NVR INC
Form 10-Q
October 30, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____
Commission File Number: 1-12378
NVR, Inc.
(Exact name of registrant as specified in its charter)

Virginia	54-1394360
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

11700 Plaza America Drive, Suite 500
Reston, Virginia 20190
(703) 956-4000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)
(Not Applicable)
(Former name, former address, and former fiscal year if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant 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 No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an 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
Non-accelerated filer (Do not check if smaller reporting company)	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 companying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No
As of October 26, 2017 there were 3,739,858 total shares of common stock outstanding.

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NVR, Inc.
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)
(unaudited)

	September 30, 2017	December 31, 2016
ASSETS		
Homebuilding:		
Cash and cash equivalents	$ 611,094	$ 375,748
Restricted cash	13,797	17,561
Receivables	20,448	18,937
Inventory:		
Lots and housing units, covered under sales agreements with customers	1,187,508	883,868
Unsold lots and housing units	158,049	145,065
Land under development	19,182	46,999
Building materials and other	11,820	16,168
	1,376,559	1,092,100
Assets related to consolidated variable interest entity	1,222	1,251
Contract land deposits, net	365,142	379,844
Property, plant and equipment, net	43,822	45,915
Reorganization value in excess of amounts allocable to identifiable assets, net	41,580	41,580
Goodwill and finite-lived intangible assets, net	1,563	2,599
Other assets	266,572	257,811
	2,741,799	2,233,346
Mortgage Banking:		
Cash and cash equivalents	15,790	19,657
Restricted cash	2,075	1,857
Mortgage loans held for sale, net	258,554	351,958
Property and equipment, net	6,308	4,903
Reorganization value in excess of amounts allocable to identifiable assets, net	7,347	7,347
Other assets	17,638	24,875
	307,712	410,597
Total assets	$ 3,049,511	$ 2,643,943
LIABILITIES AND SHAREHOLDERS' EQUITY		
Homebuilding:		
Accounts payable	$ 267,039	$ 251,212
Accrued expenses and other liabilities	337,932	336,318
Liabilities related to consolidated variable interest entity	853	882
Customer deposits	162,285	122,236
Senior notes	596,913	596,455
	1,365,022	1,307,103
Mortgage Banking:		
Accounts payable and other liabilities	33,813	32,399
	33,813	32,399
Total liabilities	1,398,835	1,339,502

Commitments and contingencies		
Shareholders' equity:		
Common stock, $0.01 par value; 60,000,000 shares authorized; 20,555,330 shares issued as of both September 30, 2017 and December 31, 2016	206	206
Additional paid-in capital	1,626,112	1,515,828
Deferred compensation trust – 108,638 and 108,640 shares of NVR, Inc. common stock as of September 30, 2017 and December 31, 2016, respectively	(17,376)	(17,375)
Deferred compensation liability	17,376	17,375
Retained earnings	6,107,321	5,695,376
Less treasury stock at cost – 16,819,467 and 16,862,327 shares as of September 30, 2017 and December 31, 2016, respectively	(6,082,963)	(5,906,969)
Total shareholders' equity	1,650,676	1,304,441
Total liabilities and shareholders' equity	$ 3,049,511	$ 2,643,943

See notes to condensed consolidated financial statements.

