair values of the acquired assets and liabilities at the date of the acquisition in accordance with ASC 350, Intangibles, Goodwill and Other ("ASC 350").

In accordance with ASC 350, the Company analyzes goodwill for impairment on an annual basis (or more often if indicators of impairment exist). The Company performs a qualitative assessment to determine whether the existence of events or circumstances leads to a determination that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. If the qualitative assessment indicates that it is more-likely-than-not that the fair value of the reporting unit is less than its carrying amount, then a quantitative assessment is performed to determine the reporting unit's fair value. If the reporting unit's carrying value exceeds its fair value, then an impairment loss is recognized for the amount of the excess of the carrying amount over the reporting unit's fair value. As of September 30, 2018, there were no indicators that our goodwill was impaired.

NOTE 8. Debt

Notes Payable - Homebuilding

The Credit Facility provides an aggregate commitment amount of $500 million, including a $125 million sub-facility for letters of credit. The Credit Facility expires on July 18, 2021. Interest on amounts borrowed under the Credit Facility is payable at a rate which is adjusted daily and is equal to the sum of the one-month LIBOR rate plus a margin of 250 basis points. The margin is subject to adjustment in subsequent quarterly periods based on the Company’s leverage ratio. The Credit Facility also contains certain financial covenants. At September 30, 2018, the Company was in compliance with all financial covenants of the Credit Facility.

The available amount under the Credit Facility is computed in accordance with a borrowing base, which is calculated by applying various advance rates for different categories of inventory, and totaled $664.2 million of availability for additional senior debt at September 30, 2018. As a result, the full $500 million commitment amount of the Credit Facility was available, less any borrowings and letters of credit outstanding. At September 30, 2018, there were $222.7 million of borrowings outstanding and $48.8 million of letters of credit outstanding, leaving net remaining borrowing availability of $228.5 million.

The Company's obligations under the Credit Facility are guaranteed by all of the Company's subsidiaries, with the exception of subsidiaries that are primarily engaged in the business of mortgage financing, title insurance or similar financial businesses relating to the homebuilding and home sales business, certain subsidiaries that are not 100%-owned by the Company or another subsidiary, and other subsidiaries designated by the Company as Unrestricted Subsidiaries (as defined in Note 12 to our financial statements), subject to limitations on the aggregate amount invested in such Unrestricted Subsidiaries in accordance with the terms of the Credit Facility and the indentures for the Company's $250.0 million aggregate principal amount of 5.625% Senior Notes due 2025 (the "2025 Senior Notes") and the Company's $300.0 million aggregate principal amount of 6.75% Senior Notes due 2021 (the "2021 Senior Notes"). The guarantors for the Credit Facility (the "Guarantor Subsidiaries") are the same subsidiaries that guarantee the 2025 Senior Notes and the 2021 Senior Notes.

The Company's obligations under the Credit Facility are general, unsecured senior obligations of the Company and the Guarantor Subsidiaries and rank equally in right of payment with all our and the Guarantor Subsidiaries' existing and future unsecured senior indebtedness. Our obligations under the Credit Facility are effectively subordinated to our and the Guarantor Subsidiaries' existing and future secured indebtedness with respect to any assets comprising security or collateral for such indebtedness.

During the third quarter of 2018, the Company was a party to a secured credit agreement (the "Letter of Credit Facility") which allowed for the issuance of letters of credit up to a total of $1.0 million secured by cash collateral. The Company elected not to extend the maturity of its Letter of Credit Facility, which expired on September 30, 2018. There were no letters of credit remaining outstanding at the time of maturity. At December 31, 2017, there was $0.6 million of outstanding letters of credit in aggregate under the Letter of Credit Facility, which were collateralized with $0.6 million of the Company's cash.

Notes Payable — Financial Services

The MIF Mortgage Warehousing Agreement is used to finance eligible residential mortgage loans originated by M/I Financial. The MIF Mortgage Warehousing Agreement provides for a maximum borrowing availability of $125 million, which may be increased to $160 million during certain periods of expected increases in the volume of mortgage originations, specifically from September 25, 2018 to October 15, 2018 and from November 15, 2018 to February 4, 2019. The MIF Mortgage Warehousing Agreement expires on June 21, 2019. Interest on amounts borrowed under the MIF Mortgage Warehousing Agreement is payable at a per annum rate equal to the floating LIBOR rate plus a spread of 200 basis points. The MIF Mortgage Warehousing Agreement also contains certain financial covenants. At September 30, 2018, M/I Financial was in compliance with all financial covenants of the MIF Mortgage Warehousing Agreement.

The MIF Mortgage Repurchase Facility is used to finance eligible residential mortgage loans originated by M/I Financial. The MIF Repurchase Facility provides for a mortgage repurchase facility with a maximum borrowing availability of $35 million which increased to $50 million from November 15, 2017 through February 1, 2018 (a period during which we typically experience higher mortgage origination volume). The MIF Mortgage Repurchase Facility expires on October 29, 2018. M/I Financial pays interest on each advance under the MIF Mortgage Repurchase Facility at a per annum rate equal to the floating LIBOR rate plus 212.5 or 250 basis points depending on the loan type. The MIF Mortgage Repurchase Facility also contains certain financial covenants. At September 30, 2018, M/I Financial was in compliance with all financial covenants of the MIF Mortgage Repurchase Facility.

At September 30, 2018 and December 31, 2017, M/I Financial's total combined maximum borrowing availability under the two credit facilities was $195.0 million and $200.0 million, respectively. At September 30, 2018 and December 31, 2017, M/I Financial had $104.0 million and $168.2 million outstanding on a combined basis under its credit facilities, respectively.

Senior Notes

As of both September 30, 2018 and December 31, 2017, we had $250.0 million of our 2025 Senior Notes outstanding. The 2025 Senior Notes bear interest at a rate of 5.625% per year, payable semiannually in arrears on February 1 and August 1 of each year (commencing on February 1, 2018), and mature on August 1, 2025. We may redeem all or any portion of the 2025 Senior Notes on or after August 1, 2020 at a stated redemption price, together with accrued and unpaid interest thereon. The redemption price will initially be 104.219% of the principal amount outstanding, but will decline to 102.813% of the principal amount outstanding if redeemed during the 12-month period beginning on August 1, 2021, will further decline to 101.406% of the principal amount outstanding if redeemed during the 12-month period beginning on August 1, 2022 and will further decline to 100.000% of the principal amount outstanding if redeemed on or after August 1, 2023, but prior to maturity.

As of both September 30, 2018 and December 31, 2017, we had $300.0 million of our 2021 Senior Notes outstanding. The 2021 Senior Notes bear interest at a rate of 6.75% per year, payable semiannually in arrears on January 15 and July 15 of each year, and mature on January 15, 2021. As of January 15, 2018, we may redeem all or any portion of the 2021 Senior Notes at 103.375% of the principal amount outstanding. This rate declines to 101.688% of the principal amount outstanding if redeemed during the 12-month period beginning on January 15, 2019, and will further decline to 100.000% of the principal amount outstanding if redeemed on or after January 15, 2020, but prior to maturity.

The 2025 Senior Notes and the 2021 Senior Notes contain certain covenants, as more fully described and defined in the indenture governing the 2025 Senior Notes and the indenture governing the 2021 Senior Notes, which limit the ability of the Company and the restricted subsidiaries to, among other things: incur additional indebtedness; make certain payments, including dividends, or repurchase any shares, in an aggregate amount exceeding our “restricted payments basket”; make certain investments; and create or incur certain liens, consolidate or merge with or into other companies, or liquidate or sell or transfer all or substantially all of our assets. These covenants are subject to a number of exceptions and qualifications as described in the indenture governing the 2025 Senior Notes and the indenture governing the 2021 Senior Notes. As of September 30, 2018, the Company was in compliance with all terms, conditions, and covenants under the indentures.

The 2025 Senior Notes and the 2021 Senior Notes are fully and unconditionally guaranteed jointly and severally on a senior unsecured basis by the Guarantor Subsidiaries. The 2025 Senior Notes and the 2021 Senior Notes are general, unsecured senior obligations of the Company and the Guarantor Subsidiaries and rank equally in right of payment with all our and the Guarantor Subsidiaries’ existing and future unsecured senior indebtedness. The 2025 Senior Notes and the 2021 Senior Notes are effectively subordinated to our and the Guarantor Subsidiaries’ existing and future secured indebtedness with respect to any assets comprising security or collateral for such indebtedness.

The indenture governing our 2025 Senior Notes and the indenture governing the 2021 Senior Notes limit our ability to pay dividends on, and repurchase, our common shares and any of our preferred shares then outstanding to the amount of the positive balance in our “restricted payments basket,” as defined in the indentures. In each case, the “restricted payments basket” is equal to $125.0 million plus (1) 50% of our aggregate consolidated net income (or minus 100% of our aggregate consolidated net loss) from October 1, 2015, excluding income or loss from Unrestricted Subsidiaries, plus (2) 100% of the net cash proceeds from either contributions to the common equity of the Company after December 1, 2015 or the sale of qualified equity interests after December 1, 2015, plus other items and subject to other exceptions. The restricted payments basket was $215.7 million and $176.1 million at September 30, 2018 and December 31, 2017, respectively. The determination to pay future dividends on, or make future repurchases of, our common shares will be at the discretion of our board of directors and will depend upon our results of operations, financial condition, capital requirements and compliance with debt covenants, and other factors deemed relevant by our board of directors.

Convertible Senior Subordinated Notes

On March 1, 2013, the Company issued $86.3 million in aggregate principal amount of 3.0% Convertible Senior Subordinated Notes due 2018 (the “2018 Convertible Senior Subordinated Notes”). The 2018 Convertible Senior Subordinated Notes matured on March 1, 2018. As a result of conversion elections made by holders of the 2018 Convertible Senior Subordinated Notes, (1) approximately $20.3 million in aggregate principal amount of the 2018 Convertible Senior Subordinated Notes were converted and settled through the issuance of approximately 0.629 million of our common shares (at a conversion price per common share of $32.31) and (2) the Company repaid in cash approximately $65.9 million in aggregate principal amount of the 2018 Convertible Senior Subordinated Notes at maturity. On December 31, 2017, we had $86.3 million of our 2018 Convertible Senior Subordinated Notes outstanding.

Notes Payable - Other

The Company had other borrowings, which are reported in Notes Payable - Other in our Unaudited Condensed Consolidated Balance Sheets, totaling $8.8 million and $10.6 million as of September 30, 2018 and December 31, 2017, respectively. The balance is made up of notes payable acquired in the normal course of business.

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NOTE 9. Earnings Per Share

The table below presents a reconciliation between basic and diluted weighted average shares outstanding, net income available to common shareholders and basic and diluted income per share for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands, except per share amounts) | 2018 | 2017 | 2018 | 2017 |
| NUMERATOR | | | | |
| Net income | $29,282 | $22,327 | $75,256 | $56,199 |
| Preferred stock dividends [a] | — | (1,218) | — | (3,656) |
| Excess of fair value over book value of preferred shares subject to redemption | — | (2,257) | — | (2,257) |
| Net income available to common shareholders | 29,282 | 18,852 | 75,256 | 50,286 |
| Interest on 3.25% convertible senior subordinated notes due 2017 [b] | — | 324 | — | 1,106 |
| Interest on 3.00% convertible senior subordinated notes due 2018 [c] | — | 530 | 408 | 1,586 |
| Diluted income available to common shareholders | $29,282 | $19,706 | $75,664 | $52,978 |
| DENOMINATOR | | | | |
| Basic weighted average shares outstanding | 28,469 | 25,581 | 28,389 | 25,106 |
| Effect of dilutive securities: | | | | |
| Stock option awards | 220 | 248 | 346 | 302 |
| Deferred compensation awards | 217 | 237 | 202 | 207 |
| 3.25% convertible senior subordinated notes due 2017 [b] | — | 1,940 | — | 2,255 |
| 3.00% convertible senior subordinated notes due 2018 [c] | — | 2,669 | 574 | 2,669 |
| Diluted weighted average shares outstanding - adjusted for assumed conversions | 28,906 | 30,675 | 29,511 | 30,539 |
| Earnings per common share: | | | | |
| Basic | $1.03 | $0.74 | $2.65 | $2.00 |
| Diluted | $1.01 | $0.64 | $2.56 | $1.73 |
| Anti-dilutive equity awards not included in the calculation of diluted earnings per common share | 437 | — | 363 | 31 |

(a) The Company's Articles of Incorporation authorize the issuance of up to 2,000,000 preferred shares, par value $.01 per share. On March 15, 2007, the Company issued 4,000,000 depositary shares, each representing 1/1000th of a 9.75% Series A Preferred Share of the Company (the "Series A Preferred Shares"), or 4,000 Series A Preferred Shares in the aggregate. On April 10, 2013, the Company redeemed 2,000 of its Series A Preferred Shares (and the 2,000,000 related depositary shares) for an aggregate redemption price of approximately $50.4 million in cash. On October 16, 2017, the Company redeemed the remaining 2,000 outstanding Series A Preferred Shares (and the 2,000,000 related depositary shares) for an aggregate redemption price of approximately $50.4 million in cash. The Company declared and paid a quarterly cash dividend of $609.375 per share on its then outstanding Series A Preferred Shares in each of the first, second and third quarter of 2017, for an aggregate dividend payment on the Series A Preferred Shares of $1.2 million and $3.7 million in the three and nine months ended September 30, 2017, respectively.

(b) On September 11, 2012, the Company issued $57.5 million in aggregate principal amount of 3.25% Convertible Senior Subordinated Notes due 2017 (the "2017 Convertible Senior Subordinated Notes"). The 2017 Convertible Senior Subordinated Notes were scheduled to mature on September 15, 2017 and the deadline for holders to convert the 2017 Convertible Senior Subordinated Notes was September 13, 2017. As a result of conversion elections made by holders of the 2017 Convertible Senior Subordinated Notes, all $57.5 million in aggregate principal amount of the 2017 Convertible Senior Subordinated Notes were converted and settled through the issuance of our common shares. In total, we issued approximately 2.4 million common shares (at a conversion price per common share of $23.80).

(c) On March 1, 2013, the Company issued $86.3 million in aggregate principal amount of 2018 Convertible Senior Subordinated Notes. The 2018 Convertible Senior Subordinated Notes were scheduled to mature on March 1, 2018 and the deadline for holders to convert the 2018 Convertible Senior Subordinated Notes was February 27, 2018. As a result of conversion elections made by holders of the 2018 Convertible Senior Subordinated Notes, (1) approximately $20.3 million in aggregate principal amount of the 2018 Convertible Senior Subordinated Notes were converted and settled through the issuance of approximately 0.629 million of our common shares (at a conversion price per common share of $32.31) and (2) the Company repaid in cash approximately $65.9 million in aggregate principal amount of the 2018 Convertible Senor Subordinated Notes at maturity.

For the nine months ended September 30, 2018 and the three and nine months ended September 30, 2017, the effect of our convertible debt then outstanding was included in the diluted earnings per share calculations.

NOTE 10. Income Taxes

During the three and nine months ended September 30, 2018, the Company recorded a tax provision of $10.2 million and $21.6 million, respectively, which reflects income tax expense related to the periods’ income before income taxes. The effective tax rate for the three and nine months ended September 30, 2018 was 25.8% and 22.3%, respectively. Our 2018 tax rates for these periods primarily reflect the lower corporate tax rate of 21% as a result of the Tax Act when compared to 2017 federal rates. In addition, during the nine months ended September 30, 2018, we recorded a $3.0 million tax benefit primarily related to the retroactive reinstatement of energy efficient homes tax credits to 2017 for which we obtained certifications in 2018. The Company is still analyzing certain aspects of the Tax Act and expects the final impact to be determined in conjunction with its tax return filings in the fourth quarter of 2018. During the three and nine months ended September 30, 2017, the Company recorded a tax provision of $12.3 million and $30.0 million, which reflects income tax expense related to the periods' income before income taxes. The effective tax rate for the three and nine months ended September 30, 2017 was 35.6% and 34.8%, respectively, which included the former 35% corporate tax rate and tax expense related to the expected tax benefits for the domestic production activities deduction.

The Company had $3.4 million of state NOL carryforwards, net of the federal benefit, at September 30, 2018. Our state NOLs may be carried forward from one to 15 years, depending on the tax jurisdiction, with $1.1 million expiring between 2022 and 2027 and $2.3 million expiring between 2028 and 2032, absent sufficient state taxable income.

NOTE 11. Business Segments

The Company's chief operating decision makers evaluate the Company's performance in various ways, including: (1) the results of our 16 individual homebuilding operating segments and the results of our financial services operations; (2) the results of our three homebuilding reportable segments; and (3) our consolidated financial results.

In accordance with ASC 280, Segment Reporting ("ASC 280"), we have identified each homebuilding division as an operating segment as each homebuilding division engages in business activities from which it earns revenue, primarily from the sale and construction of single-family attached and detached homes, acquisition and development of land, and the occasional sale of lots to third parties. Our financial services operations generate revenue primarily from the origination, sale and servicing of mortgage loans and title services primarily for purchasers of the Company's homes and are included in our financial services reportable segment. In accordance with the aggregation criteria defined in ASC 280, we have identified each homebuilding division as an operating segment and have determined our reportable segments are as follows: Midwest homebuilding; Southern homebuilding; Mid-Atlantic homebuilding; and financial services operations. The homebuilding operating segments that are included within each reportable segment have been aggregated because they share similar aggregation characteristics as prescribed in ASC 280 in the following regards: (1) long-term economic characteristics; (2) historical and expected future long-term gross margin percentages; (3) housing products, production processes and methods of distribution; and (4) geographical proximity.

