

AVATAR HOLDINGS INC

Form 10-Q

May 10, 2007

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

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

**For the quarterly period ended March 31, 2007**

**OR**

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

**Commission File Number 0-7616**

**AVATAR HOLDINGS INC.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or  
organization)*

**23-1739078**

*(I.R.S. Employer Identification No.)*

**201 Alhambra Circle, Coral Gables, Florida**

*(Address of principal executive offices)*

**33134**

*(Zip code)*

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

8,292,551 shares of Avatar's common stock (\$1.00 par value) were outstanding as of April 30, 2007

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## Consolidated Balance Sheets

(Dollars in thousands)

	(Unaudited)	
	March 31 2007	December 31 2006
<u>Assets</u>		
Cash and cash equivalents	\$ 190,745	\$ 203,760
Restricted cash	3,462	3,637
Receivables, net	6,578	13,863
Land and other inventories	438,606	443,825
Property, plant and equipment, net	64,375	59,756
Investment in unconsolidated joint ventures	7,662	7,583
Prepaid expenses	10,118	10,066
Other assets	7,859	8,487
Deferred income taxes	1,039	95
 Total Assets	 \$ 730,444	 \$ 751,072
 <u>Liabilities and Stockholders Equity</u>		
<u>Liabilities</u>		
Notes, mortgage notes and other debt:		
Corporate	\$ 119,800	\$ 120,000
Real estate	16,664	16,925
Estimated development liability for sold land	24,602	24,693
Accounts payable	12,379	22,053
Accrued and other liabilities	22,640	43,694
Customer deposits	13,968	18,351
 Total Liabilities	 210,053	 245,716
 Commitments and Contingencies		
<u>Stockholders Equity</u>		
Common Stock, par value \$1 per share		
Authorized: 50,000,000 shares		
Issued: 10,800,374 shares at March 31, 2007		
10,725,559 shares at December 31, 2006	10,800	10,726
Additional paid-in capital	229,866	226,013
Retained earnings	354,749	343,641
	595,415	580,380

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Treasury stock: at cost, 2,531,823 shares at March 31, 2007 and December 31, 2006	(75,024)	(75,024)
Total Stockholders' Equity	520,391	505,356
Total Liabilities and Stockholders' Equity	\$ 730,444	\$ 751,072

See notes to consolidated financial statements.

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## Consolidated Statements of Income

For the three months ended March 31, 2007 and 2006

(Unaudited)

(Dollars in thousands except per-share amounts)

	2007	2006
<u>Revenues</u>		
Real estate revenues	\$ 90,093	\$ 154,306
Interest income	2,216	637
Other	136	271
Total revenues	92,445	155,214
<u>Expenses</u>		
Real estate expenses	69,251	115,062
General and administrative expenses	6,059	6,572
Total expenses	75,310	121,634
Equity earnings from unconsolidated joint ventures	43	1,630
Income before income taxes	17,178	35,210
Income tax expense	(6,070)	(10,574)
Net income	\$ 11,108	\$ 24,636
Basic Earnings Per Share	\$ 1.35	\$ 3.01
Diluted Earnings Per Share	\$ 1.08	\$ 2.39

See notes to consolidated financial statements.

**Table of Contents****AVATAR HOLDINGS INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows (Unaudited)

For the three months ended March 31, 2007 and 2006

(Dollars in Thousands)

	2007	2006
<b><u>OPERATING ACTIVITIES</u></b>		
Net income	\$ 11,108	\$ 24,636
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	896	1,038
Amortization of stock-based compensation	1,249	2,237
Impairment of goodwill		654
Impairment of land and other inventories	2,000	
Distributions of earnings from an unconsolidated joint venture		5,200
Equity earnings from unconsolidated joint ventures	(43)	(1,629)
Deferred income taxes	413	(3,355)
Excess income tax benefit from exercise of stock options and restricted stock units	(1,357)	(116)
Changes in operating assets and liabilities:		
Restricted cash	175	(1,646)
Receivables, net	7,897	(225)
Land and other inventories	(3,091)	(26,848)
Prepaid expenses	(52)	(667)
Other assets	623	4
Accounts payable and accrued and other liabilities	(24,618)	(1,308)
Customer deposits	(4,383)	4,853
Assets/liabilities of business transferred under contractual arrangements		(81)
<b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b>	<b>(9,183)</b>	<b>2,747</b>
<b><u>INVESTING ACTIVITIES</u></b>		
Investment in property, plant and equipment	(5,406)	(931)
Investment in unconsolidated joint ventures	(36)	(108)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(5,442)</b>	<b>(1,039)</b>
<b><u>FINANCING ACTIVITIES</u></b>		
Principal payments of real estate borrowings	(261)	(5,307)
Proceeds from exercise of stock options	888	250
Excess income tax benefit from exercise of stock options and restricted stock units	1,357	116
Payment of withholding taxes related to restricted stock units withheld	(374)	
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>1,610</b>	<b>(4,941)</b>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(13,015)</b>	<b>(3,233)</b>
Cash and cash equivalents at beginning of period	203,760	38,479

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 190,745	\$ 35,246
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**SUPPLEMENTAL DISCLOSURES OF NON-CASH FINANCING  
ACTIVITIES**

Conversion of 4.50% Notes into Equity	\$ 200	\$
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See notes to consolidated financial statements.

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**AVATAR HOLDINGS INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**  
**March 31, 2007**

**(Dollars in thousands except share and per share data)**

**Basis of Financial Statement Presentation and Summary of Significant Accounting Policies**

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

The consolidated balance sheets as of March 31, 2007 and December 31, 2006, and the related consolidated statements of income and cash flows for the three months ended March 31, 2007 and 2006 have been prepared in accordance with United States generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statement presentation. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. Interim results are not necessarily indicative of results for a full year.

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

The consolidated balance sheet as of December 31, 2006 was derived from audited financial statements included in our 2006 Annual Report on Form 10-K but does not include all disclosures required by United States generally accepted accounting principles. These consolidated financial statements should be read in conjunction with our December 31, 2006 audited financial statements in our 2006 Annual Report on Form 10-K and the notes to the consolidated financial statements included therein.

**Reclassifications**

Certain 2006 financial statement items have been reclassified to conform to the 2007 presentation. We reclassified from Land and other inventories to Property, plant and equipment, net on the accompanying Consolidated Balance Sheet as of December 31, 2006, (1) capitalized costs related to the Parkway (as defined below) and (2) additional amenities under construction of \$8,145 and \$4,579, respectively, to conform with the presentation as of March 31, 2007. These reclassifications had no impact on reported net income.