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NVR, Inc.
Condensed Consolidated Statements of Income
(in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Homebuilding:				
Revenues	$1,633,726	$1,507,451	$4,394,027	$3,990,696
Other income	1,715	703	4,264	2,223
Cost of sales	(1,307,971)	(1,242,292)	(3,552,071)	(3,294,421)
Selling, general and administrative	(95,606)	(92,867)	(294,610)	(290,925)
Operating income	231,864	172,995	551,610	407,573
Interest expense	(5,821)	(5,338)	(17,040)	(14,734)
Homebuilding income	226,043	167,657	534,570	392,839
Mortgage Banking:				
Mortgage banking fees	34,194	30,118	95,477	79,082
Interest income	1,953	2,000	5,168	5,111
Other income	583	473	1,398	1,140
General and administrative	(18,010)	(14,959)	(50,190)	(44,345)
Interest expense	(299)	(286)	(830)	(792)
Mortgage banking income	18,421	17,346	51,023	40,196
Income before taxes	244,464	185,003	585,593	433,035
Income tax expense	(82,362)	(67,611)	(172,691)	(158,664)
Net income	$162,102	$117,392	$412,902	$274,371
Basic earnings per share	$43.26	$30.43	$110.60	$70.70
Diluted earnings per share	$38.02	$28.46	$98.33	$66.24
Basic weighted average shares outstanding	3,747	3,858	3,733	3,881
Diluted weighted average shares outstanding	4,263	4,125	4,199	4,142

See notes to condensed consolidated financial statements.

NVR, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended September 30, 2017	2016
Cash flows from operating activities:		
Net income	$412,902	$274,371
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,087	16,591
Equity-based compensation expense	32,678	32,459
Contract land deposit impairments (recoveries), net	3,396	(1,427)
Gain on sale of loans, net	(73,372)	(59,386)
Mortgage loans closed	(2,860,903)	(2,542,659)
Mortgage loans sold and principal payments on mortgage loans held for sale	3,033,239	2,633,539
Distribution of earnings from unconsolidated joint ventures	5,120	8,026
Net change in assets and liabilities:		
Increase in inventory	(284,459)	(309,824)
Decrease (increase) in contract land deposits	11,306	(32,774)
Decrease (increase) in receivables	162	(2,913)
Increase in accounts payable and accrued expenses	15,109	59,736
Increase in customer deposits	40,049	33,732
Other, net	(11,538)	(7,034)
Net cash provided by operating activities	340,776	102,437
Cash flows from investing activities:		
Investments in and advances to unconsolidated joint ventures	(455)	(653)
Distribution of capital from unconsolidated joint ventures	6,081	9,162
Purchase of property, plant and equipment	(15,670)	(16,513)
Proceeds from the sale of property, plant and equipment	664	701
Net cash used in investing activities	(9,380)	(7,303)
Cash flows from financing activities:		
Purchase of treasury stock	(230,199)	(291,743)
Distributions to partner in consolidated variable interest entity	—	(217)
Proceeds from the exercise of stock options	130,245	33,938
Net cash used in financing activities	(99,954)	(258,022)
Net increase (decrease) in cash and cash equivalents	231,442	(162,888)
Cash and cash equivalents, beginning of the period	396,619	425,316
Cash and cash equivalents, end of the period	$628,061	$262,428
Supplemental disclosures of cash flow information:		
Interest paid during the period, net of interest capitalized	$23,112	$20,899
Income taxes paid during the period, net of refunds	$169,949	$148,117

See notes to condensed consolidated financial statements.

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NVR, Inc.
Notes to Condensed Consolidated Financial Statements
(dollars and shares in thousands)
(unaudited)

1. Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements include the accounts of NVR, Inc. ("NVR" or the "Company") and its subsidiaries and certain other entities in which the Company is deemed to be the primary beneficiary (see Notes 2 and 3 to the accompanying condensed consolidated financial statements). Intercompany accounts and transactions have been eliminated in consolidation. The statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying condensed consolidated financial statements do not include all of the information and footnotes required by GAAP, they should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. In the opinion of management, all adjustments (consisting only of normal recurring accruals except as otherwise noted herein) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

On January 1, 2017, the Company adopted Accounting Standards Update ("ASU") 2016-09, Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting. In connection with the adoption of ASU 2016-09, the Company:

- Recorded the excess tax benefit from stock option exercises as a reduction to income tax expense prospectively beginning January 1, 2017. In the prior year, the excess tax benefit was recorded to additional paid-in capital within shareholders' equity. The excess tax benefit recognized during the three months ended September 30, 2017 and 2016 was $8,357 and $2,271, respectively. The excess tax benefit recognized during the nine months ended September 30, 2017 and 2016 was $44,720 and $10,949, respectively.
- Presented the aforementioned excess tax benefit recognized as an operating activity on the statement of cash flows and retrospectively adjusted the prior year Statement of Cash Flows accordingly. In the prior year, the excess tax benefit was recognized as a cash inflow from financing activities and a corresponding cash outflow from operating activities. The retrospective adjustment resulted in a $10,949 increase to net cash provided by operating activities and a $10,949 increase to net cash used in financing activities in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2016.
- Made the election to recognize forfeitures of equity-based awards in the period in which they occur. This election was applied using the modified retrospective transition method, which resulted in the Company recording a cumulative-effect adjustment, net of tax, to reduce beginning retained earnings by $957. In the prior year, the Company estimated forfeitures based on its historical forfeiture rate.

No other adjustments were made as a result of the adoption of ASU 2016-09.

The Company also adopted ASU 2015-11, Inventory – Simplifying the Measurement of Inventory effective January 1, 2017. The standard requires inventory to be measured at the lower of cost or net realizable value. Under prior GAAP, impaired inventory was written down to net realizable value less a normal profit margin. Under the new standard, impaired inventory will only be written down to the net realizable value. ASU 2015-11 was adopted prospectively and did not have a material effect on the Company's consolidated financial statements.

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For the three and nine months ended September 30, 2017 and 2016, comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying condensed consolidated financial statements.

2. Variable Interest Entities

Fixed Price Finished Lot Purchase Agreements ("Lot Purchase Agreements")

NVR generally does not engage in the land development business. Instead, the Company typically acquires finished building lots at market prices from various development entities under Lot Purchase Agreements. The Lot Purchase Agreements require deposits that may be forfeited if NVR fails to perform under the Lot Purchase Agreements. The deposits required under the Lot Purchase Agreements are in the form of cash or letters of credit in varying amounts, and typically range up to 10% of the aggregate purchase price of the finished lots.

NVR believes this lot acquisition strategy reduces the financial requirements and risks associated with direct land ownership and land development. NVR may, at its option, choose for any reason and at any time not to perform under these Lot Purchase Agreements by delivering notice of its intent not to acquire the finished lots under contract. NVR's sole legal obligation and economic loss for failure to perform under these Lot Purchase Agreements is limited to the amount of the deposit pursuant to the liquidated damage provisions contained within the Lot Purchase Agreements. In other words, if NVR does not perform under a Lot Purchase Agreement, NVR loses only its deposit. None of the creditors of any of the development entities with which NVR enters Lot Purchase Agreements have recourse to the general credit of NVR. NVR generally does not have any specific performance obligations to purchase a certain number or any of the lots, nor does NVR guarantee completion of the development by the developer or guarantee any of the developers' financial or other liabilities.

NVR is not involved in the design or creation of the development entities from which the Company purchases lots under Lot Purchase Agreements. The developer's equity holders have the power to direct 100% of the operating activities of the development entity. NVR has no voting rights in any of the development entities. The sole purpose of the development entity's activities is to generate positive cash flow returns for the equity holders. Further, NVR does not share in any of the profit or loss generated by the project's development. The profits and losses are passed directly to the developer's equity holders.

The deposit placed by NVR pursuant to the Lot Purchase Agreement is deemed to be a variable interest in the respective development entities. Those development entities are deemed to be variable interest entities ("VIE"). Therefore, the development entities with which NVR enters into Lot Purchase Agreements, including the joint venture limited liability corporations discussed below, are evaluated for possible consolidation by NVR. An enterprise must consolidate a VIE when that enterprise has a controlling financial interest in the VIE. An enterprise is deemed to have a controlling financial interest if it has (i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (ii) the obligation to absorb losses of the VIE that could be significant to the VIE or the rights to receive benefits from the VIE that could be significant to the VIE.