The homebuilding operating segments that comprise each of our reportable segments are as follows:

| Midwest | Southern | Mid-Atlantic |
| --- | --- | --- |
| Chicago, Illinois | Orlando, Florida | Charlotte, North Carolina |
| Cincinnati, Ohio | Sarasota, Florida | Raleigh, North Carolina |
| Columbus, Ohio | Tampa, Florida | Washington, D.C. |
| Indianapolis, Indiana | Austin, Texas | |
| Minneapolis/St. Paul, Minnesota | Dallas/Fort Worth, Texas | |
| Detroit, Michigan | Houston, Texas | |
| | San Antonio, Texas | |

The following table shows, by segment: revenue, operating income and interest expense for the three and nine months ended September 30, 2018 and 2017, as well as the Company's income before income taxes for such periods:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2018 | 2017 |
| Revenue: | | | | |
| Midwest homebuilding | $236,803 | $180,488 | $622,325 | $495,379 |
| Southern homebuilding | 221,044 | 176,502 | 649,014 | 504,647 |
| Mid-Atlantic homebuilding | 97,802 | 107,670 | 253,363 | 302,305 |
| Financial services [a] | 12,193 | 11,763 | 39,095 | 37,938 |
| Total revenue | $567,842 | $476,423 | $1,563,797 | $1,340,269 |
| | | | | |
| Operating income: | | | | |
| Midwest homebuilding [b] | $24,179 | $20,887 | $55,377 | $53,730 |
| Southern homebuilding [c] | 18,922 | 13,082 | 53,142 | 26,503 |
| Mid-Atlantic homebuilding | 8,211 | 9,969 | 15,909 | 26,810 |
| Financial services [a] | 5,681 | 5,887 | 21,159 | 21,977 |
| Less: Corporate selling, general and administrative expense | (13,131) | (10,548) | (32,079) | (29,178) |
| Total operating income [b] [c] | $43,862 | $39,277 | $113,508 | $99,842 |
| | | | | |
| Interest expense: | | | | |
| Midwest homebuilding | $1,297 | $1,319 | $5,175 | $3,559 |
| Southern homebuilding | 1,679 | 2,143 | 5,874 | 6,311 |
| Mid-Atlantic homebuilding | 615 | 557 | 1,844 | 1,988 |
| Financial services [a] | 835 | 656 | 2,299 | 1,989 |
| Total interest expense | $4,426 | $4,675 | $15,192 | $13,847 |
| | | | | |
| Equity in income from joint venture arrangements | (44) | (71) | (268) | (198) |
| Acquisition and integration costs [d] | — | — | 1,700 | — |
| | | | | |
| Income before income taxes | $39,480 | $34,673 | $96,884 | $86,193 |

(a) Our financial services operational results should be viewed in connection with our homebuilding business as its operations originate loans and provide title services primarily for our homebuying customers, with the exception of an immaterial amount of mortgage refinancing.

(b) Includes $0.7 million and $4.5 million of charges related to purchase accounting adjustments taken during the three and nine months ended September 30, 2018, respectively, as a result of our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018.

(c) Includes an $8.5 million charge for stucco-related repair costs in certain of our Florida communities taken during the nine months ended September 30, 2017 (as more fully discussed in Note 6 to our financial statements).

(d) Represents costs which include, but are not limited to, legal fees and expenses, travel and communication expenses, cost of appraisals, accounting fees and expenses, and miscellaneous expenses related to our recent acquisition of Pinnacle Homes. As these costs are not eligible for capitalization as initial direct costs, such amounts are expensed as incurred.

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The following tables show total assets by segment at September 30, 2018 and December 31, 2017:

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| (In thousands) | Midwest | Southern | Mid-Atlantic | Corporate, Financial Services and Unallocated | Total |
| Deposits on real estate under option or contract | $5,480 | $20,194 | $ 6,448 | $ — | $32,122 |
| Inventory [a] | 716,502 | 736,966 | 265,935 | — | 1,719,403 |
| Investments in joint venture arrangements | 534 | 5,342 | 18,692 | — | 24,568 |
| Other assets | 27,820 | 46,036 [b] | 8,331 | 200,055 | 282,242 |
| Total assets | $750,336 | $808,538 | $ 299,406 | $ 200,055 | $2,058,335 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| (In thousands) | Midwest | Southern | Mid-Atlantic | Corporate, Financial Services and Unallocated | Total |
| Deposits on real estate under option or contract | $4,933 | $20,719 | $ 6,904 | $ — | $32,556 |
| Inventory [a] | 500,671 | 636,019 | 245,328 | — | 1,382,018 |
| Investments in joint venture arrangements | 4,410 | 9,677 | 6,438 | — | 20,525 |
| Other assets | 13,573 | 38,784 [b] | 13,311 | 364,004 | 429,672 |
| Total assets | $523,587 | $705,199 | $ 271,981 | $ 364,004 | $1,864,771 |

(a) Inventory includes single-family lots, land and land development costs; land held for sale; homes under construction; model homes and furnishings; community development district infrastructure; and consolidated inventory not owned.

(b) Includes development reimbursements from local municipalities.

NOTE 12. Supplemental Guarantor Information

The Company’s obligations under the 2025 Senior Notes and the 2021 Senior Notes are not guaranteed by all of the Company’s subsidiaries and therefore, the Company has disclosed condensed consolidating financial information in accordance with SEC Regulation S-X Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered. The Guarantor Subsidiaries of the 2025 Senior Notes and the 2021 Senior Notes are the same.

The following condensed consolidating financial information includes balance sheets, statements of income and cash flow information for M/I Homes, Inc. (the parent company and the issuer of the aforementioned guaranteed notes), the Guarantor Subsidiaries, collectively, and for all other subsidiaries and joint ventures of the Company (the “Unrestricted Subsidiaries”), collectively. Each Guarantor Subsidiary is a direct or indirect 100%-owned subsidiary of M/I Homes, Inc. and has fully and unconditionally guaranteed the (1) 2025 Senior Notes on a joint and several senior unsecured basis and (2) 2021 Senior Notes on a joint and several senior unsecured basis.

There are no significant restrictions on the parent company’s ability to obtain funds from its Guarantor Subsidiaries in the form of a dividend, loan, or other means.

As of September 30, 2018, each of the Company’s subsidiaries is a Guarantor Subsidiary, with the exception of subsidiaries that are primarily engaged in the business of mortgage financing, title insurance or similar financial businesses relating to the homebuilding and home sales business, certain subsidiaries that are not 100%-owned by the Company or another subsidiary, and other subsidiaries designated by the Company as Unrestricted Subsidiaries, subject to limitations on the aggregate amount invested in such Unrestricted Subsidiaries in accordance with the terms of the Credit Facility and the indenture governing the 2025 Senior Notes and the indenture governing the 2021 Senior Notes.

In the condensed financial tables presented below, the parent company presents all of its 100%-owned subsidiaries as if they were accounted for under the equity method. All applicable corporate expenses have been allocated appropriately among the Guarantor Subsidiaries and Unrestricted Subsidiaries.

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UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF INCOME

| (In thousands) | Three Months Ended September 30, 2018 M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Revenue | $— | $ 555,649 | $ 12,193 | $ — | $ 567,842 |
| Costs and expenses: | | | | | |
| Land and housing | — | 452,029 | — | — | 452,029 |
| General and administrative | — | 30,180 | 6,717 | — | 36,897 |
| Selling | — | 35,054 | — | — | 35,054 |
| Equity in income from joint venture arrangements | — | — | (44) | — | (44) |
| Interest | — | 3,592 | 834 | — | 4,426 |
| Total costs and expenses | — | 520,855 | 7,507 | — | 528,362 |
| Income before income taxes | — | 34,794 | 4,686 | — | 39,480 |
| Provision for income taxes | — | 9,253 | 945 | — | 10,198 |
| Equity in subsidiaries | 29,282 | — | — | (29,282) | — |
| Net income | $29,282 | $ 25,541 | $ 3,741 | $ (29,282) | $ 29,282 |

| (In thousands) | Three Months Ended September 30, 2017 M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Revenue | $— | $ 464,660 | $ 11,763 | $ — | $ 476,423 |
| Costs and expenses: | | | | | |
| Land and housing | — | 374,673 | — | — | 374,673 |
| General and administrative | — | 25,263 | 6,074 | — | 31,337 |
| Selling | — | 31,136 | — | — | 31,136 |
| Equity in income from joint venture arrangements | — | — | (71) | — | (71) |
| Interest | — | 4,019 | 656 | — | 4,675 |
| Total costs and expenses | — | 435,091 | 6,659 | — | 441,750 |
| Income before income taxes | — | 29,569 | 5,104 | — | 34,673 |
| Provision for income taxes | — | 10,672 | 1,674 | — | 12,346 |
| Equity in subsidiaries | 22,327 | — | — | (22,327) | — |
| Net income | 22,327 | 18,897 | 3,430 | (22,327) | 22,327 |
| Preferred dividends | 1,218 | — | — | — | 1,218 |
| Excess of fair value over book value of preferred shares subject to redemption | 2,257 | — | — | — | 2,257 |

| | | | | | |
|---|---|---|---|---|---|
| Net income available to common shareholders | $ 18,852 | $ 18,897 | $ 3,430 | $ (22,327 ) | $ 18,852 |

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| (In thousands) | Nine Months Ended September 30, 2018<br>M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Revenue | $— | $ 1,524,702 | $ 39,095 | $ — | $ 1,563,797 |
| Costs and expenses: | | | | | |
| Land and housing | — | 1,250,067 | — | — | 1,250,067 |
| General and administrative | — | 80,921 | 18,593 | — | 99,514 |
| Selling | — | 100,708 | — | — | 100,708 |
| Acquisition and integration costs | — | 1,700 | — | — | 1,700 |
| Equity in income from joint venture arrangements | — | — | (268 ) | — | (268 ) |
| Interest | — | 12,893 | 2,299 | — | 15,192 |
| Total costs and expenses | — | 1,446,289 | 20,624 | — | 1,466,913 |
| Income before income taxes | — | 78,413 | 18,471 | — | 96,884 |
| Provision for income taxes | — | 17,711 | 3,917 | — | 21,628 |
| Equity in subsidiaries | 75,256 | — | — | (75,256 ) | — |
| Net income | $ 75,256 | $ 60,702 | $ 14,554 | $ (75,256 ) | $ 75,256 |

| (In thousands) | Nine Months Ended September 30, 2017<br>M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Revenue | $— | $ 1,302,331 | $ 37,938 | $ — | $ 1,340,269 |
| Costs and expenses: | | | | | |
| Land and housing | — | 1,062,552 | — | — | 1,062,552 |
| General and administrative | — | 72,638 | 16,571 | — | 89,209 |
| Selling | — | 88,666 | — | — | 88,666 |
| Equity in income from joint venture arrangements | — | — | (198 ) | — | (198 ) |
| Interest | — | 11,858 | 1,989 | — | 13,847 |
| Total costs and expenses | — | 1,235,714 | 18,362 | — | 1,254,076 |
| Income before income taxes | — | 66,617 | 19,576 | — | 86,193 |
| Provision for income taxes | — | 23,407 | 6,587 | — | 29,994 |
| Equity in subsidiaries | 56,199 | — | — | (56,199 ) | — |
| Net income | 56,199 | 43,210 | 12,989 | (56,199 ) | 56,199 |
| Preferred dividends | 3,656 | — | — | — | 3,656 |
| Excess of fair value over book value of preferred shares redeemed | 2,257 | — | — | — | 2,257 |

| | | | | | |
|---|---|---|---|---|---|
| Net income available to common shareholders | $50,286 | $43,210 | $ 12,989 | $ (56,199 ) | $50,286 |

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| (In thousands) | M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
| ASSETS: | | | | | |
| Cash, cash equivalents and restricted cash | $— | $21,494 | $14,866 | $— | $36,360 |
| Mortgage loans held for sale | — | — | 115,189 | — | 115,189 |
| Inventory | — | 1,751,525 | — | — | 1,751,525 |
| Property and equipment - net | — | 27,715 | 976 | — | 28,691 |
| Investment in joint venture arrangements | — | 22,073 | 2,495 | — | 24,568 |
| Deferred income tax asset | — | 16,925 | — | — | 16,925 |
| Investment in subsidiaries | 786,063 | — | — | (786,063) | — |
| Intercompany assets | 590,635 | — | — | (590,635) | — |
| Goodwill | — | 16,400 | — | — | 16,400 |
| Other assets | 2,555 | 56,215 | 9,907 | — | 68,677 |
| TOTAL ASSETS | $1,379,253 | $1,912,347 | $143,433 | $(1,376,698) | $2,058,335 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| LIABILITIES: | | | | | |
| Accounts payable | $— | $147,435 | $986 | $— | $148,421 |
| Customer deposits | — | 40,448 | — | — | 40,448 |
| Intercompany liabilities | — | 589,507 | 1,128 | (590,635) | — |
| Other liabilities | — | 111,902 | 4,749 | — | 116,651 |
| Community development district obligations | — | 16,101 | — | — | 16,101 |
| Obligation for consolidated inventory not owned | — | 21,897 | — | — | 21,897 |
| Notes payable bank - homebuilding operations | — | 222,700 | — | — | 222,700 |
| Notes payable bank - financial services operations | — | — | 104,026 | — | 104,026 |
| Notes payable - other | — | 8,838 | — | — | 8,838 |
| Senior notes due 2021 - net | 297,608 | — | — | — | 297,608 |
| Senior notes due 2025 - net | 246,441 | — | — | — | 246,441 |
| TOTAL LIABILITIES | 544,049 | 1,158,828 | 110,889 | (590,635) | 1,223,131 |
| SHAREHOLDERS' EQUITY | 835,204 | 753,519 | 32,544 | (786,063) | 835,204 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $1,379,253 | $1,912,347 | $143,433 | $(1,376,698) | $2,058,335 |

CONDENSED CONSOLIDATING BALANCE SHEET

| (In thousands) | December 31, 2017 M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| ASSETS: | | | | | |
| Cash, cash equivalents and restricted cash | $— | $ 131,522 | $ 20,181 | $— | $ 151,703 |
| Mortgage loans held for sale | — | — | 171,580 | — | 171,580 |
| Inventory | — | 1,414,574 | — | — | 1,414,574 |
| Property and equipment - net | — | 25,815 | 1,001 | — | 26,816 |
| Investment in joint venture arrangements | — | 13,930 | 6,595 | — | 20,525 |
| Deferred income tax asset | — | 18,438 | — | — | 18,438 |
| Investment in subsidiaries | 722,508 | — | — | (722,508) | — |
| Intercompany assets | 650,599 | — | — | (650,599) | — |
| Other assets | 3,154 | 48,430 | 9,551 | — | 61,135 |
| TOTAL ASSETS | $ 1,376,261 | $ 1,652,709 | $ 208,908 | $ (1,373,107) | $ 1,864,771 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| LIABILITIES: | | | | | |
| Accounts payable | $— | $ 116,773 | $ 460 | $— | $ 117,233 |
| Customer deposits | — | 26,378 | — | — | 26,378 |
| Intercompany liabilities | — | 645,048 | 5,551 | (650,599) | — |
| Other liabilities | — | 126,522 | 5,012 | — | 131,534 |
| Community development district obligations | — | 13,049 | — | — | 13,049 |
| Obligation for consolidated inventory not owned | — | 21,545 | — | — | 21,545 |
| Notes payable bank - financial services operations | — | — | 168,195 | — | 168,195 |
| Notes payable - other | — | 10,576 | — | — | 10,576 |
| Convertible senior subordinated notes due 2018 - net | 86,132 | — | — | — | 86,132 |
| Senior notes due 2021 - net | 296,780 | — | — | — | 296,780 |
| Senior notes due 2025 - net | 246,051 | — | — | — | 246,051 |
| TOTAL LIABILITIES | 628,963 | 959,891 | 179,218 | (650,599) | 1,117,473 |
| SHAREHOLDERS' EQUITY | 747,298 | 692,818 | 29,690 | (722,508) | 747,298 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 1,376,261 | $ 1,652,709 | $ 208,908 | $ (1,373,107) | $ 1,864,771 |