**Impairment of Long-Lived Assets**

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , we carry long-lived assets at the lower of the carrying amount or fair value. We evaluate an asset for impairment when indicators of impairment are present. Impairment is evaluated by estimating the sum of future undiscounted cash flows against the carrying amount of the assets. If the sum of future undiscounted cash flows is less than the carrying amount of the assets, an impairment loss is recognized. Fair value, for purposes of calculating impairment, is measured based on estimated future cash flows, discounted at a market rate of interest. During the three months ended March 31, 2007, the continued deterioration of market

**Table of Contents****Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited)**  
**continued****Impairment of Long-Lived Assets continued**

conditions at a community in Florida in which we and other builders are building homes and the increase of our speculative inventory at this community caused us to evaluate the carrying amount of the long-lived assets, consisting of homes completed and under construction, for impairment. Based on this evaluation, we recorded an impairment loss of \$2,000 on the carrying value of the long-lived assets in this community. This impairment loss is included under the caption Real Estate Expenses in the consolidated statement of income for the three months ended March 31, 2007 and is included in the Primary Residential reportable segment in accordance with SFAS No. 131 *Disclosure about Segments of an Enterprise and Related Information* .

**Land and Other Inventories**

Inventories consist of the following:

	March 31, 2007 (Unaudited)	December 31, 2006
Land developed and in process of development	\$ 239,310	\$ 220,403
Land held for future development or sale	96,203	96,214
Homes completed or under construction	102,054	126,482
Other	1,039	726
	\$ 438,606	\$ 443,825

During the three months ended March 31, 2007, we realized pre-tax profits of \$4,758 on revenues of \$5,560 from the sale of commercial and industrial and other land sales. For the three months ended March 31, 2006, we realized pre-tax profits of \$7,970 on revenues of \$8,775, from commercial and industrial and other land sales. For the three months ended March 31, 2007, pre-tax profits on sales of commercial and industrial land were \$4,758 on aggregate sales of \$5,560. During the three months ended March 31, 2006, pre-tax profits on sales of commercial and industrial land were \$7,728 on aggregate sales of \$8,491. Also during the first quarter of 2006, pre-tax profits on sales of other land were \$242 on aggregate sales of \$284.

See Financial Information Relating to Industry Segments below.

**Goodwill and Indefinite-Lived Intangible Assets**

During the first quarter of 2006, we performed an interim impairment test in accordance with SFAS No. 142 *Goodwill and Intangible Assets* on the goodwill associated with the Harbor Islands community because facts and circumstances indicated a potential impairment. Based on this impairment test, we determined that this goodwill was impaired as a result of the closing of the final housing unit in this community. Since the Harbor Islands community was completed during the first quarter of 2006, the associated goodwill of \$654 was written-off under the caption of Real Estate Expense in the consolidated statement of income for the three months ended March 31, 2006.

**Table of Contents****Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited)**  
**continued****Notes, Mortgage Notes and Other Debt**

On March 30, 2004, we issued \$120,000 aggregate principal amount of 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes) in a private, unregistered offering, subsequent to which we filed, for the benefit of the 4.50% Notes holders, a shelf registration statement covering resales of the 4.50% Notes and the shares of our common stock issuable upon the conversion of the 4.50% Notes. Interest is payable semiannually on April 1 and October 1. The 4.50% Notes are senior, unsecured obligations and rank equal in right of payment to all of our existing and future unsecured and senior indebtedness. However, the 4.50% Notes are effectively subordinated to all of our existing and future secured debt to the extent of the collateral securing such indebtedness, and to all existing and future liabilities of our subsidiaries.

Each \$1 in principal amount of the 4.50% Notes is convertible, at the option of the holder, at a conversion price of \$52.63, or 19.0006 shares of our common stock, upon the satisfaction of one of the following conditions: a) during any calendar quarter (but only during such calendar quarter) commencing after June 30, 2004 if the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is more than 120% of the conversion price per share of common stock on such last day; or b) during the five business day period after any five-consecutive-trading-day period in which the trading price per \$1 principal amount of the 4.50% Notes for each day of that period was less than 98% of the product of the closing sale price for our common stock for each day of that period and the number of shares of common stock issuable upon conversion of \$1 principal amount of the 4.5% Notes, provided that if on the date of any such conversion that is on or after April 1, 2019, the closing sale price of Avatar's common stock is greater than the conversion price, then holders will receive, in lieu of common stock based on the conversion price, cash or common stock or a combination thereof, at our option, with a value equal to the principal amount of the 4.50% Notes plus accrued and unpaid interest, as of the conversion date. The closing price of Avatar's common stock exceeded 120% (\$63.156) of the conversion price for 20 trading days out of 30 consecutive trading days as of the last trading day of the fourth quarter of 2006 and as of the last trading day of the first quarter of 2007. Therefore, the 4.50% Notes became convertible for the quarter beginning January 1, 2007 and for the quarter beginning April 1, 2007. On March 27, 2007, \$200 principal amount of the 4.50% Notes were converted into 3,800 shares of Avatar common stock.

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

On September 20, 2005, we entered into a Credit Agreement and a Guaranty Agreement for a \$100,000 (expandable up to \$175,000), four-year senior unsecured revolving credit facility (the Unsecured Credit Facility), by and among our wholly-owned subsidiary, Avatar Properties Inc. (as Borrower), Wachovia Bank, National Association (as Administrative Agent and Lender), and certain financial institutions as lenders. Interest on borrowings under the Unsecured Credit Facility ranges from LIBOR plus 1.75% to 2.25%. Our borrowing rate under the Unsecured Credit Facility as of March 31, 2007 was 7.07%.

The principal amount under the Unsecured Credit Facility is \$125,000 (as amended in October 2005); however, so long as no default or event of default has occurred and is continuing, increases may be requested, subject to lender approval, up to \$175,000. This Unsecured Credit Facility includes a \$7,500 swing line commitment and had a \$10,000 sublimit for the issuance of standby letters of credit.