NVR believes the activities that most significantly impact a development entity's economic performance are the operating activities of the entity. The development entity's equity investors bear the full risk during the development process. Unless and until a development entity completes finished building lots through the development process, the entity does not earn any revenues. The operating development activities are managed solely by the development entity's equity investors.

The development entities with which NVR contracts to buy finished lots typically select the respective projects, obtain the necessary zoning approvals, obtain the financing required with no support or guarantees from NVR, select who will purchase the finished lots and at what price, and manage the completion of the infrastructure improvements, all for the purpose of generating a cash flow return to the development entity's equity holders and all independent of NVR. The Company possesses no more than limited protective legal rights through the Lot Purchase Agreement in the specific finished lots that it is purchasing, and NVR possesses no participative rights in the development entities. Accordingly, NVR does not have the power to direct the activities of a developer that

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(unaudited)

most significantly impact the developer's economic performance. For this reason, NVR has concluded that it is not the primary beneficiary of the development entities with which the Company enters into Lot Purchase Agreements, and therefore, NVR does not consolidate any of these VIEs.

As of September 30, 2017, NVR controlled approximately 79,700 lots under Lot Purchase Agreements with third parties through deposits in cash and letters of credit totaling approximately $385,600 and $2,100, respectively. As noted above, NVR's sole legal obligation and economic loss for failure to perform under these Lot Purchase Agreements is limited to the amount of the deposit pursuant to the liquidated damage provisions contained in the Lot Purchase Agreements.

In addition, NVR has certain properties under contract with land owners that are expected to yield approximately 9,700 lots, which are not included in the number of total lots controlled. Some of these properties may require rezoning or other approvals to achieve the expected yield. These properties are controlled with deposits in cash and letters of credit totaling approximately $11,700 and $200, respectively, as of September 30, 2017, of which approximately $5,200 is refundable if certain contractual conditions are not met. NVR generally expects to assign the raw land contracts to a land developer and simultaneously enter into a Lot Purchase Agreement with the assignee if the project is determined to be feasible.

NVR's total risk of loss related to contract land deposits as of September 30, 2017 and December 31, 2016 was as follows:

	September 30, 2017	December 31, 2016
Contract land deposits	$ 397,330	$ 411,150
Loss reserve on contract land deposits	(32,188)	(31,306)
Contract land deposits, net	365,142	379,844
Contingent obligations in the form of letters of credit	2,315	2,379
Specific performance obligations (1)	1,505	1,505
Total risk of loss	$ 368,962	$ 383,728

(1) As of both September 30, 2017 and December 31, 2016, the Company was committed to purchase 10 finished lots under specific performance obligations.

3. Joint Ventures

On a limited basis, NVR obtains finished lots using joint venture limited liability corporations ("JVs"). The JVs are typically structured such that NVR is a non-controlling member and is at risk only for the amount the Company has invested, or has committed to invest, in addition to any deposits placed under Lot Purchase Agreements with the joint venture. NVR is not a borrower, guarantor or obligor on any debt of the JVs, as applicable. The Company enters into Lot Purchase Agreements to purchase lots from these JVs, and as a result has a variable interest in these JVs.

At September 30, 2017, the Company had an aggregate investment totaling approximately $42,300 in six JVs that are expected to produce approximately 7,200 finished lots, of which approximately 3,900 lots were controlled by the Company and the remaining approximately 3,300 lots were either under contract with unrelated parties or not currently under contract. In addition, NVR had additional funding commitments totaling approximately $5,800 in the aggregate to three of the JVs at September 30, 2017. The Company has determined that it is not the primary beneficiary of five of the JVs because either NVR and the other JV partner share power or the other JV partner has the controlling financial interest. The aggregate investment in unconsolidated JVs was approximately $41,900 and $49,000 at September 30, 2017 and December 31, 2016, respectively, and is reported in the "Other assets" line item on the accompanying condensed consolidated balance sheets. For the remaining JV, NVR has concluded that it is the primary beneficiary because the Company has the controlling financial interest in the JV.