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UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

| | Nine Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| (In thousands) | M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |
| OPERATING ACTIVITIES: | | | | | |
| Net cash provided by (used in) operating activities | $11,700 | $(144,828) | $ 70,933 | $(11,700) | $(73,895) |
| INVESTING ACTIVITIES: | | | | | |
| Purchase of property and equipment | — | (5,636) | (230) | — | (5,866) |
| Acquisition | — | (100,960) | — | — | (100,960) |
| Intercompany investing | (1,041) | — | — | 1,041 | — |
| Investments in and advances to joint venture arrangements | — | (19,412) | (1,075) | — | (20,487) |
| Return of capital from unconsolidated joint ventures | — | — | 676 | — | 676 |
| Net proceeds from the sale of mortgage servicing rights | — | — | 5,111 | — | 5,111 |
| Net cash (used in) provided by investing activities | (1,041) | (126,008) | 4,482 | 1,041 | (121,526) |
| FINANCING ACTIVITIES: | | | | | |
| Repayment of convertible senior subordinated notes due 2018 | — | (65,941) | — | — | (65,941) |
| Proceeds from bank borrowings - homebuilding operations | — | 519,900 | — | — | 519,900 |
| Principal repayments of bank borrowings - homebuilding operations | — | (297,200) | — | — | (297,200) |
| Net repayments of bank borrowings - financial services operations | — | — | (64,169) | — | (64,169) |
| Principal repayment of notes payable - other and CDD bond obligations | — | (1,738) | — | — | (1,738) |
| Proceeds from exercise of stock options | 426 | — | — | — | 426 |
| Intercompany financing | — | 5,862 | (4,821) | (1,041) | — |
| Repurchase of common shares | (11,085) | — | — | — | (11,085) |
| Dividends paid | — | — | (11,700) | 11,700 | — |
| Debt issue costs | — | (75) | (40) | — | (115) |
| Net cash (used in) provided by financing activities | (10,659) | 160,808 | (80,730) | 10,659 | 80,078 |
| Net decrease in cash, cash equivalents and restricted cash | — | (110,028) | (5,315) | — | (115,343) |
| Cash, cash equivalents and restricted cash balance at beginning of period | — | 131,522 | 20,181 | — | 151,703 |
| Cash, cash equivalents and restricted cash balance at end of period | $— | $21,494 | $ 14,866 | $— | $ 36,360 |

| | Nine Months Ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| (In thousands) | M/I Homes, Inc. | Guarantor Subsidiaries | Unrestricted Subsidiaries | Eliminations | Consolidated |

| | | | | | |
|---|---|---|---|---|---|
| OPERATING ACTIVITIES: | | | | | |
| Net cash provided by (used in) operating activities | $12,031 | $(152,148) | $86,123 | $(12,031) | $(66,025) |
| INVESTING ACTIVITIES: | | | | | |
| Purchase of property and equipment | — | (5,848) | (169) | — | (6,017) |
| Intercompany Investing | (13,166) | — | — | 13,166 | — |
| Investments in and advances to joint venture arrangements | — | (3,401) | (5,038) | — | (8,439) |
| Return of capital from unconsolidated joint ventures | — | — | 1,833 | — | 1,833 |
| Net proceeds from the sale of mortgage servicing rights | — | — | 7,558 | — | 7,558 |
| Net cash (used in) provided by investing activities | (13,166) | (9,249) | 4,184 | 13,166 | (5,065) |
| FINANCING ACTIVITIES: | | | | | |
| Proceeds from bank borrowings - homebuilding operations | — | 366,500 | — | — | 366,500 |
| Principal repayments of bank borrowings - homebuilding operations | — | (406,800) | — | — | (406,800) |
| Net repayments of bank borrowings - financial services operations | — | — | (61,620) | — | (61,620) |
| Principal repayments of notes payable - other and CDD bond obligations | — | (2,358) | — | — | (2,358) |
| Proceeds from issuance of senior notes | — | 250,000 | — | — | 250,000 |
| Intercompany financing | — | 22,141 | (8,975) | (13,166) | — |
| Dividends paid | (3,656) | — | (12,031) | 12,031 | (3,656) |
| Debt issue costs | — | (6,509) | (63) | — | (6,572) |
| Proceeds from exercise of stock options | 4,791 | — | — | — | 4,791 |
| Net cash provided by (used in) financing activities | 1,135 | 222,974 | (82,689) | (1,135) | 140,285 |
| Net increase in cash, cash equivalents and restricted cash | — | 61,577 | 7,618 | — | 69,195 |
| Cash, cash equivalents and restricted cash balance at beginning of period | — | 20,927 | 13,514 | — | 34,441 |
| Cash, cash equivalents and restricted cash balance at end of period | $— | $82,504 | $21,132 | $— | $103,636 |

NOTE 13. Share Repurchase Program

On August 14, 2018, the Company announced that its Board of Directors authorized a share repurchase program (the "2018 Share Repurchase Program") pursuant to which the Company may purchase up to $50 million of its outstanding common shares through open market transactions, privately negotiated transactions or otherwise in accordance with all applicable laws. During the quarter ended September 30, 2018, the Company repurchased 437,490 outstanding common shares at an aggregate purchase price of $11.1 million under the 2018 Share Repurchase Program and $38.9 million remained available for repurchases under the 2018 Share Repurchase Program. The timing, amount and other terms and conditions of any additional repurchases under the 2018 Share Repurchase Program will be determined by the Company's management at its discretion based on a variety of factors, including the market price of the Company's common shares, corporate considerations, general market and economic conditions and legal requirements. The 2018 Share Repurchase Program does not have an expiration date and the Board may modify, discontinue or suspend it at any time.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

M/I Homes, Inc. (the "Company" or "we") is one of the nation's leading builders of single-family homes having sold over 110,000 homes since we commenced homebuilding activities in 1976. The Company's homes are marketed and sold primarily under the M/I Homes brand (M/I Homes and Showcase Collection (exclusively by M/I)). In addition, the Hans Hagen brand is used in older communities in our Minneapolis/St. Paul, Minnesota market, and, following our recent acquisition of the homebuilding assets and operations of Pinnacle Homes, a privately-held homebuilder in the Detroit, Michigan market ("Pinnacle Homes"), in March 2018, the Pinnacle Homes brand is used in that market in connection with the sale of homes in communities in existence on the date of the acquisition. The Company has homebuilding operations in Columbus and Cincinnati, Ohio; Indianapolis, Indiana; Chicago, Illinois; Minneapolis/St. Paul, Minnesota; Detroit, Michigan; Tampa, Sarasota and Orlando, Florida; Austin, Dallas/Fort Worth, Houston and San Antonio, Texas; Charlotte and Raleigh, North Carolina; and the Virginia and Maryland suburbs of Washington, D.C.

Included in this Management's Discussion and Analysis of Financial Condition and Results of Operations are the following topics relevant to the Company's performance and financial condition:

- Information Relating to Forward-Looking Statements;
- Application of Critical Accounting Estimates and Policies;
- Results of Operations;
- Discussion of Our Liquidity and Capital Resources;
- Summary of Our Contractual Obligations;
- Discussion of Our Utilization of Off-Balance Sheet Arrangements; and
- Impact of Interest Rates and Inflation.

FORWARD-LOOKING STATEMENTS

Certain information included in this report or in other materials we have filed or will file with the Securities and Exchange Commission (the "SEC") (as well as information included in oral statements or other written statements made or to be made by us) contains or may contain forward-looking statements, including, but not limited to, statements regarding our future financial performance and financial condition. Words such as "expects," "anticipates," "envisions," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar express intended to identify such forward-looking statements. These statements involve a number of risks and uncertainties. Any forward-looking statements that we make herein and in future reports and statements are not guarantees of future performance, and actual results may differ materially from those in such forward-looking statements as a result of various risk factors. Please see "Item 1A. Risk Factors" in Part I of our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K") and "Item 1A. Risk Factors" in Part II of this Quarterly Report on Form 10-Q, as the same may be updated from time to time in our subsequent filings with the SEC, for more information regarding those risk factors.

Any forward-looking statement speaks only as of the date made. Except as required by applicable law, we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in our subsequent reports on Forms 10-K, 10-Q and 8-K should be consulted. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995, and all of our forward-looking statements are expressly qualified in their entirety by the cautionary statements contained or referenced in this section.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates and assumptions on historical experience and on various other factors that it believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. On an ongoing basis, management evaluates such estimates and assumptions and makes adjustments as deemed necessary. Actual results could differ from these estimates using different estimates and assumptions, or if conditions are significantly different in the future. Please see Note 1 (Summary of Significant Accounting Policies) to our consolidated financial statements included in our 2017 Form 10-K for additional information about our accounting policies.

We believe that there have been no significant changes to our critical accounting policies during the quarter ended September 30, 2018 as compared to those disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2017 Form 10-K, other than the changes described in our Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Quarterly Report on Form 10-Q for the three months ended March 31, 2018 and in Note 1 (Basis of Presentation) to our financial statements of this Quarterly Report on Form 10-Q.

RESULTS OF OPERATIONS

The Company's chief operating decision makers evaluate the Company's performance at various levels, including: (1) the results of our 16 individual homebuilding operating segments and the results of our financial services operations; (2) the results of our three homebuilding reportable segments; and (3) our consolidated financial results.

In accordance with ASC 280, Segment Reporting ("ASC 280"), we have identified each homebuilding division as an operating segment as each homebuilding division engages in business activities from which it earns revenue, primarily from the sale and construction of single-family attached and detached homes, acquisition and development of land, and the occasional sale of lots to third parties. Our financial services operations generate revenue primarily from the origination, sale and servicing of mortgage loans and title services primarily for purchasers of the Company's homes and are included in our financial services reportable segment. Corporate is a non-operating segment that develops and implements strategic initiatives and supports our operating segments by centralizing key administrative functions such as accounting, finance, treasury, information technology, insurance and risk management, legal, marketing and human resources.

In accordance with the aggregation criteria defined in ASC 280, we have determined our reportable segments are as follows: Midwest homebuilding; Southern homebuilding; Mid-Atlantic homebuilding; and financial services operations. The homebuilding operating segments included in each reportable segment have been aggregated because they share similar aggregation characteristics as prescribed in ASC 280 in the following regards: (1) long-term economic characteristics; (2) historical and expected future long-term gross margin percentages; (3) housing products, production processes and methods of distribution; and (4) geographical proximity. We may, however, be required to reclassify our reportable segments if markets that currently are being aggregated do not continue to share these aggregation characteristics which are evaluated annually.

The homebuilding operating segments that comprise each of our reportable segments are as follows:

| Midwest | Southern | Mid-Atlantic |
|---|---|---|
| Chicago, Illinois | Orlando, Florida | Charlotte, North Carolina |
| Cincinnati, Ohio | Sarasota, Florida | Raleigh, North Carolina |
| Columbus, Ohio | Tampa, Florida | Washington, D.C. |
| Indianapolis, Indiana | Austin, Texas | |
| Minneapolis/St. Paul, Minnesota | Dallas/Fort Worth, Texas | |
| Detroit, Michigan | Houston, Texas | |
| | San Antonio, Texas | |

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Overview

For both the third quarter and nine months ended September 30, 2018, we achieved record levels of new contracts, homes delivered and revenue. We also achieved record levels of income before income taxes and net income during the third quarter of 2018. Additionally, our complementary financial services business achieved record revenue and a record number of loans originated in both the third quarter and nine months ended September 30, 2018. For the first nine months of 2018, the housing market continued to be relatively strong as a result of improved consumer confidence, growth in employment, wage increases, and the positive impact on our business from the Tax Cuts and Jobs Act of 2017 (the "Tax Act") which has provided additional momentum to the U.S. economy. These economic conditions, along with a constrained supply of both new and existing homes, led to improved housing demand across most of our markets when compared to the same period in 2017, particularly during the spring selling season, and despite increases in mortgage rates.

During the third quarter, we experienced a modest slowdown in demand for our homes from the pace of sales we experienced during the first half of the year, after adjusting for normal seasonality, but demand remained healthy overall. Company-wide, our absorption pace per community slowed in the third quarter from the third quarter of 2017, but remained at a pace consistent with the third quarter in years prior to 2017. Recent national housing starts and permits data have also indicated a modest slowdown which analysts have attributed to additional increases in mortgage rates and/or higher prices that have stretched affordability in some markets.

The overall level of housing demand, together with the continued execution of our strategic business initiatives, enabled us to achieve the following improved results in comparison to the third quarter and nine months ended September 30, 2017:

- New contracts increased 6% to 1,302 and 15% to 4,672, respectively
- Homes delivered increased 13% to 1,422 homes and 13% to 3,953 homes, respectively
- Average sales price of homes delivered increased 7% to $390,000 and 4% to $384,000, respectively
- Number of homes in backlog at September 30, 2018 increased 20% to 2,846
- Total sales value in backlog increased 25% to $1.1 billion - a third quarter record for the Company
- Average sales price of homes in backlog increased 5% to $401,000
- Revenue increased 19% to $567.8 million and 17% to $1.6 billion, respectively
- Number of active communities at September 30, 2018 increased 18% to 212 - an all-time record for the Company

Summary of Company Financial Results

The calculations of adjusted income before income taxes, adjusted net income available to common shareholders, and adjusted housing gross margin (referred to below), which we believe provide a clearer measure of the ongoing performance of our business, are described and reconciled to income before income taxes, net income available to common shareholders, and housing gross margin, the financial measures that are calculated using our GAAP results, below under "Non-GAAP Financial Measures."

Income before income taxes for the third quarter of 2018 increased 14% from $34.7 million in the third quarter of 2017 to $39.5 million - a third quarter record for the Company. Income before income taxes for the third quarter of 2018 was unfavorably impacted by $0.7 million of charges for the amortization of inventory profit write-up related to purchase accounting adjustments on Detroit homes that were delivered during the third quarter of 2018 incurred as a result of our acquisition of Pinnacle Homes in March 2018. Excluding the purchase accounting adjustments for the quarter ended September 30, 2018, adjusted income before income taxes increased 16% from $34.7 million in the third quarter of 2017 to $40.2 million in the third quarter of 2018. For the nine months ended September 30, 2018, income before income taxes increased 12% from $86.2 million for the nine months ended September 30, 2017 to $96.9 million for the nine months ended September 30, 2018. Income before income taxes for the nine months ended September 30, 2018 was unfavorably impacted by $4.5 million of purchase accounting adjustments and $1.7 million of acquisition and integration costs, both of which were incurred as a result of our acquisition of Pinnacle Homes. Income before income taxes for the nine months ended September 30, 2017 was unfavorably impacted by an $8.5 million charge for stucco-related repair costs in certain of our Florida communities (as more fully discussed in Note 6 to our financial statements). Excluding these acquisition-related charges for the nine months ended September 30, 2018 and the stucco-related charge for the nine months ended September 30, 2017, adjusted income before income

taxes increased 9% from $94.7 million in 2017's first nine months to $103.1 million in 2018's first nine months.
We achieved net income available to common shareholders of $29.3 million, or $1.01 per diluted share, in 2018's third quarter, which includes a $0.7 million ($0.02 per diluted share) pre-tax charge for purchase accounting adjustments as discussed above. This compares to net income available to common shareholders of $18.9 million, or $0.64 per diluted share, in 2017's third quarter, which is net of a $2.3 million ($0.07 per diluted share) non-cash charge resulting from the excess of fair value over carrying value of our Series A Preferred Shares that were called for redemption in that quarter. Exclusive of the purchase accounting adjustments in the third quarter of 2018 and the equity adjustment related to the redemption of our Series A Preferred Shares in the third quarter

of 2017, our adjusted net income available to common shareholders increased $8.7 million to $29.8 million in the third quarter of 2018 compared to $21.1 million in the prior year. In the nine months ended September 30, 2018, we achieved net income available to common shareholders of $75.3 million, or $2.56 per diluted share, which includes a $4.5 million pre-tax charge for purchase accounting adjustments and a $1.7 million pre-tax charge for acquisition and integration costs as discussed above (collectively $0.16 per diluted share). This compares to net income available to common shareholders of $50.3 million, or $1.73 per diluted share, in the nine months ended September 30, 2017, which included an $8.5 million ($0.18 per diluted share) pre-tax charge for stucco-related repair costs as discussed above and a $2.3 million ($0.07 per diluted share) non-cash charge resulting from the excess of fair value over carrying value of our Series A Preferred Shares that were called for redemption in that period. Exclusive of these acquisition-related charges in the nine months ended September 30, 2018 and the stucco-related charge and equity adjustment in the nine months ended September 30, 2017, our adjusted net income available to common shareholders increased $21.9 million to $79.9 million in the nine months ended September 30, 2018 compared to $58.0 million in the prior year.

During the quarter ended September 30, 2018, we recorded record third quarter total revenue of $567.8 million, of which $554.8 million was from homes delivered, $0.8 million was from land sales and $12.2 million was from our financial services operations. Revenue from homes delivered increased 21% in 2018's third quarter compared to the same period in 2017 driven primarily by a 13% increase in the number of homes delivered (166 units) and a 7% increase in the average sales price of homes delivered ($24,000 per home delivered). Revenue from land sales decreased $4.5 million from the third quarter of 2017 primarily due to fewer land sales in our Mid-Atlantic region in 2018's third quarter compared to the prior year. During the nine months ended September 30, 2018, we recorded record total revenue of $1.6 billion of which $1.5 billion was from homes delivered, $6.4 million was from land sales and $39.1 million was from our financial services operations. Revenue from homes delivered increased 18% during the nine months ended September 30, 2018 compared to the same period in 2017 driven primarily by a 13% increase in the number of homes delivered (448 units) and a 4% increase in the average sales price of homes delivered ($16,000 per home delivered). Revenue from land sales decreased $6.0 million during 2018's first nine months primarily due to fewer land sales in our Southern region in the current year period compared to the prior year.

Revenue from our financial services segment increased 4% to $12.2 million in the quarter ended September 30, 2018 and increased 3% to $39.1 million in the nine months ended September 30, 2018 compared to the same periods in 2017. The increases were primarily a result of an increase in the number of loan originations, an increase in the average loan amount, and a higher volume of loans sold, partially offset by lower margins on loans sold during the periods than we experienced in the same periods in 2017.