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

**Notes, Mortgage Notes and Other Debt continued**

On May 25, 2006, we amended the Unsecured Credit Facility to clarify the timing of applicable interest rate adjustments and increase the availability for letters of credit from \$10,000 to \$50,000. The Unsecured Credit Facility contains customary representations, warranties and covenants limiting liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans. In addition, the Unsecured Credit Facility contains covenants to the effect that we (i) will maintain a minimum consolidated tangible net worth (as defined in the Unsecured Credit Facility), (ii) shall maintain an adjusted EBITDA/debt service ratio (as defined in the Unsecured Credit Facility) of not less than 2.75 to 1.0, (iii) will not permit the leverage ratio (as defined in the Unsecured Credit Facility) to exceed 2.0 to 1.0, and (iv) the sum of the net book value of unentitled land, entitled land, land under development and finished lots shall not exceed 150% of consolidated tangible net worth. Borrowings under the Unsecured Credit Facility may be limited based on the amount of borrowing base available. We are in compliance with these covenants as of March 31, 2007. The Unsecured Credit Facility also contains a covenant whereby the sum of speculative homes and models cannot exceed 25% of the aggregate number of unit sales for the last twelve month period. As of December 31, 2006 and March 31, 2007, we exceeded this limitation. However, during the fourth quarter of 2006, we obtained a waiver of this requirement for the quarter ended December 31, 2006 and the entirety of 2007.

In the event of a default under the Unsecured Credit Facility, including cross-defaults relating to specified other debt of Avatar or its consolidated subsidiaries in excess of \$1,000, the lenders may terminate the commitments under the Unsecured Credit Facility and declare the amounts outstanding, and all accrued interest, immediately due and payable.

The Unsecured Credit Facility provides that once each fiscal year, we may request a twelve-month extension of the maturity date. The maturity date of the Unsecured Credit Facility is September 20, 2010. As of March 31, 2007, we had borrowings totaling \$0 under the Unsecured Credit Facility and \$102,431 was available for borrowing under the Unsecured Credit Facility, net of \$22,569 outstanding letters of credit.

Payments of all amounts due under the Unsecured Credit Facility are guaranteed by Avatar Holdings Inc. pursuant to the Restated Guaranty Agreement dated as of October 21, 2005.

We made interest payments of \$299 and \$613 for the three months ended March 31, 2007 and 2006, respectively. Interest costs incurred of \$1,840 and \$1,990 were capitalized for the three months ended March 31, 2007 and 2006, respectively.

**Warranty Costs**

Warranty reserves for houses are established to cover potential costs for materials and labor with regard to warranty-type claims to be incurred subsequent to the closing of a house. Reserves are determined based on historical data and other relevant factors. We may have recourse against subcontractors for claims relating to workmanship and materials. Warranty reserves are included in Accrued and Other Liabilities in the consolidated balance sheets.

**Table of Contents****Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited)**  
**continued****Warranty Costs continued**

During the three months ended March 31, 2007 and 2006 changes in the warranty reserve consisted of the following (unaudited):

	March 31, 2007	March 31, 2006
Accrued warranty reserve, beginning of period	\$ 2,319	\$ 1,616
Estimated warranty expense	564	949
Amounts charged against warranty reserve	(1,077)	(641)
Accrued warranty reserve, end of period	\$ 1,806	\$ 1,924

**Earnings Per Share**

We present earnings per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of Avatar.

The weighted average number of shares outstanding in calculating basic earnings per share includes the issuance of 74,815 and 10,000 shares of our common stock for the three months ended March 31, 2007 and 2006, respectively, due to the exercise of stock options, restricted stock units and conversion of 4.50% Notes.

The following table represents a reconciliation of the income from continuing operations, net income and weighted average shares outstanding for the calculation of basic and diluted earnings per share for the three months ended March 31, 2007 and 2006 (unaudited):

	2007	2006
<b><u>Numerator:</u></b>		
Basic earnings per share net income	\$ 11,108	\$ 24,636
Interest on 4.50% Notes, net of tax	816	816
Diluted earnings per share net income	\$ 11,924	\$ 25,452
<b><u>Denominator:</u></b>		
Basic weighted average shares outstanding	8,209,509	8,184,352
Effect of dilutive restricted stock units	473,899	143,088
Effect of dilutive employee stock options	47,765	37,568
Effect of dilutive 4.50% Notes	2,279,815	2,280,068
Diluted weighted average shares outstanding	11,010,988	10,645,076

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

**Repurchase and Exchange of Common Stock**

During the three months ended March 31, 2007, we did not repurchase shares of our common stock and/or the 4.50% Notes under previous authorizations by the Board of Directors to make purchases from time to time, in the open market, through privately negotiated transactions or otherwise, depending on market and business conditions and other factors. As of March 31, 2007, the remaining authorization is \$15,829.

**Comprehensive Income**

Net income and comprehensive income are the same for the three months ended March 31, 2007 and 2006.

**Share-Based Payments and Other Executive Compensation**

The Amended and Restated 1997 Incentive and Capital Accumulation Plan (2005 Restatement) (the Incentive Plan ) provides that stock options, including incentive stock options and non-qualified stock options; stock appreciation rights; stock awards; performance-conditioned stock awards ( restricted stock units ); and stock units may be granted to officers, employees and directors of Avatar. The exercise prices of stock options may not be less than the market value of our common stock on the date of grant. Stock option awards under the Incentive Plan generally expire 10 years after the date of grant.

As of March 31, 2007, an aggregate of 1,034,814 shares of our Common Stock, subject to certain adjustments, were reserved for issuance under the Incentive Plan, which represents an aggregate of 737,027 options and stock units granted and 297,787 shares available for grant, including stock awards that are potentially issuable under earnings participation award agreements with certain executive officers.

Compensation expense related to the stock option and restricted stock unit awards during the three months ended March 31, 2007 and 2006 was \$878 and \$681, respectively, of which \$72 and \$71, respectively, related to stock options and \$806 and \$610, respectively, related to restricted stock units. During the three months ended March 31, 2007, we granted 21,400 restricted stock units which have a weighted average grant date fair value of \$80.84 per share. During the three months ended March 31, 2006, we granted 600 restricted stock units which have a weighted average grant date fair value of \$56.03 per share. No stock options were granted for the three months ended March 31, 2007 and 2006.

As of March 31, 2007, there was \$9,092 of unrecognized compensation expense related to unvested restricted stock units and unvested stock options, of which \$8,877 relates to restricted stock units and \$215 relates to stock options. That expense is expected to be recognized over a weighted-average period of 2.0 years.

During March 2003, we entered into earnings participation award agreements with certain executive officers providing for stock awards relating to achievement of performance goals. These agreements were amended and restated as of April 15, 2005 and further amended and restated as of December 26, 2006. As amended and restated, the stock award entitles the executives to receive a number of shares of our Common Stock having a fair market value (as defined) equal to a percentage of the excess of actual gross profit (as defined) from January 1, 2003 through December 31, 2007 over minimum levels established. Compensation expense related to the stock awards of \$334 and \$1,518 was recognized for the three months ended March 31, 2007 and 2006, respectively.

