

Comstock Homebuilding Companies, Inc.

Form 10-K/A

April 30, 2007

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-K/A**

**(Amendment No. 1)**

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

**For the fiscal year ended December 31, 2006**

**Commission file number 1-32375**

**Comstock Homebuilding Companies, Inc.**

*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**

*(State or Other Jurisdiction of Incorporation or  
Organization)*

**20-1164345**

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

**11465 Sunset Hills Road**  
**5th Floor**  
**Reston, Virginia 20190**  
**(703) 883-1700**

*(Address, including zip code, and telephone number, including area code, of principal executive offices)*

**Securities registered pursuant to Section 12(b) of the Act:**

**None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Class A common stock, par value \$.01 per share**

*(Title of Class)*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (check one)  
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 Act). Yes  No

The aggregate market value of voting and non-voting common equity held by nonaffiliates of the registrant (9,279,883 shares) based on the last reported sale price of the registrant's common equity on the NASDAQ Global Market on June 30, 2006, which was the last business day of the registrant's most recently completed second fiscal quarter, was \$58,741,659. For purposes of this computation, all officers, directors, and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed to be an admission that such officers, directors, or 10% beneficial owners are, in fact, affiliates of the registrant.

As of February 28, 2007, there were outstanding 13,552,567 shares of the registrant's Class A common stock, par value \$.01 per share, and 2,733,500 shares of the registrant's Class B common stock, par value \$.01 per share.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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**COMSTOCK HOMEBUILDING COMPANIES, INC.**

**ANNUAL REPORT ON FORM 10-K  
For the Fiscal Year Ended December 31, 2006**

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## **EXPLANATORY NOTE**

The purpose of this Form 10-K/A is to amend Part I, Item 1, Part II, Item 7 and Part III, Items 10 through 14 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which was filed with the Securities and Exchange Commission on March 16, 2007 (the "2006 Form 10-K"). The reason for this 10-K/A is to correct typographical and other errors and to meet our filing deadline for Part III hereof. In addition, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), new certifications by our principal executive officer and principal financial officer are being filed as exhibits to this Form 10-K/A under Item 15 of Part IV hereof.

For purposes of this Form 10-K/A, and in accordance with Rule 12b-15 under the Exchange Act, Items 1, 7, 10 through 14 and the Consolidated Financial Statements have been amended and restated in their entireties. No attempt has been made in this Form 10-K/A to modify or update other disclosures as presented in the original 2006 Form 10-K.

## **PART I**

### **Item 1. Business**

#### **Overview**

We are a real estate developer that has substantial experience building a diverse range of products including single-family homes, townhouses, mid-rise condominiums, high-rise multi-family buildings and mixed-use (residential and commercial) developments in suburban communities and high density urban infill areas. We build projects with the intent that they be sold either as fee-simple properties, condominiums, or stabilized investment properties. We focus on geographic areas, products and price points where we believe there is significant demand for new housing and potential for attractive returns. We currently develop and build in the Washington, D.C., Raleigh, North Carolina, and Atlanta, Georgia markets where we target a diverse range of home buyers, including first-time, early move-up, secondary move-up, empty nester move-down and active adult home buyers. We focus on what we call the "middle-market" meaning that we tend to build in the middle price points in each market, avoiding low end and upper end products. We believe that these price points cater to a significant and stable segment of the home buyers in our markets. Since our founding in 1985 and as of December 31, 2006, we have built and delivered over 4,000 homes valued at over \$1.0 billion.

Our markets have generally been characterized by strong population and economic growth trends that have led to strong demand for traditional housing. While we prefer to purchase building lots that are developed by others when practical, our core capabilities include the ability to manage the entitlement and development of land for our home building operations. We believe this is a complement to the purchasing of finished building lots developed by others because it enables us to pursue projects that have potentially higher returns. In addition, our business includes the development, redevelopment and construction of residential mid-rise and high-rise condominium complexes. The majority of our multi-family projects are in our core market of the greater Washington, D.C. area. We believe that the demographics and housing trends in the Washington, DC area will continue to produce significant demand for high density housing and mixed-use developments. In our other markets, Raleigh, North Carolina and Atlanta, Georgia, we are currently focused on lower density housing such as single family homes and townhomes.

We were incorporated in Delaware in May 2004. Our business was founded in 1985 by Christopher Clemente, our current Chief Executive Officer, as a residential land developer and home builder focused on the move-up home market in the northern Virginia suburbs of Washington, D.C. Prior to our initial public offering in December 2004, we operated our business through four primary holding companies. In connection with our initial public offering, these

primary holding companies were consolidated and merged into Comstock Homebuilding Companies, Inc. Our principal executive offices are located at 11465 Sunset Hills Road, 5th floor, Reston, Virginia 20190, and our telephone number is (703) 883-1700. Our Web site is [www.comstockhomebuilding.com](http://www.comstockhomebuilding.com). References to Comstock, we, our and us refer to Comstock Homebuilding Companies, Inc. together in each case with our subsidiaries and any predecessor entities unless the context suggests otherwise.

## **Our Markets**

We operate in the greater Washington, D.C., Raleigh, North Carolina and Atlanta, Georgia markets. We believe that the new home industry in our core markets is, over the long term, characterized by consistent demand and a limited supply of affordable new housing. Based on our experience, we believe that in the home building industry, local economic trends and influences have a more significant impact on supply and demand, and therefore on profitability, than national economic trends and influences. We believe the leading economic indicator of housing demand is job growth. Each of our primary markets experienced strong job growth in recent years. We believe that where there is strong job growth there will be population growth which will result in demand for new housing. According to the National Association of Home Builders, the Washington, D.C., Raleigh, North Carolina and Atlanta, Georgia metropolitan areas were each ranked in the top 20 housing markets in the country based upon single-family residential building permits issued in 2006. The Washington, D.C. metropolitan area was ranked as the #10 housing market in the country based upon multi-family building permits issued in 2006, and the Atlanta, Georgia market was ranked #2 in the country based upon residential building permits issued in 2006.

## **Our Business Strategy**

Our general business strategy is to focus on for-sale residential real estate development opportunities in the southeastern United States that afford us the ability to produce products at price points where we believe there is significant and consistent long-term demand for new housing. We believe the housing industry is cyclical in nature. We recognize that current market conditions are extremely challenging. Accordingly, we have adapted our business plan and strategy with the goal of protecting liquidity, enhancing our balance sheet and positioning the Company for future growth when market conditions improve. In connection with this strategy, we have adopted a conservative approach to land acquisition and investment and have taken a patient approach with respect to market expansion. We believe that by doing so we are enhancing our ability to take advantage of attractive real estate investment opportunities in our core markets as market conditions improve. Our general operating business strategy has the following key elements:

*Attract and retain experienced personnel at all levels.* We believe the key to success in our business is attracting and retaining experienced professionals at all levels within the organization. This is just as important with sales and field supervisor positions as it is with management level positions. We work to identify, recruit, train and retain the most qualified management and support personnel available.

*Build in and expand with the strong growth markets of the Mid-Atlantic and Southeast region of the United States.* We believe there are significant opportunities for long term growth in our existing markets and region. Our strategy is to operate our business in our current markets and region to capitalize on the robust economies and continued population growth of these areas. We expect the economic growth in these markets to continue. We plan to utilize our strong regional presence and our extensive experience in these markets to expand our operations in these markets through acquisition of both finished and raw land as well as acquisition of local home builders whose operations would complement ours and enhance our competitive position in the marketplace. With regards to such corporate acquisitions we look for homebuilders that have strategic land positions, strong local management teams, access to additional land supply and good relationships with local subcontractors. We expect to target new markets within our core region that have favorable demographic and economic trends where we believe we will be able to achieve sufficient scale over time to successfully implement our business strategy.

*Manage our land inventory to provide the most attractive margins or returns possible.* We believe that our market knowledge and experience in land entitlement and development enable us to successfully identify attractive land acquisition opportunities, efficiently manage the process of obtaining development rights and maximize land value. We have the expertise needed to acquire land positions in various stages of the entitlement and development process,

which we believe provides us more opportunities to acquire development opportunities than many of our competitors. We believe we are able to utilize our capabilities in land acquisition, land planning, and land development to maximize the potential return achieved from developing each property. As a complement to this approach we also seek to acquire finished building lots that have been developed by others for our home building operation. We believe our network of relationships and broad recognition in our core markets gives us an advantage over some of our competitors in acquiring finished lots. Because in the case of finished lots we can often acquire



options on large numbers of lots with relatively small deposits in relation to the total land purchase price, this strategy of purchasing finished lots allows us to cost-efficiently control significant land positions with reduced capital risk. As such, we intend to continue to option land positions whenever possible.

*Create opportunities in areas overlooked by our competitors.* We believe there is a significant market opportunity for well-designed, quality homes and condominiums in urban and suburban areas in close proximity to transportation facilities. Local governments in our markets, especially the greater Washington, D.C. market, have modified zoning codes in response to mounting traffic concerns to allow for high-density residential development near transportation improvements. In our experience, buyers place a premium on new homes in developments within these areas. We believe that our high density townhouse and condominium products, along with our substantial experience in dealing with both the market and regulatory requirements of urban mixed-use developments, enable us to identify and create value in land parcels often overlooked by traditional home builders. As a result, we believe we have an opportunity to generate profit in more ways than some of our larger competitors. We plan to continue to focus on developing and creating these opportunities within our core markets.

*Focus on a broad segment of the home buying market, the middle of the market.* Our single-family homes, townhouses and condominiums are deliberately designed and priced to appeal to a broad segment of the home buying market. We serve a diverse customer base including first-time, early move-up, secondary move-up, empty nester move-down and active adult home buyers. We refer to customers in these demographics as middle market homebuyers. We believe first-time and early move-up home buyers represent a significant portion of home buyers and have in the past, we believe, been more resistant to market downturns and more responsive to market rebounds. We believe that the aging of the American population makes it more likely that a significant percentage of the population will continue to be attracted to secondary move-up, empty nester move-down and active adult housing products as well. We expect our diversified product offerings to position us to benefit from the projected population growth in our core markets and provide long term protection against periodic market fluctuations.

*Position our inventory for the growing active adult market.* We expect the large and aging baby boom population in the United States to fuel growth in the active adult market of the home building industry. As the baby boom generation ages, we anticipate that housing developments focused on this population will capture a larger share of the market. We believe this growing segment of the population will also likely be attracted to the convenience and activities available in upscale urban mixed-use active adult developments. Active adult developments are often favored by local governments because they increase the tax base while requiring fewer government-funded services and infrastructure, such as schools and summer programs, as compared to traditional developments that attract younger families. We believe that because of our experience and capabilities and our focus on the southeastern United States that we are well positioned to benefit from this growing demand.

*Maximize our economies of scale.* We apply a production home builder approach to all of our product categories. In many instances, we utilize plans across multiple markets which we have built numerous times. This repetitive manufacturing process allows us to minimize cost through value engineering resulting from previous field experience. We are also able to coordinate labor and material purchasing under bulk contracts thereby reducing unit costs. As a result, we are able to realize economies of scale in the purchase of raw materials, supplies, manufactured inputs and labor. As we expand, we will seek to maximize these benefits through purchasing arrangements with national and regional vendors.

In light of current depressed market conditions in the homebuilding industry we have adopted the following additional business strategies which we will focus on throughout 2007 and into 2008:

*Protect liquidity and maximize capital availability.* For so long as market demand for housing remains depressed we will remain highly focused on maintaining liquidity by limiting our investments in long term real estate projects. We

will build our pipeline of new development opportunities through a cautious and measured approach. When available, we will focus on the acquisition of finished building lots and parcels with shorter times to market that often have reduced equity requirements as compared to raw land parcels that require entitlement and development. In addition, in order to maintain sufficient operating liquidity and capital availability we will continue to sell certain assets that are either highly leveraged or have significant cash equity.

*Invest in creating a highly qualified sales force capable of closing sales in difficult times.* We believe that enhancing the capabilities of our sales force is critical to success in a difficult market. Accordingly, we have initiated an organized recruiting effort and enhanced our training programs to ensure that we have the best possible sales force. We believe this will increase conversion ratios, decrease cancellations, and improve pricing power.

*Maximize the realized value of our real estate owned.* Because of the our depth of experience in many different aspects of real estate development we believe that we are able to continuously evaluate and re-evaluate the use of the real estate we own and therefore are well positioned to identify alternative uses for the inventory we own that may increase the value of such properties. This effort is currently primarily focused on our multi-family assets in the greater Washington, D.C. area where the demand for such products has been temporarily depressed as a result of over building and high price appreciation. One manner in which we are addressing this is by selling certain condominium projects in part, or in whole, to buyers of for-rent properties. As a result of the very low vacancy rates in the apartment inventory in the Washington, D.C. area the values of for-rent apartment properties continue to be enhanced. We have been successful in selling certain condominium assets as for-rent property and may continue our efforts in that regard to ensure that we are taking steps that we believe will enhance our balance sheet and liquidity. Our effort in this regard tends to be with respect to certain inventory that is either underperforming or holds a higher total value for a rental property owner that it otherwise would for individual homeowners in the aggregate. In properties where a bulk sale is impractical we have initiated our own internal bridge rental operations to maximize short term cash flow from the property and minimize net debt service obligations while we wait for market conditions to improve.

*Concentrate on finished lot option takedown opportunities.* In an effort to minimize the equity required in an acquisition of building lots and shorten our asset turn cycles we have increased our focus on finished building lots sold by developers on an option takedown basis.

*Identify and capitalize on undervalued and/or distressed real estate assets.* We believe that in every real estate downturn there are opportunities to acquire properties for development that have the potential of delivering above average returns in the future. Because of our extensive experience in real estate development and our experience in managing more than one cyclical downturn and cyclical upturn, we believe that we are well positioned to identify attractive opportunities. By intensely focusing in the short term on our liquidity and by taking steps to enhance our balance sheet and cash reserves, we believe that we will be well positioned to capitalize on such opportunities.

*Capitalize on our public status to attract capital and build a sustainable pipeline for future growth.* We believe that as a public homebuilder we have advantages over our private peers when it comes to access to capital by virtue of our public status. We intend to capitalize on the transparent nature of our financial reporting and utilize our public currency to attract alternative sources of capital into the company and acquire growth assets without depleting our liquidity.

*Invest in technology to streamline operations, increase our ability to communicate with customers and facilitate growth.* During 2006 we invested in the upgrade of our information management and accounting systems. This new platform will allow us to manage our business more efficiently and better control our costs as we grow. The platform we have created will help position us to better utilize technology to facilitate the sale of our products, communicate with customers and enhance operating results.

## **Our Operations**

We integrate the process of building a home by carefully controlling each phase of the process from land acquisition to the construction, marketing and sale of a home. During every stage of the process we manage risk and focus on products, geographic areas and price points in an effort to maximize our revenue and profit opportunities.

***Land Identification and Acquisition***

We believe that by controlling and managing a significant portion of our land inventory through options we will be better able to manage our growth in accordance with our business plan and long term growth objectives.

In the past we have acquired land for our home building operations both as finished building lots and as raw land that we develop. Today we seek to acquire land that will be delivered to us as finished building lots and/or

developed building pads whenever practical. Our goal is to contract to purchase land from land developers who will maintain ownership of the land through the entitlement and development process. When we contract to purchase land in this manner we typically will provide our home building and entitlement expertise to the seller in order to ensure the land is developed in a manner consistent with our plans for the project. By contracting to purchase land during the entitlement and development process that will deliver upon completion of development we reduce the financial risks associated with seeking entitlements and performing land development.

We currently own and buy land that we develop into building lots ourselves. We will generally buy undeveloped land when we are developing high-density projects because the product design is often integrated into the site development operations. We also buy land that we develop into traditional building lots when we believe the capital outlay and additional risk associated with developing the land is manageable and the return on investment will be enhanced. When we purchase these types of sites, it is after the development rights have been secured, which eliminates or substantially reduces risks associated with seeking entitlements.

We also engage in the business of converting existing rental apartment properties to for-sale condominium projects. This process involves the purchase of existing structures which are occupied by tenants with leases of varying duration. When we purchase these properties we subdivide the units and form a condominium association. In these projects we have and continue to invest capital in the improvement of the common areas and exteriors. In the past, our strategy was that as the tenants' leases expired we renovated the interiors of the apartments and then sold each apartment as an individual condominium unit. In recent months our business model has changed due to market conditions. In response to slowed absorption at these projects we have elected to continue to lease unsold inventory to renters. We have not abandoned our intent to sell the units as condominiums over time but we have chosen to temporarily manage the properties as rental assets to offset the debt service associated with holding the assets for sale. In certain cases we have sold condo conversion units in bulk to rental project investors and operators. We do not currently expect to continue to acquire additional condominium conversion and similar projects.

Our land acquisition and development process is overseen by an executive land committee that includes representatives from our various business departments. This committee meets regularly to evaluate prospective land acquisitions and underperforming assets. The committee evaluates several factors that could affect the outcome of a project under consideration. These factors include:

- supply and absorption rates of similar new home projects;

- supply and absorption rates of existing homes in the area;

- projected equity requirements;

- projected return on invested capital;

- status of land development entitlements;

- projected net margins of homes to be sold by us;

- projected absorption rates;

- demographics, school districts, transportation facilities and other locational factors; and

- competitive market positioning.

We focus on acquiring new projects that we believe have the potential to generate revenue on home sales as well as appreciation in land value through the application of our entitlement and development expertise. Many of the sites we choose to invest in have been overlooked by large, national competitors due to the complexity of zoning and entitlement issues or other development characteristics. Our acquisition due diligence process involves a high level of scrutiny which includes a variety of analyses, including land title examination, applicable zoning evaluations, environmental analysis, soil analysis, utility availability studies, and marketing studies that review population and employment trends, school districts, access to regional transportation facilities, prospective home buyer profiles, sales forecasts, projected construction costs, labor and material availability, assessment of political risks and other factors. While we make assumptions about costs of development and construction as well as sales pricing, we often will not know these items for sure until after we have committed to or purchased the project.

### ***Land Entitlement and Development***

We manage development opportunities and risks through our in-house entitlement processing group.

We have extensive knowledge and experience in all aspects of the site selection, land planning, entitlement and land development processes. Specifically, we have significant experience in dealing with the governmental and regulatory authorities that govern the site selection, development and zoning processes. Entitlement is the process by which a local government determines the density it will permit to be developed on a particular property. Entitlements and development permits are often obtained through negotiations with local governmental authorities. This process often involves consultation with various parties, including the local homeowner associations, federal governmental agencies and environmental protection groups. Infrastructure improvements, such as sewers, roads, utilities and transportation improvements are often required to be built in connection with the development of a parcel of land.