Total gross margin (total revenue less total land and housing costs) increased $14.0 million in the third quarter of 2018 compared to the third quarter of 2017 as a result of a $13.6 million improvement in the gross margin of our homebuilding operations and a $0.4 million improvement in the gross margin of our financial services operations. With respect to our homebuilding gross margin, our gross margin on homes delivered (housing gross margin) improved $13.9 million as a result of the 13% increase in the number of homes delivered and the 7% increase in the average sales price of homes delivered. Our housing gross margin percentage declined 80 basis points from 19.5% in prior year's third quarter to 18.7% in 2018's third quarter. Exclusive of the $0.7 million charge for purchase accounting adjustments taken in the third quarter of 2018 discussed above, our adjusted housing gross margin percentage declined 70 basis points from 19.5% in the prior year’s third quarter to 18.8% in 2018's third quarter, primarily as a result of higher construction and lot costs when compared to the same period in 2017 as well as the mix of homes delivered during 2018's third quarter compared to the same period in the prior year. Our gross margin on land sales (land sale gross margin) declined $0.3 million as a result of fewer third party land sales in the third quarter of 2018 compared to the third quarter of 2017. The gross margin of our financial services operations increased $0.4 million in the third quarter of 2018 compared to the third quarter of 2017 as a result of increases in the number of loan originations, the average loan amount and the volume of loans sold. Total gross margin increased $36.0 million for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 as a result of a $34.9 million improvement in the gross margin of our homebuilding operations and a $1.2 million improvement in the gross margin of our financial services operations. With respect to our homebuilding gross margin for the nine months ended September 30, 2018, our housing gross margin improved $35.2 million as a result of the 13% increase in the number of homes delivered and the 4% increase in the average sales price of homes delivered. Our housing gross margin percentage declined 40 basis points from 18.5% in the nine months ended September 30, 2017 to 18.1% in the nine months ended September 30, 2018. Exclusive of the $4.5 million charge for purchase accounting adjustments taken during the nine months ended September 30, 2018 and the $8.5 million charge for stucco-related repair costs taken during the nine months ended September 30, 2017 discussed above, our adjusted housing gross margin percentage declined 80 basis points to 18.4% in the nine months ended September 30, 2018 from 19.2%, largely as a result of higher construction and lot costs in 2018's first nine months compared to 2017's first nine months as well as the mix of homes delivered during the period compared to prior year. We expect our gross margins throughout 2018 to be negatively impacted by the purchase accounting adjustments related to our acquisition of Pinnacle Homes. Our gross margin on land sales declined $0.3 million as a result of fewer third party land sales in the nine months ended September 30, 2018 compared to 2017's first nine months. The gross margin of our financial services operations increased $1.2 million in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 as a result of increases in the number of loan originations, the average loan amount and the volume of loans sold.

We believe the increased sales volume during the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017 was driven primarily by the opening of new communities which increased our average number of locations selling homes, along with the strengthening economy described above, constrained supply/demand conditions (particularly the decreased inventory of resale homes), better pricing leverage in select locations and submarkets and shifts in both product and community mix. We opened 54 new communities during the nine months ended September 30, 2018. We sell a variety of home types in various communities and markets, each of which yields a different gross margin. The timing of the openings of new replacement communities as well as underlying lot costs varies from year to year. As a result, our new contracts and housing gross margin may fluctuate up or down from quarter to quarter depending on the mix of communities delivering homes. The improvements described above were partially offset by higher average lot and construction costs related to homebuilding industry conditions and normal supply and demand dynamics. During the three and nine months ended September 30, 2018 and 2017, we were able to pass a portion of the higher construction and lot costs to our homebuyers in the form of higher sales prices. However, we cannot provide any assurance that we will be able to continue to raise prices.

For the three months ended September 30, 2018, selling, general and administrative expense increased $9.5 million, which partially offset the increase in our gross margin discussed above, but declined as a percentage of revenue from 13.1% in the third quarter of 2017 to 12.7% in the third quarter of 2018. Selling expense increased $3.9 million from 2017's third quarter but improved as a percentage of revenue to 6.2% in 2018's third quarter compared to 6.5% for the same period in 2017. Variable selling expense for sales commissions contributed $3.0 million to the increase ($0.5 million of which related to incremental costs associated with our new Detroit division) due to the higher average sales price of homes delivered and the higher number of homes delivered in the quarter. The increase in selling expense was also attributable to a $0.9 million increase in non-variable selling expense primarily related to costs associated with our sales offices and models as a result of our increased average community count and a $0.6 million increase related to incremental costs associated with our new Detroit division. General and administrative expense increased $5.6 million compared to the third quarter of 2017 but declined as a percentage of revenue from 6.6% in the third quarter of 2017 to 6.5% in the third quarter of 2018. The dollar increase in general and administrative expense was primarily due to a $2.3 million increase in compensation related expenses due to our increased headcount as well as higher incentive compensation due to improved operating results, a $1.0 million increase related to incremental costs associated with our new Detroit division, a $0.7 million increase in land related expenses, a $0.5 million increase in costs associated with new information systems, and a $1.1 million increase in other miscellaneous expenses. For the nine months ended September 30, 2018, selling, general and administrative expense increased $22.3 million, which partially offset the increase in our gross margin discussed above, but improved as a percentage of revenue from 13.3% in the nine months ended September 30, 2017 to 12.8% in the nine months ended September 30, 2018. Selling expense increased $12.0 million from the nine months ended September 30, 2017 but improved as a percentage of revenue to 6.4% in 2018's first nine months compared to 6.6% for the same period in 2017. Variable selling expense for sales commissions contributed $8.7 million to the increase ($1.6 million of which related to incremental costs associated with our new Detroit division) due to the higher average sales price of homes delivered and the higher number of homes delivered. The increase in selling expense was also attributable to a $3.3 million increase in non-variable selling expense primarily related to costs associated with our sales offices and models as a result of our increased community count and a $1.1 million increase related to incremental costs associated with our new Detroit division. General and administrative expense increased $10.3 million compared to the nine months ended September 30, 2017 but declined as a percentage of revenue from 6.7% in 2017's first nine months to 6.4% in the nine months ended September 30, 2018. This dollar increase was primarily due to a $2.4 million increase related to incremental costs associated with our new Detroit division, a $2.2 million increase in compensation expense as a result of an increased headcount, a $1.7 million increase in professional fees (the majority of which related to our first quarter acquisition), a $1.2 million increase in land related expenses primarily due to our increased community count, a $1.1 million increase in costs associated with new information systems, and a $1.7 million increase in other miscellaneous expenses.

Outlook

Although recent national housing data indicate that higher prices and rising interest rates may have begun to adversely impact new home sales, housing starts and permits, we believe that the basic underlying fundamentals of housing demand, linked to low unemployment, higher wages and low inventory levels, remain favorable and are likely to support continued steady demand in the housing market into 2019.

We expect to continue to emphasize the following strategic business objectives throughout the remainder of 2018:

- profitably growing our presence in our existing markets, including opening new communities;
- reviewing new markets for investment opportunities;
- maintaining a strong balance sheet; and
- emphasizing customer service, product quality and design, and premier locations.

Consistent with these objectives, we took a number of steps during the nine months ended September 30, 2018 for continued improvement in our financial and operating results in 2018 and beyond, including investing $256.5 million in land acquisitions and $152.3 million in land development to help grow our presence in our existing markets. We currently estimate that we will spend approximately $575 million to $600 million on land purchases and land development in 2018, including the $408.8 million spent during the nine months ended September 30, 2018. However, land transactions are subject to a number of factors, including our financial condition and market conditions, as well as satisfaction of various conditions related to specific properties. We will continue to monitor market conditions and our ongoing pace of home sales and deliveries, and we will adjust our land spending accordingly. We opened 54 communities and closed 40 communities in the nine months ended September 30, 2018, ending the nine months ended September 30, 2018 with a total of 212 communities compared to 179 communities at September 30, 2017.
Going forward, we believe our abilities to leverage our fixed costs, obtain land at desired rates of return, and open and grow our active communities provide our best opportunities for continuing to improve our financial results. However, we can provide no assurance that the positive trends reflected in our financial and operating metrics will continue in the future.

The following table shows, by segment: revenue; gross margin; selling, general and administrative expense; operating income (loss); and interest expense for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2018 | 2017 | 2018 | 2017 |
| Revenue: | | | | |
| Midwest homebuilding | $236,803 | $180,488 | $622,325 | $495,379 |
| Southern homebuilding | 221,044 | 176,502 | 649,014 | 504,647 |
| Mid-Atlantic homebuilding | 97,802 | 107,670 | 253,363 | 302,305 |
| Financial services [(a)] | 12,193 | 11,763 | 39,095 | 37,938 |
| Total revenue | $567,842 | $476,423 | $1,563,797 | $1,340,269 |
| | | | | |
| Gross margin: | | | | |
| Midwest homebuilding [(b)] | $44,385 | $37,264 | $110,807 | $100,284 |
| Southern homebuilding [(c)] | 42,924 | 33,159 | 123,281 | 84,638 |
| Mid-Atlantic homebuilding | 16,311 | 19,564 | 40,547 | 54,857 |
| Financial services [(a)] | 12,193 | 11,763 | 39,095 | 37,938 |
| Total gross margin [(b) (c)] | $115,813 | $101,750 | $313,730 | $277,717 |
| | | | | |
| Selling, general and administrative expense: | | | | |
| Midwest homebuilding | $20,206 | $16,377 | $55,430 | $46,554 |
| Southern homebuilding [(c)] | 24,002 | 20,077 | 70,139 | 58,135 |
| Mid-Atlantic homebuilding | 8,100 | 9,595 | 24,638 | 28,047 |
| Financial services [(a)] | 6,512 | 5,876 | 17,936 | 15,961 |
| Corporate | 13,131 | 10,548 | 32,079 | 29,178 |
| Total selling, general and administrative expense | $71,951 | $62,473 | $200,222 | $177,875 |
| | | | | |
| Operating income (loss): | | | | |
| Midwest homebuilding [(b)] | $24,179 | $20,887 | $55,377 | $53,730 |
| Southern homebuilding [(c)] | 18,922 | 13,082 | 53,142 | 26,503 |
| Mid-Atlantic homebuilding | 8,211 | 9,969 | 15,909 | 26,810 |
| Financial services [(a)] | 5,681 | 5,887 | 21,159 | 21,977 |
| Less: Corporate selling, general and administrative expense | (13,131) | (10,548) | (32,079) | (29,178) |
| Total operating income [(b) (c)] | $43,862 | $39,277 | $113,508 | $99,842 |
| | | | | |
| Interest expense: | | | | |
| Midwest homebuilding | $1,297 | $1,319 | $5,175 | $3,559 |
| Southern homebuilding | 1,679 | 2,143 | 5,874 | 6,311 |
| Mid-Atlantic homebuilding | 615 | 557 | 1,844 | 1,988 |
| Financial services [(a)] | 835 | 656 | 2,299 | 1,989 |
| Total interest expense | $4,426 | $4,675 | $15,192 | $13,847 |
| | | | | |
| Equity in income of joint venture arrangements | (44) | (71) | (268) | (198) |
| Acquisition and integration costs [(d)] | — | — | 1,700 | — |
| | | | | |
| Income before income taxes | $39,480 | $34,673 | $96,884 | $86,193 |

(a) Our financial services operational results should be viewed in connection with our homebuilding business as its operations originate loans and provide title services primarily for our homebuying customers, with the exception of a small amount of mortgage refinancing.

(b) Includes \$0.7 million and \$4.5 million of charges related to purchase accounting adjustments taken during the three and nine months ended September 30, 2018, respectively, as a result of our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018.

(c) Includes an \$8.5 million charge for stucco-related repair costs in certain of our Florida communities taken during the nine months ended September 30, 2017 (as more fully discussed in Note 6 to our financial statements).

(d) Represents costs which include, but are not limited to, legal fees and expenses, travel and communication expenses, cost of appraisals, accounting fees and expenses, and miscellaneous expenses related to our acquisition of Pinnacle Homes. As these costs are not eligible for capitalization as initial direct costs, such amounts are expensed as incurred.

The following tables show total assets by segment at September 30, 2018 and December 31, 2017:

| | At September 30, 2018 | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | Midwest | Southern | | Mid-Atlantic | Corporate, Financial Services and Unallocated | | Total |
| Deposits on real estate under option or contract | $5,480 | $20,194 | | $ 6,448 | $ — | | $32,122 |
| Inventory [a] | 716,502 | 736,966 | | 265,935 | — | | 1,719,403 |
| Investments in joint venture arrangements | 534 | 5,342 | | 18,692 | — | | 24,568 |
| Other assets | 27,820 | 46,036 | (b) | 8,331 | 200,055 | (c) | 282,242 |
| Total assets | $750,336 | $808,538 | | $ 299,406 | $ 200,055 | | $2,058,335 |

| | At December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | Midwest | Southern | | Mid-Atlantic | Corporate, Financial Services and Unallocated | Total |
| Deposits on real estate under option or contract | $4,933 | $20,719 | | $ 6,904 | $ — | $32,556 |
| Inventory [a] | 500,671 | 636,019 | | 245,328 | — | 1,382,018 |
| Investments in joint venture arrangements | 4,410 | 9,677 | | 6,438 | — | 20,525 |
| Other assets | 13,573 | 38,784 | (b) | 13,311 | 364,004 | 429,672 |
| Total assets | $523,587 | $705,199 | | $ 271,981 | $ 364,004 | $1,864,771 |

(a) Inventory includes single-family lots; land and land development costs; land held for sale; homes under construction; model homes and furnishings; community development district infrastructure; and consolidated inventory not owned.

(b) Includes development reimbursements from local municipalities.

(c) Includes asset held for sale for $5.6 million.

Reportable Segments

The following table presents, by reportable segment, selected operating and financial information as of and for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2018 | 2017 |
| Midwest Region | | | | |
| Homes delivered | 583 | 461 | 1,548 | 1,277 |
| New contracts, net | 537 | 458 | 1,891 | 1,545 |
| Backlog at end of period | 1,284 | 1,025 | 1,284 | 1,025 |
| Average sales price of homes delivered | $406 | $389 | $402 | $386 |
| Average sales price of homes in backlog | $427 | $406 | $427 | $406 |
| Aggregate sales value of homes in backlog | $548,698 | $416,029 | $548,698 | $416,029 |
| Housing revenue | $236,619 | $179,363 | $621,712 | $493,464 |
| Land sale revenue | $184 | $1,125 | $613 | $1,915 |
| Operating income homes [(a)] [(b)] | $24,112 | $20,771 | $55,097 | $53,327 |
| Operating income land | $67 | $116 | $280 | $403 |
| Number of average active communities | 88 | 64 | 82 | 63 |
| Number of active communities, end of period | 88 | 62 | 88 | 62 |
| Southern Region | | | | |
| Homes delivered | 612 | 520 | 1,819 | 1,459 |
| New contracts, net | 597 | 583 | 2,147 | 1,798 |
| Backlog at end of period | 1,236 | 1,013 | 1,236 | 1,013 |
| Average sales price of homes delivered | $361 | $338 | $357 | $343 |
| Average sales price of homes in backlog | $367 | $355 | $367 | $355 |
| Aggregate sales value of homes in backlog | $454,194 | $359,833 | $454,194 | $359,833 |
| Housing revenue | $221,044 | $175,644 | $648,777 | $500,504 |
| Land sale revenue | $— | $858 | $237 | $4,143 |
| Operating income homes [(a)] [(c)] | $18,926 | $12,924 | $53,010 | $26,234 |
| Operating income land | $(4 ) | $158 | $132 | $269 |
| Number of average active communities | 95 | 86 | 92 | 84 |
| Number of active communities, end of period | 95 | 85 | 95 | 85 |
| Mid-Atlantic Region | | | | |
| Homes delivered | 227 | 275 | 586 | 769 |
| New contracts, net | 168 | 184 | 634 | 736 |
| Backlog at end of period | 326 | 340 | 326 | 340 |
| Average sales price of homes delivered | $428 | $379 | $423 | $385 |
| Average sales price of homes in backlog | $421 | $399 | $421 | $399 |
| Aggregate sales value of homes in backlog | $137,145 | $135,795 | $137,145 | $135,795 |
| Housing revenue | $97,157 | $104,335 | $247,789 | $295,925 |
| Land sale revenue | $645 | $3,335 | $5,574 | $6,380 |
| Operating income homes [(a)] | $8,207 | $9,877 | $15,768 | $26,598 |
| Operating income land | $4 | $92 | $141 | $212 |
| Number of average active communities | 28 | 33 | 30 | 35 |
| Number of active communities, end of period | 29 | 32 | 29 | 32 |
| Total Homebuilding Regions | | | | |
| Homes delivered | 1,422 | 1,256 | 3,953 | 3,505 |
| New contracts, net | 1,302 | 1,225 | 4,672 | 4,079 |
| Backlog at end of period | 2,846 | 2,378 | 2,846 | 2,378 |

| | | | | |
|---|---|---|---|---|
| Average sales price of homes delivered | $390 | $366 | $384 | $368 |
| Average sales price of homes in backlog | $401 | $383 | $401 | $383 |
| Aggregate sales value of homes in backlog | $1,140,037 | $911,657 | $1,140,037 | $911,657 |
| Housing revenue | $554,820 | $459,342 | $1,518,278 | $1,289,893 |
| Land sale revenue | $829 | $5,318 | $6,424 | $12,438 |
| Operating income homes [(a) (b) (c)] | $51,245 | $43,572 | $123,875 | $106,159 |
| Operating income land | $67 | $366 | $553 | $884 |
| Number of average active communities | 211 | 183 | 204 | 182 |
| Number of active communities, end of period | 212 | 179 | 212 | 179 |

(a) Includes the effect of total homebuilding selling, general and administrative expense for the region as disclosed in the first table set forth in this "Outlook" section.

(b) Includes $0.7 million and $4.5 million of charges related to purchase accounting adjustments taken during the three and nine months ended September 30, 2018, respectively, as a result of our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018.

(c) Includes an $8.5 million charge for stucco-related repair costs in certain of our Florida communities taken during the nine months ended September 30, 2017 (as more fully discussed in Note 6 to our financial statements).

| (Dollars in thousands) | Three Months Ended September 30, 2018 | 2017 | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Financial Services | | | | |
| Number of loans originated | 1,011 | 902 | 2,722 | 2,467 |
| Value of loans originated | $308,598 | $263,755 | $828,400 | $732,587 |
| | | | | |
| Revenue | $12,193 | $11,763 | $39,095 | $37,938 |
| Less: Selling, general and administrative expenses | 6,512 | 5,876 | 17,936 | 15,961 |
| Less: Interest expense | 835 | 656 | 2,299 | 1,989 |
| | | | | |
| Income before income taxes | $4,846 | $5,231 | $18,860 | $19,988 |

A home is included in “new contracts” when our standard sales contract is executed. “Homes delivered” represents homes for which the closing of the sale has occurred. “Backlog” represents homes for which the standard sales contract has been executed, but which are not included in homes delivered because closings for these homes have not yet occurred as of the end of the period specified.