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

**Income Taxes**

The exercise and issuance of restricted stock units and stock options for the three months ended March 31, 2007 generated additional income tax benefits of \$1,357 which is reflected as an increase to additional paid-in capital.

We made income tax payments of approximately \$16,000 and \$14,300 for the three months ended March 31, 2007 and 2006, respectively.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

Based on our evaluation of tax positions, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the open tax years ended December 31, 2003, 2004, 2005 and 2006 which remain subject to examination and adjustment by major tax jurisdictions as of March 31, 2007. FIN 48 did not have an impact on our financial position and results of operations.

Any interest or penalties that have been assessed in the past have been minimal and immaterial to our financial results. In the event we are assessed any interest or penalties in the future, we plan to include them in our financial statements as income tax expense.

**Investments in Unconsolidated Joint Ventures**

The FASB issued Interpretation No. 46(R) ( FIN 46(R) ), (which further clarified and amended FIN 46, *Consolidation of Variable Interest Entities* ) which requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

As of March 31, 2007, we own an equity interest in a joint venture formed for the acquisition and/or development of land in which we do not have a controlling interest. This entity meets the criteria of VIEs under FIN 46(R). We evaluated the impact of FIN 46(R) as it relates to this joint venture and determined that we are not the primary beneficiary since we are not the entity that will absorb a majority of the losses and/or receive a majority of the expected residual returns (profits). Therefore, this joint venture is recorded using the equity method of accounting. Our investment in this entity as of March 31, 2007 and December 31, 2006 is the amount invested of \$7,723 and \$7,686, respectively. This entity has assets consisting of land and land development totaling approximately \$15,387 and \$15,313 as of March 31, 2007 and December 31, 2006, respectively.

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

**Investments in Unconsolidated Joint Ventures continued**

In December 2002, our subsidiary, Avatar Ocean Palms, Inc., entered into a joint venture for the development of Ocean Palms (the Ocean Palms Joint Venture), a 38-story, 240-unit highrise condominium on a 3.5-acre oceanfront site in Hollywood, Florida. We are accounting for our investment in the Ocean Palms Joint Venture under the equity method of accounting. Closings of units commenced during February 2006 and were completed during the second quarter of 2006. Our capital account in the investment in the Ocean Palms Joint Venture as of March 31, 2007 and December 31, 2006 is a deficit of \$60 and \$103, respectively. The Ocean Palms Joint Venture has assets of \$282 and \$409 as of March 31, 2007 and December 31, 2006, respectively, and liabilities of \$402 and \$615 as of March 31, 2007 and December 31, 2006, respectively. Net income for the Ocean Palms Joint Venture was \$85 and \$2,747 for the three months ended March 31, 2007 and 2006, respectively. Our share of the net income from the Ocean Palms Joint Venture was \$43 and \$1,655 for the three months ended March 31, 2007 and 2006, respectively.

**Recently Issued Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is January 1, 2008 for us, and interim periods within those fiscal years. We are currently evaluating the provisions of SFAS No. 157 and assessing the impact it may have on our financial position and results of operations.

In November 2006, the FASB issued Emerging Issues Task Force Issue No. 06-8, *Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums* (EITF 06-8). EITF 06-8 establishes that a company should evaluate the adequacy of the buyer's continuing investment in determining whether to recognize profit under the percentage-of-completion method. EITF 06-8 is effective for the first annual reporting period beginning after March 15, 2007 (which is January 1, 2008 for us). The effect of EITF 06-8 is not expected to be material to our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective for the first fiscal year that begins after November 15, 2007 (which is January 1, 2008 for us). We have not yet determined what, if any, impact SFAS No. 159 will have on our financial position or results of operations.



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

**Commitments and Contingencies**

We are involved in various pending litigation matters primarily arising in the normal course of our business. Although the outcome of these matters cannot be determined, management believes that the resolution of these matters will not have a material effect on our business or financial statements.

In December 2006, we entered into agreements with Osceola and Polk Counties in Florida for us to develop and construct a 9.66 mile four-lane road in Osceola and Polk Counties, to be known as the Poinciana Parkway (the Parkway). It will include a 4.15 mile segment to be operated as a private toll road. We will pay the costs associated with the right-of-way acquisition, development and construction of the Parkway. Except for the toll road, the Parkway will be owned, maintained and operated by the Counties upon completion. We will own the private toll road, and under our agreements we have the right to sell it to a third party together with our rights to operate the toll road. Under our agreements with the Counties, the Parkway is to be substantially complete and open to traffic by October 31, 2008, barring delays for some period of time resulting from causes beyond our reasonable control. We have agreed to indemnify Osceola and Polk Counties against liability for loss, injury or damage to persons or property, including, without limitation, consequential damages, imposed on the Counties, except for any such loss, injury or damage that is caused by or results from the gross negligence or willful misconduct of the Counties.

We have made significant progress toward obtaining the various necessary governmental and environmental permits and approvals for construction of the Parkway. However, we have experienced some delays in obtaining other necessary permits and approvals for the Parkway and, therefore, its completion is likely to be delayed beyond October 31, 2008. It is early in the process and our preliminary estimates of our right-of-way acquisition, development and construction costs for the Parkway approximate \$125,000 to \$175,000, of which approximately \$12,500 has been expended as of March 31, 2007, but no assurances of the ultimate amount can be given at this early stage. We have obtained bids for construction of the Parkway and currently are in the right-of-way acquisition phase.

**Table of Contents****Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited)**  
**continued****Financial Information Relating To Industry Segments**

The following table summarizes Avatar's information for reportable segments for the three months ended March 31, 2007 and 2006 (unaudited):

	2007	2006
<u>Revenues:</u>		
Segment revenues		
Primary residential	\$ 52,322	\$ 95,476
Active adult community	31,310	47,851
Commercial and industrial and other land sales	5,560	8,775
Other operations	988	2,312
	90,180	154,414
Unallocated revenues		
Interest income	2,216	637
Other	49	163
Total revenues	\$ 92,445	\$ 155,214
<u>Operating income:</u>		
Segment operating income		
Primary residential	\$ 11,164	\$ 23,675
Active adult community	6,929	9,773
Commercial and industrial and other land sales	4,758	7,970
Other operations	187	1,098
	23,038	42,516
Unallocated income (expenses)		
Equity earnings from unconsolidated joint ventures	43	1,630
Interest income	2,216	637
General and administrative expenses	(6,059)	(6,572)
Other real estate expenses	(2,060)	(3,001)
Income before income taxes	\$ 17,178	\$ 35,210

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data)**

The discussion in this section may contain forward-looking statements within the meaning of the Private Securities Litigation Act of 1995. Please see our discussion under the heading Forward-Looking Statements below.