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(unaudited)

The condensed balance sheets as of September 30, 2017 and December 31, 2016 of the consolidated JV were as follows:

	September 30, 2017	December 31, 2016
Assets:		
Cash	$ 1,177	$ 1,214
Other assets	45	37
Total assets	$ 1,222	$ 1,251
Liabilities and equity:		
Accrued expenses	$ 521	$ 550
Equity	701	701
Total liabilities and equity	$ 1,222	$ 1,251

The Company recognizes income from the JVs as a reduction to the lot cost of the lots purchased from the respective JVs when the homes are settled and is based on the expected total profitability and the total number of lots expected to be produced by the respective JVs. Distributions received from the unconsolidated JVs are allocated between return of capital and distributions of earnings based on the ratio of capital contributed by NVR to the total expected returns for the respective JVs, and are classified within the accompanying condensed consolidated statements of cash flows as cash flows from investing activities and operating activities, respectively.

4. Land Under Development

On a limited basis, NVR directly acquires raw land parcels already zoned for its intended use to develop into finished lots. Land under development includes the land acquisition costs, direct improvement costs, capitalized interest where applicable, and real estate taxes.

In January 2017, the Company purchased a raw land parcel for approximately $14,400. In September 2017, the Company sold that land parcel to a developer for an amount which approximated NVR's net investment in the property as of the sale date. In conjunction with the sale, the Company also entered into a Lot Purchase Agreement with the developer for the option to purchase finished lots expected to be developed from the parcel.

As of September 30, 2017, NVR directly owned a total of three separate raw land parcels with a carrying value of $19,182 that are expected to produce approximately 400 finished lots. The Company also has additional funding commitments of approximately $9,000 under a joint development agreement related to one parcel, a portion of which the Company expects will be offset by development credits of approximately $4,800.

None of the raw parcels had any indicators of impairment as of September 30, 2017. Based on market conditions, NVR may on a limited basis continue to directly acquire additional raw parcels to develop into finished lots.

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(unaudited)

5. Capitalized Interest

The Company capitalizes interest costs to land under development during the active development of finished lots. In addition, the Company capitalizes interest costs to its joint venture investments while the investments are considered qualified assets pursuant to Accounting Standards Codification 835-20, Interest. Capitalized interest is transferred to sold or unsold inventory as the development of finished lots is completed, then charged to cost of sales upon the Company's settlement of homes and the respective lots. Interest incurred in excess of the interest capitalizable based on the level of qualified assets is expensed in the period incurred. NVR's interest costs incurred, capitalized, expensed and charged to cost of sales during the three and nine months ended September 30, 2017 and 2016 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest capitalized, beginning of period	$5,952	$4,576	$5,106	$4,434
Interest incurred	6,615	6,562	19,754	19,347
Interest charged to interest expense	(6,120)	(5,624)	(17,870)	(15,526)
Interest charged to cost of sales	(778)	(600)	(1,321)	(3,341)
Interest capitalized, end of period	$5,669	$4,914	$5,669	$4,914

6. Earnings per Share

The following weighted average shares and share equivalents were used to calculate basic and diluted earnings per share for the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Weighted average number of shares outstanding used to calculate basic EPS	3,747	3,858	3,733	3,881
Dilutive securities:				
Stock options and restricted share units	516	267	466	261
Weighted average number of shares and share equivalents outstanding used to calculate diluted EPS	4,263	4,125	4,199	4,142

The following stock options and restricted share units issued under equity incentive plans were outstanding during the three and nine months ended September 30, 2017 and 2016, but were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Anti-dilutive securities	8	88	17	89

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7. Shareholders’ Equity

A summary of changes in shareholders’ equity is presented below:

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Deferred Compensation Trust	Deferred Compensation Liability	Total
Balance, December 31, 2016	$ 206	$ 1,515,828	$ 5,695,376	$ (5,906,969)	$ (17,375)	$ 17,375	$ 1,304,441
Cumulative-effect adjustment from adoption of ASU 2016-09, net of tax	—	1,566	(957)	—	—	—	609
Net income	—	—	412,902	—	—	—	412,902
Deferred compensation activity	—	—	—	—	(1)	1	—
Purchase of common stock for treasury	—	—	—	(230,199)	—	—	(230,199)
Equity-based compensation	—	32,678	—	—	—	—	32,678
Proceeds from stock options exercised	—	130,245	—	—	—	—	130,245
Treasury stock issued upon option exercise and restricted share vesting	—	(54,205)	—	54,205	—	—	—
Balance, September 30, 2017	$ 206	$ 1,626,112	$ 6,107,321	$ (6,082,963)	$ (17,376)	$ 17,376	$ 1,650,676

The Company repurchased 110 shares of its common stock during the nine months ended September 30, 2017. The Company settles stock option exercises and vesting of restricted share units by issuing shares of treasury stock. Approximately 153 shares were issued from the treasury account during the nine months ended September 30, 2017 in settlement of stock option exercises and vesting of restricted share units. Shares are relieved from the treasury account based on the weighted average cost basis of treasury shares acquired.

8. Product Warranties

The Company establishes warranty and product liability reserves (“Warranty Reserve”) to provide for estimated future expenses as a result of construction and product defects, product recalls and litigation incidental to NVR’s homebuilding business. Liability estimates are determined based on management’s judgment, considering such factors as historical experience, the likely current cost of corrective action, manufacturers’ and subcontractors’ participation in sharing the cost of corrective action, consultations with third party experts such as engineers, and discussions with the Company’s general counsel and outside counsel retained to handle specific product liability cases.

The following table reflects the changes in the Company’s Warranty Reserve during the three and nine months ended September 30, 2017 and 2016:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Warranty reserve, beginning of period	$ 95,394	$ 87,953	$ 93,895	$ 87,407
Provision	12,940	11,622	35,107	33,331
Payments	(11,677)	(11,551)	(32,345)	(32,714)

Warranty reserve, end of period	$96,657	$88,024	$96,657	$88,024

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9. Segment Disclosures

The following disclosure includes four homebuilding reportable segments that aggregate geographically the Company's homebuilding operating segments, and the mortgage banking operations presented as one reportable segment. The homebuilding reportable segments are comprised of operating divisions in the following geographic areas:

Mid Atlantic:	Maryland, Virginia, West Virginia, Delaware and Washington, D.C.
North East:	New Jersey and Eastern Pennsylvania
Mid East:	New York, Ohio, Western Pennsylvania, Indiana and Illinois
South East:	North Carolina, South Carolina, Florida and Tennessee

Homebuilding profit before tax includes all revenues and income generated from the sale of homes, less the cost of homes sold, selling, general and administrative expenses and a corporate capital allocation charge. The corporate capital allocation charge is eliminated in consolidation and is based on the segment's average net assets employed. The corporate capital allocation charged to the operating segment allows the Chief Operating Decision Maker ("CODM") to determine whether the operating segment's results are providing the desired rate of return after covering the Company's cost of capital. In addition, certain assets, including goodwill and intangible assets and consolidation adjustments as discussed further below, are not allocated to the operating segments as those assets are neither included in the operating segment's corporate capital allocation charge, nor in the CODM's evaluation of the operating segment's performance. The Company records charges on contract land deposits when it is determined that it is probable that recovery of the deposit is impaired. For segment reporting purposes, impairments on contract land deposits are generally charged to the operating segment upon the termination of a Lot Purchase Agreement with the developer, or the restructuring of a Lot Purchase Agreement resulting in the forfeiture of the deposit. Mortgage banking profit before tax consists of revenues generated from mortgage financing, title insurance and closing services, less the costs of such services and general and administrative costs. Mortgage banking operations are not charged a corporate capital allocation charge.