The composition of our homes delivered, new contracts, net and backlog is constantly changing and may be based on a dissimilar mix of communities between periods as new communities open and existing communities wind down. Further, home types and individual homes within a community can range significantly in price due to differing square footage, option selections, lot sizes and quality and location of lots. These variations may result in a lack of meaningful comparability between homes delivered, new contracts, net and backlog due to the changing mix between periods.

Cancellation Rates

The following table sets forth the cancellation rates for each of our homebuilding segments for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, 2018 | 2017 | Nine Months Ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Midwest | 13.8% | 14.1% | 12.4% | 12.3% |
| Southern | 19.0% | 16.7% | 15.7% | 16.7% |
| Mid-Atlantic | 9.2 % | 12.4% | 9.8 % | 11.1% |
| | | | | |
| Total cancellation rate | 15.7% | 15.1% | 13.6% | 14.1% |

Seasonality

Typically, our homebuilding operations experience significant seasonality and quarter-to-quarter variability in homebuilding activity levels. In general, homes delivered increase substantially in the second half of the year compared to the first half of the year. We believe that this seasonality reflects the tendency of homebuyers to shop for a new home in the spring with the goal of closing in the fall or winter, as well as the scheduling of construction to accommodate seasonal weather conditions. Our financial services operations also experience seasonality because loan originations correspond with the delivery of homes in our homebuilding operations.

Non-GAAP Financial Measures

This report contains information about our adjusted housing gross margin, adjusted income before income taxes and adjusted net income available to common shareholders each of which constitutes a non-GAAP financial measure. Because adjusted housing gross margin, adjusted income before income taxes and adjusted net income available to common shareholders are not calculated in accordance with GAAP, these financial measures may not be completely comparable to similarly-titled measures used by other companies in the homebuilding industry and, therefore, should not be considered in isolation or as an alternative to operating performance and/or financial measures prescribed by GAAP. Rather, these non-GAAP financial measures should be used to supplement our GAAP results in order to provide a greater understanding of the factors and trends affecting our operations.

Adjusted housing gross margin, adjusted income before income taxes and adjusted net income available to common shareholders are calculated as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2018 | 2017 |
| Housing revenue | $554,820 | $459,342 | $1,518,278 | $1,289,893 |
| Housing cost of sales | 451,267 | 369,721 | 1,244,196 | 1,050,998 |
| Housing gross margin | 103,553 | 89,621 | 274,082 | 238,895 |
| Add: Purchase accounting adjustments [(a)] | 692 | — | 4,549 | — |
| Add: Stucco-related charges [(c)] | — | — | — | 8,500 |
| Adjusted housing gross margin | $104,245 | $89,621 | $278,631 | $247,395 |
| Housing gross margin percentage | 18.7 % | 19.5 % | 18.1 % | 18.5 % |
| Adjusted housing gross margin percentage | 18.8 % | 19.5 % | 18.4 % | 19.2 % |
| Income before income taxes | $39,480 | $34,673 | $96,884 | $86,193 |
| Add: Purchase accounting adjustments [(a)] | 692 | — | 4,549 | — |
| Add: Acquisition and integration expenses [(b)] | — | — | 1,700 | — |
| Add: Stucco-related charges [(c)] | — | — | — | 8,500 |
| Adjusted income before income taxes | $40,172 | $34,673 | $103,133 | $94,693 |
| Net income available to common shareholders | $29,282 | $18,852 | $75,256 | $50,286 |
| Add: Purchase accounting adjustments - net of tax [(a)] | 512 | — | 3,366 | — |
| Add: Acquisition and integration expenses - net of tax [(b)] | — | — | 1,258 | — |
| Add: Stucco-related charges - net of tax [(c)] | — | — | — | 5,440 |
| Add: Excess of fair value over book value of preferred shares subject to redemption [(d)] | — | 2,257 | — | 2,257 |
| Adjusted net income available to common shareholders | $29,794 | $21,109 | $79,880 | $57,983 |

(a) Represents purchase accounting adjustments related to our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018.

(b) Represents costs which include, but are not limited to, legal fees and expenses, travel and communication expenses, cost of appraisals, accounting fees and expenses, and miscellaneous expenses related to our acquisition of Pinnacle Homes. As these costs are not eligible for capitalization as initial direct costs, such amounts are expensed as incurred.

(c)

Represents warranty charges for stucco-related repair costs in certain of our Florida communities (as more fully discussed in Note 6 to our financial statements).

(d) Represents the non-cash charge resulting from the excess of fair value over carrying value of our Series A Preferred Shares that were called for redemption in the third quarter of 2017.

We believe adjusted housing gross margin, adjusted income before income taxes and adjusted net income available to common shareholders are relevant and useful financial measures to investors in evaluating our operating performance as they measure the gross profit, income before income taxes and net income available to common shareholders we generated specifically on our operations during a given period. These non-GAAP financial measures isolate the impact that the acquisition-related charges and stucco-related charges have on housing gross margins and income before income taxes, and that the acquisition-related charges, stucco-related charges and equity adjustment have on net income available to common shareholders, and allow investors to make comparisons with our competitors that adjust housing gross margins, income before income taxes, and net income available to common shareholders in a similar manner. We also believe investors will find these adjusted financial measures relevant and useful because they represent a profitability measure that may be compared to a prior period without regard to variability of the

charges noted above. These financial measures assist us in making strategic decisions regarding community location and product mix, product pricing and construction pace.
Year Over Year Comparison
Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017
The calculation of adjusted housing gross margin (referred to below), which we believe provides a clearer measure of the ongoing performance of our business, is described and reconciled to housing gross margin, the financial measure that is calculated using our GAAP results, below under “Segment Non-GAAP Financial Measures.”

Midwest Region. During the three months ended September 30, 2018, homebuilding revenue in our Midwest region increased $56.3 million, from $180.5 million in the third quarter of 2017 to $236.8 million in the third quarter of 2018. This 31% increase in homebuilding revenue was the result of a 26% increase in the number of homes delivered (122 units, which benefited from our new Detroit division) and an increase in the average sales price of homes delivered ($17,000 per home delivered). Operating income in our Midwest region increased $3.3 million from $20.9 million in the third quarter of 2017 to $24.2 million during the quarter ended September 30, 2018. This increase in operating income was the result of a $7.1 million improvement in our gross margin offset partially by a $3.8 million increase in selling, general, and administrative expense. With respect to our homebuilding gross margin, our housing gross margin improved $7.2 million due to the increases in the number of homes delivered and average sales price of homes delivered noted above, offset partially by the $0.7 million charge for purchase accounting adjustments related to our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018. Our housing gross margin percentage declined 200 basis points to 18.7% in the third quarter of 2018 from 20.7% in the prior year’s third quarter. Exclusive of the $0.7 million charge for purchase accounting adjustments, our adjusted housing gross margin for the third quarter of 2018 declined 170 basis points to 19.0% compared to the third quarter of 2017. The decline in housing gross margin percentage was primarily due to increased lot and construction costs compared to 2017's same period as well as changes in product type and market mix of homes delivered. Our land sale gross margin declined $0.1 million due to fewer strategic land sales in the third quarter of 2018 compared to the same period in 2017.
Selling, general and administrative expense increased $3.8 million, from $16.4 million for the quarter ended September 30, 2017 to $20.2 million for the quarter ended September 30, 2018, and declined as a percentage of revenue to 8.5% in 2018’s third quarter from 9.1% in 2017’s third quarter. The increase in selling, general and administrative expense was attributable to a $2.5 million increase in selling expense due to (1) a $1.8 million increase in variable selling expenses resulting from increases in sales commissions produced by the higher number of homes delivered and higher average sales price of homes delivered, $0.5 million of which was associated with our new Detroit division, and (2) a $0.7 million increase in non-variable selling expenses primarily related to costs associated with our additional sales offices and models related to our new Detroit division. The $1.3 million increase in general and administrative expense primarily related to a $1.0 million increase in incremental costs from our Detroit acquisition and a $0.3 million increase in land related expenses.
During the three months ended September 30, 2018, we experienced a 17% increase in new contracts in our Midwest region, from 458 in the third quarter of 2017 to 537 in the third quarter of 2018 (which benefited from our new Detroit division), and a 25% increase in backlog from 1,025 homes at September 30, 2017 to 1,284 homes at September 30, 2018. The increases in new contracts and backlog were partially due to improving demand in our newer communities compared to prior year and due to an increase in our average number of communities during the period, and backlog also benefited from the addition of homes from our recent acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018. Average sales price in backlog increased to $427,000 at September 30, 2018 compared to $406,000 at September 30, 2017 which was primarily due to changes in product type and market mix. During the three months ended September 30, 2018, we opened six new communities in our Midwest region compared to one during 2017's third quarter. Our monthly absorption rate in our Midwest region declined to 2.0 per community in the third quarter of 2018 compared to 2.4 per community in 2017's third quarter.
Southern Region. During the three month period ended September 30, 2018, homebuilding revenue in our Southern region increased $44.5 million, from $176.5 million in the third quarter of 2017 to $221.0 million in the third quarter of 2018. This 25% increase in homebuilding revenue was the result of an 18% increase in the number of homes

delivered (92 units) and a 7% increase in the average sales price of homes delivered ($23,000 per home delivered). Operating income in our Southern region increased $5.8 million from $13.1 million in the third quarter of 2017 to $18.9 million during the quarter ended September 30, 2018. This increase in operating income was the result of a $9.8 million improvement in our gross margin, partially offset by a $3.9 million increase in selling, general, and administrative expense. With respect to our homebuilding gross margin, our housing gross margin improved $9.9 million, due primarily to the 18% increase in the number of homes delivered and the 7% increase in the average sales price of homes delivered noted above. Our housing gross margin percentage improved from 18.8% in prior year's third quarter to 19.4% in the third quarter of 2018, largely due to the mix of communities delivering homes and a more favorable product mix, offset in part, by rising lot and construction costs. Our land sale gross margin declined $0.1 million due to fewer strategic land sales in the third quarter of 2018 compared to the third quarter of 2017.

Selling, general and administrative expense increased $3.9 million from $20.1 million in the third quarter of 2017 to $24.0 million in the third quarter of 2018 but declined as a percentage of revenue to 10.9% from 11.4% in the third quarter of 2017. The increase in selling, general and administrative expense was attributable, in part, to a $2.3 million increase in selling expense due to (1) a $1.9 million increase in variable selling expenses resulting from increases in sales commissions produced by the higher number of homes delivered and higher average sales price of homes delivered and (2) a $0.3 million increase in non-variable selling expenses primarily related to costs associated with our sales offices and models as a result of our increased community count. The increase in selling, general and administrative expense was also attributable to a $1.6 million increase in general and administrative expense, which was primarily related to a $0.9 million increase in compensation expense as a result of an increase in employee count and a $0.7 million increase in land related expenses, and other miscellaneous expenses.

During the three months ended September 30, 2018, we experienced a 2% increase in new contracts in our Southern region, from 583 in the third quarter of 2017 to 597 for the third quarter of 2018, and a 22% increase in backlog from 1,013 homes at September 30, 2017 to 1,236 homes at September 30, 2018. The increases in new contracts and backlog were primarily due to an increase in our average number of communities during the period, along with improvement in demand across our Southern markets. Average sales price in backlog increased to $367,000 at September 30, 2018 from $355,000 at September 30, 2017 due to changes in product type and market mix. During the three months ended September 30, 2018, we opened six communities in our Southern region compared to three during 2017's third quarter. Our monthly absorption rate in our Southern region declined to 2.1 per community in the third quarter of 2018 from 2.3 per community in the third quarter of 2017.

Mid-Atlantic Region. During the three month period ended September 30, 2018, homebuilding revenue in our Mid-Atlantic region decreased $9.9 million from $107.7 million in the third quarter of 2017 to $97.8 million in the third quarter of 2018. This 9% decrease in homebuilding revenue was the result of a 17% decrease in the number of homes delivered (48 units) primarily due to a decrease in the average number of communities during the period compared to prior year as a result of delayed new replacement community openings, offset partially by a 13% increase in the average sales price of homes delivered ($49,000 per home delivered). Operating income in our Mid-Atlantic region decreased $1.8 million from $10.0 million in the third quarter of 2017 to $8.2 million during the quarter ended September 30, 2018. This decline in operating income was primarily the result of a $3.3 million decrease in our gross margin, offset, in part, by a $1.5 million decrease in selling, general and administrative expense. With respect to our homebuilding gross margin, our housing gross margin declined $3.2 million, due to the 17% decrease in the number of homes delivered noted above and a decline in housing gross margin percentage, partially attributable to delayed replacement community openings. Our housing gross margin percentage declined 190 basis points from 18.7% in last year’s third quarter to 16.8% in the third quarter of 2018 due primarily to the mix of homes delivered and increased construction and lot costs. Our land sale gross margin declined slightly by $0.1 million due to fewer strategic land sales during the third quarter of 2018 compared to prior year.

Selling, general and administrative expense decreased $1.5 million from $9.6 million in the third quarter of 2017 to $8.1 million in the third quarter of 2018 and declined as a percentage of revenue to 8.3% compared to 8.9% for the third quarter of 2017. The decrease in selling, general and administrative expense was primarily due to a $0.8 million decrease in selling expenses primarily as a result of decreased sales commissions produced by the lower number of homes delivered. General and administrative expense decreased $0.7 million primarily related to a $0.4 million decrease in land related expenses and a $0.3 million decrease in compensation expense as a result of a decrease in employee count.

During the three months ended September 30, 2018, we experienced a 9% decrease in new contracts in our Mid-Atlantic region, from 184 in the third quarter of 2017 to 168 for the third quarter of 2018, and a 4% decrease in the number of homes in backlog from 340 homes at September 30, 2017 to 326 homes at September 30, 2018. The decreases in new contracts and backlog were primarily due to a decrease in the average number of active communities during the period compared to the prior year, as a result of delays in replacement community openings in the period compared to the prior year’s third quarter. Average sales price of homes in backlog increased, however, from $399,000 at September 30, 2017 to $421,000 at September 30, 2018. During the three months ended September 30, 2018, we opened four communities in our Mid-Atlantic region compared to two during the third quarter of 2017. Our monthly absorption rate in our Mid-Atlantic region increased to 2.0 per community in the third quarter of 2018 from 1.9 per community in the third quarter of 2017.

Financial Services. Revenue from our mortgage and title operations increased $0.4 million to $12.2 million (a third quarter record) in the third quarter of 2018 from $11.8 million in the third quarter of 2017. We experienced a 12% increase in the number of loan originations, from 902 in the third quarter of 2017 to 1,011 in the third quarter of 2018, and an increase in the average loan amount from $292,000 in the quarter ended September 30, 2017 to $305,000 in the quarter ended September 30, 2018. We also experienced an increase in the volume of loans sold, but continue to experience lower margins on loans sold due to increased competitive pressures.

We experienced a $0.2 million decrease in operating income in the third quarter of 2018 compared to 2017's third quarter, which was primarily due to an increase in selling, general and administrative expense compared to the third quarter of 2017, which was attributable primarily to an increase in compensation expense related to our increase in employee headcount and the absence of $0.4 million of income from the sale of a portion of our mortgage servicing rights in the third quarter of last year.
At September 30, 2018, M/I Financial provided financing services in all of our markets.
Approximately 81% of our homes delivered during the third quarter of 2018 were financed through M/I Financial, compared to 80% in the third quarter of 2017. Capture rate is influenced by financing availability and competition in the mortgage market, and can fluctuate from quarter to quarter.
Corporate Selling, General and Administrative Expense. Corporate selling, general and administrative expense increased $2.6 million from $10.5 million for the third quarter of 2017 to $13.1 million for the third quarter of 2018. This increase primarily resulted from a $1.2 million increase in compensation expense primarily attributable to higher incentive compensation due to improved operating results, a $0.5 million increase in depreciation costs associated with new information systems, a $0.2 million increase in professional fees, and a $0.7 million increase in other miscellaneous expenses.
Equity in Income from Joint Venture Arrangements. Income from joint venture arrangements represent our portion of pre-tax earnings from our joint ownership and development agreements, joint ventures and other similar arrangements. During the three months ended September 30, 2018 and 2017, the Company experienced less than $0.1 million in equity in income from joint venture arrangements.
Interest Expense - Net. Interest expense for the Company decreased $0.3 million from $4.7 million for the three months ended September 30, 2017 to $4.4 million for the three months ended September 30, 2018. This decrease was primarily the result of higher capitalized interest related to our increased land development and home construction during the third quarter of 2018 compared to prior year, in addition to the maturity of our 3.25% Convertible Senior Subordinated Notes due 2017 (the “2017 Convertible Senior Subordinated Notes”) in September 2017 and our 3.0% Convertible Senior Subordinated Notes due 2018 (the “2018 Convertible Senior Subordinated Notes”) in March 2018, which were not outstanding during the third quarter of 2018. Partially offsetting this impact was an increase in borrowings under our Credit Facility (as defined below) during the third quarter of 2018 compared to the third quarter of 2017, in addition to the issuance of our $250.0 million aggregate principal amount of 5.625% Senior Notes due 2025 (the “2025 Senior Notes”) during the third quarter of 2017. Our weighted average borrowings increased from $714.0 million in 2017's third quarter to $817.5 million in 2018's third quarter, and our weighted average borrowing rate increased from 6.12% in the third quarter of 2017 to 6.19% for third quarter of 2018.
Income Taxes. Our overall effective tax rate was 25.8% for the three months ended September 30, 2018 and 35.6% for the same period in 2017. The decline in the effective rate from the three months ended September 30, 2017 was primarily attributable to the decrease in the corporate income tax rate from 35% to 21% partially offset by the repeal of the domestic production activity deduction, both of which are the result of the enactment of the Tax Act during the fourth quarter of 2017 (please see Note 10 to our financial statements for more information).
Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Midwest Region. During the nine months ended September 30, 2018, homebuilding revenue in our Midwest region increased $126.9 million, from $495.4 million in the nine months ended September 30, 2017 to $622.3 million in the nine months ended September 30, 2018. This 26% increase in homebuilding revenue was the result of an 21% increase in the number of homes delivered (271 units, which benefited from our new Detroit division) and a 4% increase in the average sales price of homes delivered ($16,000 per home delivered), offset partially by a $1.3 million decrease in land sale revenue. Operating income in our Midwest region increased $1.7 million, from $53.7 million during the nine months ended September 30, 2017 to $55.4 million during the nine months ended September 30, 2018. The increase in operating income was primarily the result of a $10.5 million increase in our gross margin, offset, in part, by an $8.8 million increase in selling, general, and administrative expense. With respect to our homebuilding gross margin, our housing gross margin improved $10.6 million, due to the 21% increase in the number of homes delivered and the 4% increase in the average sales price of homes delivered noted above. Our housing gross margin percentage declined 240 basis points from 20.2% in the prior year's first nine months to 17.8% for the same period in 2018. Our housing gross margin for 2018's first nine months was unfavorably impacted by a $4.5 million charge for purchase accounting adjustments from our recent Detroit acquisition. Exclusive of the $4.5 million charge for purchase accounting adjustments related to our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018, our adjusted housing gross margin percentage declined 170 basis points to 18.5% for the first nine months of 2018 primarily due to increased lot and construction costs as well as a change in product type and market mix of homes delivered compared to the prior year. Our land sale gross margin declined $0.1 million as a result of fewer strategic land sales in the nine months ended September 30, 2018 compared to the same period in 2017.