Our experience and knowledge allow us to effectively negotiate with all concerned parties in an attempt to ensure the costs of the improvements associated with obtaining entitlements are commensurate with the development potential of the subject property. We can quickly assess the likely approvals on a particular property in the early stages of our due diligence process. As a result, we can control the details of development, from the design of each community entryway to the placement of streets, utilities and amenities, in order to efficiently design a development that we expect will improve our ability to maximize the potential return on our investment in the property. We seek to manage development risk by acquiring options to purchase properties after the approval of the necessary entitlements, while assuming control of their entitlement process, thereby deferring acquisition of the property until all necessary entitlements are obtained.

Our goal is to maximize returns on assets we control or own. As such we may, from time to time, sell lots and parcels within our developments to other home builders. This strategy enables us to better balance our inventory and create a more well-rounded community. With respect to our inventory, our goal is to purchase our inventory when it is ready for a home to be built but we also buy raw land that is entitled. Typically we will own approximately 50% of the total land we have under our control at any given time. Our goal in 2007 is to reduce that to 30-40% on average so that we reduce the risk associated with ownership of the land under our control. We expect to expand our control of building lots through more option contracts for finished building lots and developed sites. As of December 31, 2006, we controlled over 5,000 building lots in our markets.

### ***Sales, Marketing and Production***

Our primary target markets are first-time; early-move up and first move-down home buyers. We have a wide variety of product lines and custom options for our products that enable us to meet the specific needs of each of our markets and each of our home buyers. We believe that our diversified product strategy enables us to best serve a wide range of home buyers in our target demographics and adapt quickly to changing market conditions. We continually reevaluate and improve upon our existing product designs and develop new product offerings to keep up with changing consumer demands and emerging market trends.

Our single-family homes range in size from approximately 1,400 square feet to over 6,000 square feet with target pricing from the \$100,000s to the \$700,000s. Our townhouses range in size from approximately 1,200 square feet to over 4,500 square feet and are typically priced from the \$100,000s to the \$600,000s.

Unlike many of our traditional home building competitors, we also design, sell and build mid-rise and high-rise condominiums. We believe that our condominium products are particularly well-suited to the high-density, infill and active adult home buyer markets. Our condominiums range in size from approximately 400 square feet to over 2,400 square feet and are priced from the \$100,000s to over \$1 million. Our average new order price over all product types,

was \$245,000, \$365,000 and \$369,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

We typically act as the general contractor in the construction of our wood frame single-family homes, townhouses and mid-rise condominium buildings. On projects where we offer these product lines our employees provide land development management, construction management, material purchasing and quality control supervision on the homes we build. Substantially all construction work on these types of projects is done by subcontractors that contract directly with us and with whom we typically have an established relationship. On our



high-rise and mixed-use developments where we typically build concrete structures, we engage a general contractor for the site preparation and construction management, and typically we have a fixed price or a gross maximum price bonded contract with the selected general contractor. In these instances the subcontractors that perform the construction work are typically contracted directly by the general contractor that we select. On projects where we offer these product lines our employees provide land development oversight management, construction quality supervision and construction management services. In all instances we follow generally accepted management procedures and construction techniques which are consistent with local market practices. We believe that we comply with local and state building codes on all of our developments.

Our goal is to commence construction on a majority of our single-family homes after a contract is signed and mortgage approval has been obtained by the home buyer. We generally begin construction of our townhouses and condominiums after we have obtained customer pre-sale commitments for a significant percentage of the units in the building. Depending on the market conditions and the specific community, we may also build speculative homes. Most of these homes are sold while under construction or are used as model homes during the marketing phase of the project. We closely monitor our inventory of speculative units applying a measured approach to unit production in keeping with sales absorption. In recent months we have experienced increases in cancellation rates which have caused us to have more constructed speculative inventory. We have suspended additional speculative building at most of our projects as we work through the process of selling existing inventory first. On occasion we will sell a completed model home to a third party investor purchaser who is willing to lease back the home to us for use during the marketing phase of a project.

To facilitate the sale of our products, we normally build, decorate, furnish and landscape model homes for each product line and maintain onsite sales offices. In most cases, we employ in-house commissioned sales personnel to sell our homes. On occasion we will contract for marketing services with a third party brokerage firm. All personnel engaged in the sale of Comstock homes receive extensive training in the sales process from our in-house sales training group. We strive to provide a high level of customer service during the sales process. Through multi lingual home buying seminars, relationships with preferred mortgage lenders and utilization of a series of proprietary custom marketing programs, we are able to educate our prospects, prepare our customers for home ownership and help our homebuyers obtain a mortgage tailored to their specific needs.

Our unique NextHome<sup>tm</sup> programs are designed to assist our customers in many aspects of purchasing a Comstock home, as follows:

DownRight<sup>tm</sup> a program designed to help identify ways to meet the down payment requirements of a new home purchase;

Tailor Made<sup>tm</sup> a program with unique financing products and agreements with major lenders that tailor a monthly payment in order to make home ownership affordable in any interest rate climate;

Get It Sold<sup>tm</sup> a program designed to help our customers sell their current home quickly and efficiently in order to facilitate their purchase of a new Comstock home;

All@Home<sup>tm</sup> a program enabling our customers to design technology solutions for their new Comstock home to meet their individual specifications;

Built Right<sup>tm</sup> a quality assurance program incorporating quality assurance inspections with high-quality materials; and

Home Style™ an optional upgrade program providing hundreds of options to choose from to customize a new Comstock home to suit the specific desires of our customers.

All personnel involved in the sale of our homes receive extensive training on the product they are selling. In addition, our sales professionals are trained on the specialized programs offered by us in connection with the purchasing, customizing and financing of a Comstock home and the warranty we provide. We employ in-house commissioned sales personnel to sell our homes. We intend to employ our sales personnel on a long-term basis, rather than a project-by-project basis, which we believe results in a more committed and motivated sales force with better product knowledge. We believe that this has a positive impact on sales and conversion.

Our corporate and local marketing directors work with local project and sales managers to develop marketing objectives, sales strategies and advertising and public relations programs for our communities. These objectives, strategies and home pricing decisions are subject to approval by senior management. We typically build, decorate, furnish and landscape model homes for each product line and maintain onsite sales offices, which are open seven days a week. We believe that model homes play a critical role in our marketing efforts.

Our homes are typically sold before or during construction through sales contracts that are accompanied by a cash deposit. Such sales contracts are usually subject to certain contingencies such as the home buyer's ability to qualify for financing. Cancellation rates are subject to a variety of factors beyond our control such as consumer confidence, media hype relating to homebuilding and adverse economic conditions which lower consumer confidence, increase mortgage interest rates and negatively affect the sale of our existing homes. During 2006 our cancellation rate increased across all of our products in all of our markets. Cancellations and other factors can increase the level of speculative inventory we hold from time to time.

In 2006, we opened an innovative sales center located in Reston, Virginia. Unlike the typical builder design center, this facility does not sell options; rather it supports cross-product and cross-community shopping in one central location. In the Comstock NextHome store prospects are able to see multiple Comstock projects within multiple markets, arrange for financing and shop for options all in one location. While this location does not replace on-site models, it allows us to shorten a project's time-to-market and it provides a permanent location where projects are previewed and prospects are introduced to the Comstock experience.

### Our Communities

We currently have active communities under development in the following states and counties:

| State                | County  |
|----------------------|---|
| Georgia              | Forsyth, Gwynett, Fulton, Paulding, Jackson, Cherokee |
| Maryland             | Frederick   |
| North Carolina       | Wake, Raleigh, Johnston, Durham                       |
| District of Columbia | Washington, DC  |
| Virginia             | Arlington, Fairfax Loudoun, Prince William, Culpeper  |

The following chart summarizes certain information for our current and planned communities at December 31, 2006:

| Project                  | State | Product Type | As of December 31, 2006       |               |         | Owned Agreement Unsold | Lots under Option | Average New Order Revenue to Date |
|--------------------------|-------|--------------|-------------------------------|---------------|---------|------------------------|-------------------|-----------------------------------|
|                          |       |              | Estimated Units at Completion | Units Settled | Backlog |                        |                   |                                   |
| <b>Status: Active(1)</b> |       |              |                               |               |         |                        |                   |                                   |
| Allen Creek              | GA    | SF           | 26                            | 18            |         | 8                      |                   | \$ 210,272                        |
| Arcanum                  | GA    | SF           | 34                            | 11            | 1       | 22                     |                   | \$ 403,450                        |
| Brentwood Estates        | GA    | SF           | 31                            | 19            |         | 12                     |                   | \$ 139,139                        |
| Falling Water            | GA    | SF           | 22                            | 7             | 4       | 11                     |                   | \$ 424,164                        |

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|                               |    |    |     |     |    |     |            |
|-------------------------------|----|----|-----|-----|----|-----|------------|
| Gates of Luberon              | GA | SF | 31  |     | 1  | 30  | \$ 609,000 |
| Glenn Ivey(7)                 | GA | SF | 65  | 5   | 5  | 55  | \$ 235,523 |
| Highland Station              | GA | SF | 105 | 22  | 4  | 79  | \$ 296,611 |
| Maristone                     | GA | SF | 40  | 3   |    | 37  | \$ 264,930 |
| Senators Ridge                | GA | SF | 60  | 16  |    | 44  | \$ 244,618 |
| Traditions                    | GA | SF | 4   |     |    | 4   | n/a        |
| Wyngate                       | GA | SF | 28  |     |    | 28  | n/a        |
| Sub-Total/Weighted Average(4) |    |    | 446 | 101 | 15 | 330 | \$ 270,005 |
| <br>                          |    |    |     |     |    |     |            |
| Emerald Farm                  | MD | SF | 84  | 77  |    | 7   | \$ 457,625 |
| Sub-Total/Weighted Average(4) |    |    | 84  | 77  |    | 7   | \$ 457,625 |

As of December 31, 2006

| Project                        | State | Product Type(2) | Estimated Units |              | Settled Backlog(3) | Lots Owned   | Lots under Option | Average New Order Revenue to Date |
|--------------------------------|-------|-----------------|-----------------|--------------|--------------------|--------------|-------------------|-----------------------------------|
|                                |       |                 | at Completion   | Units        |                    |              |                   |                                   |
| Allyn's Landing                | NC    | TH              | 116             | 39           | 17                 | 60           |                   | \$ 230,423                        |
| Brookefield Station            | NC    | SF              | 130             |              |                    | 30           | 100               | n/a                               |
| Carpenter Pointe               | NC    | SF              | 5               | 5            |                    |              |                   | \$ 142,280                        |
| Haddon Hall                    | NC    | Condo           | 90              |              |                    | 90           |                   | n/a                               |
| Holland Road                   | NC    | SF              | 81              |              | 17                 | 64           |                   | \$ 417,786                        |
| Kelton at Preston              | NC    | TH              | 56              | 39           | 4                  | 13           |                   | \$ 310,133                        |
| North Farms                    | NC    | SF              | 138             | 29           | 2                  | 11           | 96                | \$ 179,262                        |
| Pine Hollow                    | NC    | SF              | 10              | 3            |                    |              | 7                 | \$ 168,908                        |
| Providence-SF                  | NC    | SF              | 148             |              |                    | 34           | 114               | n/a                               |
| Riverbrooke                    | NC    | SF              | 67              | 29           | 1                  | 37           |                   | \$ 167,807                        |
| Strathaven                     | NC    | SF              | 6               | 6            |                    |              |                   | \$ 382,402                        |
| Wakefield Plantation           | NC    | TH              | 77              | 40           | 1                  | 16           | 20                | \$ 493,762                        |
| Wheatleigh Preserve            | NC    | SF              | 28              | 12           | 3                  | 13           |                   | \$ 281,630                        |
| Sub-Total/Weighted Average(4)  |       |                 | 952             | 202          | 45                 | 368          | 337               | \$ 291,151                        |
| Barrington Park                | VA    | Condo           | 148             |              | 12                 | 136          |                   | \$ 314,774                        |
| Beacon Park at Belmont Bay 8&9 | VA    | Condo           | 600             |              |                    | 112          | 488               | n/a                               |
| Blooms Mill Carriage           | VA    | TH              | 91              | 91           |                    |              |                   | \$ 453,642                        |
| Carter Lake                    | VA    | Condo           | 258             | 258          |                    |              |                   | \$ 155,040                        |
| Commons at Bellemeade          | VA    | Condo           | 316             | 58           | 3                  | 255          |                   | \$ 222,147                        |
| Commons on Potomac Sq          | VA    | Condo           | 192             | 40           | 2                  | 150          |                   | \$ 264,144                        |
| Commons on Williams Sq         | VA    | Condo           | 180             | 104          | 2                  | 74           |                   | \$ 352,060                        |
| Penderbrook                    | VA    | Condo           | 424             | 239          | 7                  | 178          |                   | \$ 257,814                        |
| River Club at Belmont Bay 5    | VA    | Condo           | 84              | 82           |                    | 2            |                   | \$ 449,210                        |
| The Eclipse on Center Park     | VA    | Condo           | 465             | 134          | 258                | 73           |                   | \$ 414,831                        |
| Woodlands at Round Hill        | VA    | SF              | 46              | 24           |                    | 22           |                   | \$ 757,118                        |
| Sub-Total/Weighted Average(4)  |       |                 | 2,804           | 1,030        | 284                | 1,002        | 488               | \$ 325,772                        |
| <b>Total Active</b>            |       |                 | <b>4,286</b>    | <b>1,410</b> | <b>344</b>         | <b>1,707</b> | <b>825</b>        | <b>\$ 322,717</b>                 |
| <b>Status: Development(1)</b>  |       |                 |                 |              |                    |              |                   |                                   |
| East Capitol                   | DC    | Condo           | 130             |              |                    | 130          |                   | n/a                               |
| Sub-Total/Weighted Average(4)  |       |                 | 130             |              |                    | 130          |                   | n/a                               |
| Cedars Road                    | GA    | SF              | 109             |              |                    |              | 109               | n/a                               |
| Highland Avenue                | GA    | SF              | 28              |              |                    | 28           |                   | n/a                               |
| James Road                     | GA    | SF              | 47              |              |                    | 47           |                   | n/a                               |
| Kelly Mill Road                | GA    | SF              | 28              |              |                    |              | 28                | n/a                               |
| Post Road                      | GA    | SF              | 59              |              |                    | 59           |                   | n/a                               |

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|                               |    |    |     |     |     |     |
|-------------------------------|----|----|-----|-----|-----|-----|
| Post Road II                  | GA | TH | 54  | 54  |     | n/a |
| Settingdown Circle            | GA | SF | 172 | 162 | 10  | n/a |
| Shiloh Road I                 | GA | SF | 61  | 61  |     | n/a |
| Tribble Lakes                 | GA | SF | 200 | 200 |     | n/a |
| Sub-Total/Weighted Average(4) |    |    | 758 | 611 | 147 | n/a |
|                               |    |    | 10  |     |     |     |

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| As of December 31, 2006               |       |                 |               |              |            |              |                   |
|---------------------------------------|-------|-----------------|---------------|--------------|------------|--------------|-------------------|
| Project                               | State | Product Type(2) | Estimated     | Units        | Backlog(3) | Owned        | Average           |
|                                       |       |                 | Units         | Settled      | Units      | Lots         | Revenue           |
|                                       |       |                 | at Completion |              |            | Under Option | to Date           |
| Blakeney Heath                        | NC    | SF              | 80            |              |            |              | n/a               |
| Boyce Road                            | NC    | SF              | 33            |              |            |              | n/a               |
| Fairhills                             | NC    | SF              | 18            |              |            |              | n/a               |
| Lakeshore Hills                       | NC    | SF              | 34            |              |            |              | n/a               |
| Massey Preserve                       | NC    | SF              | 297           |              |            | 297          | n/a               |
| Providence-TH                         | NC    | TH              | 80            |              |            |              | n/a               |
| Stowe Road                            | NC    | SF              | 110           |              |            |              | n/a               |
| Sub-Total/Weighted Average(4)         |       |                 | 652           |              |            | 297          | n/a               |
| Aldie Singles                         | VA    | SF              | 15            |              |            |              | n/a               |
| Blake Crossing                        | VA    | TH              | 130           |              |            | 130          | n/a               |
| Brandy Station                        | VA    | SF              | 350           |              |            |              | n/a               |
| Loudoun Station Condominiums          | VA    | Condo           | 484           |              |            |              | n/a               |
| Station View                          | VA    | TH              | 47            |              |            | 47           | n/a               |
| Sub-Total/Weighted Average(4)         |       |                 | 1,026         |              |            | 177          | n/a               |
| <b>Total Development</b>              |       |                 | <b>2,566</b>  |              |            | <b>1,215</b> | <b>n/a</b>        |
| <b>Total Active &amp; Development</b> |       |                 | <b>6,852</b>  | <b>1,410</b> | <b>344</b> | <b>2,922</b> | <b>\$ 322,997</b> |
| <b>Status: Joint Venture</b>          |       |                 |               |              |            |              |                   |
| North Shore Condominiums(5)           | NC    | Condo           | 196           |              | 7          | 189          | \$ 286,361        |
| North Shore Townhomes(5)              | NC    | TH              | 163           | 33           | 7          | 123          | \$ 239,107        |
| Countryside(6)                        | VA    | Condo           | 102           | 76           | 1          | 25           | \$ 283,300        |
| <b>Total Joint Venture</b>            |       |                 | <b>461</b>    | <b>109</b>   | <b>15</b>  | <b>312</b>   | <b>\$ 269,103</b> |

(1) Active communities are open for sales. Development communities are in the development process and have not yet opened for sales.

(2) SF means single family home, TH means townhouse and Condo means condominium.

(3) Backlog means we have an executed order with a buyer, inclusive of lot sales, but the settlement has not yet taken place.

(4) Weighted Average means the weighted average new order sale price

(5) Not consolidated

(6) Consolidated, under Fin 46

**Greater Washington, DC Area**

***Northern Virginia Market***

*Aldie Singles* is planned to be a 15-unit in development in Aldie, Virginia. The community is planned to have 15 single family homes on 3 acre and above home sites. At December 31, 2004 the project was under contract. We are attempting to renegotiate terms with the sellers.

*Barrington Park* is a 148-unit mid-rise, walk-up, garden style condominium development in Manassas Park, Virginia. We completed the acquisition of the land in late 2005. Sales at the project were slow during the course of 2006 so we decided to postpone settlements in order to preserve the value of the project as an intact rental community. In early 2007 we initiated rental operations at the project while we wait for either an offer to purchase in bulk or an improvement in the condominium market. We have postponed the start of construction on the remaining buildings at the community.