**RESULTS OF OPERATIONS**

In the preparation of our financial statements, we apply United States generally accepted accounting principles. The application of generally accepted accounting principles may require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying results. For a description of our accounting policies, refer to Avatar Holdings Inc.'s 2006 Annual Report on Form 10-K.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.

The following table provides a comparison of certain financial data related to our operations for the three months ended March 31, 2007 and 2006:

	2007	2006
<u>Operating income:</u>		
Primary residential		
Revenues	\$ 52,322	\$ 95,476
Expenses	41,158	71,801
Segment operating income	11,164	23,675
Active adult community		
Revenues	31,310	47,851
Expenses	24,381	38,078
Segment operating income	6,929	9,773
Commercial and industrial and other land sales		
Revenues	5,560	8,775
Expenses	802	805
Segment operating income	4,758	7,970
Other operations		
Revenues	988	2,312
Expenses	801	1,214
Segment operating income	187	1,098
Operating income	23,038	42,516
<u>Unallocated income (expenses):</u>		
Equity earnings from unconsolidated joint ventures	43	1,630
Interest income	2,216	637
General and administrative expenses	(6,059)	(6,572)
Other real estate expenses	(2,060)	(3,001)
Income before income taxes	17,178	35,210

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Income tax expense	(6,070)	(10,574)
Net income	\$ 11,108	\$ 24,636

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued****RESULTS OF OPERATIONS** continued

Data from single-family primary residential and active adult homebuilding operations for the three months ended March 31, 2007 and 2006 is summarized as follows:

	2007	2006
<u>Units closed</u>		
Number of units	230	516
Aggregate dollar volume	\$ 79,602	\$ 138,528
Average price per unit	\$ 346	\$ 268
<u>Contracts signed, net of cancellations</u>		
Number of units	142	428
Aggregate dollar volume	\$ 38,091	\$ 156,523
Average price per unit	\$ 268	\$ 366
<u>Backlog at March 31</u>		
Number of units	461	1,977
Aggregate dollar volume	\$ 147,781	\$ 652,474
Average price per unit	\$ 321	\$ 330

The number of net housing contracts signed during the three months ended March 31, 2007 compared to the same period in 2006 declined by 66.8%, while the dollar volume of housing contracts signed declined by 75.7%. The decline in housing contracts signed for the three months ended March 31, 2007, continues to reflect the weak market for new residences in the geographic areas in which our developments are located.

We have not experienced any improvement in the market for new homes in the first three months of 2007. We continued to experience through March 31, 2007 cancellations of home sales contracts. Our communities are located in areas of Florida and Arizona where there is an excess of investor and speculator-owned units for sale and an increasing use of various sales incentives by residential builders in our markets, including Avatar. During the three months ended March 31, 2007, cancellations of signed contracts totaled 63, compared to 65 for the three-month period ended March 31, 2006.

During the three months ended March 31, 2007 compared to the three months ended March 31, 2006, the number of homes closed decreased by 55.4% and the dollar volume by 42.5%. We anticipate that we will close in excess of 80% of the homes in backlog as of March 31, 2007 during the subsequent 12-month period, subject to cancellations by purchasers prior to scheduled delivery dates. We do not anticipate a meaningful improvement in our markets in the near term. It is not our intention to implement programs which may offer some short-term earnings advantage, but which could compromise our long-term objectives.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we carry long-lived assets at the lower of the carrying amount or fair value. We evaluate an asset for impairment when indicators of impairment are present. Impairment is evaluated by estimating the sum of future undiscounted cash flows against the carrying amount of the assets. If the sum of future undiscounted cash flows is less than the carrying amount of the assets, an impairment loss is recognized. Fair value, for

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued****RESULTS OF OPERATIONS** continued

purposes of calculating impairment, is measured based on estimated future cash flows, discounted at a market rate of interest. During the three months ended March 31, 2007, the continued deterioration of market conditions at a community in Florida in which we and other builders are building homes and the increase of our speculative inventory at this community caused us to evaluate the carrying amount of the long-lived assets, consisting of homes completed and under construction, for impairment. Based on this evaluation, we recorded an impairment loss of \$2,000, on the carrying value of the long-lived assets in this community. This impairment loss is included under the caption Real Estate Expenses in the consolidated statement of income for the three months ended March 31, 2007 and is included in the Primary Residential reportable segment in accordance with SFAS No. 131 *Disclosure about Segments of an Enterprise and Related Information*.

Net income for the three months ended March 31, 2007 and 2006 was \$11,108 or \$1.08 per diluted share (\$1.35 per basic share) and \$24,636 or \$2.39 per diluted share (\$3.01 per basic share), respectively. The decrease in net income for 2007 compared to 2006 was primarily due to decreased profitability of primary residential operations, active adult operating results and commercial and industrial and other land sales. The decrease in net income was partially mitigated by an increase in interest income as well as decreases in general and administrative expenses and other real estate expenses.

Revenues from primary residential operations decreased \$43,154 or 45.2%, for the three months ended March 31, 2007 compared to the same period in 2006. Expenses from primary residential operations decreased \$30,643 or 42.7%, for the three months ended March 31, 2007, compared to the same period in 2006. The decrease in revenues is attributable to decreased closings at Poinciana, Bellalago, Cory Lake Isles and Rio Rico and was partially mitigated by higher average closing prices. During the same period, the decrease in expenses is attributable to lower volume of closings partially mitigated by the impairment loss of \$2,000 recorded on the carrying value of long-lived assets (as discussed above).

Revenues from active adult operations decreased \$16,541 or 34.6% for the three months ended March 31, 2007 compared to the same period in 2006. Expenses from active adult operations decreased \$13,697 or 36.0%, for the three months ended March 31, 2007 compared to the same period in 2006. The decrease in revenues is attributable to decreased closings partially mitigated by higher average closing prices. The decrease in expenses is attributable to lower volume of closings.

Revenues from commercial and industrial and other land sales decreased \$3,215 for the three months ended March 31, 2007 compared to the same period in 2006. For the three months ended March 31, 2007, pre-tax profits on sales of commercial and industrial land were \$4,758 on aggregate sales of \$5,560. During the three months ended March 31, 2006, pre-tax profits on sales of commercial and industrial land were \$7,728 on aggregate sales of \$8,491. Also during the first quarter of 2006, pre-tax profits on sales of other land were \$242 on aggregate sales of \$284. The amount and types of commercial and industrial and other land sold vary from year to year depending upon demand, ensuing negotiations and the timing of the closings of these sales.