Selling, general and administrative expense increased $8.8 million, from $46.6 million for the nine months ended September 30, 2017 to $55.4 million for the nine months ended September 30, 2018, and declined as a percentage of revenue to 8.9% compared to 9.4% for the same period in 2017. The increase in selling, general and administrative expense was attributable, in part, to a $6.4 million increase in selling expense due to (1) a $4.6 million increase in variable selling expenses resulting from increases in sales commissions produced by the higher average sales price of homes delivered and higher number of homes delivered, $1.6 million of which was associated with our new Detroit division, and (2) a $1.8 million increase in non-variable selling expenses primarily related to costs associated with our additional sales offices and models as a result of our increased community count, $1.1 million of which related to our new Detroit division. The increase in selling, general and administrative expense was also attributable to a $2.4 million increase in general and administrative expense, which was primarily related to incremental costs from our Detroit acquisition.

During the nine months ended September 30, 2018, we experienced a 22% increase in new contracts in our Midwest region, from 1,545 in the nine months ended September 30, 2017 to 1,891 in the first nine months of 2018 (which benefited from our new Detroit division), and a 25% increase in backlog from 1,025 homes at September 30, 2017 to 1,284 homes at September 30, 2018. The increases in new contracts and backlog were partially due to improving demand in our newer communities compared to prior year and due to an increase in our average number of communities during the period, and backlog also benefited from the addition of homes from our recent acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018. Average sales price in backlog increased to $427,000 at September 30, 2018 compared to $406,000 at September 30, 2017 which was primarily due to product type and market mix in the first nine months of 2018 compared to the same period last year. During the nine months ended September 30, 2018, we opened 19 new communities in our Midwest region (excluding the 10 communities added as part of our acquisition in Detroit) compared to 18 during 2017's first nine months. Our monthly absorption rate in our Midwest region declined slightly to 2.6 per community in the first nine months of 2018 from 2.7 per community in the nine months ended September 30, 2017.

Southern Region. During the nine months ended September 30, 2018, homebuilding revenue in our Southern region increased $144.4 million from $504.6 million in the nine months ended September 30, 2017 to $649.0 million in the nine months ended September 30, 2018. This 29% increase in homebuilding revenue was the result of a 25% increase in the number of homes delivered (360 units) and a 4% increase in the average sales price of homes delivered ($14,000 per home delivered), partially offset by a $3.9 million decrease in land sale revenue. Operating income in our Southern region increased $26.6 million from $26.5 million in the nine months ended September 30, 2017 to $53.1 million during the nine months ended September 30, 2018. This increase in operating income was the result of a $38.6 million improvement in our gross margin offset by a $12.0 million increase in selling, general, and administrative expense. With respect to our homebuilding gross margin, our gross margin on homes delivered improved $38.8 million, due primarily to the 25% increase in the number of homes delivered, the 4% increase in the average sales price of homes delivered, and the absence of $8.5 million in charges for stucco-related repair costs in certain of our Florida communities taken during the nine months ended September 30, 2017 (as more fully discussed in Note 6 to our financial statements). Our housing gross margin percentage improved 210 basis points from 16.9% in prior year's first nine months to 19.0% for the same period in 2018. Exclusive of the $8.5 million charge for stucco-related repair costs taken during 2017's first nine months, our adjusted housing gross margin percentage improved 40 basis points from 18.6% for the nine months ended September 30, 2017 to 19.0% for the nine months ended September 30, 2018, largely due to the mix of communities delivering homes and a more favorable product mix, offset, in part, by rising lot and construction costs. Our land sale gross margin declined $0.2 million as a result of fewer strategic land sales in the nine months ended September 30, 2018 compared to the same period in 2017.

Selling, general and administrative expense increased $12.0 million from $58.1 million in the nine months ended September 30, 2017 to $70.1 million in the nine months ended September 30, 2018 but declined as a percentage of revenue to 10.8% compared to 11.5% for the nine months ended September 30, 2017. The increase in selling, general and administrative expense was attributable, in part, to a $8.5 million increase in selling expense due to (1) a $6.6 million increase in variable selling expenses resulting from increases in sales commissions produced by the higher number of homes delivered and higher average sales price of homes delivered, and (2) a $1.9 million increase in non-variable selling expenses primarily related to costs associated with our sales offices and models as a result of our increased community count. The increase in selling, general and administrative expense was also attributable to a $3.5 million increase in general and administrative expense, which was primarily related to a $1.6 million increase in land related expenses, a $1.0 million increase in compensation expense as a result of an increase in employee count and a $0.9 million increase in professional fees.

During the nine months ended September 30, 2018, we experienced a 19% increase in new contracts in our Southern region, from 1,798 in the nine months ended September 30, 2017 to 2,147 in the first nine months of 2018, and a 22% increase in backlog from 1,013 homes at September 30, 2017 to 1,236 homes at September 30, 2018. The increases in new contracts and backlog were primarily due to an increase in our average number of communities during the period, along with improvement in demand across our Southern markets in the first nine months of 2018 compared to the nine months ended September 30, 2017. Average sales price in backlog increased from $355,000 at September 30, 2017 to $367,000 at September 30, 2018 due to a change in product type and market mix. During the nine months ended September 30, 2018, we opened 28 communities in our Southern region compared to 23 during 2017's first nine months. Our monthly absorption rate in our Southern region increased to 2.6 per community in the nine months ended September 30, 2018 from 2.4 per community in the nine months ended September 30, 2017.

Mid-Atlantic Region. During the nine months ended September 30, 2018, homebuilding revenue in our Mid-Atlantic region decreased $48.9 million from $302.3 million in the nine months ended September 30, 2017 to $253.4 million in 2018's first nine months. This 16% decrease in homebuilding revenue was the result of a 24% decrease in the number of homes delivered (183 units) primarily due to a decrease in the average number of communities during the period compared to prior year as a result of delayed new replacement community openings, offset partially by a 10% increase in the average sales price of homes delivered ($38,000 per home delivered). Operating income in our Mid-Atlantic region decreased $10.9 million, from $26.8 million in 2017's first nine months to $15.9 million during the nine months ended September 30, 2018. This decrease in operating income was primarily the result of a $14.3 million decrease in our gross margin, partially offset by a $3.4 million decrease in selling, general and administrative expense. With respect to our homebuilding gross margin, our housing gross margin declined $14.2 million, due primarily to the 24% decrease in the number of homes delivered noted above and a decline in housing gross margin percentage, partially attributable to delayed openings of new replacement communities. Our housing gross margin percentage declined 220 basis points from 18.5% in prior year’s first nine months to 16.3% for 2018’s first nine month period as a result of increased construction and lot costs as well as the mix of homes delivered. Our land sale gross margin declined $0.1 million due to fewer strategic land sales in the nine months ended September 30, 2018 compared to the same period in 2017.

Selling, general and administrative expense decreased $3.4 million from $28.0 million in the nine months ended September 30, 2017 to $24.6 million in 2018's first nine months but increased as a percentage of revenue to 9.7% from 9.3% for 2017's first nine months. The decrease in selling, general and administrative expense was primarily attributable to a decrease in variable selling expenses resulting from reduced sales commissions produced by the lower number of homes delivered. General and administrative expense decreased $0.6 million primarily related to a decrease in land related expenses.

During the nine-month period ended September 30, 2018, we experienced a 14% decrease in new contracts in our Mid-Atlantic region, from 736 in the nine months ended September 30, 2017 to 634 in the nine months ended September 30, 2018, and a 4% decrease in the number of homes in backlog from 340 homes at September 30, 2017 to 326 homes at September 30, 2018. The decreases in new contracts and backlog were primarily due to a decrease in the average number of active communities during the first nine months of 2018 compared to the same period in the prior year as a result of delays in replacement community openings. Average sales price of homes in backlog increased, however, from $399,000 at September 30, 2017 to $421,000 at September 30, 2018. During the nine months ended September 30, 2018, we opened seven communities in our Mid-Atlantic region compared to seven during 2017's first nine months. Our monthly absorption rate in our Mid-Atlantic region remained flat at 2.4 per community in both the nine months ended September 30, 2018 and 2017.

Financial Services. Revenue from our mortgage and title operations increased $1.2 million (3%) from $37.9 million in the nine months ended September 30, 2017 to $39.1 million in the nine months ended September 30, 2018 as a result of a 10% increase in the number of loan originations from 2,467 in the nine months ended September 30, 2017 to 2,722 in the nine months ended September 30, 2018, and an increase in the average loan amount from $297,000 in the nine months ended September 30, 2017 to $304,000 in the nine months ended September 30, 2018. We also experienced an increase in the volume of loans sold and a gain from the sale of a portion of our servicing portfolio during the nine months ended September 30, 2018, but continue to experience lower margins on loans sold in the period than we experienced in prior year due to increased competitive pressures.

We experienced a $0.8 million decrease in operating income in the first nine months of 2018 compared to the nine months ended September 30, 2017, which was primarily due to a $2.0 million increase in selling, general and administrative expense compared to 2017's first nine months, offset, in part, by the increase in our revenue discussed above. The increase in selling, general and administrative expense was primarily attributable to an increase in compensation expense related to our increase in employee headcount.

At September 30, 2018, M/I Financial provided financing services in all of our markets. Approximately 80% of our homes delivered during the nine months ended September 30, 2018 were financed through M/I Financial, the same as in 2017's first nine months. Capture rate is influenced by financing availability and can fluctuate from quarter to quarter.

Corporate Selling, General and Administrative Expense.  Corporate selling, general and administrative expense increased $2.9 million from $29.2 million for the nine months ended September 30, 2017 to $32.1 million for the nine months ended September 30, 2018. The increase was primarily due to a $1.1 million increase in depreciation costs associated with new information systems, a $0.5 million increase in professional fees, a $0.3 million increase in advertising expense, a $0.2 million increase in compensation expense, and a $0.8 million increase in other miscellaneous expenses.

Acquisition and Integration Costs. During the nine months ended September 30, 2018, the Company incurred $1.7 million in acquisition and integration related costs related to our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018. These costs include, but are not limited to, legal fees and expenses, travel and communication expenses, cost of appraisals, accounting fees and expenses, and miscellaneous expenses. As these costs are not eligible for capitalization as initial direct costs under GAAP, such amounts are expensed as incurred.
Income from Joint Venture Arrangements. Income from joint venture arrangements represent our portion of pre-tax earnings from our joint ownership and development agreements, joint ventures and other similar arrangements. During the nine months ended September 30, 2018 and 2017, the Company earned $0.3 million and $0.2 million in equity in income from joint venture arrangements, respectively.
Interest Expense - Net. Interest expense for the Company increased $1.4 million from $13.8 million in the nine months ended September 30, 2017 to $15.2 million in the nine months ended September 30, 2018. This increase was primarily the result of an increase in our weighted average borrowings from $665.5 million in the nine months ended September 30, 2017 to $783.3 million in the nine months ended September 30, 2018, in addition to an increase in our weighted average borrowing rate from 5.87% in 2017's first nine months to 6.23% in 2018's first nine months. The increase in our weighted average borrowings and our weighted average borrowing rate primarily related to the issuance of our $250.0 million in aggregate principal amount of 2025 Senior Notes during the third quarter of 2017 in addition to increased borrowings under our Credit Facility (as defined below) during 2018's first nine months compared to 2017's first nine months, partially offset by the maturity of our 2017 Convertible Senior Subordinated Notes in September 2017 and our 2018 Convertible Senior Subordinated Notes in March 2018 as well as higher capitalized interest related to our increased land development and home construction during the nine months ended September 30, 2018 compared to prior year.
Income Taxes. Our overall effective tax rate was 22.3% for the nine months ended September 30, 2018 and 34.8% for the same period in 2017. The decline in the effective rate for the nine months ended September 30, 2018 was primarily attributable to the decrease in the corporate income tax rate from 35% to 21% partially offset by the repeal of the domestic production activity deduction, both of which are the result of the enactment of the Tax Act during the fourth quarter of 2017. In addition, during the quarter ended June 30, 2018, we recorded a $3.0 million tax benefit primarily related to the retroactive reinstatement of energy efficient homes tax credits to 2017 for which we obtained certifications in 2018 (please see Note 10 to our financial statements for more information).

Segment Non-GAAP Financial Measures. This report contains information about our adjusted housing gross margin, which constitutes a non-GAAP financial measure. Because adjusted housing gross margin is not calculated in accordance with GAAP, this financial measure may not be completely comparable to similarly-titled measures used by other companies in the homebuilding industry and, therefore, should not be considered in isolation or as an alternative to operating performance and/or financial measures prescribed by GAAP. Rather, this non-GAAP financial measure should be used to supplement our GAAP results in order to provide a greater understanding of the factors and trends affecting our operations.

Adjusted housing gross margin for our Midwest and Southern regions is calculated as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2018 | 2017 |
| Midwest region: | | | | |
| Housing revenue | $236,619 | $179,363 | $621,712 | $493,464 |
| Housing cost of sales | 192,301 | 142,215 | 511,185 | 393,583 |
| Housing gross margin | 44,318 | 37,148 | 110,527 | 99,881 |
| Add: Purchase accounting adjustments [(a)] | 692 | — | 4,549 | — |
| Adjusted housing gross margin | $45,010 | $37,148 | $115,076 | $99,881 |
| Housing gross margin percentage | 18.7 % | 20.7 % | 17.8 % | 20.2 % |
| Adjusted housing gross margin percentage | 19.0 % | 20.7 % | 18.5 % | 20.2 % |
| Southern region: | | | | |
| Housing revenue | $221,044 | $175,644 | $648,777 | $500,504 |
| Housing cost of sales | 178,116 | 142,643 | 525,628 | 416,135 |
| Housing gross margin | 42,928 | 33,001 | 123,149 | 84,369 |
| Add: Stucco-related charges [(b)] | — | — | — | 8,500 |
| Adjusted housing gross margin | $42,928 | $33,001 | $123,149 | $92,869 |
| Housing gross margin percentage | 19.4 % | 18.8 % | 19.0 % | 16.9 % |
| Adjusted housing gross margin percentage | 19.4 % | 18.8 % | 19.0 % | 18.6 % |

(a) Represents purchase accounting adjustments from our acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018.

(b) Represents warranty charges for stucco-related repair costs in certain of our Florida communities. With respect to this matter, during the quarter ended September 30, 2018, we identified 37 additional homes in need of repair and completed repairs on 61 homes, and, at September 30, 2018, we have 162 homes in various stages of repair. Please see Note 6 to our financial statements for further information.

LIQUIDITY AND CAPITAL RESOURCES

Overview of Capital Resources and Liquidity.

At September 30, 2018, we had $36.4 million of cash, cash equivalents and restricted cash, with $35.5 million of this amount comprised of unrestricted cash and cash equivalents, which represents a $115.2 million decrease in unrestricted cash and cash equivalents from December 31, 2017. Our principal uses of cash for the nine months ended September 30, 2018 were investment in land and land development, the acquisition of Pinnacle Homes in Detroit, Michigan on March 1, 2018 (please see Note 7 to our financial statements for more information), construction of homes, mortgage loan originations, investment in joint ventures, operating expenses, short-term working capital, debt service requirements, including the repayment of amounts outstanding under our credit facilities, the repayment of approximately $65.9 million in aggregate principal amount of our 3.0% Convertible Senior Subordinated Notes due 2018 (the “2018 Convertible Senior Subordinated Notes”), and the repurchase of $11.1 million of our outstanding common shares under our 2018 Share Repurchase Program (as defined below). In order to fund these uses of cash, we used proceeds from home deliveries, the sale of mortgage loans and the sale of mortgage servicing rights, as well as excess cash balances, borrowings under our credit facilities, and other sources of liquidity.