*Beacon Park at Belmont Bay* is planned as a 600-unit active adult condominium community located at the convergence of the Potomac and Occoquan Rivers at Belmont Bay in Woodbridge, Virginia. This development is designed as a combination of nine and five-story buildings with open rooftop decks overlooking the water and golf course. The project is deed-restricted such that at least 80% of the buyers must be 55 years of age or older and will include active adult lifestyle amenities, such as a health and wellness center, a business center, guest accommodations and swimming pools. We currently own 112 lots for 4 buildings of 28 units each with a long term option on the remaining 488 lots. Sales opened in March 2007.

*Blakes Crossing* is a parcel we own in Culpeper, Virginia designed for 130-unit townhouses. The project is currently under contract to be sold for commercial development.

*Blooms Mill* is a 377-unit development in Manassas, Virginia. This development offers a mix of single-family homes, attached carriage homes and townhouses. The development's amenities include a community club, swimming pool and family friendly street plan all in a traditional village setting. At December 31, 2006, the single family homes were sold out and fully delivered.

*Brandy Station* is a 350-unit single-family home development in Culpeper, Virginia. The project is currently under option takedown contract while we manage it through the entitlement process. We will close on the property when approvals have been received if we are still confident that the option price in place makes sense given market conditions at the time. We expect to open this project for sales in 2008.

*Commons at Bellemeade* is a 316-unit condominium conversion located in Leesburg, Virginia. We acquired the property in September 2005 and immediately began the process of converting the units into condominiums. We are in the process of renovating the common areas and the unit interiors. We opened the project for sales to existing tenants in October 2005 and to the general public in November 2005. The project began settling units in late 2005 and is expected to continue settling units into 2009.

*Commons on Potomac Square* is a 192-unit mid-rise condominium complex in Loudoun County, Virginia. The complex will consist of four buildings. The project is positioned for first-time homeowners and is intended to offer significant appeal to renters in the market seeking to move up to home ownership. Sales opened in late 2004 and settlements began in early 2006 and will continue into 2008.

*Commons on the Park* was a 258-unit condominium conversion project in Reston, Virginia. We purchased the project in January 2006 and sold it to a rental property owner in November 2006.

*Commons on William Square* is a 180-unit two-over-two townhouse condominium development in Prince William County, Virginia. Sales opened in the fourth quarter of 2004 and settlements began in the second half of 2005 and we expect sales and settlements to continue throughout 2007 and perhaps into 2008.

*Countryside* is a 102-unit apartment complex in Sterling, Virginia that we converted to condominiums. We acquired the property in March 2005. We completed improvements to the common areas and exteriors of the buildings. Sales opened during the third quarter of 2005 with settlements beginning in the fourth quarter 2005. In December 2006 we sold the balance of the unsold units in a bulk transaction. We entered into a marketing services agreement whereby we continued to manage sales in the community and earn a commission on the resale of those units individually.

*The Eclipse on Center Park* is a 465-unit high-rise condominium complex in Arlington County, Virginia. Located at Potomac Yard, just minutes from downtown Washington, D.C., the Pentagon and Reagan National Airport, the project is designed as an upscale, urban-style mixed-use complex with residential condominiums being built above an 80,000 square foot retail complex that will host a grocery store and other convenience oriented retailers. Upper floors will

have views of the Potomac River and the monuments in Washington, D.C. Sales for Phase I opened in the second quarter of 2004. Sales for Phase II began in December 2005 and continued throughout 2006. Settlements began in November 2006 and will continue throughout 2007 and possibly into 2008.

*Loudoun Station Condominiums* is planned as an up to 484 unit mid-rise condominium complex located in Ashburn, Virginia. The project is part of a high-density, transit-oriented, mixed-use development which is modeled after the successful Reston Town Center in Reston, Virginia. The project is at the terminus of the planned Metro extension past Washington Dulles International Airport. The project will have 1,500 multi-family residential units

between condominiums and rentals and will have over one million square feet of retail and commercial space. In light of current market conditions we have delayed the closing on the land and the opening of this project indefinitely. Because of our continuing involvement in this project we are still carrying approximately \$1.2 million of real estate cost in our real estate held for development and sale. If we are unsuccessful at selling the remaining units for a profit we may be required to writedown our carrying value.

*Penderbrook Square* is a 424-unit rental apartment complex which we are converting to condominiums in the Fair Oaks area of Fairfax County, Virginia. We acquired the property in February 2005. We have made a significant investment in renovations at this project including common areas, building exteriors and units heating systems. Sales opened in April 2005 with settlements beginning in June 2005 and continuing to date. We are currently managing both for-sale and rental programs at this project to help offset carrying costs until the market improves.

*River Club at Belmont Bay 5* is a three-building, 84-unit condominium development located at the convergence of the Potomac and Occoquan Rivers at Belmont Bay in Woodbridge, Virginia. Settlements began in 2005 and will conclude in 2007.

*Woodlands at Round Hill* is located in western Loudoun County, Virginia, one of the fastest growing counties in the United States. This large lot single-family home development has 65 lots of three or more acres each. We are acting as the developer of the site, and we are currently building road and utility infrastructure for the home sites. This project opened for sales in 2004. Settlements began in early 2005 and will continue into 2008 and possibly into 2009. In September 2005, we sold 19 lots to another homebuilder who is now open to sales in the community.

### ***Maryland***

*Emerald Farm* is an 84-unit development of single-family homes in Frederick, Maryland. The development is conveniently located near major transportation routes. Frederick, Maryland is currently experiencing a water moratorium that has shut down development in the area. The project has been open for sales since 2000 and is expected to be completed in 2007 or 2008.

### **North Carolina Market**

#### ***Raleigh, North Carolina***

*Allyn s Landing* is a 116-unit townhouse development located in the heart of Raleigh, North Carolina near Research Triangle Park and the Raleigh-Durham International Airport. The project overlooks an eight-acre lake and includes amenities such as a fountain, gazebo, walking trails and canoe rack. In 2006 we repositioned the project by changing product types. The project is currently open for sales and is delivering homes. Deliveries are expected to continue into 2008.

*Holland Road* is a 81-unit single family homes development in Raleigh, North Carolina which is opened for sales and expected to began deliveries in the second half of 2007.

*Kelton at Preston* is a 56-unit upscale townhouse development in the prestigious Kelton golf course community of Cary, North Carolina. This project has three 18-hole courses, a swimming complex and a clubhouse with fitness, tennis and dining facilities. Many of our home sites have golf course views. This project is currently open for sales and is delivering homes. Deliveries are expected to continue into 2008.

*North Shore* is a unique community located on the Centennial Campus of North Carolina State University. It consists of 163 townhouses and 196 mid-rise condominium units. The mid-rise condominium residences are five-story elevator

buildings with structured garage parking. The townhouse residences feature four finished levels, private garages, a rear deck and a rooftop terrace. This project is owned through a 50/50 joint venture with Raleigh Property Group II, LLC and as such is reported through the equity method and excluded from our home building revenue and backlog. (See Note 7 of notes to our consolidated and combined financial statements as of December 31, 2006). This project is not currently open for sales pending resolution of litigation between us and our joint venture partner.

*Wakefield Plantation* is a 77-unit development in Raleigh, North Carolina consisting of townhouses and carriage homes. Our unique carriage homes at Wakefield are attached homes with as much as 5,300 square feet of

finished living space in three and four-unit configurations with two-car garages and interior court yards. This project is currently open for sales and is delivering homes. Deliveries are expected to continue into early 2008.

*Brookfield* is a 130-unit single family development in Raleigh, North Carolina. This development, with its projected swimming pool complex, is conveniently located near Rt. 264 in Raleigh. This development is projected to open for sales in the end of 2007 and is expected to be completed in 2009.

*Haddon Hall* is a three building 90-unit condominium development located in Apex, North Carolina. This development is currently open for sales and expected to begin deliveries in the end of 2007.

*Massey Preserve* is a 297-unit single family development in Raleigh, North Carolina. These 2,600 to 3,000 square foot homes are conveniently located to the new I-540 by pass as well as a new elementary school in walking distance. This development is now open for sales and is expected to be completed in 2008 or 2009.

*North Farm* is a 138-unit single family homes development in Clayton, North Carolina. These spacious craftsman-style homes are located within the Flower Plantation community with shopping and recreation facilities in walking distance.

*Pine Hollow* is a 10-unit single family development in Raleigh, North Carolina. This development has an 18-hole golf course, tennis center and community pool complex. This development is expected to be completed by mid 2007.

*Providence single family* is a 148-unit single family development in Raleigh, North Carolina. This development is convenient to downtown Raleigh as well as walking distance to both North Hill and Crabtree Valley Malls. This development is now open for sale.

*Providence townhomes* is an 80-unit single family development in Raleigh, North Carolina. This development is conveniently located to downtown Raleigh as well as walking distance to both North Hill and Crabtree Valley Malls.

*Riverbrooke II* is the second phase of a 67-unit single family development in Raleigh, North Carolina. This development's easy accessibility to interstates I-40 and I-440 make for quick commuting around the city of Raleigh.

*Wheatleigh Preserve* is a 28-unit single family development in Raleigh, North Carolina. These quarter-acre lots are fully amenitized, with a community pool, tree-lined hiking trails and playgrounds. This development is currently open for sale.

### ***Charlotte, North Carolina Market***

In early 2007 we made the decision to withdraw from the Charlotte, North Carolina market. This decision affected Boyce Road, Stowe Village, Blakeney Heath and Fairhills, which we now no longer plan to open for sales.

### **Greater Atlanta Market**

#### ***Atlanta, Georgia***

*Allen Creek-* is a 26-unit single family home development in the suburbs of Atlanta, Georgia. These single family homes have brick or stacked-stone exteriors and a hardwood foyer, chair rails, shadow-box trim and tray ceilings in the master suite. This development is currently open for sales and should be completed by the end of 2007.

*Arcanum*- is a 34-unit single family home development in the suburbs of Atlanta, Georgia. These single family homes have brick, stone and shake exteriors and a hardwood floors in the interior. This development has access to the Polo Country Club. This development is currently delivering homes and is projected to be closed out in 2007.

*Brentwood Estates*- is a 31-unit single family home development in the suburbs of Atlanta, Georgia. These single family homes have brick or stacked-stone exteriors and a hardwood foyer, chair rails, shadow-box trim and tray ceilings in the master suite. This development is currently open for sales and should be completed by the end of 2007.

*Falling Water-* is a 22-unit single family home development in Woodstock, Georgia a suburb of Atlanta. These single family homes have brick, stone and shake exteriors. This development is currently delivering homes and is projected to be closed out in 2007.

*Gates of Luberon-* is a 31-unit single family home development in the suburbs of Atlanta, Georgia. The homes in this development are some of the largest homes Comstock Homebuilding of Atlanta has built in Atlanta. The single family homes have brick, stone and shake exteriors and spacious floor plan. The development has easy access downtown Atlanta via Hwy. 141. This development is currently delivering homes and is projected to be closed out in 2007.

*Glen Ivey-* is a 65-unit single family home development in the suburbs of Atlanta, Georgia. Homes in this project have a spacious layout. The development has a community pool complex and nature trails as well as being located near Lake Lanier. This development is delivering homes currently and is projected to be closed out in mid-year 2008.

*Highland Ave-* is a 28-unit single family home development in the Inman Park section of downtown Atlanta, Georgia. The development is currently under development and is projected to begin selling homes in mid 2008.

*Highland Station-* is a 105-unit single family home development in Suwanee, Georgia a suburb of Atlanta. The homes in this development are appointed with 9 ceilings, hardwood floors and Corian countertops as standard. The development also has a pool complex with cabana. This development is delivering homes currently and is projected to be closed out in 2008.

*James Road-* is a 47-unit single family home development in the suburbs of Atlanta, Georgia. The development is currently under development and is projected to begin selling homes in mid 2008.

*Maristone-* is a 40-unit single family home development in the suburbs of Atlanta, Georgia. The development is complete with tennis courts, swimming complex and a cabana. This development is currently open for sale and is projected is scheduled to be closed out in mid-year 2008.

*Post Road-* is a 59-unit single family home development in the suburbs of Atlanta, Georgia. The development is currently under development and is projected to begin selling homes in 2007.

*Post Road II-* is a 54-unit townhouse development located in the suburbs of Atlanta, Georgia. Development of this development is projected to start at the end of 2007 and be open for sales in 2008.

*Senators Ridge-* is a 60-unit single family home development in the western suburbs of Atlanta, Georgia. The development offers extensive amenities like a clubhouse, swimming pool, tennis courts and basketball courts. This development is currently delivering homes and is projected to be closed out in 2007.

*Settingdown Circle-* is a 172-unit single family home development in the suburbs of Atlanta, Georgia. Development of this development is projected to start at the end of 2007 and is expected to be open for sales in 2008.

*Shiloh Road-* is a 61-unit single family home development in the suburbs of Atlanta, Georgia. The development is currently under development and is projected to begin selling homes in 2007.

*Traditions at Braselton-* is a 4-unit single family home development in the outskirts of Atlanta, Georgia. These estate homes are located directly on a championship 18-hole golf course with many other amenities. These homes that start at 4,500 square feet, have bountiful views of the course. This development is currently open for sales and is projected to be closed out in 2007.

*Tribble Lakes*- is a 200-unit single family home development in the suburbs of Atlanta, Georgia. This development will have a wide array of amenities strategically located around the beautiful lake. The development is currently under development and is projected to begin selling homes in 2008.

*Wyngate*- is a 28-unit single family home development in the suburbs of Atlanta, Georgia. This development is currently open for sales and is projected to be closed out in 2007.



## **South Carolina Market**

### ***Myrtle Beach, South Carolina***

In September 2006 we sold our Carolina Waterway community in the Myrtle Beach area, our only project in South Carolina. We no longer operate in the South Carolina market.

## **Warranty**

We provide our single-family and townhouse home buyers with a one-year limited warranty covering workmanship and materials. The limited warranty is transferable to subsequent buyers not under direct contract with us and requires that home buyers agree to the definitions and procedures set forth in the warranty. Our condominium home buyers typically have a statutory two-year warranty on their purchases. In addition, we provide a five-year structural warranty pursuant to statutory requirements. From time to time, we assess the appropriateness of our warranty reserves and adjust future accruals as necessary. When deemed appropriate by us, we will accrue additional warranty reserves. We rely on our sub-contractors to warrant their work and they are contractually obligated to fix defects in their work. Beyond our sub-contractor warranties we self-insure the balance of all of our warranties.

## **Competition**

The real estate development and home building industries are highly competitive and fragmented. Competitive overbuilding in local markets, among other competitive factors, could materially adversely affect home builders in those markets. Home builders compete for financing, raw materials and skilled labor, as well as for the sale of homes. Additionally, competition for prime properties is intense and the acquisition of such properties may become more expensive in the future to the extent demand and competition increase. We compete with other local, regional and national real estate companies and home builders. Some of our competitors have greater financial, marketing, sales and other resources than we have.

The principal competition we faced in each of our markets, as of December 31, 2006, was as follows:

*Atlanta, Georgia.* In the Atlanta, Georgia market we compete against approximately 10 to 15 publicly-traded national home builders, approximately 10 to 15 privately-owned regional home builders, and a large number of small, local home builders.

*Raleigh, North Carolina.* In the Raleigh, North Carolina market we compete against approximately 10 to 15 publicly-traded national home builders, approximately 10 to 15 privately-owned regional home builders, and a large number of small, local home builders.

*Washington, D.C.* In the greater Washington, D.C. metropolitan market we compete against approximately 15 to 20 publicly-traded national home builders, approximately 10 to 15 privately-owned regional home builders, and many local home builders, some of whom are very small and may build as few as five to 25 homes per year.

We do not compete against all of the builders in our geographic markets in all of our product types or submarkets, as some builders focus on particular types of projects within those markets, such as large estate homes, that are not in competition with our communities. We believe the factors that home buyers consider in deciding whether to purchase from us include the location, value and design of our products. We believe that we typically build attractive, innovative products in sought-after locations that are perceived as good values by customers. Accordingly, we believe that we compare favorably on these factors.

We also compete with resale of existing homes and condominiums and available rental housing.

**Regulation**

We and our competitors are subject to various local, state and federal statutes, ordinances, rules and regulations concerning zoning, building design, construction and similar matters, including local regulation, which imposes restrictive zoning and density requirements in order to limit the number of homes that can ultimately be built within

the boundaries of a particular project. We and our competitors may also be subject to periodic delays or may be precluded entirely from developing in certain communities due to building moratoriums or slow-growth or no-growth initiatives that could be implemented in the future in the states in which we operate. Local and state governments also have broad discretion regarding the imposition of development fees for projects in their jurisdiction.

We and our competitors are also subject to a variety of local, state and federal statutes, ordinances, rules and regulations concerning protection of the environment. Some of the laws to which we and our properties are subject may impose requirements concerning development in waters of the United States, including wetlands, the closure of water supply wells, management of asbestos-containing materials, exposure to radon, and similar issues. The particular environmental laws that apply to any given community vary greatly according to the community site, the site's environmental conditions and the present and former uses of the site. These environmental laws may result in delays, may cause us and our competitors to incur substantial compliance and other costs, and may prohibit or severely restrict development in certain environmentally sensitive regions or areas. However, environmental laws have not, to date, had a material adverse impact on our operations.

### **Technology**

We are committed to the use of Internet-based technology for managing our business and communicating with our customers. For customer relationship management, we use Builder's Co-Pilot, a management information system that was custom developed in accordance with our needs and requirements. This system allows for online and collaborative efforts between our sales and marketing functions and integrates our sales, production and divisional office operations in tracking the progress of construction on each of our projects. We believe that real-time access to our construction progress and our sales and marketing data and documents through our systems increases the effectiveness of our sales and marketing efforts as well as management's ability to monitor our business. Through our Web site, [www.comstockhomebuilding.com](http://www.comstockhomebuilding.com), our customers and prospects receive automatic electronic communications from us on a regular basis. We believe this application of technology has and will continue to greatly enhance our conversion rates.

In April 2006 we commenced preparations for the conversion of our accounting and purchasing management software to the JD Edwards, Enterprise One software system. We effected the conversion to the JD Edwards software in January 2007. This highly scaleable purchasing and accounting system will position us to be more cost competitive and will, we hope, contribute to future margin expansion.