Revenues from other operations decreased \$1,324 or 57.3% for the three months ended March 31, 2007 compared to the same period in 2006. Expenses from other operations decreased \$413 or 34.0% for the three months ended March 31, 2007 compared to the same period in 2006. The decrease in revenues and expenses is primarily attributable to decreased operating results from our title insurance agency operations due to reduced closings.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued**

**RESULTS OF OPERATIONS** continued

Equity earnings from unconsolidated joint ventures represent our proportionate share of profits and losses from our investment in unconsolidated joint ventures whereby we account for our investment under the equity method. We recognized \$43 and \$1,655 of earnings for the three months ended March 31, 2007 and 2006, respectively, from our investment in the Ocean Palms Joint Venture. As of March 31, 2007, substantially all earnings have been recognized. The Ocean Palms Joint Venture's operations currently consist primarily of the sale of the remaining parking spaces, sale of the realty operations and activities related to winding down the Ocean Palms Joint Venture.

Interest income increased \$1,579 or 247.9% for the three months ended March 31, 2007, compared to the same period in 2006. The increase was primarily attributable to higher interest rates earned on cash and cash equivalents as well as higher cash and cash equivalents balances during 2007 compared to 2006.

Other real estate expenses represents real estate taxes and property maintenance not allocable to specific operations decreased by \$941 or 31.4% for the three months ended March 31, 2007 compared to the same period in 2006. The decrease is primarily attributable to a goodwill impairment loss of \$654 recognized during the three months ended March 31, 2006.

Income tax expense was provided for at an effective tax rate of 35.3% for the three months ended March 31, 2007, compared to 30.0% for the three months ended March 31, 2006. The variance in the effective tax rate for the three months ended March 31, 2007 as compared to the federal and state statutory rate of 38% is primarily due to tax-exempt interest earned on our available cash balances. The variance in the effective tax rate for the three months ended March 31, 2006 as compared to the federal and state statutory rate of 38% is primarily attributable to a reduction to the valuation allowance for deferred tax assets of \$2,525.

In order to adjust to changing market conditions, during 2006, we began designing new homes with lower square footage and smaller lots to enable us to sell lower priced houses at meaningful profit margins. We introduced a new multi-family product at Solivita in the fourth quarter of 2006, a smaller product for our scattered lot program in February 2007 and anticipate introducing smaller lots and smaller houses in Bellalago during the third quarter and late fourth quarter 2007.

We continue to manage Avatar and its assets for the long-term benefit of our shareholders, including the monetization of commercial and industrial land from our holdings, and the possible sale of certain residential land to bring forward future cash flows from what would otherwise constitute long-term residential developments.

A significant deterioration of our markets continues. The number of investor-owned units for sale, the current tightening of mortgage underwriting standards, the availability of significant discounts and incentives, the difficulty of potential purchasers in selling their existing homes and the significant amount of standing inventory continue to adversely affect both the number of homes we have been able to sell and the prices at which we are able to sell them. While the level and duration of the downturn cannot currently be predicted, we anticipate that these conditions will continue to have an adverse effect on our earnings for the balance of 2007. Nevertheless, as previously indicated, we continue to anticipate that we will be profitable for the year.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued**  
**LIQUIDITY AND CAPITAL RESOURCES**

Our real estate business strategy is designed to capitalize on our competitive advantages and emphasize higher profit margin businesses by concentrating on the development and management of active adult communities and primary residential communities, and utilizing third-party commercial and industrial development to maximize the value of our residential community developments. We also seek to identify additional sites that are suitable for development consistent with our business strategy and anticipate that we will acquire or develop them directly or through joint venture, partnership or management arrangements. Our primary business activities are capital intensive in nature. Significant capital resources are required to finance primary residential and active adult communities, homebuilding construction in process, community infrastructure, selling expenses, new projects and working capital needs, including funding of debt service requirements and the carrying cost of land.

Our operating cash flows fluctuate relative to the status of development within existing communities, expenditures for land, new developments or other real estate activities, and sales of various homebuilding product lines within those communities and other developments. From time to time we have generated, and may continue to generate, additional cash flow through sales of non-core assets.

As of March 31, 2007, the amount of cash available totaled \$190,745, substantially generated through homebuilding operations, sales of commercial and industrial properties, and sales of other properties.

On March 30, 2004, we issued \$120,000 aggregate principal amount of 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes) in a private, unregistered offering, subsequent to which we filed, for the benefit of the 4.50% Notes holders, a shelf registration statement covering resales of the 4.50% Notes and the shares of our common stock issuable upon the conversion of the 4.50% Notes. Interest is payable semiannually on April 1 and October 1. The 4.50% Notes are senior, unsecured obligations and rank equal in right of payment to all of our existing and future unsecured and senior indebtedness. However, the 4.50% Notes are effectively subordinated to all of our existing and future secured debt to the extent of the collateral securing such indebtedness, and to all existing and future liabilities of our subsidiaries.

Each \$1 in principal amount of the 4.50% Notes is convertible, at the option of the holder, at a conversion price of \$52.63, or 19.0006 shares of our common stock, upon the satisfaction of one of the following conditions: a) during any calendar quarter (but only during such calendar quarter) commencing after June 30, 2004 if the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is more than 120% of the conversion price per share of common stock on such last day; or b) during the five business day period after any five-consecutive-trading-day period in which the trading price per \$1 principal amount of the 4.50% Notes for each day of that period was less than 98% of the product of the closing sale price for our common stock for each day of that period and the number of shares of common stock issuable upon conversion of \$1 principal amount of the 4.5% Notes, provided that if on the date of any such conversion that is on or after April 1, 2019, the closing sale price of Avatar's common stock is greater than the conversion price, then holders will receive, in lieu of common stock based on the conversion price, cash or common stock or a combination thereof, at our option, with a value equal to the principal amount of the 4.50% Notes plus accrued and unpaid interest, as of the conversion date. The closing price of Avatar's common stock exceeded 120% (\$63.156) of the conversion price for 20 trading days out of 30 consecutive trading days as of the last trading day of the fourth quarter of 2006 and as of the last trading day of the first quarter of 2007. Therefore, the 4.50% Notes became convertible for the quarter beginning January 1, 2007 and for the quarter beginning April 1, 2007. On March 27, 2007, \$200 principal amount of the 4.50% Notes were converted into 3,800 shares of Avatar common stock.