We are actively acquiring and developing lots in our markets to replenish and grow our lot supply and active community count. We expect to continue to expand our business based on the anticipated level of demand for new homes in our markets. Accordingly, we expect that our cash outlays for land purchases, land development, home construction and operating expenses will exceed our cash generated by operations during some weekly and monthly periods during the final three months of 2018, and we expect to continue to utilize our Credit Facility (as defined below) during the final three months of 2018.

During the nine months ended September 30, 2018, we delivered 3,953 homes, started 4,907 homes, and spent $256.5 million on land purchases and $152.3 million on land development. Based upon our business activity levels, market conditions, and

opportunities for land in our markets, we currently estimate that we will spend approximately $575 million to $600 million on land purchases and land development during 2018, including the $408.8 million spent during the nine months ended September 30, 2018 and excluding our acquisition of Pinnacle Homes in March 2018.
We also continue to enter into land option agreements, taking into consideration current and projected market conditions, to secure land for the construction of homes in the future. Pursuant to such land option agreements, as of September 30, 2018, we had a total of 15,825 lots under contract, with an aggregate purchase price of approximately $699.9 million to be acquired during the remainder of 2018 through 2028.
Land transactions are subject to a number of factors, including our financial condition and market conditions, as well as satisfaction of various conditions related to specific properties. We will continue to monitor market conditions and our ongoing pace of home deliveries and adjust our land spending accordingly. The planned increase in our land spending in 2018 compared to 2017 is driven primarily by the growth of our business.
Operating Cash Flow Activities. During the nine-month period ended September 30, 2018, we used $73.9 million of cash in operating activities, compared to using $66.0 million of cash in operating activities during the nine months ended September 30, 2017. The cash used in operating activities in the first nine months of 2018 was primarily a result of a $221.3 million increase in inventory and a decrease in accrued compensation and other liabilities of $20.5 million, offset partially by net income of $75.3 million, along with $56.3 million of proceeds from the sale of mortgage loans net of mortgage loan originations, an increase in accounts payable of $20.7 million and an increase in customer deposits totaling $9.9 million. The $66.0 million of cash used in operating activities in the first nine months of 2017 was primarily a result of a $212.7 million increase in inventory and a decrease in accrued compensation of $9.3 million, offset partially by net income totaling $56.2 million, along with $66.4 million of proceeds from the sale of mortgage loans net of mortgage loan originations and an increase in accounts payable and customer deposits totaling $25.8 million.

Investing Cash Flow Activities. During the nine months ended September 30, 2018, we used $121.5 million of cash in investing activities, compared to generating $5.1 million of cash in investing activities during the nine months ended September 30, 2017. This increase in cash used was primarily due to our acquisition of Pinnacle Homes, a privately held homebuilder in Detroit, Michigan, during the first quarter of 2018 for approximately $101.0 million, in addition to a $20.5 million increase in investment in joint venture arrangements.

Financing Cash Flow Activities. During the nine months ended September 30, 2018, we generated $80.1 million of cash from financing activities, compared to generating $140.3 million of cash during the nine months ended September 30, 2017. The $60.2 million decrease in cash generated by financing activities was primarily due to the issuance of our $250.0 million in aggregate principal amount of 2025 Senior Notes during the third quarter of 2017, repayment during the first quarter of 2018 of that portion of our 2018 Convertible Senior Subordinated Notes that were not converted into common shares by the holders thereof, and the repurchase of $11.1 million of our common shares under our 2018 Share Repurchase Program during the third quarter of 2018 offset, in part, by increased borrowings under our Credit Facility (as defined below) during the nine months ended September 30, 2018.
On August 14, 2018, the Company announced that its Board of Directors authorized a share repurchase program (the “2018 Repurchase Program”) pursuant to which the Company may purchase up to $50 million of its outstanding common shares (see Note 13 to our financial statements). During the quarter ended September 30, 2018, the Company repurchased 437,490 common shares with an aggregate purchase price of $11.1 million which was funded with cash on hand and borrowings under our Credit Facility. As of September 30, 2018, the Company is authorized to repurchase an additional $38.9 million of outstanding common shares under the 2018 Share Repurchase Program.

At September 30, 2018 and December 31, 2017, our ratio of homebuilding debt to capital was 48% and 46%, respectively, calculated as the carrying value of our outstanding homebuilding debt divided by the sum of the carrying value of our outstanding homebuilding debt plus shareholders’ equity. This increase was due to higher debt levels compared to December 31, 2017, offset partially by an increase in shareholders’ equity at September 30, 2018. We believe that this ratio provides useful information for understanding our financial position and the leverage employed in our operations, and for comparing us with other homebuilders.

We fund our operations with cash flows from operating activities, including proceeds from home deliveries, land sales and the sale of mortgage loans. We believe that these sources of cash, along with our balance of unrestricted cash and borrowings available under our credit facilities, will be sufficient to fund our currently anticipated working capital needs, investment in land and land development, construction of homes, operating expenses, planned capital spending, and debt service requirements for at least the next twelve months. In addition, we routinely monitor current operational and debt service requirements, financial market conditions, and credit relationships and we may choose to seek additional capital by issuing new debt and/or equity securities to

strengthen our liquidity or our long-term capital structure. The financing needs of our homebuilding and financial services operations depend on anticipated sales volume in the current year as well as future years, inventory levels and related turnover, forecasted land and lot purchases, debt maturity dates, and other factors. If we seek such additional capital, there can be no assurance that we would be able to obtain such additional capital on terms acceptable to us, if at all, and such additional equity or debt financing could dilute the interests of our existing shareholders and/or increase our interest costs.
The Company is a party to three primary credit agreements: (1) a $500 million unsecured revolving credit facility, dated July 18, 2013, as amended, with M/I Homes, Inc. as borrower and guaranteed by the Company's wholly owned homebuilding subsidiaries (the "Credit Facility"); (2) a $125 million secured mortgage warehousing agreement (which increases to $160 million during certain periods), as most recently amended on June 22, 2018, with M/I Financial as borrower (the "MIF Mortgage Warehousing Agreement"); and (3) a $35 million mortgage repurchase agreement (which increases to $50 million during certain periods), as amended and restated on October 30, 2017, with M/I Financial as borrower (the "MIF Mortgage Repurchase Facility").
Included in the table below is a summary of our available sources of cash from the Credit Facility, the MIF Mortgage Warehousing Agreement and the MIF Mortgage Repurchase Facility as of September 30, 2018:

| (In thousands) | Expiration Date | Outstanding Balance | Available Amount |
|---|---|---|---|
| Notes payable – homebuilding [(a)] | 7/18/2021 | $ 222,700 | $ 228,521 |
| Notes payable – financial services [(b)] | (b) | $ 104,026 | $ 10,157 |

(a) The available amount under the Credit Facility is computed in accordance with the borrowing base calculation under the Credit Facility, which applies various advance rates for different categories of inventory and totaled $664.2 million of availability for additional senior debt at September 30, 2018. As a result, the full $500 million commitment amount of the facility was available, less any borrowings and letters of credit outstanding. There were $222.7 million of borrowings outstanding and $48.8 million of letters of credit outstanding at September 30, 2018, leaving $228.5 million available. The Credit Facility has an expiration date of July 18, 2021.

(b) The available amount is computed in accordance with the borrowing base calculations under the MIF Mortgage Warehousing Agreement and the MIF Mortgage Repurchase Facility, each of which may be increased by pledging additional mortgage collateral. The maximum aggregate commitment amount of these agreements as of September 30, 2018 was $195 million. The MIF Mortgage Warehousing Agreement has an expiration date of June 21, 2019. Subsequent to the quarter ended September 30, 2018, M/I Financial entered into an amendment to the MIF Mortgage Repurchase Facility which extended its term for an additional year to October 28, 2019 and also increased the maximum borrowing availability to $50 million from $35 million. The amendment allows the maximum borrowing availability to be increased to $65 million during certain periods of expected increases in mortgage origination volume.

Notes Payable - Homebuilding.

Homebuilding Credit Facility. The Credit Facility provides for an aggregate commitment amount of $500 million, including a $125 million sub-facility for letters of credit. The Credit Facility matures on July 18, 2021. Interest on amounts borrowed under the Credit Facility is payable at a rate which is adjusted daily and is equal to the sum of the one month LIBOR rate plus a margin of 250 basis points. The margin is subject to adjustment in subsequent quarterly periods based on the Company's leverage ratio.

Borrowings under the Credit Facility constitute senior, unsecured indebtedness and availability is subject to, among other things, a borrowing base calculated using various advance rates for different categories of inventory. The Credit Facility contains various representations, warranties and covenants which require, among other things, that the Company maintain (1) a minimum level of Consolidated Tangible Net Worth of $517.5 million (subject to increase over time based on earnings and proceeds from equity offerings), (2) a leverage ratio not in excess of 60%, and (3) either a minimum Interest Coverage Ratio of 1.5 to 1.0 or a minimum amount of available liquidity. In addition, the Credit Facility contains covenants that limit the Company's number of unsold housing units and model homes, as well as the amount of Investments in Unrestricted Subsidiaries and Joint Ventures.

The Company’s obligations under the Credit Facility are guaranteed by all of the Company’s subsidiaries, with the exception of subsidiaries that are primarily engaged in the business of mortgage financing, title insurance or similar financial businesses relating to the homebuilding and home sales business, certain subsidiaries that are not 100%-owned by the Company or another subsidiary, and other subsidiaries designated by the Company as Unrestricted Subsidiaries (as defined in Note 12 to our financial statements), subject to limitations on the aggregate amount invested in such Unrestricted Subsidiaries. The guarantors for the Credit Facility are the same subsidiaries that guarantee our 2025 Senior Notes and our $300.0 million aggregate principal amount of 6.75% Senior Notes due 2021 (the “2021 Senior Notes”).

As of September 30, 2018, the Company was in compliance with all covenants of the Credit Facility, including financial covenants. The following table summarizes the most significant restrictive covenant thresholds under the Credit Facility and our compliance with such covenants as of September 30, 2018:

| Financial Covenant | Covenant Requirement | Actual |
|---|---|---|
| | (Dollars in millions) | |
| Consolidated Tangible Net Worth | ≥ $517.5 | $795.5 |
| Leverage Ratio | ≤ 0.60 | 0.50 |
| Interest Coverage Ratio | ≥ 1.5 to 1.0 | 4.6 to 1.0 |
| Investments in Unrestricted Subsidiaries and Joint Ventures | ≤ $238.7 | $2.9 |
| Unsold Housing Units and Model Homes | ≤ 1,982 | 1,310 |

Homebuilding Letter of Credit Facility. During the third quarter of 2018, the Company was a party to a secured credit agreement (the “Letter of Credit Facility”) which allowed for the issuance of letters of credit up to a total of $1.0 million secured by cash collateral. The Company elected not to extend the maturity of its Letter of Credit Facility, which expired on September 30, 2018. There were no letters of credit remaining outstanding at the time of maturity.

Notes Payable - Financial Services.

MIF Mortgage Warehousing Agreement. The MIF Mortgage Warehousing Agreement is used to finance eligible residential mortgage loans originated by M/I Financial. The MIF Mortgage Warehousing Agreement provides a maximum borrowing availability of $125 million, which may be increased to $160 million during certain periods of expected increases in the volume of mortgage originations, specifically from September 25, 2018 to October 15, 2018 and from November 15, 2018 to February 4, 2019. The MIF Mortgage Warehousing Agreement expires on June 21, 2019. Interest on amounts borrowed under the MIF Mortgage Warehousing Agreement is payable at a per annum rate equal to the floating LIBOR rate plus a spread of 200 basis points.

The MIF Mortgage Warehousing Agreement is secured by certain mortgage loans originated by M/I Financial that are being “warehoused” prior to their sale to investors. The MIF Mortgage Warehousing Agreement provides for limits with respect to certain loan types that can secure outstanding borrowings. There are currently no guarantors of the MIF Mortgage Warehousing Agreement, although M/I Financial may, at its election, designate from time to time any one or more of M/I Financial’s subsidiaries as guarantors.

As of September 30, 2018, there was $81.9 million outstanding under the MIF Mortgage Warehousing Agreement and M/I Financial was in compliance with all covenants thereunder. The financial covenants, as more fully described and defined in the MIF Mortgage Warehousing Agreement, are summarized in the following table, which also sets forth M/I Financial’s compliance with such covenants as of September 30, 2018:

| Financial Covenant | Covenant Requirement | Actual |
|---|---|---|
| | (Dollars in millions) | |
| Leverage Ratio | ≤ 10.0 to 1.0 | 4.7 to 1.0 |
| Liquidity | ≥ $6.25 | $15.8 |
| Adjusted Net Income | > $0.0 | $13.3 |
| Tangible Net Worth | ≥ $12.5 | $24.0 |

MIF Mortgage Repurchase Facility. The MIF Mortgage Repurchase Facility is used to finance eligible residential mortgage loans originated by M/I Financial and is structured as a mortgage repurchase facility. The MIF Repurchase Facility provides for a maximum borrowing availability of $35 million, and was scheduled to expire on October 29,

2018. M/I Financial pays interest on each advance under the MIF Mortgage Repurchase Facility at a per annum rate equal to the floating LIBOR rate plus 212.5 or 250 basis points depending on the loan type.

Subsequent to the quarter ended September 30, 2018, M/I Financial entered into an amendment to the MIF Mortgage Repurchase Facility which becomes effective on October 29, 2018. The amendment extends the term of the MIF Mortgage Repurchase Facility for an additional year to October 28, 2019, increases the maximum borrowing availability to $50 million, which may be increased to $65 million during certain periods of expected increases in mortgage origination volume, and lowers the per annum rate to the floating LIBOR rate plus 200 or 225 basis points depending on the loan type.

The covenants in the MIF Mortgage Repurchase Facility are substantially similar to the covenants in the MIF Mortgage Warehousing Agreement. The MIF Mortgage Repurchase Facility provides for limits with respect to certain loan types that can secure outstanding borrowings, which are substantially similar to the restrictions in the MIF Mortgage Warehousing Agreement. There are no guarantors of the MIF Mortgage Repurchase Facility. As of September 30, 2018, there was $22.2 million outstanding under the MIF Mortgage Repurchase Facility. M/I Financial was in compliance with all financial covenants as of September 30, 2018.
Senior Notes.

5.625% Senior Notes. In August 2017, the Company issued $250 million aggregate principal amount of 5.625% Senior Notes due 2025. The 2025 Senior Notes contain certain covenants, as more fully described and defined in the indenture governing the 2025 Senior Notes, which limit the ability of the Company and the restricted subsidiaries to, among other things: incur additional indebtedness; make certain payments, including dividends, or repurchase any shares, in an aggregate amount exceeding our “restricted payments basket”; make certain investments; and create or incur certain liens, consolidate or merge with or into other companies, or liquidate or sell or transfer all or substantially all of our assets. These covenants are subject to a number of exceptions and qualifications as described in the indenture governing the 2025 Senior Notes. As of September 30, 2018, the Company was in compliance with all terms, conditions, and covenants under the indenture. Please see Note 8 to our financial statements for more information regarding the 2025 Senior Notes.

6.75% Senior Notes. In December 2015, the Company issued $300 million aggregate principal amount of 6.75% Senior Notes due 2021. The 2021 Senior Notes contain certain covenants, as more fully described and defined in the indenture governing the 2021 Senior Notes, which limit the ability of the Company and the restricted subsidiaries to, among other things: incur additional indebtedness; make certain payments, including dividends, or repurchase any shares, in an aggregate amount exceeding our “restricted payments basket”; make certain investments; and create or incur certain liens, consolidate or merge with or into other companies, or liquidate or sell or transfer all or substantially all of our assets. These covenants are subject to a number of exceptions and qualifications as described in the indenture governing the 2021 Senior Notes. As of September 30, 2018, the Company was in compliance with all terms, conditions, and covenants under the indenture. Please see Note 8 to our financial statements for more information regarding the 2021 Senior Notes.

Weighted Average Borrowings. For the three months ended September 30, 2018 and 2017, our weighted average borrowings outstanding were $817.5 million and $714.0 million, respectively, with a weighted average interest rate of 6.19% and 6.12%, respectively. The increase in our weighted average borrowings related to the issuance of our $250.0 million aggregate principal amount of 2025 Senior Notes during the third quarter of 2017 in addition to increased borrowings under our Credit Facility on a weighted average basis during the third quarter of 2018 compared to the same period in 2017, partially offset by the maturity of our 2017 Convertible Senior Subordinated Notes in September 2017 and our 2018 Convertible Senior Subordinated Notes in March 2018. Our weighted average interest rate increased as a result of the issuance of the 2025 Senior Notes in the third quarter of 2017, which have a higher interest rate than the 3.0% rate on the 2018 Convertible Senior Subordinated Notes and the 3.25% rate on the 2017 Convertible Senior Subordinated Notes, which were both outstanding during prior year’s third quarter.