### **Intellectual Property and Other Proprietary Rights**

We rely primarily on a combination of copyright, trade secret and trademark laws to protect our proprietary rights. We do not own the Comstock brand or trademark. Christopher Clemente owns the Comstock brand and trademark and has licensed them to us under a perpetual, royalty-free license agreement. We have filed a U.S. federal trademark application with respect to Comstock Homes Worthy of the Investment and we will file a U.S. federal trademark application with respect to Comstock Homebuilding Companies. We believe the strength of these trademarks benefits our business. In addition, as a result of recent acquisitions, we now own the Capitol Homes and Parker-Chandler brands which we do not currently use in our marketing efforts.

### **Employees**

At December 31, 2006, we had 205 full-time and part-time employees. Our employees are not represented by any collective bargaining agreement and we have never experienced a work stoppage. We believe we have good relations with our employees.



## Executive Officers

Our executive officers and other management employees and their respective ages and positions as of December 31, 2006 are as follows:

| <b>Name</b>           | <b>Age</b> | <b>Position</b>                      |
|-----------------------|------------|--------------------------------------|
| Christopher Clemente* | 47         | Chairman and Chief Executive Officer |
| Gregory V. Benson*    | 52         | Regional President, Southeast        |
| Bruce J. Labovitz*    | 38         | Chief Financial Officer              |
| Jason Parikh*         | 35         | Chief Accounting Officer             |
| Jubal R. Thompson     | 37         | General Counsel and Secretary        |

\* Section 16 officers.

## Executive Officers and Key Employees

*Christopher Clemente* founded Comstock in 1985 and has been director since May 2004. Since 1992, Mr. Clemente has served as our Chairman and Chief Executive Officer. Mr. Clemente has over 20 years of experience in all aspects of real estate development and home building, and 25 years of experience as an entrepreneur.

*Gregory V. Benson* joined us in 1991 as President and Chief Operating Officer and has been director since May 2004. Mr. Benson is also a member of our board of directors. Mr. Benson has over 30 years of home building experience including over 13 years at national home builders, including NVHomes, Ryan Homes and Centex Homes.

*Bruce J. Labovitz* has served as our Chief Financial Officer since January 2004, after serving as our Vice President Finance from April 2002 to January 2004 and Vice President Investment Finance from January 2002 to April 2002. From June 2001 to January 2002, Mr. Labovitz was a Vice President of Viking Communications, a telecommunications company. From November 2000 to June 2001, Mr. Labovitz was the President, Marketing & Services of Inlec Communications, a telecommunications company. Prior to that, from May 1996 to November 2000, Mr. Labovitz was Executive Vice President/ Chief Operating Officer of BMK Advertising, an advertising agency.

*Jason Parikh* has served as our Chief Accounting Officer since April 2004. Mr. Parikh was Chief Financial Officer and Secretary of On-Site Sourcing, Inc. from May 2000 to April 2004 and Controller from July 1997 to May 2000. From July 1994 until July 1997, Mr. Parikh was Controller of Shirt Explosion Inc., a clothing manufacturer.

*Jubal R. Thompson* has served as our General Counsel since October 1998 and our Secretary as of December 2004. From April 2002 to April 2003, Mr. Thompson also served as our Vice President Finance. From 1995 to 1998, Mr. Thompson was associated with Robert Weed & Associates, PLLC, a law firm.

## Other Information

We file annual, quarterly, and current reports, proxy statements, and other documents with the Securities and Exchange Commission ( SEC ) under the Securities Exchange Act of 1934 (the Exchange Act ). The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, including us, that file electronically with the SEC. The public can

obtain any documents that we file with the SEC at <http://www.sec.gov>.

We also make available, free of charge, at our Internet website located at [www.comstockhomebuilding.com](http://www.comstockhomebuilding.com), our annual reports on Form 10-K, our proxy statements, our quarterly reports on Form 10-Q, and our current reports on Form 8-K as well as Form 3, Form 4, and Form 5 Reports for our directors, officers, and principal stockholders, together with amendments to those reports filed or furnished pursuant to Section 13(a), 15(d), or 16 under the

Exchange Act. These reports are available as soon as reasonably practicable after their electronic filing with the Securities and Exchange Commission.

### **CAUTIONARY NOTES REGARDING FORWARD-LOOKING STATEMENTS**

Some of the statements contained in this report include forward-looking statements. These forward-looking statements can be identified by the use of words such as anticipate, believe, estimate, may, intend, expect, will, other similar expressions. Forward-looking statements are based largely on our expectations and involve inherent risks and uncertainties including certain risks described in this report. When considering those forward-looking statements, you should keep in mind the risks, uncertainties and other cautionary statements made in this report. You should not place undue reliance on any forward-looking statement, which speaks only as of the date made. Some factors which may affect the accuracy of the forward-looking statements apply generally to the real estate industry, while other factors apply directly to us. Any number of important factors which could cause actual results to differ materially from those in the forward-looking statements include, without limitation: general economic and market conditions, including interest rate levels; our ability to service our substantial debt; inherent risks in investment in real estate; our ability to compete in the markets in which we operate; regulatory actions; fluctuations in operating results; our anticipated growth strategies; shortages and increased costs of labor or building materials; the availability and cost of land in desirable areas; natural disasters; our ability to raise debt and equity capital and grow our operations on a profitable basis; and our continuing relationships with affiliates.

Many of these factors are beyond our control. For a discussion of factors that could cause actual results to differ, please see the discussion in this report under the heading Risk Factors in Item 1A.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected Financial and Other Data and our consolidated and combined financial statements and related notes appearing elsewhere in this report. Other than in the Overview below, this discussion and analysis does not incorporate the financial condition and results of operations of Comstock Service, Inc., under which entity we previously conducted our Raleigh, North Carolina operations before the merger of Comstock Service, Inc. into Comstock Homebuilding Companies, Inc. The merger of Comstock Service, Inc. was treated as an acquisition for accounting purposes. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Please see Cautionary Notes Regarding Forward-looking Statements for more information. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors including, but not limited to, those discussed below and elsewhere in this report, particularly under the headings Risk Factors and Cautionary Notes Regarding Forward-looking Statements.

#### **Overview**

We engage in the business of residential land development, production home building and high-rise condominium development in the greater Washington, D.C., Raleigh, North Carolina, and Atlanta, Georgia markets. Our business was started in 1985 by Christopher Clemente, our Chief Executive Officer, as a residential land developer and home builder focused on the luxury home market in the northern Virginia suburbs of Washington, D.C. In 1992, we repositioned ourselves as a production home builder focused on moderately priced homes in areas where we could more readily purchase finished building lots through option contracts. In 1997, we entered the Raleigh, North Carolina market. In 2006, we entered the Charlotte, North Carolina, Myrtle Beach, South Carolina and Atlanta, Georgia markets through the acquisition of Parker Chandler Homes, Inc. In late 2006 we exited the Myrtle Beach, SC market and in early 2007 we plan to exit the Charlotte, NC market.

In the late 1990s, in response to increasing competition for finished lots, we diversified our product base to include multiple product types and home designs and we rebuilt our in-house land development department to include significant experience in both land development operations and land entitlement expertise. Our strategic goal was to secure and control a pipeline of diversified land inventory at various stages of entitlement, thus reducing our dependence on other land developers for finished building lots and improving our ability to control our growth.



In 2005 we became involved in the business of converting existing rental apartment properties to for-sale condominium projects. This process involves the purchase of existing structures which are occupied by tenants with leases of varying duration. When we purchase these properties we subdivide the units and form a condominium association. In these projects we have and continue to invest capital in the improvement of the common areas and exteriors. In the past, our strategy was that as the tenants' leases expired we renovated the interiors of the apartments and then sold each apartment as an individual condominium unit. In recent months our business model has changed due to market conditions. In response to slowed absorption at these projects we have elected to continue to lease unsold inventory to renters. We have not abandoned our intent to sell the units as condominiums over time but we have chosen to manage the properties as rental assets to offset the debt service associated with holding the assets for sale. In certain cases we have sold condo conversion units in bulk to rental project investors and operators. We do not expect to continue to acquire additional condominium conversion and similar projects.

In recent years, our financial results have been influenced significantly by the availability of building lots, the timing of entitlement processes, the mix of products available for sale and the timing of settlements. The amount of time that it takes to bring a new development to market varies greatly depending on, among other things, the location and jurisdiction, governmental zoning and permitting processes, site development conditions, weather conditions, and the type of product to be constructed on the subject site. There can be a six to 36-month lag time between the time we contract to purchase a site and the time we begin developing and/or delivering homes on the site. For example, a site that requires entitlement processing takes longer than a site where we purchase finished building lots. Additionally, condominium homes take longer to construct than townhouses and single-family homes and high-rise developments take longer to construct than low-rise developments. As a result of this lag, it has been our experience that an increasing lot inventory in one period does not necessarily correlate to increasing sales in the immediately following periods. Thus, there are both market risks and benefits associated with the lag time between controlling a property and realizing revenue from the property.

We can experience significant variation from one period to the next with respect to average price per new order and average settlement revenue. This variation often results from shifts in the mix of products being sold during the period. While it is most typical that single-family homes are priced higher than townhouses or condominiums, it is possible that during a given period, orders and deliveries may include townhouses, based on location, that price higher than single-family homes. Likewise, in any project in any period, condominium units may produce higher average per unit sales prices and/or settlement revenues. Lower average per unit orders or settlements does not necessarily indicate that margins have been eroded or that profits have been reduced. Average settlement revenue can be both higher and lower than average price per new order in the prior period based on the mix of available product for sale.

Our general business strategy is to focus on for sale residential real estate development opportunities in the southeastern United States that afford us the ability to produce products at price points where we believe there is significant and consistent long-term demand for new housing. We believe the housing industry is cyclical in nature. We recognize that current market conditions are extremely challenging. Accordingly, we have adapted our business plan and strategy with the goal of protecting liquidity, enhancing our balance sheet and positioning the Company for future growth when market conditions improve. In order to protect our liquidity we have adopted a conservative approach to land acquisition and investment and have taken a patient approach with respect to market expansion. We believe that by doing so we are enhancing our ability to take advantage of attractive real estate investment opportunities in our core markets as market conditions improve. At December 31, 2006, we either owned or controlled under option agreements over 5,000 building lots.

For the 12 month periods ended December 31, the approximate average order prices for our market rate homes (which exclude county government mandated affordable housing program units required to be sold at a discount) were as follows:

**Twelve Months Ended December 31,  
2006**

|                          | <b>Washington<br/>Metro<br/>Area</b> | <b>North<br/>Carolina</b> | <b>Georgia</b> | <b>Total</b> |
|--------------------------|--------------------------------------|---------------------------|----------------|--------------|
| New orders               | 503                                  | 169                       | 122            | 794          |
| New order revenues       | \$ 119,877                           | \$ 42,257                 | \$ 32,605      | \$ 194,739   |
| Average new order price  | \$ 238                               | \$ 250                    | \$ 267         | \$ 245       |
| Settlements              | 675                                  | 132                       | 107            | 914          |
| Settlement revenue       | \$ 180,182                           | \$ 32,255                 | \$ 27,657      | \$ 240,094   |
| Average settlement price | \$ 267                               | \$ 244                    | \$ 258         | \$ 263       |
| Backlog units            | 285                                  | 45                        | 15             | 345          |
| Backlog                  | \$ 123,081                           | \$ 13,245                 | \$ 4,948       | \$ 141,274   |
| Average backlog price    | \$ 432                               | \$ 294                    | \$ 330         | \$ 409       |

**2005**

|                          | <b>Washington<br/>Metro<br/>Area</b> | <b>North<br/>Carolina</b> | <b>Georgia</b> | <b>Total</b> |
|--------------------------|--------------------------------------|---------------------------|----------------|--------------|
| New orders               | 598                                  | 33                        |                | 631          |
| New order revenues       | \$ 218,684                           | \$ 11,575                 |                | \$ 230,259   |
| Average new order price  | \$ 366                               | \$ 351                    |                | \$ 365       |
| Settlements              | 570                                  | 33                        |                | 603          |
| Settlement revenue       | \$ 204,933                           | \$ 11,330                 |                | \$ 216,263   |
| Average settlement price | \$ 360                               | \$ 343                    |                | \$ 359       |
| Backlog units            | 466                                  | 9                         |                | 475          |
| Backlog                  | \$ 186,939                           | \$ 3,443                  |                | \$ 190,382   |
| Average backlog price    | \$ 401                               | \$ 383                    |                | \$ 401       |

**2004**

|                          | <b>Washington<br/>Metro<br/>Area</b> | <b>North<br/>Carolina</b> | <b>Georgia</b> | <b>Total</b> |
|--------------------------|--------------------------------------|---------------------------|----------------|--------------|
| New orders               | 608                                  |                           |                | 608          |
| New order revenues       | \$ 224,292                           |                           |                | \$ 224,292   |
| Average new order price  | \$ 369                               |                           |                | \$ 369       |
| Settlements              | 263                                  |                           |                | 263          |
| Settlement revenue       | \$ 87,003                            |                           |                | \$ 87,003    |
| Average settlement price | \$ 331                               |                           |                | \$ 331       |

|                       |    |         |    |         |
|-----------------------|----|---------|----|---------|
| Backlog units         |    | 329     |    | 329     |
| Backlog               | \$ | 174,600 | \$ | 174,600 |
| Average backlog price | \$ | 531     | \$ | 531     |

**Recent accounting pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently reviewing the effect of SFAS 157 on its consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109, Accounting for Income Taxes* ( FIN 48 ), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of January 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to the opening balance of retained earnings and is not expected to have a significant impact on the Company's consolidated financial position. The adoption of FIN 48 may cause greater volatility in the effective tax rate going forward. The Company expects to record a benefit of approximately \$1,194 as a benefit to opening retained earnings as a result of the adoption of FIN 48.

### **Critical Accounting Policies and Estimates**

Our consolidated and combined financial statements are prepared in accordance with generally accepted accounting principles, which require us to make certain estimates and judgments that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates, including those related to the consolidation of variable interest entities, revenue recognition, impairment of real estate held for development and sale, warranty reserve and our environmental liability exposure. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates.

A summary of significant accounting policies is provided in Note 2 to our audited consolidated and combined financial statements. The following section is a summary of certain aspects of those accounting policies that require our most difficult, subjective or complex judgments and estimates.

### ***Consolidation of Variable Interest Entities***

In January 2003, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, or FIN 46. FIN 46 requires the primary beneficiary of a variable interest entity to consolidate that entity. A variable interest entity is created when (i) the equity investment at risk is not sufficient to permit the entity from financing its activities without additional subordinated financial support from other parties or (ii) equity holders either (a) lack direct or indirect ability to make decisions about the entity, (b) are not obligated to absorb expected losses of the entity or (c) do not have the right to receive expected residual returns of the entity if they occur. The primary beneficiary of a variable interest entity is the party that absorbs a majority of the variable interest 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. Expected losses are the expected negative variability of an entity's net assets exclusive of its variable interests, and expected residual returns are the expected positive variability in the fair value of an entity's assets, exclusive of variable interests. Prior to the issuance of FIN 46, an enterprise generally consolidated an entity when the enterprise had a controlling financial interest in the entity through ownership of a majority voting interest.

In December 2003, the FASB issued a revision of FIN 46 ( FIN 46-R ), clarifying certain provisions of FIN 46. We adopted the provisions of FIN 46-R on February 1, 2003 to the extent that they related to variable interest entities created on or after that date. For variable interest entities created before January 31, 2003, FIN 46-R was deferred to the end of the first interim or annual period ending after March 15, 2004. We fully adopted FIN 46-R effective March 31, 2004. Based on the provisions of FIN 46-R, we have concluded that whenever we option land or lots from an entity and pay a significant nonrefundable deposit, a variable interest entity is created under condition (ii) (b) of the

previous paragraph. This is because we have been deemed to have provided subordinated financial support, which refers to variable interests that will absorb some or all of an entity's expected theoretical losses if they occur. Therefore, for each variable interest entity created, we compute the expected losses and residual returns based on the probability of future cash flows as outlined in FIN 46 to determine if we are deemed to be the primary beneficiary of the variable interest entity.

The methodology used to evaluate our primary beneficiary status requires substantial management judgment and estimation. These judgments and estimates involve assigning probabilities to various estimated cash flow possibilities relative to the selling entity's expected profits and losses and the cash flows associated with changes in the fair value of the land under contract. Because we do not have any ownership interests in the entities with which we contract to buy land (such as LLCs), we may not have the ability to compel these entities to provide financial or other data to assist us in the performance of the primary beneficiary evaluation. This lack of direct information from the contracting entities may result in our evaluation being conducted solely based on the aforementioned management judgments and estimates. Further, where we deem ourselves to be the primary beneficiary of such an entity created after December 31, 2003 and that entity refuses to provide financial statements, we utilize estimation techniques to perform the consolidation. While management believes that our estimation techniques provide a reasonable basis for determining the financial condition of an entity that refuses to provide financial statements, the actual financial condition of the entity could differ from that reported. In addition, although management believes that our accounting policy is designed to properly assess our primary beneficiary status relative to our involvement with the entities from which we acquire land, changes to the probabilities and the cash flow possibilities used in our evaluation could produce different conclusions regarding our primary beneficiary status.

### ***Revenue Recognition***

We primarily derive our earned revenues from the sale of residential property. We recognize residential revenue and all related costs and expenses when full payment has been received, title and possession of the property has been conveyed and risks and rewards of ownership transfer to the buyer and other sale and profit recognition criteria are satisfied. Management estimates of future costs to be incurred after the completion of each sale are included in cost of sales. A change in circumstances that causes these estimates of future costs to increase or revenues to decrease would significantly affect the profit recognized on these sales.

### ***Impairment of Real Estate Held for Development and Sale***

Real estate held for development and sale includes land, land development costs, interest and other construction costs and is stated at cost or, when circumstances or events indicate that the real estate held for development or sale is impaired, at estimated fair value. Circumstances or events we consider important which could trigger an impairment review include the following:

- significant negative industry or economic trends;
- a significant underperformance relative to historical or projected future operating results;
- a significant change in the manner in which an asset is used; and
- an accumulation of costs significantly in excess of the amount originally expected to construct an asset.