In addition to the corporate capital allocation and contract land deposit impairments discussed above, the other reconciling items between segment profit and consolidated profit before tax include unallocated corporate overhead (including all management incentive compensation), equity-based compensation expense, consolidation adjustments and external corporate interest expense. NVR's overhead functions, such as accounting, treasury and human resources, are centrally performed and the costs are not allocated to the Company's operating segments. Consolidation adjustments consist of such items necessary to convert the reportable segments' results, which are predominantly maintained on a cash basis, to a full accrual basis for external financial statement presentation purposes, and are not allocated to the Company's operating segments. External corporate interest expense primarily consists of interest charges on the Company's 3.95% Senior Notes due 2022 (the "Senior Notes") and is not charged to the operating segments because the charges are included in the corporate capital allocation discussed above.

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(dollars and shares in thousands)
(unaudited)

The following tables present segment revenues, profit and assets with reconciliations to the amounts reported for the consolidated enterprise, where applicable:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Homebuilding Mid Atlantic	$927,551	$873,490	$2,521,967	$2,279,207
Homebuilding North East	141,033	123,754	374,804	329,674
Homebuilding Mid East	338,900	327,387	895,168	877,921
Homebuilding South East	226,242	182,820	602,088	503,894
Mortgage Banking	34,194	30,118	95,477	79,082
Total consolidated revenues	$1,667,920	$1,537,569	$4,489,504	$4,069,778

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Profit before taxes:				
Homebuilding Mid Atlantic	$109,417	$81,137	$274,527	$191,476
Homebuilding North East	18,762	8,711	41,980	18,354
Homebuilding Mid East	44,990	34,699	103,135	87,488
Homebuilding South East	26,849	16,548	64,330	45,159
Mortgage Banking	19,336	18,155	53,293	42,503
Total segment profit before taxes	219,354	159,250	537,265	384,980
Reconciling items:				
Contract land deposit reserve adjustment (1)	1,910	785	(882)	3,421
Equity-based compensation expense	(11,211)	(11,081)	(32,678)	(32,459)
Corporate capital allocation (2)	51,904	50,032	147,737	140,606
Unallocated corporate overhead	(18,768)	(18,459)	(69,362)	(74,485)
Consolidation adjustments and other	7,087	9,798	20,513	25,660
Corporate interest expense	(5,812)	(5,322)	(17,000)	(14,688)
Reconciling items sub-total	25,110	25,753	48,328	48,055
Consolidated profit before taxes	$244,464	$185,003	$585,593	$433,035

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	September 30, 2017	December 31, 2016
Assets:		
Homebuilding Mid Atlantic	$ 1,163,794	$ 1,054,779
Homebuilding North East	145,094	126,720
Homebuilding Mid East	278,609	222,736
Homebuilding South East	288,473	214,225
Mortgage Banking	300,365	403,250
Total segment assets	2,176,335	2,021,710
Reconciling items:		
Consolidated variable interest entity	1,222	1,251
Cash and cash equivalents	611,094	375,748
Deferred taxes	176,892	170,652
Intangible assets and goodwill	50,490	51,526
Contract land deposit reserve	(32,188)	(31,306)
Consolidation adjustments and other	65,666	54,362
Reconciling items sub-total	873,176	622,233
Consolidated assets	$ 3,049,511	$ 2,643,943

(1) This item represents changes to the contract land deposit impairment reserve, which are not allocated to the reportable segments.

(2) This item represents the elimination of the corporate capital allocation charge included in the respective homebuilding reportable segments. The corporate capital allocation charge is based on the segment's monthly average asset balance, and was as follows for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Corporate capital allocation charge:				
Homebuilding Mid Atlantic	$32,025	$31,960	$92,154	$87,911
Homebuilding North East	4,244	4,572	12,191	13,972
Homebuilding Mid East	7,747	7,366	22,024	21,523
Homebuilding South East	7,888	6,134	21,368	17,200
Total	$51,904	$50,032	$147,737	$140,606

10. Fair Value

GAAP assigns a fair value hierarchy to the inputs used to measure fair value. Level 1 inputs are quoted prices in active markets for identical assets and liabilities. Level 2 inputs are inputs other than quoted market prices that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs.