At September 30, 2018, we had $222.7 million of borrowings outstanding under the Credit Facility, an increase from having no outstanding borrowings at December 31, 2017. During the first nine months of 2018, we used the Credit Facility to fund our acquisition of Pinnacle Homes, a privately-held homebuilder in Detroit, Michigan, and repay that portion of our 2018 Convertible Senior Subordinated Notes that were not converted into common shares, in addition to investment in land and land development, construction of homes, mortgage loan originations, operating expenses, working capital requirements and share repurchases under our 2018 Share Repurchase Program. During the nine months ended September 30, 2018, the average daily amount outstanding under the Credit Facility was $144.6 million and the maximum amount outstanding under the Credit Facility was $247.1 million. Based on our currently anticipated spending on home construction, land acquisition and development in 2018, offset by expected cash receipts from home deliveries, we expect to continue to borrow under the Credit Facility during 2018, with an estimated peak amount outstanding not expected to exceed $275 million. The actual amount borrowed during 2018 (and the estimated peak amount outstanding) and related timing are subject to numerous factors, including the timing and amount of land and house construction expenditures, payroll and other general and administrative expenses, cash receipts from home deliveries, other cash receipts and payments, any capital markets transactions or other additional financings by the Company, any repayments or redemptions of outstanding debt, any additional share repurchases under the 2018 Share Repurchase Program and any other extraordinary events or transactions. The Company may experience significant variation in cash and Credit Facility balances from week to week due to the timing of such receipts and payments.

There were $48.8 million of letters of credit issued and outstanding under the Credit Facility at September 30, 2018. During the nine months ended September 30, 2018, the average daily amount of letters of credit outstanding under the Credit Facility was $46.2 million and the maximum amount of letters of credit outstanding under the Credit Facility was $51.2 million.

At September 30, 2018, M/I Financial had $81.9 million outstanding under the MIF Mortgage Warehousing Agreement. During the nine months ended September 30, 2018, the average daily amount outstanding under the MIF Mortgage Warehousing Agreement was $46.3 million and the maximum amount outstanding was $128.1 million, which occurred during January, while the temporary increase provision was in effect and the maximum borrowing availability was $150.0 million.

At September 30, 2018, M/I Financial had $22.2 million outstanding under the MIF Mortgage Repurchase Facility. During the nine months ended September 30, 2018, the average daily amount outstanding under the MIF Mortgage Repurchase Facility was $20.5 million and the maximum amount outstanding was $40.1 million, which occurred during January, while the temporary increase provision was in effect and the maximum borrowing availability was $50.0 million.

Universal Shelf Registration. In October 2016, the Company filed a $400 million universal shelf registration statement with the SEC, which registration statement became effective on November 9, 2016 and will expire in November 2019. Pursuant to the registration statement, the Company may, from time to time, offer debt securities, common shares, preferred shares, depositary shares, warrants to purchase debt securities, common shares, preferred shares, depositary shares or units of two or more of those securities, rights to purchase debt securities, common shares, preferred shares or depositary shares, stock purchase contracts and units. The timing and amount of offerings, if any, will depend on market and general business conditions.

CONTRACTUAL OBLIGATIONS

There have been no material changes to our contractual obligations appearing in the Contractual Obligations section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2017, except for the maturity of our $86.3 million in aggregate principal amount of 2018 Convertible Senior Subordinated Notes during the first quarter of 2018, as further discussed above in Note 8 to our financial statements and in our Liquidity and Capital Resources section.

OFF-BALANCE SHEET ARRANGEMENTS

Notes 3, 5 and 6 to our financial statements discuss our off-balance sheet arrangements with respect to land acquisition contracts and option agreements, and land development joint ventures, including the nature and amounts of financial obligations relating to these items. In addition, these Notes discuss the nature and amounts of certain types of commitments that arise in the ordinary course of our land development and homebuilding operations, including commitments of land development joint ventures for which we might be obligated.

Our off-balance sheet arrangements relating to our homebuilding operations include joint venture arrangements, land option agreements, guarantees and indemnifications associated with acquiring and developing land, and the issuance of letters of credit and completion bonds. Our use of these arrangements is intended to secure the most desirable lots on which to build homes for our homebuyers in a manner that we believe reduces the overall risk to the Company. Additionally, in the ordinary course of its business, M/I Financial issues guarantees and indemnities relating to the sale of loans to third parties.

Land Option Agreements. In the ordinary course of business, the Company enters into land option or purchase agreements for which we generally pay non-refundable deposits. Pursuant to these land option agreements, the Company provides a deposit to the seller as consideration for the right to purchase land at different times in the future, usually at predetermined prices. In accordance with ASC 810, we analyze our land option or purchase agreements to determine whether the corresponding land sellers are VIEs and, if so, whether we are the primary beneficiary. Although we do not have legal title to the optioned land, ASC 810 requires a company to consolidate a VIE if the company is determined to be the primary beneficiary. In cases where we are the primary beneficiary, even though we do not have title to such land, we are required to consolidate these purchase/option agreements and reflect such assets and liabilities as Consolidated Inventory not Owned in our Unaudited Condensed Consolidated Balance Sheets. At both September 30, 2018 and December 31, 2017, we have concluded that we were not the primary beneficiary of any VIEs from which we are purchasing under land option or purchase agreements.

At September 30, 2018, “Consolidated Inventory Not Owned” was $21.9 million. At September 30, 2018, the corresponding liability of $21.9 million has been classified as Obligation for Consolidated Inventory Not Owned on our Unaudited Condensed Consolidated Balance Sheets.

Other than the Consolidated Inventory Not Owned balance, the Company currently believes that its maximum exposure as of September 30, 2018 related to our land option agreements is equal to the amount of the Company’s outstanding deposits and prepaid acquisition costs, which totaled $54.0 million, including cash deposits of $32.1 million, prepaid acquisition costs of $7.7 million, letters of credit of $10.1 million and $4.1 million of other non-cash deposits.

Letters of Credit and Completion Bonds.  The Company provides standby letters of credit and completion bonds for development work in progress, deposits on land and lot purchase agreements and miscellaneous deposits.  As of September 30, 2018, the Company had outstanding $205.9 million of completion bonds and standby letters of credit, some of which were issued to various local governmental entities, that expire at various times through September 2026.  Included in this total are: (1) $150.3 million of performance and maintenance bonds and $38.2 million of performance letters of credit that serve as completion bonds for land development work in progress; (2) $10.6 million of financial letters of credit; and (3) $6.8 million of financial bonds.  The development agreements under which we are required to provide completion bonds or letters of credit are generally not subject to a required completion date and only require that the improvements are in place in phases as houses are built and sold.  In locations where development has progressed, the amount of development work remaining to be completed is typically less than the remaining amount of bonds or letters of credit due to timing delays in obtaining release of the bonds or letters of credit.

Guarantees and Indemnities.  In the ordinary course of business, M/I Financial enters into agreements that guarantee purchasers of its mortgage loans that M/I Financial will repurchase a loan if certain conditions occur.  The risks associated with these guarantees are offset by the value of the underlying assets, and the Company accrues its best estimate of the probable loss on these loans.  Additionally, the Company has provided certain other guarantees and indemnities in connection with the acquisition and development of land by our homebuilding operations.  Please see Note 5 to our financial statements for additional details relating to our guarantees and indemnities.

INTEREST RATES AND INFLATION

Our business is significantly affected by general economic conditions within the United States and, particularly, by the impact of interest rates and inflation.  Inflation can have a long-term impact on us because increasing costs of land, materials and labor can result in a need to increase the sales prices of homes. In addition, inflation is often accompanied by higher interest rates, which can have a negative impact on housing demand and the costs of financing land development activities and housing construction. Higher interest rates also may decrease our potential market by making it more difficult for homebuyers to qualify for mortgages or to obtain mortgages at interest rates that are acceptable to them.  The impact of increased rates can be offset, in part, by offering variable rate loans with lower interest rates.  In conjunction with our mortgage financing services, hedging methods are used to reduce our exposure to interest rate fluctuations between the commitment date of the loan and the time the loan closes. Rising interest rates, as well as increased materials and labor costs, may reduce gross margins. An increase in material and labor costs is particularly a problem during a period of declining home prices. Conversely, deflation can impact the value of real estate and make it difficult for us to recover our land costs. Therefore, either inflation or deflation could adversely impact our future results of operations.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market risk results from fluctuations in interest rates. We are exposed to interest rate risk through borrowings under our revolving credit facilities, consisting of the Credit Facility, the MIF Mortgage Warehousing Agreement, and the MIF Mortgage Repurchase Facility which permitted borrowings of up to $695 million as of September 30, 2018, subject to availability constraints. Additionally, M/I Financial is exposed to interest rate risk associated with its mortgage loan origination services.

Interest Rate Lock Commitments: Interest rate lock commitments (“IRLCs”) are extended to certain homebuying customers who have applied for a mortgage loan and meet certain defined credit and underwriting criteria. Typically, the IRLCs will have a duration of less than six months; however, in certain markets, the duration could extend to nine months.

Some IRLCs are committed to a specific third party investor through the use of whole loan delivery commitments matching the exact terms of the IRLC loan. Uncommitted IRLCs are considered derivative instruments and are fair value adjusted, with the resulting gain or loss recorded in current earnings.

Forward Sales of Mortgage-Backed Securities: Forward sales of mortgage-backed securities (“FMBSs”) are used to protect uncommitted IRLC loans against the risk of changes in interest rates between the lock date and the funding date. FMBSs related to uncommitted IRLCs are classified and accounted for as non-designated derivative instruments and are recorded at fair value, with gains and losses recorded in current earnings.

Mortgage Loans Held for Sale: Mortgage loans held for sale consist primarily of single-family residential loans collateralized by the underlying property. During the period between when a loan is closed and when it is sold to an investor, the interest rate risk is covered through the use of a whole loan contract or by FMBSs. The FMBSs are classified and accounted for as non-designated derivative instruments, with gains and losses recorded in current earnings.

The table below shows the notional amounts of our financial instruments at September 30, 2018 and December 31, 2017:

| Description of Financial Instrument (in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Whole loan contracts and related committed IRLCs | $ 8,163 | $ 2,182 |
| Uncommitted IRLCs | 135,450 | 50,746 |
| FMBSs related to uncommitted IRLCs | 143,000 | 53,000 |
| Whole loan contracts and related mortgage loans held for sale | 11,015 | 80,956 |
| FMBSs related to mortgage loans held for sale | 103,000 | 91,000 |
| Mortgage loans held for sale covered by FMBSs | 103,258 | 90,781 |

The table below shows the measurement of assets and liabilities at September 30, 2018 and December 31, 2017:

| Description of Financial Instrument (in thousands) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Mortgage loans held for sale | $ 115,189 | $ 171,580 |
| Forward sales of mortgage-backed securities | 1,624 | 177 |
| Interest rate lock commitments | 384 | 271 |
| Whole loan contracts | 87 | 12 |
| Total | $ 117,284 | $ 172,040 |

The following table sets forth the amount of gain (loss) recognized on assets and liabilities for the three and nine months ended September 30, 2018 and 2017:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| Description (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Mortgage loans held for sale | $(1,383) | $(64) | $(66) | $4,326 |
| Forward sales of mortgage-backed securities | 2,407 | (128) | 1,447 | 241 |
| Interest rate lock commitments | (763) | 22 | 80 | 116 |
| Whole loan contracts | 252 | (41) | 108 | 30 |
| Total gain (loss) recognized | $513 | $(211) | $1,569 | $4,713 |

The following table provides the expected future cash flows and current fair values of borrowings under our credit facilities and mortgage loan origination services that are subject to market risk as interest rates fluctuate, as of September 30, 2018. Because the MIF Mortgage Warehousing Agreement and MIF Mortgage Repurchase Facility are effectively secured by certain mortgage loans held for sale which are typically sold within 30 to 45 days, their outstanding balances are included in the most current period presented. The interest rates for our variable rate debt represent the weighted average interest rates in effect at September 30, 2018. For fixed-rate debt, changes in interest rates generally affect the fair market value of the debt instrument, but not our earnings or cash flow. Conversely, for variable-rate debt, changes in interest rates generally do not affect the fair market value of the debt instrument, but do affect our earnings and cash flow. We do not have the obligation to prepay fixed-rate debt prior to maturity, and, as a result, interest rate risk and changes in fair market value should not have a significant impact on our fixed-rate debt until we are required or elect to refinance it.

| | Expected Cash Flows by Period | | | | | | | Fair Value |
|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2019 | 2020 | 2021 | 2022 | Thereafter | Total | 9/30/2018 |
| ASSETS: | | | | | | | | |
| Mortgage loans held for sale: | | | | | | | | |
| Fixed rate | $113,866 | — | — | — | — | — | $113,866 | $111,451 |
| Weighted average interest rate | 4.57 % | — | — | — | — | — | 4.57 % | |
| Variable rate | $3,780 | — | — | — | — | — | $3,780 | $3,738 |
| Weighted average interest rate | 3.98 % | — | — | — | — | — | 3.98 % | |
| LIABILITIES: | | | | | | | | |
| Long-term debt — fixed rate | $2,224 | $1,214 | $1,693 | $301,268 | $866 | $250,000 | $557,265 | $545,245 |
| Weighted average interest rate | 5.63 % | 5.41 % | 5.41 % | 6.72 % | 5.63 % | 5.63 % | 6.23 % | |
| Short-term debt — variable rate | $326,726 | — | — | — | — | — | $326,726 | $327,726 |
| Weighted average interest rate | 4.52 % | — | — | — | — | — | 4.52 % | |

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ITEM 4: CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

An evaluation of the effectiveness of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended) was performed by the Company’s management, with the participation of the Company’s principal executive officer and principal financial officer. Based on that evaluation, the Company’s principal executive officer and principal financial officer concluded that the Company’s disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company and certain of its subsidiaries have received claims from homeowners in certain of our Florida communities (and been named as a defendant in legal proceedings initiated by certain of such homeowners) related to stucco on their homes. Please see Note 6 to the Company’s financial statements for further information regarding these stucco claims.

The Company and certain of its subsidiaries have been named as defendants in certain other legal proceedings which are incidental to our business. While management currently believes that the ultimate resolution of these other legal proceedings, individually and in the aggregate, will not have a material effect on the Company’s financial condition, results of operations and cash flows, such legal proceedings are subject to inherent uncertainties. The Company has recorded a liability to provide for the anticipated costs, including legal defense costs, associated with the resolution of these other legal proceedings. However, the possibility exists that the costs to resolve these legal proceedings could differ from the recorded estimates and, therefore, have a material effect on the Company’s net income for the periods in which they are resolved.

Item 1A. Risk Factors

Except as set forth below, there have been no material changes to the risk factors appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

We may write-off intangible assets, such as goodwill.

We have recorded goodwill in connection with the acquisition of the assets and operations of Pinnacle Homes. On an ongoing basis, we will evaluate whether facts and circumstances indicate any impairment of the value of intangible assets. As circumstances change, we cannot assure that the value of these intangible assets will be realized by us. If we determine that a significant impairment has occurred, we will be required to write-off the impaired portion of intangible assets, which could have a material adverse effect on our results of operations in the period in which the write-off occurs.

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

(a) Recent Sales of Unregistered Securities — None.

(b) Use of Proceeds — Not Applicable.

(c) Purchases of Equity Securities

Common shares purchased during the third quarter ended September 30, 2018 were as follows:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs(1) |
|---|---|---|---|---|
| August 14, 2018 - August 31, 2018 | 123,889 | $ 26.16 | 123,889 | 46,758,582 |
| September 1, 2018 - September 30, 2018 | 313,601 | $ 25.01 | 313,601 | 38,915,133 |
| Quarter ended September 30, 2018 | 437,490 | $ 25.34 | 437,490 | 38,915,133 |

(1) On August 14, 2018, the Company announced that its Board of Directors authorized the 2018 Share Repurchase Program pursuant to which the Company may purchase up to $50 million of its outstanding common shares through open market transactions, privately negotiated transactions or otherwise in accordance with all applicable laws, including pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934. The 2018 Share Repurchase Program does not have an expiration date and may be modified, suspended or discontinued at any time. Please see Note 13 to our financial statements for additional information.

Please see Note 8 to our financial statements above for more information regarding the limit imposed by the indenture governing our 2025 Senior Notes and the indenture governing our 2021 Senior Notes on our ability to pay dividends on, and repurchase, our common shares and any preferred shares of the Company then outstanding to the amount of the positive balance in our “restricted payments basket,” as defined in the indentures.

Item 3. Defaults Upon Senior Securities - None.

Item 4. Mine Safety Disclosures - None.

Item 5. Other Information - None.

Item 6. Exhibits

The exhibits required to be filed herewith are set forth below.

| Exhibit Number | Description |
|---|---|
| 10.1 | First Amendment to Second Amended and Restated Master Repurchase Agreement effective as of October 29, 2018 by and between M/I Financial and Sterling National Bank (filed herewith). |
| 31.1 | Certification by Robert H. Schottenstein, Chief Executive Officer, pursuant to Item 601 of Regulation S-K as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.) |
| 31.2 | Certification by Phillip G. Creek, Chief Financial Officer, pursuant to Item 601 of Regulation S-K as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (Filed herewith.) |
| 32.1 | Certification by Robert H. Schottenstein, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.) |
| 32.2 | Certification by Phillip G. Creek, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (Filed herewith.) |
| 101.INS | XBRL Instance Document. (Furnished herewith.) |
| 101.SCH | XBRL Taxonomy Extension Schema Document. (Furnished herewith.) |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. (Furnished herewith.) |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. (Furnished herewith.) |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. (Furnished herewith.) |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. (Furnished herewith.) |

SIGNATURES

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

| | | |
|---|---|---|
| | M/I Homes, Inc.<br>(Registrant) | |
| Date: October 26, 2018 | By: | /s/ Robert H. Schottenstein<br>Robert H. Schottenstein<br>Chairman, Chief Executive Officer and President<br>(Principal Executive Officer) |
| Date: October 26, 2018 | By: | /s/ Ann Marie W. Hunker<br>Ann Marie W. Hunker<br>Vice President, Corporate Controller<br>(Principal Accounting Officer) |