Real estate is stated at the lower of cost or estimated fair value using the methodology described as follows. A write-down to estimated fair value is recorded when we determine that the net book value exceeds the estimated selling prices less cost to sell. These evaluations are made on a property-by-property basis. When we determine that the net book value of an asset may not be recoverable based upon the estimated undiscounted cash flow, an impairment write-down is recorded. The evaluation of future cash flows and fair value of individual properties requires significant judgment and assumptions, including estimates regarding expected sales prices, development absorption and remaining development costs. Significant adverse changes in circumstances affecting these judgments and assumptions in future periods could cause a significant impairment adjustment to be recorded. As discussed in Note 5 in the accompanying financial statements, we recorded impairment charges of \$9.5 million in second quarter

2006, \$1.8 million in third quarter 2006 and \$39.9 million during the fourth quarter of 2006.

***Warranty Reserve***

Warranty reserves for houses sold are established to cover potential costs for materials and labor with regard to warranty-type claims expected to arise during the one-year warranty period provided by us or within the five-year statutorily mandated structural warranty period. Since we generally subcontract our home building work,

subcontractors are required to provide us with an indemnity and a certificate of insurance prior to receiving payments for their work. Claims relating to workmanship and materials are generally the primary responsibility of the subcontractors and product manufacturers. The warranty reserve is established at the time of closing, and is calculated based upon historical warranty cost experience and current business factors. Variables used in the calculation of the reserve, as well as the adequacy of the reserve based on the number of homes still under warranty, are reviewed on a periodic basis. Although management considers the warranty reserve to be adequate, there can be no assurance that this reserve will prove to be adequate over time to cover losses due to increased costs for material and labor, the inability or refusal of manufacturers or subcontractors to financially participate in corrective action, unanticipated adverse legal settlements, or other unanticipated changes to the assumptions used to estimate the warranty reserve.

### ***Environmental Liability Exposure***

Development and sale of real property creates a potential for environmental liability on our part as owner and developer, for our own acts as well as the acts of prior owners of the subject property or owners or past owners of adjacent parcels. If hazardous substances are discovered on or emanating from any of our properties, we and prior owners may be held liable for costs and liabilities relating to those hazardous substances. We generally undertake environmental studies in connection with our property acquisitions, when warranted. If we incur environmental remediation costs in connection with properties we previously sold, including clean up costs, consulting fees for environmental studies and investigations, monitoring costs, and legal costs relating to clean up, litigation defense and the pursuit of responsible third parties, they are expensed. We capitalize costs relating to land under development and undeveloped land as part of development costs. Costs incurred for properties to be sold are deferred and charged to cost of sales when the properties are sold. Should a previously undetected, substantial environmental hazard be found on our properties, significant liquidity could be consumed by the resulting clean up requirements and a material expense may be recorded. Further, governmental regulation on environmental matters affecting residential development could impose substantial additional expense on us, which could adversely affect our results of operations or the value of properties owned under contract, or purchased by us. For additional information regarding risks associated with environmental hazards and environmental regulation, see **Business Risk Factors We are Subject to Certain Environmental Laws and the Cost of Compliance Could Adversely Affect our Business.**

### **Results of Operations**

#### ***Year ended December 31, 2006 compared to year ended December 31, 2005***

##### ***Orders, backlog and cancellations***

Net new orders for the year ended December 31, 2006 decreased \$35.5 million, or 15.4%, to \$194.7 million on 794 homes as compared to \$230.3 million on 631 homes for the year ended December 31, 2005. The 163 unit increase in new orders was primarily attributable to increased condominium and bulk condominium conversion sales at Carter Lake which were offset by decreases in sales at our Eclipse project which was substantially pre-sold in 2005. The Company's 2006 acquisitions of Parker Chandler Homes Inc., and Capitol Homes Inc., in the Georgia and North Carolina markets, contributed approximately 122 and 91 new order units, respectively.

The average sale price per new order for the year ended December 31, 2006 decreased by \$120,000 to \$245,000 as compared to \$365,000 for the year ended December 31, 2005. The decrease in average sales price per new order is attributable to lower priced product offerings in our North Carolina and Georgia markets, higher sales of lower priced condominiums, discounted bulk sales of condominium conversion units and general price decreases throughout in response to slower demand throughout our markets as compared to 2005. Our backlog at December 31, 2006 decreased \$49.1 million, or 25.8%, to \$141.3 million on 345 homes as compared to our backlog at December 31, 2005 of \$190.4 million on 475 homes. Of the Company's December 31, 2006 backlog, approximately \$116.5 million is



derived from 258 orders at the Company's Eclipse on Center Park at Potomac Yard project, of which \$46.1 million on 134 units settled in the fourth quarter of 2006.

Our average cancellation rate for the year ended December 31, 2006 was approximately 17.7% on 965 gross new orders compared to cancellation rate of 14.6% on 739 gross new orders for the comparable period in 2005.

Cancellations were most prevalent in the greater Washington, DC market where we experienced 122 cancellations on 625 gross new orders or 19.5%. At the Eclipse project we experienced 35 cancellations on 46 new orders although most of the cancellations we related to contracts entered into in 2004. In the Raleigh market our cancellation rate was 3.4% on six cancellations out of 175 gross new orders and in the Atlanta market our cancellation rate was 26.1% on 43 cancellations out of 165 gross new orders. We believe that the high rate of cancellations in our Atlanta market was due in part to the first-time buyer orientation of our products as well as a slowing of the resale market for our move-up buyers.

### *Revenues*

The number of homes delivered in the year ended December 31, 2006 increased by 51.6%, or 311 homes, to 914 from 603 homes in the year ended December 31, 2005. Average revenue per home delivered decreased by approximately \$96,000 or 26.7% to \$263,000 for the year ended December 31, 2006 as compared to \$359,000 for the year ended December 31, 2005. In December 2006, the Company delivered an additional 30 bulk sale units at its Countryside condominium project to a related party purchaser who is a former officer of the Company for \$4.2 million and subsequently entered into a marketing and sales agreement with the buyer to sell the units on his behalf. Because the Company will participate in the profits of the sales, the Company is deemed to have an on-going involvement and as such the revenue from the sale of these units was deferred and will be recognized along with the revenue generated from the marketing agreement at the time the units are delivered to subsequent purchasers.

Homebuilding revenues increased by \$23.8 million, or 11.0%, to \$240.1 million for the year ended December 31, 2006 as compared to \$216.3 million for the year ended December 31, 2005. The total number of homes delivered and total homebuilding revenue for the year ended December 31, 2006 includes 259 homes and \$40.0 million in revenue related to the bulk sale of the Company's Carter Lake condominium conversion project. The Company delivered this project in its entirety to a rental operator during November 2006.

Excluding the sale of Carter Lake, the increase in the number of units delivered is attributable to the company's Eclipse project which delivered 134 units, and the Company's expansion in the North Carolina and Atlanta markets as a result of the acquisition of Capitol Homes Inc. and Parker Chandler Homes Inc. During the year ended December 31, 2006 we delivered 132 homes in Raleigh and 107 homes in Atlanta as compared to 33 homes in Raleigh and zero homes in Atlanta for the year ended December 31, 2005. The decrease in revenues and average revenue per home is attributable to lower priced product offerings in our North Carolina and Georgia markets, higher sales of lower priced condominiums and condominium conversion units and general decreases in the prices of homes as compared to 2005.

### *Other Revenues*

Other revenue for the year ended December 31, 2006 decreased by \$2.2 million, or 27.5% to \$5.8 million, as compared to \$8.0 million for the year ended December 31, 2005. Other revenue for the year ended December 31, 2006 and 2005 includes lot sales made to third parties, revenue associated with the Company's Settlement Title Services division, management fees received from Comstock Asset Management Inc. (as discussed in Note 12), and revenue received from a marketing services alliance. The decrease is attributable to lower overall lot sales during 2006 as compared to 2005. The Company considers a sale to be from homebuilding when there is a structure built on the lot when it is sold. Sales of lots occur, and are included in Other Revenues, when the Company sells raw or finished home sites in advance of any substantial home construction.

### *Cost of Sales and Cost of sales other*

Cost of sales for the year ended December 31, 2006 increased \$58.5 million, or 38.3%, to \$211.4 million, or 88.1% of homebuilding revenue, as compared to \$152.9 million, or 70.7% of revenue, for the year ended December 31, 2005.

The 17.4 percentage point increase in cost of sales as a percentage of homebuilding revenue for the year ended December 31, 2006 is attributable to several factors. Due to weakening market conditions, we have extended the sales cycle of many of our projects, which in turn has increased direct costs per unit by increasing the amount of real estate tax, interest and overhead capitalized to the project. In many cases, since we relive our capitalized costs pro-rata to the individual lots, fewer remaining lots must absorb increased costs. In addition, we

have experienced pricing concessions and increases in material and labor costs throughout our markets. Due to the factors stated above, the Company expects costs of sales as a percentage of revenue to continue to face additional upward pressure until general market conditions improve, costs of materials moderate and new inventory is acquired. Cost of sales other for the year ended December 31, 2006 increased by \$1.6 million, or 44.4% to \$5.2 million, as compared to \$3.6 million for the year ended December 31, 2005. Cost of sales other for the year ended December 2006 and 2005 includes expenses associated with lot sales made to third parties and expenses associated with the management of the Company's Settlement Title Services division. Cost of sales other as a percentage of other revenue was 89.7% and 45.0% for the year ended December 31, 2006 and 2005 respectively. The 44.7 percentage point increase in cost of sales other as a percentage of other revenue is due to the Company selling lots at book value to exit underperforming projects as compared to sales of lots for a gain in 2005.

#### *Impairments and write-offs*

As discussed in Note 3 in the accompanying notes to the financial statements, the Company, for the year ended December 31, 2006 and 2005, recorded impairment charges of \$51.2 and \$1.2 million, respectively. For the year ended December 31, 2006 the Company wrote-off \$6.2 million related to deposits on forfeited option contracts, value assigned to forfeited option contracts and related feasibility costs. Based on management's assessment of current market conditions and estimates for the future, the Company believes there are no additional impairments warranted at this time. However, if market conditions continue to deteriorate or actual costs are higher than budgeted, the Company would be required to re-evaluate the recoverability of its real estate held for development and sale and may incur additional impairment charges. Total impairments and write-offs were taken in all of our geographic regions, with approximately \$26.8 million, \$7.5 million and \$23.1 million in the Washington metro area, North and South Carolina and Georgia, respectively. The bulk of the Company's impairments, \$39.9 million, were recorded at December 31, 2006 based on the continuing need for price concession the weakening of pricing power and increasing inventory costs resulting from the capitalization of interest, overheads and real estate taxes.

At December 31, 2006, the Company had approximately \$3.8 million related to non-refundable option deposits to purchase real estate. In addition, the Company has approximately \$7.9 million related to feasibility costs incurred on projects under option agreements or under feasibility study periods. The Company is in the process of re-negotiating its remaining option contracts for both price concessions and deferral of scheduled lot purchases. The Company could incur additional write downs in the event the Company is not successful in renegotiating terms of existing option contracts and choose to cancel its option and not close on the underlying land.

#### *Selling, general and administrative expenses*

Selling, general and administrative costs for the year ended December 31, 2006, increased \$13.3 million or 55.0% to \$37.5 million, as compared to \$24.2 million for the year ended December 31, 2005. Selling, general and administrative expenses represented 15.3% of total revenue for the year ended December 31, 2006, as compared to 10.8% for the year ended December 31, 2005.

This increase was the result of additional staffing and related compensation costs of \$5.2 million, increased media and other marketing related costs of \$2.5 million, office and model rent of \$1.2 million, feasibility and consulting fees of \$2.4 million, and legal fees of \$ 0.4 million, and general administrative expenses including depreciation and amortization of \$1.6 million.

In addition, our acquisition during the year of both Parker Chandler Homes and Capitol Homes increased our selling, general and administrative expenses by \$4.7 million and \$1.2 million, respectively.

#### **Operating income**

Operating income for the year ended December 31, 2006 decreased \$108.1 million to \$(65.7) million as compared to \$42.4 million for the year ended December 31, 2005. Operating margin for the year ended December 31, 2006 was (26.7%) compared to 18.9% for the year ended December 31, 2005. The decrease in operating margin is primarily attributable to \$57.4 million of impairments and write-offs for the year ended December 31, 2006 as compared to \$1.2 million for the year ended December 31, 2005. Net of impairments and write-offs, operating loss for the year ended December 31, 2006 was \$(8.3) million which represents a decrease of

\$50.7 million as compared to the year ended December 31, 2005. The additional decrease over the impairments and write-offs is attributable to higher costs of sales as a percentage of revenue and increased selling, general and administrative expenses as a percentage of total revenue.

*Other (income) expense, net*

Other (income) expense, net increased by \$37,000 to net other income of \$1.5 million for the year ended December 31, 2006 as compared to net other income of \$1.5 million for the year ended December 31, 2005.

*Income before minority interest*

Income before minority interest decreased by \$108.1 million, or 246.4%, to \$(64.2) million for the year ended December 31, 2006 as compared to \$43.9 million for the year ended December 31, 2005. The decrease is consistent with the decrease in Operating Income detailed above.

*Minority interest*

Minority interest expense decreased by \$15,000 to \$15,000 for the year ended December 31, 2006 as compared to \$30,000 for the year ended December 31, 2005. This decrease is primarily the result of a slower pace of deliveries at the Company's Comstock North Carolina subsidiary in which there is a small minority partner who retained its interest at the initial public offering when all other minority interests were purchased by Comstock Homebuilding Companies, Inc.

*Income taxes*

Income tax (benefit) expense for the year ended December 31, 2006 was \$(24.5) million compared to \$16.4 million for the year ended December 31, 2005. Our combined effective tax rate including both current and deferred provisions for the year ended December 31, 2006 was 38.1% as compared to 37.3% for the year ended December 31, 2005.

***Year ended December 31, 2005 compared to year ended December 31, 2004***

*Orders and Backlog*

New orders for the year ended December 31, 2005 increased \$5.9 million, or 2.7%, to \$230.3 million on 631 homes as compared to \$224.2 million on 608 homes for the year ended December 31, 2004. This increase in new orders was primarily attributable to an increase in saleable inventory resulting from the opening of new projects including Penderbrook (183 sales), Villas at Countryside (58 sales) and Commons on Potomac Square (19 sales).

The average sale price per new order for the year ended December 31, 2005 decreased by \$4,000 to \$365,000 as compared to \$369,000 for the year ended December 31, 2004. The decrease was a result of significant amount of unit sales at our Penderbrook, Villas at Countryside and Bellemeade Farms condominium conversion projects, in which existing apartment units are being converted to condominiums. By design, sales prices tend to be lower in these conversion projects as compared to our new construction projects. Our strategy with respect to conversion projects is to identify assets where we can offer lower priced, affordable product to first time home buyers. We focus on older assets where we can add value while maintaining price points which are more attractive to our target buyers. Because we tend to be buying, renovating, and selling older assets that are in prime locations we are able to position the assets to be more affordable, and therefore, average new order prices are lower. On average, the sale price of our townhouses increased by approximately \$81,900 during the year ended December 31, 2005 to \$443,600 from \$361,700 at December 31, 2004. On average, the sale price of our single-family homes increased by approximately \$89,500 during

the year ended December 31, 2005 to \$598,200 from \$508,700 at December 31, 2004. The average sale price of our condominiums increased by \$32,100 to \$413,100 for the period ending December 31, 2005 as compared to \$381,000 for the period ended December 31, 2004.

Our backlog at December 31, 2005 increased \$15.8 million, or 9.1%, to \$190.4 million on 475 homes as compared to our backlog at December 31, 2004 of \$174.6 million on 329 homes. Of our December 31, 2005

backlog, approximately \$157.6 million is derived from 390 sold units at our Eclipse on Center Park at Potomac Yard project.

#### *Revenues*

The number of homes delivered in the year ended December 31, 2005 increased by 129.3% to 603 from 263 homes in the year ended December 31, 2004. Average revenue per home delivered increased by approximately \$28,000 to \$359,000 for the year ended December 31, 2005 as compared to \$331,000 for the year ended December 31, 2004. Homebuilding revenues increased by \$129.3 million, or 148.6%, to \$216.3 million for the year ended December 31, 2005 as compared to \$87.0 million for the year ended December 31, 2004. The increase in deliveries and revenues from December 31, 2004 to December 31, 2005 is primarily attributable to settlements from the opening of new communities and the release of inventory for sale at projects such as Penderbrook (180 units), Villas at Countryside (53 units), Bellemeade Farms (21 units), Woodlands at Round Hill (17 units) and Commons on William Square (56 units). In addition, we generated 33 settlements in 2005, as a result of its merger with Comstock Service in December 2004.

#### *Other Revenue*

Other revenue for the year ended December 31, 2005 decreased by \$1.0 million, or 11% to \$8.0 million, as compared to \$9.0 million for the year ended December 31, 2004. Other revenue for the year ended December 31, 2005 and 2004 includes lot sales made to third parties, revenue associated with our Settlement Title Services division, management fees received from Comstock Asset Management Inc. (as discussed in Note 12), and revenue received from a marketing services alliance. For the year ended December 31, 2004, other revenue included revenues associated with the management of Comstock Service. The decrease in other revenue was primarily the result of not recording management revenues from Comstock Service, which was merged into Comstock Homebuilding on December 17, 2004.

#### *Cost of sales and selling, general and administrative expenses.*

Cost of sales for the year ended December 31, 2005 increased \$96.7 million, or 168.8%, to \$154.1 million, or 71.3% of homebuilding revenue, as compared to \$57.3 million, or 65.9% of revenue, for the year ended December 31, 2004. The 5.4 percentage point increase in cost of sales for the year ended December 31, 2005 is primarily attributable to lower margins on sales in the North Carolina market and the increase in settlements from the opening of our condominium conversion projects.

As discussed above, Comstock Service, our North Carolina division, was merged into Comstock Homebuilding on December 17, 2004. Due to current market conditions in the North Carolina market, which have caused extended hold and carry periods between acquisition and delivery, we experienced lower margins on its North Carolina settlements, as compared to margins in the Washington, DC market, primarily due to increasing interest and overhead carrying costs and modest revenue concessions. In addition, as discussed in Note 5 in the accompanying financial statements, we recorded a \$1.2 million impairment charge on the carrying value of real estate held for development and sale at Kelton II, a townhouse community in Raleigh, North Carolina. For 2005, our North Carolina projects accounted for 5.5% of our total settlements and 5.2% of total homebuilding revenues. Cost of sales as a percentage of revenue for our North Carolina division was approximately 84.2%

In addition, our newly opened condo conversion projects experienced lower margins than our traditional homebuilding projects due to the nature of a conversion project in which we buy an existing structure, adds value through upgrades and sells the renovated units with a focus on affordability. As a result, costs of sales tend to be higher as a percentage of revenue than our new construction projects. For 2005, our condo conversion projects



accounted for 42.1% of our total settlements and 30.1% of total homebuilding revenues. Cost of sales as a percentage of revenue for our condo conversion projects was approximately 86.1%.