Financial Instruments

The estimated fair value of NVR's Senior Notes as of September 30, 2017 was $628,500. The estimated fair value is based on recent market prices of similar transactions, which is classified as Level 2 within the fair value hierarchy. The carrying value of the Senior Notes was $596,913 at September 30, 2017. Except as otherwise noted below, NVR believes that insignificant differences exist between the carrying value and the fair value of its financial instruments, which consist of cash equivalents, due to their short term nature.

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Derivative Instruments and Mortgage Loans Held for Sale

In the normal course of business, NVR's wholly-owned mortgage subsidiary, NVR Mortgage Finance, Inc. ("NVRM"), enters into contractual commitments to extend credit to NVR's homebuyers with fixed expiration dates. The commitments become effective when the borrowers "lock-in" a specified interest rate within time frames established by NVRM. All mortgagors are evaluated for credit worthiness prior to the extension of the commitment. 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 a broker/dealer. To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, NVRM enters into optional or mandatory delivery forward sale contracts to sell whole loans and mortgage-backed securities to broker/dealers. The forward sales contracts lock in an interest rate and price for the sale of loans similar to the specific rate lock commitments. NVRM does not engage in speculative or trading derivative activities. Both the rate lock commitments to borrowers and the forward sale contracts to broker/dealers are undesignated derivatives and, accordingly, are marked to fair value through earnings. At September 30, 2017, there were contractual commitments to extend credit to borrowers aggregating $668,936 and open forward delivery contracts aggregating $838,131, which hedge both the rate lock loan commitments and closed loans held for sale.

The fair value of NVRM's rate lock commitments to borrowers and the related input levels include, as applicable:

i) the assumed gain/loss of the expected resultant loan sale (Level 2);
ii) the effects of interest rate movements between the date of the rate lock and the balance sheet date (Level 2); and
iii) the value of the servicing rights associated with the loan (Level 2).

The assumed gain/loss considers the excess servicing to be received or buydown fees to be paid upon securitization of the loan. The excess servicing and buydown fees are calculated pursuant to contractual terms with investors. To calculate the effects of interest rate movements, NVRM 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. NVRM sells all of its loans on a servicing released basis, and receives a servicing released premium upon sale. Thus, the value of the servicing rights is included in the fair value measurement and is based upon contractual terms with investors and varies depending on the loan type. NVRM assumes a fallout rate when measuring the fair value of rate lock commitments. Fallout is defined as locked loan commitments for which NVRM does not close a mortgage loan and is based on historical experience.

The fair value of NVRM'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 (Level 2). The market price changes are multiplied by the notional amount of the forward sales contracts to measure the fair value.

Mortgage loans held for sale are recorded at fair value when closed, and thereafter are carried at the lower of cost or fair value, net of deferred origination costs, until sold. Fair value is measured using Level 2 inputs. The fair value of loans held for sale of $258,554 included on the accompanying condensed consolidated balance sheet has been increased by $2,537 from the aggregate principal balance of $256,017.

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The undesignated derivative instruments are included on the accompanying condensed consolidated balance sheet, as of September 30, 2017, as follows:

	Fair Value	Balance Sheet Location
Rate lock commitments:		
Gross assets	$7,221	
Gross liabilities	3,610	
Net rate lock commitments	$3,611	NVRM - Other assets
Forward sales contracts:		
Gross assets	$1,771	
Gross liabilities	802	
Net forward sales contracts	$969	NVRM - Other assets

The fair value measurement as of September 30, 2017 was as follows:

Notional or Principal Amount