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued**  
**LIQUIDITY AND CAPITAL RESOURCES continued**

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

On September 20, 2005, we entered into a Credit Agreement and a Guaranty Agreement for a \$100,000 (expandable up to \$175,000), four-year senior unsecured revolving credit facility (the Unsecured Credit Facility), by and among our wholly-owned subsidiary, Avatar Properties Inc. (as Borrower), Wachovia Bank, National Association (as Administrative Agent and Lender), and certain financial institutions as lenders. Interest on borrowings under the Unsecured Credit Facility ranges from LIBOR plus 1.75% to 2.25%. Our borrowing rate under the Unsecured Credit Facility as of March 31, 2007 was 7.07%.

The principal amount under the Unsecured Credit Facility is \$125,000 (as amended in October 2005); however, so long as no default or event of default has occurred and is continuing, increases may be requested, subject to lender approval, up to \$175,000. This Unsecured Credit Facility includes a \$7,500 swing line commitment and had a \$10,000 sublimit for the issuance of standby letters of credit.

On May 25, 2006, we amended the Unsecured Credit Facility to clarify the timing of applicable interest rate adjustments and increase the availability for letters of credit from \$10,000 to \$50,000. The Unsecured Credit Facility contains customary representations, warranties and covenants limiting liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans. In addition, the Unsecured Credit Facility contains covenants to the effect that we (i) will maintain a minimum consolidated tangible net worth (as defined in the Unsecured Credit Facility), (ii) shall maintain an adjusted EBITDA/debt service ratio (as defined in the Unsecured Credit Facility) of not less than 2.75 to 1.0, (iii) will not permit the leverage ratio (as defined in the Unsecured Credit Facility) to exceed 2.0 to 1.0, and (iv) the sum of the net book value of unentitled land, entitled land, land under development and finished lots shall not exceed 150% of consolidated tangible net worth. Borrowings under the Unsecured Credit Facility may be limited based on the amount of borrowing base available. We are in compliance with these covenants as of March 31, 2007. The Unsecured Credit Facility also contains a covenant whereby the sum of speculative homes and models cannot exceed 25% of the aggregate number of unit sales for the last twelve month period. As of December 31, 2006 and March 31, 2007, we exceeded this limitation. However, during the fourth quarter of 2006, we obtained a waiver of this requirement for the quarter ended December 31, 2006 and the entirety of 2007.

In the event of a default under the Unsecured Credit Facility, including cross-defaults relating to specified other debt of Avatar or its consolidated subsidiaries in excess of \$1,000, the lenders may terminate the commitments under the Unsecured Credit Facility and declare the amounts outstanding, and all accrued interest, immediately due and payable.

The Unsecured Credit Facility provides that once each fiscal year, we may request a twelve-month extension of the maturity date. The maturity date of the Unsecured Credit Facility is September 20, 2010. As of March 31, 2007, we had borrowings totaling \$0 under the Unsecured Credit Facility and \$102,431 was available for borrowing under the Unsecured Credit Facility, net of \$22,569 outstanding letters of credit.

Payments of all amounts due under the Unsecured Credit Facility are guaranteed by Avatar Holdings Inc. pursuant to the Restated Guaranty Agreement dated as of October 21, 2005.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued**  
**LIQUIDITY AND CAPITAL RESOURCES continued**

During the three months ended March 31, 2007, we did not repurchase shares of our common stock and/or the 4.50% Notes under previous authorizations by the Board of Directors to make purchases from time to time, in the open market, through privately negotiated transactions or otherwise, depending on market and business conditions and other factors. As of March 31, 2007, the remaining authorization is \$15,829.

For the three months ended March 31, 2007, net cash used in operating activities amounted to \$9,183, primarily as a result of an increase in expenditures on land and other inventories of \$3,091, a reduction in customer deposits of \$4,383 and decreases in accounts payable and accrued liabilities of \$24,618. Partially offsetting net cash used in operating activities is the decrease in receivables of \$7,897 and net income of \$11,108. Net cash used in investing activities amounted to \$5,442 as a result of expenditures of \$5,406 for investments in property, plant and equipment primarily resulting from expenditures of \$4,292 on the Parkway, and expenditures of \$36 for investments in unconsolidated joint ventures. Net cash provided by financing activities of \$1,610 resulted from proceeds of \$888 from the exercise of stock options and \$1,357 as a result of excess income tax benefits from the exercise of stock options and restricted stock units. Partially offsetting net cash provided by financing activities is the repayment of \$261 in real estate debt and payment of \$374 for withholding taxes related to restricted stock units withheld.

For the three months ended March 31, 2006, net cash provided by operating activities amounted to \$2,747, primarily as a result of net income of \$24,636, an increase in customer deposits of \$4,853 and distributions from an unconsolidated joint venture of \$5,200 partially offset by increases in land and other inventories of \$26,848. Contributing to the increase in inventories for the three months ended March 31, 2006 were land acquisitions of \$18,300 and expenditures on construction and land development of approximately \$8,548. Net cash used in investing activities amounted to \$1,039, as a result of expenditures of \$931 for investments in property, plant and equipment, as well as expenditures of \$108 for investment in an unconsolidated joint venture. Net cash used in financing activities of \$4,941 resulted from repayment of real estate debt of \$5,307, partially offset by proceeds of \$250 from the exercise of stock options.

In December 2006, we entered into agreements with Osceola and Polk Counties in Florida for us to develop and construct a 9.66 mile four-lane road in the Counties, to be known as the Poinciana Parkway (the Parkway). Under our agreements with the Counties, the Parkway is to be substantially complete and open to traffic by October 31, 2008, barring delays for some period of time resulting from causes beyond our reasonable control. However, we have experienced some delays in obtaining other necessary permits and approvals for the Parkway, and, therefore, its completion is likely to be delayed beyond October 31, 2008. It is early in the process and our preliminary estimates of our right-of-way acquisition, development and construction costs for the Parkway approximate \$125,000 to \$175,000, of which approximately \$12,500 has been expended as of March 31, 2007, but no assurances of the ultimate amount can be given at this early stage. We have obtained bids for construction of the Parkway and currently are in the right-of-way acquisition phase. On May 8, 2007, we entered into an agreement that enables us to purchase mitigation credits and most of the remaining land necessary for construction of the Parkway. Based on preliminary discussions with potential third-party purchasers, we believe that the value of the toll road, upon completion, would be not less than our estimated right-of-way acquisition, development and construction costs.