Cost of sales other for the year ended December 31, 2005 decreased by \$3.1 million, or 45.8% to \$3.6 million, as compared to \$6.7 million for the year ended December 31, 2004. Cost of sales for the year ended December 2005 and 2004 includes expenses associated with lot sales made to third parties and expenses associated with the management of our Settlement Title Services division. For the year ended December 2004, cost of sales other also

included expenses associated with the management of Comstock Service, which was merged into Comstock Homebuilding on December 17, 2004. The decrease for the year ended December 31, 2005, as compared to 2004, was primarily the result not recording costs associated with the management of Comstock Service.

Selling, general and administrative costs for the year ended December 31, 2005 increased \$12.3 million to \$24.1 million from \$11.9 million for the year ended December 31, 2004. As a percentage of revenue, selling, general and administrative expenses represented 10.8% and 12.4% of total revenue during the year ended December 31, 2005 and 2004, respectively. This increase was the result of additional staffing costs and compensation of \$5.5 million to support our growth, increased advertising expenses of \$740,000, board fees and stock compensation of \$2.0 million, office and model rent of \$1.2 million, consulting fees of \$928,000, legal and computer expenses of \$458,000, insurance costs of \$268,000 and other miscellaneous expenses associated with our growth in staffing and land acquisition efforts of \$1.1 million.

#### *Operating income*

Operating income for the year ended December 31, 2005 increased \$22.3 million to \$42.4 million as compared to \$20.1 million for the year ended December 31, 2004. Operating margin for the year ended December 31, 2005 was 18.9% compared to 20.9% for the year ended December 31, 2004. The decrease in operating margin is primarily attributable to an increase in cost of sales as a percentage of revenue as discussed above.

#### *Other (income) expense, net*

Other (income) expense, net increased by \$2.4 million to net other income of \$1.5 million for the year ended December 31, 2005 as compared to net other expense of 908,000 for the year ended December 31, 2004. The increase in other (income) expense is primarily attributable to interest earned on our cash balances generated as a result of the proceeds from our initial and follow on public offering.

#### *Income before minority interest*

Our income before minority interest increased by \$24.7 million, or 228%, to \$43.9 million for the year ended December 31, 2005 as compared to \$19.2 million for the year ended December 31, 2004. Net margins as a percentage of revenues remained consistent at approximately 20% for the year ended December 31, 2005 and 2004.

#### *Minority interest*

Minority interest expense decreased by \$5.2 million to \$30,000 for the year ended December 31, 2005 as compared to \$5.3 million for the year ended December 31, 2004. This decrease is the result of our repurchase or redemption of substantially all of the minority interests in four of our limited liability company subsidiaries including Comstock Investors V, L.C., Comstock Investors VI, L.C., Comstock Potomac Yard, L.C. and Comstock North Carolina, L.L.C. subsequent to our initial public offering in December 2004.

#### *Income taxes*

On December 17, 2004, we reorganized from a group of S-corporations to a C-corporation. As a result, we were subject to income taxes for only 14 days during 2004. Income tax expense for the year ended December 31, 2005 was \$16.4 million compared to \$(241,000) for the year ended December 31, 2004. Our combined effective tax rate including both current and deferred provisions for the year ended December 31, 2005 was 37.3%.

### **Liquidity and Capital Resources**

We require capital to post deposits on new deals, to purchase and develop land, to construct homes, to fund related carrying costs and overhead and to fund various advertising and marketing programs to facilitate sales. These expenditures include engineering, entitlement, architecture, site preparation, roads, water and sewer lines, impact fees and earthwork, as well as the construction costs of the homes and amenities. Our sources of capital include, and will continue to include, funds derived from various secured and unsecured borrowings, operations

which include the sale of constructed homes and finished lots, and the sale of equity securities. Our currently owned and controlled inventory of home sites will require substantial capital to develop and construct.

In production home building, it is common for builders such as us to employ revolving credit facilities whereby the maximum funding available under the facility exceeds the maximum outstanding balance allowed at any given time. Our overall borrowing capacity may be constrained by loan covenants which limit the ratio of our total liabilities to our total equity. This revolving debt will typically provide for funding of an amount up to a pre-determined percentage of the cost of each asset funded. The balance of the funding for that asset is provided for by us as equity. The efficiency of revolving debt in production home building allows us to operate with less overall debt capital than would be required if we built each project with long-term amortizing debt. At December 31, 2006, we had approximately \$ 295.4 million of debt financing and \$21.3 million of unrestricted cash. Credit markets are tightening as a result of the slowing of demand for residential for-sale housing and the oversupply of speculative inventory in the market. In spite of this, we believe that internally generated cash, borrowings available under existing and new credit facilities and access to public debt and equity markets will provide us with sufficient access to capital to meet our existing and expected capital needs.

### *Credit Facilities*

A majority of our debt is variable rate, based on LIBOR or the prime rate plus a specified number of basis points, typically ranging from 190 to 375 basis points over the LIBOR rate and from 25 to 100 basis points over the prime rate. As a result, we are exposed to market risk in the area of interest rate changes. At December 31, 2006, the one-month LIBOR and prime rates of interest were 5.32% and 8.25%, respectively, and the interest rates in effect under our existing secured revolving acquisition, development and construction credit facilities ranged from 7.22% to 9.25%. For information regarding risks associated with our level of debt and changes in interest rates, see [Business-Risk Factors](#) and [Quantitative and Qualitative Disclosures About Market Risk](#).

On May 26, 2006 we entered into \$40 million Secured Revolving Borrowing Base Credit Facility for the financing of entitled land, land under development, construction and letters of credit. All letters of credit issued will also be secured by collateral in the facility. Funding availability will be limited to compliance with a borrowing base and facility covenants. As of December 31, 2006, \$40.0 million was outstanding with this facility. At December 31, 2006 we were not in compliance with the financial covenants of this credit facility, however the lender did not issue a notice of default as was their right. In February 2007 we entered into a Forbearance Agreement with the lender which reduced the covenants and eliminated the ability of the lender to claim an event of default as a result of non-compliance with the financial covenants of the original loan. The Forbearance Agreement runs through March 2008.

On May 4, 2006 we closed on a \$30 million Junior Subordinated Note Offering. The term of the note was thirty years and it could be retired after five years with no penalty. The rate was fixed at 9.72% the first five years and LIBOR plus 420 basis points the remaining twenty-five years. As of December 31, 2006, we were not in compliance with the financial covenants of the Note, however the lender did not issue a notice of default as was their right. In March 2007 we retired the original notes and entered into a new 10-year \$30 million Senior Secured Note Offering with the same lender at the same interest rate. We are in compliance with all covenants associated with the new notes.

As of December 31, 2006, we had \$8.1 million outstanding to Key Bank. Under the terms of the loan agreement, we are required to maintain certain covenants. As of December 31, 2006 we were not in compliance with the interest coverage covenant of the loans by which we are required to maintain a specified EBITDA to debt service ratio, however the lender did not issue a notice of default as was their right. In January 2007 we entered into loan modification agreements lower the interest coverage ratio. We are in compliance with the loans as modified.

As of December 31, 2006 we had \$10.3 million outstanding to M&T Bank. Under the terms of the loan agreement, we are required to maintain certain covenants. As of December 31, 2006 we were not in compliance with both the interest coverage covenant of the loans by which we are required to maintain a specified EBITDA to debt service ratio and the minimum tangible net worth covenant, however the lender did not issue a notice of default as was their right. In March 2007 we entered into loan modification agreements lower the interest coverage ratio and the tangible net worth covenant. We are in compliance with the loans as modified.

On October 24, 2006 we received a purported notice of default under a \$46 million credit facility with Bank of America related to our Bellemeade condominium project in Leesburg, Virginia. We disputed the notice and received a stand-still agreement from Bank of America until December 29, 2006. During the term of the stand-still agreement we had a \$26 million secured loan and a \$10 million unsecured loan mature. Prior to the expiration of the stand-still agreement we negotiated a settlement with Bank of America whereby the bank withdrew the purported notice of default in connection with a \$26 million reduction in the secured loan (from proceeds of the \$40 million sale of the collateral) and a \$5 million reduction in the outstanding balance of the unsecured loan. All other curtailments were extended. All financial covenants of the Company with Bank of America were removed as part of the settlement.

In December 2005 the Company entered into a \$147 million secured, limited recourse loan with Corus Bank related to our Eclipse project. Under the terms of the loan there is a single deed of trust covering two loan tranches. The two tranches have varying interest rates with Traunche A at LIBOR plus 375 basis points and Traunche B at 16.0%. At December 31, 2006 our outstanding balance under this loan was \$85.7 million.

From time to time, we employ subordinated and unsecured credit facilities to supplement our capital resources or a particular project or group of projects. Our lenders under these credit facilities will typically charge interest rates that are substantially higher than those charged by the lenders under our senior and secured credit facilities. These credit facilities will vary with respect to terms and costs. As of December 31, 2006, only one unsecured credit facility remained in place. And at December 31, 2006 the annual variable interest rate on the facility was 7.52% and \$5.0 million was outstanding under the facility. We intend to continue to use these types of facilities on a selected basis to supplement our capital resources.

Many of our loan facilities contains Material Adverse Effect Clauses which if invoked could create an event of default under the loan. In the event all our loans were deemed to be in default as a result of a Material Adverse Effect, our ability to meet our capital and debt obligations would be compromised.

As illustrated by the following debt maturity schedule, we have a significant amount of debt maturing in 2007. In our industry, it is customary for secured debt to be renewed until a project is complete but we have no assurance that this will be the case with our debts. Our recently reported and cured loan covenant violations, may impact our ability to renew and extend our debt.

As of December 31, 2006, future maturities of our borrowings are as follows:

|                          |            |
|--------------------------|------------|
| Year ending December 31, |            |
| 2007                     | \$ 205,922 |
| 2008                     | 16,986     |
| 2009                     | 39,981     |
| 2010                     | 2,514      |
| 2011 and thereafter      | 30,000     |
| Total                    | \$ 295,403 |

We are considering replacing our credit facilities with one or more larger facilities, which may reduce our aggregate debt financing costs. We would be the borrower and primary obligor under this larger facility or facilities, and we anticipate the indebtedness would be secured, non-recourse and based on an available borrowing base.

### *Cash Flow*

Net cash provided by/(used in) operating activities was \$(86.4) million for the year ended December 31, 2006, \$(131.1 million) for the year ended December 31, 2005 and \$11.1 million for the year ended December 31, 2004. In 2006, the primary source for the decrease in cash used in operating activities was attributable to investment in real estate held for development and sale resulting from our acquisitions of Parker Chandler Homes, Inc. and Capitol Homes, Inc. as well as our continued construction of our Eclipse project. In 2005, the primary source for the increase in cash used in operating activities was attributable to increased investments in real estate held for development and sale. In 2004, the primary source of the increase in cash from operating activities was attributable

to increases in net income and accounts payable which were only partially offset by increased investments in real estate held for development and sale.

Net cash provided by/(used in) investing activities was \$(17.9) million for the year ended December 31, 2006, \$0.7 million for the year ended December 31, 2005 and \$1.0 million for the year ended December 31, 2004. In 2006, the primary source of the decrease in cash from investing activities was attributable to business acquisitions, net of cash acquired. In 2005, the primary source of the increase in cash from investing activities was attributable to the return of capital in the amount of \$1.0 million upon the redemption of our investment in TCG Fund I. In 2004, the primary source of the increase in cash from investing activities was attributable to cash received from the acquisition of Comstock Service as discussed in Note 1 of the accompanying notes to consolidated financial statements.

Net cash provided by/(used in) financing activities was \$83.3 million for the year ended December 31, 2006, \$105.0 million for the year ended December 31, 2005 and \$38.3 million for the year ended December 31, 2004. The primary source of the increase in cash from financing activities for the year ended December 31, 2006 was the proceeds from notes and other indebtedness as well as the proceeds an equity offering in May 2006. The primary source of the increase in cash from financing activities for the period ended December 31, 2005 was attributable to net proceeds from our follow on public offering and increased borrowings from our credit facilities. The primary source of the increase in cash from financing activities for the period ended December 31, 2004 was the net proceeds received from our initial public offering which were partially offset by distributions paid to stockholders.

### ***Recent Acquisitions***

In May 2006, we completed the acquisition of Capitol Homes, Inc., in the Raleigh, North Carolina area. The acquisition price was approximately \$7.5 million plus the assumption of approximately \$20.6 million in liabilities. The results of Capitol Homes, Inc. are included in the accompanying financial statements from the period May 5, 2006 to December 31, 2006. The acquisition added approximately 1,350 lots in 13 communities to our inventory of controlled land.

In January 2006, we completed the acquisition of Parker Chandler Homes, Inc. in the Atlanta, Georgia area. The acquisition price was approximately \$10.4 million plus the assumption of approximately \$63.8 million in debt. The results of Parker Chandler, Inc. are included in the accompanying financial statements from the period January 19, 2006 to December 31, 2006. The acquisition added over 1,500 lots to our inventory of controlled land.

### ***Subsequent Events***

In February 2007 we received a ruling from a panel of arbitrators ordering payment of approximately \$3.0 million with respect to an allegation of a loan brokerage fee being owed for placement of a \$147.0 million project loan for the Eclipse at Potomac Yard project and a \$67.0 million project loan at Penderbrook. We are assessing our rights of appeal with respect to this decision.

In February 2007 we entered into a limited recourse \$28.0 million loan agreement with Guggenheim Capital Partners to refinance an existing loan with Corus Bank. The new loan has a term of 3 years and bears a floating interest rate of LIBOR + 500 basis points.

In January 2007 we entered into a contract to sell 110 lots at our Massey Preserve project in Raleigh, NC to another builder in two takedowns. The first closing on 55 lots occurred in February 2007 for proceeds of \$3.6 million. The second takedown is scheduled to occur in July 2007.



On May 4, 2006 we closed on a \$30 million Junior Subordinated Note Offering. The term of the note was thirty years which could be retired after five years with no penalty. The rate was fixed at 9.72% the first five years and LIBOR plus 420 basis points for the remaining twenty-five years. In March 2007 we retired the original Junior Subordinated Note and entered into a new 10-year \$30 million Senior Secured Note Offering with the same lender at the same interest rate.

|                  | Total      | Payments due by period |           |              | More than<br>5 Years |
|------------------|------------|------------------------|-----------|--------------|----------------------|
|                  |            | Less than<br>1 Year    | 1-3 Years | 3-5<br>Years |                      |
| Notes payable(1) | \$ 295,403 | \$ 205,922             | \$ 59,481 | \$           | \$ 30,000            |
| Operating leases | \$ 3,423   | \$ 1,231               | \$ 2,187  | \$ 5         | \$                   |
| Capital leases   | \$ 237     | \$ 86                  | \$ 151    | \$           | \$                   |
| Total            | \$ 299,063 | \$ 207,239             | \$ 61,819 | \$ 5         | \$ 30,000            |

(1) Notes payable includes estimated interest payments based on interest rates in effect at December 31, 2006.

Notes payable have an undefined repayment due date and are typically due and payable as homes are settled.

We are not an obligor under, or guarantor of, any indebtedness of any party other than for obligations entered into by the subsidiaries of one of the now-consolidated primary holding companies.

We have no off-balance sheet arrangements except for the operating leases described above.

As discussed in Note 3 in the accompanying consolidated financial statements as of December 31, 2006, the Company has posted aggregate non-refundable deposits of \$3.8 million on \$37.0 million worth of land purchase options.

### Seasonality and Weather

Our business is affected by seasonality with respect to orders and deliveries. In the markets in which we operate, the primary selling seasons are from January through May as well as September and October. Orders in other months typically are lower. In addition, the markets in which we operate are four-season markets that experience significant periods of rain and snow. Construction cycles and efforts are often adversely affected by severe weather.

### Inflation

Inflation can have a significant impact on our business performance and the home building industry in general. Rising costs of land, transportation costs, utility costs, materials, labor, overhead, administrative costs and interest rates on floating credit facilities can adversely affect our business performance. In addition, rising costs of certain items, such as lumber, can adversely affect the expected profitability of our backlog. Generally, we have been able to recover any increases in costs through increased selling prices. However, there is no assurance we will be able to increase selling prices in the future to cover the effects of inflation and other cost increases.

**PART III****ITEM 10. Directors, Executive Officers and Corporate Governance****Executive Officers, Key Employees and Directors**

Our executive officers, key employees and directors and their respective ages and positions as of April 16, 2007 are as follows:

| <b>Name</b>           | <b>Age</b> | <b>Position</b>                                 |
|-----------------------|------------|---|
| Christopher Clemente* | 46         | Chairman and Chief Executive Officer            |
| Gregory V. Benson*    | 52         | President, Chief Operating Officer and Director |
| Bruce J. Labovitz*    | 38         | Chief Financial Officer                         |
| Jason Parikh*         | 35         | Chief Accounting Officer                        |
| David D. Howell       | 56         | Vice President Market Development               |
| Jubal R. Thompson     | 37         | General Counsel and Secretary                   |
| A. Clayton Perfall    | 52         | Director  |
| David M. Guernsey     | 52         | Director  |
| James A. MacCuthcheon | 44         | Director  |
| Robert P. Pincus      | 52         | Director  |
| Socrates Verses       | 58         | Director  |
| Norman D. Chirite     | 51         | Director  |

\* Section 16 officers.

*Christopher Clemente* founded Comstock in 1985 and has been director since May 2004. Since 1992, Mr. Clemente has served as our Chairman and Chief Executive Officer. Mr. Clemente has over 20 years of experience in all aspects of real estate development and home building, and 25 years of experience as an entrepreneur.

*Gregory V. Benson* joined us in 1991 as President and Chief Operating Officer and has been director since May 2004. Mr. Benson is also a member of our board of directors. Mr. Benson has over 30 years of home building experience including over 13 years at national home builders, including NVHomes, Ryan Homes and Centex Homes.

*Bruce J. Labovitz* has served as our Chief Financial Officer since January 2004, after serving as our Vice President Finance from April 2002 to January 2004 and Vice President Investment Finance from January 2002 to April 2002. From June 2001 to January 2002, Mr. Labovitz was a Vice President of Viking Communications, a telecommunications company. From November 2000 to June 2001, Mr. Labovitz was the President, Marketing & Services of Inlec Communications, a telecommunications company. Prior to that, from May 1996 to November 2000, Mr. Labovitz was Executive Vice President/ Chief Operating Officer of BMK Advertising, an advertising agency.

*Jason Parikh* has served as our Chief Accounting Officer since April 2004. Mr. Parikh was Chief Financial Officer and Secretary of On-Site Sourcing, Inc. from May 2000 to April 2004 and Controller from July 1997 to May 2000. From July 1994 until July 1997, Mr. Parikh was Controller of Shirt Explosion Inc., a clothing manufacturer.

*David D. Howell* has served as our Vice President Market Development since August 2004. Prior to that, from July 2000 to July 2004, Mr. Howell served as Vice President Comstock Homes of Washington. From 1995 to March 2000, Mr. Howell was a Division President with M/ I Homes, Inc., a national home builder. Prior to that Mr. Howell spent

several years as division manager at Ryan Homes.

*Jubal R. Thompson* has served as our General Counsel since October 1998 and our Secretary as of December 2004. From April 2002 to April 2003, Mr. Thompson also served as our Vice President Finance. From 1995 to 1998, Mr. Thompson was associated with Robert Weed & Associates, PLLC, a law firm.

*A. Clayton Perfall* has been a director since December 2004, and is a member and Chairman of the Audit Committee of our Board of Directors. He has served as the Chief Executive Officer and as a director of AHL Services, Inc., a provider of outsourced business services, since October 2001. Prior to that, from December 2000 to September 2001, Mr. Perfall served as the Chief Executive Officer of Convergence Holdings, a marketing services company. From September 1996 to October 2000, Mr. Perfall served as the Chief Financial Officer and a director of Snyder Communications, a marketing services company. Prior to that, Mr. Perfall was a partner at Arthur Andersen LLP.

*David M. Guernsey* has been a director since December 2004, and is a member of the Compensation Committee of our Board of Directors. Mr. Guernsey has served as the President and Chief Executive Officer of Guernsey Office Products, Inc., an office supply company, since May 1971. Mr. Guernsey serves on the Board of Directors of Virginia Commerce Bancorp, Inc., a banking company.

*James A. MacCutcheon* has been a director since December 2004, and is a member of the Audit Committee of our Board of Directors. Mr. MacCutcheon has served as the President and Chief Executive Officer of Sunburst Hospitality Corporation, a private hospitality company, since September 2000 and served as its Executive Vice President and Chief Financial Officer from 1997 to September 2000.

*Robert P. Pincus* has been a director since June 2005 and is a member of the Audit Committee of our Board of Directors. Since March 2005, Mr. Pincus has been the director of Fidelity & Trust Financial Corporation, a financial holding company, chairman of Fidelity & Trust Bank, a regional banking institution, and a director of Fidelity & Trust Mortgage Inc., a regional mortgage lending company. He also has served as chairman of Milestone Capital Partners, a private equity firm, since October 2002, and director of the Mills Corporation, a NYSE listed company, since April 1994. From 2000 to 2002, Mr. Pincus served as regional Chairman of the Board and from 1998 to 2000 he served as regional chief executive officer and president of the Branch Banking and Trust Company's DC Metro Region. From 1991 to 1998, Mr. Pincus served as President of Franklin Bank prior to its acquisition by the Branch Banking and Trust Company. Mr. Pincus currently serves on the Board of the University of Maryland Foundation and is a Trustee of American University.

*Socrates Verses* has been a director since June 2005 and is a member of the Compensation Committee of our Board of Directors. Mr. Verses has been the President and Chief Executive Officer of Realeum, Inc., a property management and business integration software company, since March 2001. From January 1995 to February 2001, Mr. Verses served as President and a director of Technology Enablers, Inc., an e-services company. From 1987 to 1995, he served as Vice President of Sales for the Recognition Equipment Software Division of IBM Corporation.

*Norman D. Chirite* has been a director and a member of the Compensation Committee of our Board of Directors since March 2006. At that time, Mr. Chirite was nominated and appointed by the independent members of the Board of Directors to fill the vacancy created by the resignation of Gary Martin from the Board of Directors in February 2006. Mr. Chirite currently serves as Corporate Development Adviser to inVentiv Health, Inc., a provider of clinical, commercialization and communications services to the pharmaceutical and life sciences industries. He previously served as Executive Vice President and General Counsel of Washington Football Inc. from August 2002 until October 2005, and from May 2001 until July 2002, served as Managing Director of Counsel Corporation, an investment holding company. Prior to that, Mr. Chirite was a partner at Weil, Gotshal & Manges LLP in New York City, where he practiced corporate law from 1987 until 2000.

#### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Exchange Act requires our directors, officers, and persons that own more than 10% of a registered class of our Company's equity securities to file reports of ownership and changes in ownership with the SEC. Officers, directors, and greater than 10% stockholders are required by SEC regulations to furnish our Company with copies of

all Section 16(a) forms they file. Based solely upon our review of the copies of such forms received by us during the fiscal year ended December 31, 2006, and written representations that no other reports were required, we believe that each person who, at any time during such fiscal year, was a director, officer, or beneficial owner of more than 10% of our common stock complied with all Section 16(a) filing requirements during such fiscal year, except for the following, each of which was due to administrative error: (i) a Form 4 for each of

Messrs. Chirite, Guernsey, MacCutcheon, Perfall, Pincus and Verses to report stock awards that occurred on June 2, 2006 that were reported on August 28, 2006; and (ii) a Form 4 for Mr. Parikh to report stock awards that occurred on May 15, 2006 that were reported on August 28, 2006.

### **Code of Conduct**

Our Board of Directors has adopted a Code of Conduct and a Code of Ethics for the CEO and Senior Financial Officers. The Code of Conduct and Code of Ethics for the CEO and Senior Financial Officers are available on our website at [www.comstockhomebuilding.com](http://www.comstockhomebuilding.com). The Code of Conduct and Code of Ethics for the CEO and Senior Financial Officers are also available in print to any stockholder requesting a copy in writing from our corporate secretary at our executive offices. We intend to disclose any amendments to or waivers of a provision of our Code of Conduct or Code of Ethics for the CEO and Senior Financial Officers made with respect to our directors or executive officers on our website.

### **Audit Committee**

The Audit Committee currently consists of Messrs. MacCutcheon, Perfall and Pincus, each of whom is an independent director of our Company under the Nasdaq marketplace rules as well as under rules adopted by the SEC pursuant to the Sarbanes-Oxley Act of 2002. The Board of Directors has determined that Mr. Perfall (whose background is detailed above) qualifies as an Audit Committee financial expert in accordance with applicable rules and regulations of the SEC. Mr. Perfall serves as the Chairman of the Audit Committee.

## **ITEM 11. *Executive Compensation***

### ***Compensation Discussion and Analysis***

This section discusses the principles underlying our executive compensation policies and decisions and the most important factors relevant to an analysis of these policies and decisions. It provides qualitative information regarding the manner and context in which compensation is awarded to and earned by our executive officers and places in perspective the data presented in the narrative and tables that follow.

#### **Overview**

*Compensation Philosophy.* Our executive compensation program is intended to:

Attract, retain, motivate and reward highly qualified executive officers who preserve and create value for our stockholders; and

Reinforce our performance oriented, results-based culture that rewards individual and corporate successes.

Our executive compensation program is also designed to link executive pay levels with individual performance, our financial performance and stockholder returns.

Our executive compensation program currently has three primary components:

base salaries that are intended to be competitive relative to other publicly traded companies in our industry and peer group;

annual cash bonuses under a performance-based cash bonus program; and

long-term incentive compensation that is delivered principally through grants of shares of restricted stock, deferred stock and stock option awards.

*Role of Compensation Committee and CEO.* The Compensation Committee of our Board of Directors has primary responsibility for reviewing, approving and determining the compensation of our executive officers. Annually, our Compensation Committee evaluates the performance of the CEO and determines the CEO's compensation in light of the goals and objectives of the compensation program. The CEO and Compensation Committee together annually assess the performance of the other named executive officers. The CEO also proposes compensation packages for the other executive officers, which the Committee considers and evaluates. The other



named executive officers do not play a role in their own compensation determination, other than discussing individual performance objectives with the CEO. Upon reviewing and evaluating the performance of both the CEO and the other named executive officers and the CEO's proposals for compensation packages for the other named executive officers, the Committee decides the compensation packages for the executive officers and recommends that the full Board of Directors approve the packages. The Committee makes regular reports to the full Board of Directors on the Committee's activities, and the Committee prepares an annual report on executive compensation for inclusion in our proxy statement.

*Role of Compensation Consultant.* The Compensation Committee has the sole authority to select, retain and/or replace any compensation or other outside consultant for assistance in the evaluation of director, CEO or other executive officers' compensation, including the sole authority to approve the consultant's fees and other retention terms. In 2004, the Company selected PricewaterhouseCoopers LLP, or PwC, as its compensation consultant in connection with its initial public offering. This relationship was renewed in 2006 when the Committee engaged PwC as its compensation consultant. The Committee considers PwC to be independent and selected PwC because of its experience in compensation consulting and its knowledge of compensation practices in the homebuilding industry and among newly public companies. Services provided by PwC have included evaluating our existing executive officer and director compensation based on market comparables, analyzing compensation design alternatives and advising us on the new proxy statement disclosure rules. PwC assisted the compensation committee with its evaluation of peer group comparables but did not provide specific recommendations on compensation decisions regarding the CEO or other executive officers.

### **Objectives of the Comstock Executive Compensation Programs**

We believe strongly in pay-for-performance and measurement of quantifiable results. While base salaries for the CEO and other executive officers should reflect the marketplace for similar positions, a significant portion of their compensation is earned based on their individual job performance, our financial performance and the financial performance of each executive's area of responsibility. While quantifiable performance objectives are established in advance and approved by the Compensation Committee, we also provide potentially significant incentives for exceeding performance objectives. Our emphasis on measurable performance objectives emanates from our belief that sustained strong financial performance is an effective means of enhancing long-term stockholder return.

The Compensation Committee considers competitive benchmarking data in the establishment of base salaries, incentive targets, equity awards and total compensation levels. In 2006 the Committee relied on a benchmarking study conducted by PwC during 2006 based principally on reported data for 2005. The study compared Comstock's executive compensation levels, mix of compensation elements and plan designs to nine comparable publicly traded homebuilders: Standard Pacific, Technical Olympic USA, Inc., Meritage Corporation, WCI Communities, Inc., M/I Homes, Inc., William Lyon Homes, Dominion Homes, Inc., Orleans Homebuilders, Inc. and Avatar Holdings, Inc.

### **Elements of our Executive Compensation Program**

*Base Salary.* The base salary we pay to our executive officers was negotiated as part of their employment agreements for the term of the employment agreements or negotiated at the time of hire in the case of Mr. Jason Parikh, the only executive officer who does not have an employment agreement. Base salaries for our executive officers depend on the scope of their responsibilities, qualifications, experience, prior salary and competitive salary information, performance, and the period over which they have performed those responsibilities. In 2006, the Compensation Committee approved, subject to approval by the full Board of Directors, execution of an employment agreement with Mr. Jubal Thompson, our General Counsel and Secretary. The base salary payable to Mr. Thompson under the agreement is \$200,000, representing a 33% increase over Mr. Thompson's base salary in 2005. In 2006, the Committee also approved, subject to approval by the full Board of Directors, increased salaries of \$700,000, \$400,000 and

\$200,000 for Christopher Clemente, our Chief Executive Officer and Chairman, Bruce Labovitz, our Chief Financial Officer, and Jason Parikh, our Chief Accounting Officer, respectively. These salary increases represent a 27%, 33% and 33% increase over Mr. Clemente's, Mr. Labovitz's and Mr. Parikh's base salaries in 2005, respectively. The full Board of Directors approved Mr. Thompson's employment agreement and the salary increases for Messrs. Clemente, Labovitz and Parikh.

*Benefits and Perquisites.* Our executive officers are able to participate in the employee benefits that are available to all employees. In addition, we provide benefits and perquisites to our executive officers based on the terms of their employment agreements. None of our named executive officers received perquisites in 2006 that exceeded \$10,000 in value.

*Incentive Compensation.* Our incentive compensation is composed of a cash bonus based on the achievement of annual individual performance goals and corporate performance goals, and equity awards typically consisting of grants of shares of restricted stock, deferred stock and stock option awards.

*Annual Cash Incentive Plan.* We provide a cash bonus opportunity to all of our employees including our executive officers. The performance goals for our executive officers are based in part on individual performance goals, our Company's performance, and the achievement of a pre-established annual pre-tax net income goal. The other portion of the bonus is based on the specific performance goals of the individual executive. Seventy-five percent (75%) of the total cash bonus potential of the executive is based on the executive officer accomplishing his/her annual individual performance goals, otherwise known as the Performance Bonus. Twenty-five percent (25%) is based on the Company meeting its annual pre-tax net income goal, otherwise known as the Net Income Bonus.

Our Compensation Committee chose pre-tax net income as the indicator of corporate performance because it believed that we should reward our executive officers based on the profitability of the Company. Our Compensation Committee considered pre-tax net income to be the best indicator of financial success and stockholder value creation. The personal performance objectives are determined by the executive officer to whom the potential bonus recipient reports or, in the case of our chief executive officer, by our Compensation Committee.

In 2006 the Company initiated an additional bonus program for certain executives and executive officers whose positions are such that they can directly impact the bottom line results of the Company. This is known as the Executive Management Income Percentage Bonus Program (Income Percentage Bonus). Eligible executives may earn a cash bonus override over and above the executive's Net Income Bonus, based on the earnings generated by the division(s) or operating unit(s) of the Company that the executive has responsibility for managing. The Income Percentage Bonus is intended to reward executives for their leadership and management of profit center operations, and of the Company, and is designed to create incentives for executives to maximize the financial performance of the Company's divisional operations, regional operations and the Company as a whole. The potential amount of the Income Percentage Bonus is limited only by the profitability of the company and ranges from 1% to 3% of pre-tax income. As a result of current operating conditions and limited long-term earnings predictability in the homebuilding industry, the Compensation Committee has not made a recommendation to the full Board of Directors with respect to the target pre-tax net income level which will serve as the basis for the 2007 Net Income Bonus. The Committee will, based in part on input to be provided by executive management of the Company, make a recommendation to the full Board of Directors regarding the target pre-tax net income level later in 2007.

In 2006 no Income Percentage Bonus was paid. In addition, no executive officer received Net Income Bonus. In recognition of the difficult market conditions which existed at year end and the pressures on the Company's liquidity, the CEO recommended, and the Board of Directors agreed, to pay substantially all of the bonuses earned by the named executives and other employees with Company stock in lieu of cash. Our CEO received 100% of his Performance Bonus as stock with no provision for tax.

*Long-Term Incentive Compensation.* In 2006, our long-term incentive compensation consisted of grants of restricted stock and deferred stock awards. By providing executives with an ownership stake in the Company, grants of restricted stock and deferred stock awards are intended to align executive interests with stockholder interests and to motivate executives to focus on maximizing the long-term performance of the Company. Use of restricted stock as a

part of the annual grant process is intended to encourage direct share ownership by executives and to provide an additional retention incentive for members of the executive team.

Grants of restricted and deferred stock during 2006, and in 2007 regarding 2006 performance, were awarded under our 2004 Long-Term Incentive Compensation Plan. Details on awards granted during 2006 to our CEO and other named executive officers may be found in the table entitled Grants of Plan-Based Awards. Details on all shares of restricted stock that vested in 2006 and option awards exercised in 2006 by our CEO and other named

executive officers may be found in the table entitled "Options Exercised and Stock Vested." Details on all outstanding restricted stock grants and stock option awards of our CEO and other named executive officers as of the end of 2006 may be found in the table entitled "Outstanding Equity Awards at Fiscal Year End."

No new stock option awards were granted in 2006 or in 2007 regarding 2006 performance. During 2006, restricted stock grants were made to named executive officers both in connection with 2005 performance and as additional long term retention incentives. These awards are detailed in the accompanying "Grants of Plan Based Awards" table. In June 2006, the Board of Directors, upon the recommendation of the Compensation Committee, approved the issuance of 250,000 shares of restricted stock to Mr. Labovitz which vest over a seven year period. As a result of limitations in the Company's equity incentive plan which establish a 150,000 share maximum grant of restricted stock to any single individual in a 12-month period, 165,195 shares of the 250,000 grant to Mr. Labovitz are issued contingent upon stockholder approval of an amendment to our equity incentive plan to be considered by our stockholders in connection with our 2007 annual meeting that would increase the annual per-person award limit. In August 2006, the Board of Directors, upon the recommendation of the Compensation Committee, approved the issuance of 60,000 shares of restricted stock to Mr. Parikh which vest over a seven year period. In August 2006, the Board of Directors, upon the recommendation of the Compensation Committee, approved the issuance of 19,841 shares of restricted stock to Mr. Thompson which vest over a 4 year period.

In April 2007, in connection with 2006 performance, the Compensation Committee granted shares of restricted and deferred stock to the CEO and other named executive officers some of which were contingent upon stockholder approval of an amendment to our equity incentive plan to be considered by our stockholders in connection with our 2007 annual meeting as referenced above. Mr. Clemente received an award of 148,148 shares of restricted stock and 151,764 shares of contingent restricted stock, Mr. Benson received an award of 117,284 shares of restricted stock and 96,939 shares of contingent restricted stock, Mr. Labovitz received an award of 64,938 shares of contingent restricted stock and 34,898 shares of deferred stock, Mr. Parikh received an award of 11,605 shares of restricted stock and 13,087 shares of deferred stock, and Mr. Thompson received an award of 25,069 shares of restricted stock and 13,087 shares of deferred stock. In determining the number of shares to award, the Committee considered several different factors including competitive practices among the peer group companies, individual performance during 2006 and our achievements navigating through the extremely challenging operating environment of 2006.

All equity awards granted to our executive officers in 2006, and in 2007 with respect to 2006 performance, were approved by the Compensation Committee and the full Board of Directors. The restricted stock issued in 2006 and 2007 vests over varying terms. This vesting is contingent on the continued employment of the executive officer. The majority of restricted stock grants issued by the Company have identical four (4) year vesting schedules. Each deferred stock grant issued in 2007 in connection with 2006 performance has a single fixed vesting date prior to December 31, 2007, was fully expensed in 2006 through an accrual of compensation liability and is not contingent on continued employment.

*Executive Severance Programs.* Consistent with peer-group practice (as determined in PwC's 2006 research), we have entered into employment agreements, which we believe to be consistent with industry practices, with all but one of our executive officers. The purpose of these employment agreements is to enhance our executive recruiting and retention efforts. PwC's 2006 research indicated that the severance-related benefits provided to our executive officers in these agreements are at the lower end of the peer-group range of practices.