We anticipate that cash on hand, cash flow generated through homebuilding and related operations, sales of commercial and industrial land, sales of non-core assets and external borrowings, positions us to be able to continue to acquire new development opportunities and expand operations at our existing communities, fund the right-of-way acquisition, development and construction of the Parkway, as well as to commence appropriate development of new projects on properties currently owned and/or to be acquired.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued**

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

Based on our evaluation of tax positions, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the open tax years ended December 31, 2003, 2004, 2005 and 2006 which remain subject to examination and adjustment by major tax jurisdictions as of March 31, 2007. FIN 48 did not have an impact on our financial position and results of operations.

Any interest or penalties that have been assessed in the past have been minimal and immaterial to our financial results. In the event we are assessed any interest or penalties in the future, we plan to include them in our financial statements as income tax expense.

There has been no other significant changes to our critical accounting policies and estimates during the three months ended March 31, 2007 as compared to those we disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2006 Annual Report on Form 10-K.

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, which is January 1, 2008 for us, and interim periods within those fiscal years. We are currently evaluating the provisions of SFAS No. 157 and assessing the impact it may have on our financial position and results of operations.

In November 2006, the FASB issued Emerging Issues Task Force Issue No. 06-8, *Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums* (EITF 06-8). EITF 06-8 establishes that a company should evaluate the adequacy of the buyer's continuing investment in determining whether to recognize profit under the percentage-of-completion method. EITF 06-8 is effective for the first annual reporting period beginning after March 15, 2007 (which is January 1, 2008 for us). The effect of EITF 06-8 is not expected to be material to our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. SFAS No. 159's objective is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 is effective for the first fiscal year that begins after November 15, 2007 (which is January 1, 2008 for us). We have not yet determined what, if any, impact SFAS No. 159 will have on our financial position or results of operations.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (dollars in thousands except share and per share data) continued**

**FORWARD LOOKING STATEMENTS**

Certain statements discussed under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others: the successful implementation of Avatar's business strategy; shifts in demographic trends affecting demand for active adult (55 years and older) and primary housing; the level of immigration and in-migration into the areas in which we conduct real estate activities; the level of competition in geographic areas in which we do business; the number of investor and speculator resale homes for sale in our communities and in the geographic areas in which we develop and sell homes; international (in particular Latin America), national and local economic conditions and events, including employment levels, income levels, interest rates, mortgage rates, consumer confidence, the availability and terms of residential mortgage financing and subprime mortgage financing and demand for new and existing housing; Avatar's access to financing; geopolitical risks; changes in, or the failure or inability to comply with, government regulations; and other factors as are described in Avatar's filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk**

There have been no material changes in Avatar's market risk during the three months ended March 31, 2007. For additional information regarding Avatar's market risk, refer to Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our 2006 Annual Report on Form 10-K.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective for the purpose of ensuring that material information required to be in this report is made known to our management, including our Chief Executive Officer and Chief Financial Officer, and others, as appropriate, to allow timely decisions regarding required disclosures and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have determined that, during the fiscal quarter ended March 31, 2007, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) that have affected, or are reasonably likely to affect, materially, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (dollars in thousands except share and per share data)**

**Unregistered Sales of Equity Securities**

On March 27, 2007, \$200 principal amount of the 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes ) were converted into 3,800 shares of Avatar common stock. As of March 31, 2007, a total of \$119,800 aggregate principal amount of the 4.50% Notes was outstanding and convertible into 2,276,268 of Avatar s common stock.

As previously disclosed, as a result of the closing price of Avatar s common stock exceeding 120% of the conversion price for twenty trading days within the thirty consecutive trading day period ending on December 29, 2006, holders of the 4.50% Notes could convert the 4.50% Notes into shares of common stock during the calendar quarter ending March 31, 2007. In addition, as previously disclosed, as a result of the closing price of Avatar s common stock exceeding 120% of the conversion price for twenty trading days within the thirty consecutive trading day period ending on March 30, 2007, holders of the 4.50% Notes may convert the 4.50% Notes into shares of common stock during the calendar quarter ending June 30, 2007. The 4.50% Notes are convertible at the conversion rate of 19.0006 shares of common stock per \$1 principal amount of the 4.50% Notes.

The shares of common stock were issued solely to holders of the 4.50% Notes upon conversion of the 4.50% Notes pursuant to the exemption from registration provided under Section 3(a)(9) of the Securities Act of 1933, as amended, which is available since the shares of common stock were exchanged by Avatar with its existing security holders exclusively where no commissions or other remunerations were paid or given directly or indirectly for soliciting such an exchange.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (dollars in thousands except share and per share data) continued**  
**Repurchases of Equity Securities**

The following table represents shares repurchased by Avatar under the stock repurchase authorizations for the three months ended March 31, 2007:

Period	Total Number of Shares Purchased	Average Price Paid  Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program (1)	Maximum Amount That  May Yet Be Purchased Under the Plan or Program (1)
January 1, 2007 to January 31, 2007		\$		\$ 15,829
February 1, 2007 to February 28, 2007				\$ 15,829
March 1, 2007 to March 31, 2007				\$ 15,829
Total		\$		

(1) On March 20, 2003, Avatar's Board of Directors authorized the expenditure of up to \$30,000 to purchase, from time to time, shares of Avatar's common stock and/or 7% Convertible Subordinated Notes due April 2005 (the 7% Notes), which were subsequently called for redemption, in the open market, through privately negotiated

transactions or otherwise, depending on market and business conditions and other factors. On June 29, 2005, Avatar's Board of Directors amended the March 20, 2003 repurchase authorization to include the 4.50% Notes in addition to shares of common stock. As of March 31, 2007, the remaining authorization for purchase of shares of Avatar's common stock and 4.50% notes was \$15,829. During the three months ended March 31, 2007, Avatar did not repurchase shares of its common stock and/or 4.50% Notes.

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**Item 6. Exhibits**

- 10.1 Severance Arrangement with respect to Charles L. McNairy (filed herewith).
  
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
  
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
  
- 32.1 Certification of Chief Executive Officer required by 18 U.S.C. Section 1350 (as adopted by Section 906 of the Sarbanes-Oxley Act of 2002) (furnished herewith).
  
- 32.2 Certification of Chief Financial Officer required by 18 U.S.C. Section 1350 (as adopted by Section 906 of the Sarbanes-Oxley Act of 2002) (furnished herewith).



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**SIGNATURES**

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

**AVATAR HOLDINGS INC.**

Date: May 10, 2007

By: /s/ Charles L. McNairy  
Charles L. McNairy  
Executive Vice President, Treasurer and  
Chief Financial Officer

Date: May 10, 2007

By: /s/ Michael P. Rama  
Michael P. Rama  
Controller and Chief Accounting  
Officer

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<b>Exhibit</b>	<b>Index</b>
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