Pursuant to the terms of the option grant notices and restricted stock award notices, all unvested option awards for Messrs. Clemente, Benson, Labovitz, Parikh and Thompson would become immediately exercisable upon a change-in-control of Comstock unless the unvested options are assumed by the acquirer. In addition, all unvested shares of restricted stock would immediately vest unless our repurchase rights are assigned to the acquirer.



## **Impact of Regulatory Requirements**

The Compensation Committee considers regulatory requirements and their impact when making executive compensation decisions concerning the CEO and other executive officers. Regulatory requirements that influence the Committee's decisions include:

Internal Revenue Code Section 162(m) of the Internal Revenue Code disallows a tax deduction to public companies for compensation not deemed to be performance-based over \$1,000,000 paid for any fiscal year to the CEO and other executive officers. We intend to attempt to qualify executive compensation for deductibility under applicable tax laws to the fullest extent practicable. We believe that our bonus programs qualify for the performance-based exception. We also believe that we will not lose any compensation-related tax deductions for compensation decisions made in 2006 but may experience gains or losses on the tax we have recorded based on the variance between the price of our stock on the date of issuance of a restricted stock award and the actual price of our stock on the date of vesting of the stock award. The Compensation Committee will not, however, necessarily seek to limit executive compensation to the amount deductible under Section 162(m).

We believe that employees will not be subject to any tax penalties under Internal Revenue Code Section 409A as a result of participating in any of our compensation programs or agreements.

We adopted SFAS No. 123R for the 2006 fiscal year. In determining restricted stock and stock option awards for 2006, the Committee generally considered the potential expense of those programs under SFAS No. 123R and the impact on earnings per share. The Committee concluded that the award levels were in the best interests of stockholders given competitive compensation practices in the homebuilding industry and among our peer companies, the awards' potential expense, the Company's performance, and the impact of the awards on employee motivation and retention.

## **Conclusions**

We believe that our executive compensation programs strongly support our philosophy of pay-for-performance. We further believe that compensation levels and programs for the CEO and other executive officers are consistent with competitive practices in our industry and thus advance our recruiting and retention objectives. We will continue to review our programs on a regular basis and expect to update them from time to time, based on changes in competitive practices, regulatory requirements and corporate needs.

## **Compensation Committee Report**

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management. Based on these reviews and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company's Annual Report on Form 10-K.

Respectfully submitted by the Compensation Committee,

Socrates Verses, Chair  
Norman D. Chirite  
David M. Guernsey





| Name and Principal Position   | Year | Summary Compensation Table(1), (4) |        |                 |                  |   | Total Compensation |
|---|------|------------------------------------|--------|-----------------|------------------|---|--------------------|
|   |      | Salary                             | Bonus  | Stock Awards(2) | Option Awards(2) | Non-equity Incentive Plan Compensation(3) |                    |
|   |      | \$                                 | \$     | \$              | \$               | \$  | \$                 |
| Christopher Clemente<br>Chairman of the Board and<br>Chief Executive Officer (PEO)<br>(5) | 2006 | 637,500                            | 76,100 | 400,894         | 144,209          | 665,000                                   | 1,923,703          |
| Bruce J. Labovitz<br>Chief Financial Officer (PFO)  | 2006 | 358,333                            |        | 603,760         | 330,978          | 285,000                                   | 1,578,071          |
| Gregory V. Benson<br>Regional President   | 2006 | 550,000                            |        | 300,314         | 48,071           | 475,000                                   | 1,373,385          |
| Jason Parikh<br>Chief Accounting Officer  | 2006 | 186,667                            |        | 83,515          | 24,033           | 106,875                                   | 401,090            |
| Jubal Thompson<br>General Counsel and Secretary   | 2006 | 197,917                            |        | 90,127          | 24,033           | 106,875                                   | 418,952            |

- (1) No named executive officer was a participant in a defined benefit or deferred compensation plan.
- (2) Actual GAAP expenses incurred during 2006 with respect of awards issued under the 2004 Equity Incentive Plan. A discussion of the assumptions used in calculating these values may be found in our annual report at Note 14 to our 2006 audited financial statements.
- (3) These amounts were accrued at December 31, 2006 as incentive plan compensation awards payable in 2007 for 2006 performance. However, prior to their payment, the named officers agreed to receive all or a portion of the awards in shares of restricted or deferred stock.
- (4) On December 27, 2006, William Bensten, who was previously a named executive officer of the Company, resigned as a Senior Vice President. In connection with his resignation he purchased 30 unsold condominium units in one of the Company's condominium projects for a purchase price of \$4.2 million and he forfeited \$1.3 million of previously expensed but yet unvested restricted stock awards. As a result, \$1.3 million of the difference between the purchase price and the carrying value of the units has been recorded as compensation expense and is included in selling, general and administrative expense in the Company's audited 2006 financial statements. This expense was offset by the reversal of the \$1.3 million expense of forfeited stock awards.
- (5) Bonus payment relates to the reclassification, for tax purposes, of certain business related travel expenses paid to Mr. Clemente during the first half of 2006.

## Grants of Plan Based Awards During 2006

| Name                    | Grant Date | Compensation<br>Committed<br>Action<br>Date | Estimated<br>Possible Payouts |              |         | All Other<br>Stock<br>Awards:<br>Number<br>of<br>Shares of<br>Stock or<br>Units | Grant Date<br>Fair Value<br>of Equity<br>Awards |
|-------------------------|------------|---|-------------------------------|--------------|---------|---|---|
|                         |            |   | Threshold                     | Target       | Maximum |   |   |
| Christopher Clemente(2) | 03/31/06   | 2/24/2006                                   | \$ 825,000                    | \$ 1,100,000 |         | 77,078  | \$ 848,636                                      |
| Gregory V. Benson       | 03/31/06   | 2/24/2006                                   | \$ 825,000                    | \$ 1,100,000 |         | 54,705  | 602,298   |
| Bruce J. Labovitz(3)    | 03/31/06   | 2/24/2006                                   | \$ 300,000                    | \$ 400,000   |         | 30,297  | 333,567   |
|                         | 06/15/06   | 4/14/2006                                   |                               |              |         | 84,805  | 1,289,205                                       |
|                         | 06/15/06   | 4/14/2006                                   |                               |              |         | 165,195   | 1,403,295                                       |
| Jason Parikh            | 03/31/06   | 2/24/2006                                   | \$ 112,500                    | \$ 150,000   |         | 9,300   | 102,391   |
|                         | 08/28/06   | 06/01/06                                    |                               |              |         | 60,000  | 292,800   |
| Jubal Thompson          | 03/31/06   | 2/24/2006                                   | \$ 112,500                    | \$ 150,000   |         | 7,385   | 81,310  |
|                         | 08/29/06   | 06/01/06                                    |                               |              |         | 14,184  | 71,487  |
|                         | 12/29/06   | 06/01/06                                    |                               |              |         | 5,657   | 32,019  |

- (1) These columns show the range of payouts targeted for 2006 performance under the Comstock Net Income and Performance Bonus plans as described in the Compensation Discussion and Analysis. The 2007 bonus payment for 2006 performance has been made based on the metrics described and is shown in the Summary Compensation Table in the column titled Non-equity Incentive Plan Compensation.
- (2) Stock awards for Mr. Clemente include 492 shares of restricted stock granted to Tracy Schar, his wife, who serves as the Company's VP, Corporate Marketing. Excluded from the grants for Mr. Clemente are 21,882 shares of restricted stock granted to Mr. Clemente in March 2006 in lieu of cash related to a portion of his 2005 bonus.
- (3) The 165,195 shares of restricted stock granted to Mr. Labovitz in June 2006 are contingent on approval of an amendment to our equity incentive plan that would increase the per-person award limit to be considered by our stockholders in connection with our 2007 annual meeting.

## Outstanding Equity Awards at December 31, 2006(1)

| Option Awards                            |                                       |                             |                      | Stock Awards   |   |
|--|---------------------------------------|-----------------------------|----------------------|--|---|
| Number<br>of<br>Securities<br>Underlying | Number of<br>Securities<br>Underlying | Option<br>Exercise<br>Price | Option<br>Expiration | Number<br>of<br>Shares or<br>Units of<br>Stock<br>That<br>Have Not<br>Vested | Market  |
|  |                                       |                             |                      |  | Value<br>of Shares<br>or Units of<br>Stock That<br>Have Not<br>Vested |
| Unexercised<br>Options<br>(#)(2)         | Unexercised<br>Options<br>(#)(2)      |                             |                      |  |   |

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| Name                    | Exercisable | Unexercisable | (\$)  | Date     | (#)     | (\$)(4)      |
|-------------------------|-------------|---------------|-------|----------|---------|--------------|
| Christopher Clemente(3) | 10,274      | 30,822        | 23.90 | 07/06/15 | 78,020  | \$ 448,615   |
| Gregory V. Benson       | 3,425       | 10,274        | 23.90 | 07/06/15 | 54,705  | \$ 314,554   |
| Bruce J. Labovitz(5)    | 7,877       | 23,630        | 23.90 | 07/06/15 | 289,672 | \$ 1,665,612 |
|                         |             | 107,144       | 16.00 | 12/14/14 |         |              |
| Jason Parikh            | 1,712       | 5,137         | 23.90 | 07/06/15 | 69,300  | \$ 398,475   |
| Jubal Thompson          | 1,712       | 5,137         | 23.90 | 7/6/2015 | 27,226  | \$ 156,550   |

(1) No executive officer had any unearned equity awards outstanding as of December 31, 2006.

(2) The vesting date of each option is listed in the table below by expiration date:

| Expiration Date | Vesting Date |
|-----------------|--------------|
| 12/14/2014      | 06/30/2007   |
| 12/14/2014      | 12/31/2007   |
| 12/14/2014      | 06/30/2008   |
| 12/14/2014      | 12/31/2008   |
| 07/06/2015      | 06/30/2007   |
| 07/06/2015      | 12/31/2007   |
| 07/06/2015      | 06/30/2008   |

(3) Includes 1,437 shares of restricted stock issued to Tracy Schar, Mr. Clemente's wife.

- (4) Based on closing price of \$5.75 per share of our Class A common stock on December 31, 2006.
- (5) Includes 165,165 shares of restricted stock granted to Mr. Labovitz in June 2006 which are contingent on an amendment to our equity incentive plan in connection with our 2007 annual meeting.

| Name                    | Stock Vested in 2006<br>Stock Awards                       |   |
|-------------------------|--|---|
|                         | Number<br>of<br>Shares<br>Acquired<br>on<br>Vesting<br>(#) | Value(1)<br>Realized<br>on<br>Vesting<br>(\$) |
| Christopher Clemente(2) | 9,689  | \$ 52,587                                     |
| Gregory V. Benson       | 6,250  | \$ 35,938                                     |
| Bruce J. Labovitz       | 15,625   | \$ 89,844                                     |
| Jason Parikh            | 3,125  | \$ 17,969                                     |
| Jubal Thompson          | 6,250  | \$ 29,688                                     |

- (1) Amounts reflect the market value of the stock at the closing of the market on the trading day immediately preceding the date on which the stock vested.
- (2) Includes 3,439 shares to Tracy Schar, his wife, with a value of \$16,469.

#### EMPLOYMENT ARRANGEMENTS WITH EXECUTIVE OFFICERS

Christopher Clemente and Gregory Benson each serve pursuant to the terms of executive employment agreements dated as of December 17, 2004. Mr. Clemente's agreement has an initial term of five years and Mr. Benson's has an initial term of four years. Each agreement will automatically be extended for successive one-year periods beginning on the one year anniversary of the date of the agreement unless either party notifies the other that the term will not be extended. Under the agreements, Mr. Clemente's and Mr. Benson's minimum annual salary is \$550,000, subject to potential increase by our Board of Directors from time to time. Mr. Clemente and Mr. Benson are eligible for a cash bonus of not less than 200% of his then-current salary, based upon the satisfaction of financial performance criteria. Mr. Clemente and Mr. Benson are also eligible for awards under our equity incentive plan and any similar executive compensation plans we may adopt from time to time. In 2006, our Board of Directors increased the minimum annual salary payable to Mr. Clemente to \$700,000.

Mr. Clemente has agreed not to compete with us during the term of his employment and for two years after the termination of the agreement. Mr. Benson has agreed not to compete with us during the term of his employment and for 18 months after the termination of the agreement. Each of Mr. Clemente's and Mr. Benson's employment agreements and non-competition agreements, allow them to engage in the following permitted business activities: (i) development of commercial or for-rent residential (such as apartment buildings) real estate investment properties; (ii) development of speculative land holdings as residential lots intended for construction of for-sale residential dwellings, provided, however, that any such development by any entity in which Mr. Clemente or Mr. Benson, as applicable, has a controlling interest or decision-making power, must first be offered to the Company at a fair market

value price; and (iii) secured real estate lending to unrelated third parties. In addition, each has agreed not to (i) engage in any for-sale residential construction activities in any of our then existing markets or in any market which we then plan to enter within six-months; or (ii) solicit our employees or certain other third parties for 24 months, in the case of Mr. Clemente and 18 months in the case of Mr. Benson.

Bruce Labovitz serves pursuant to the terms of an executive employment agreement dated December 17, 2004. Jubal Thompson serves pursuant to the terms of an executive employment agreement dated August 29, 2006. Each agreement has an initial term of three years and will automatically renew for successive one-year periods beginning on the one year anniversary of the date of the agreement unless either party notifies the other that the term will not be extended. Under his agreement, Mr. Labovitz's minimum annual salary is \$300,000, subject to potential increase by our Board of Directors from time to time. In 2006 our Board of Directors increased the minimum annual salary

payable to Mr. Labovitz to \$400,000. Under his agreement, Mr. Thompson's minimum annual salary is \$200,000, subject to potential increase by our Board of Directors from time to time.

### POTENTIAL PAYMENTS ON TERMINATION OR CHANGE IN CONTROL

Under the employment agreements with Messrs. Clemente, Benson, Labovitz and Thompson, if such executive's employment is terminated without cause or if such executive were to terminate his employment for good reason, each as defined in the agreement, such executive is entitled to continue to receive his then-current salary for 24, 18, 12 and 12 months, respectively. Messrs. Clemente, Benson, Labovitz and Thompson will also be entitled to receive a cash payment in an amount equal to two times, one and one half times, one times and one times, respectively, 100% of the bonus he would have been entitled to had he remained our employee until the end of our fiscal year. This cash payment will be due and payable on the earlier of (i) 90 days after our last payment of such executive's then-current salary or (ii) the end of the fiscal year in which our termination of such executive without cause or such executive's termination for good reason occurs. In the event of our termination of such executive without cause or such executive's termination for good reason within the six calendar month period prior to the effective date of a Change in Control (as defined in the agreement) or within the 12 calendar month period following the effective date of a Change in Control, the cash payment will be due and payable in full within 30 days of the effective date of the Change in Control. Upon termination without cause, each executive is further entitled to continue to participate in employee benefit plans, programs and arrangements for a period of 12 months following termination.

Furthermore, subject to certain termination events, we have agreed to reimburse Mr. Labovitz for premium payments he makes on his life insurance policy with a national insurer. These reimbursements are in addition to the standard insurance benefits provided by us to our employees. The reimbursement of life insurance expenses covers the period January 1, 2005 through December 31, 2008. The annual premium reimbursement payable by us shall not exceed \$6,000.

The following table describes the potential payments and benefits to which our executive officers would be entitled upon the happening of the following events: (i) a change of control of Comstock (with no termination of employment), (ii) a change in the executive's responsibilities by us, (iii) the executive's death or disability and (iv) termination of the executive's employment by us without cause. Calculations for this table are based on the following assumptions: (i) the triggering event took place on December 31, 2006, (ii) bonus amounts are based on the 2006 Net Income Bonus and (iii) the per share price of our Class A common stock is \$5.75, the closing price on December 29, 2006.

|                      | Change of Control |                              | Change in Responsibilities |                              |
|----------------------|-------------------|------------------------------|----------------------------|------------------------------|
|                      | Cash              | Acceleration of Stock Awards | Cash                       | Acceleration of Stock Awards |
| Christopher Clemente | \$ 4,066,000      | \$ 443,201                   | \$ 4,066,000               | \$                           |
| Bruce Labovitz       | \$ 948,000        | \$ 1,665,612                 | \$ 948,000                 | \$                           |
| Gregory Benson       | \$ 2,731,000      | \$ 314,554                   | \$ 2,731,000               | \$                           |
| Jason Parikh         | \$                | \$ 398,475                   | \$                         | \$                           |
| Jubal Thompson       | \$ 606,000        | \$ 156,550                   | \$ 606,000                 | \$                           |

### Directors Compensation

We pay each non-employee director an annual retainer fee of \$36,000, plus \$2,000 for each regular meeting of the Board of Directors attended. We pay our non-employee directors \$5,000 to serve on the Audit Committee, \$3,000 to serve on the Compensation Committee and \$2,000 for each committee meeting attended. The chairman of the Compensation Committee is paid \$6,000, the chairman of the Audit Committee is paid \$15,000 and the Audit Committee designated financial expert is paid \$32,500. All payments to our non-employee directors are paid 50% in cash and 50% in shares of restricted stock based on the stock price at the date of commencement of their term or the date of the annual meeting in the case of members not up for re-election in a given year. Directors are also eligible to participate in our equity incentive plan. We also reimburse our directors for travel and related expenses incurred in connection with attendance at board and committee meetings. Employees who also serve as directors receive no additional compensation for their services as a director.

The following table details the compensation earned by our non-employee directors in 2006:

| <b>Name</b>       | <b>Fees Earned<br/>or Paid in<br/>Cash in 2006<br/>(\$)(1)</b> | <b>Stock<br/>Awards<br/>(\$)(2)</b> | <b>Total<br/>(\$)</b> |
|-------------------|--|-------------------------------------|-----------------------|
| Norman Chirite    | 80,999   | 11,727                              | 92,726                |
| Socrates Verses   | 36,978   | 24,003                              | 60,981                |
| Clayton Perfall   | 69,973   | 46,447                              | 116,420               |
| David Guernsey    | 32,588   | 23,581                              | 56,169                |
| James MacCutcheon | 35,426   | 24,414                              | 59,840                |
| Robert Pincus     | 35,426   | 23,993                              | 59,419                |

- (1) Includes annual retainer fees, advisory fees, committee participation fees and meeting attendance stipends paid in cash or earned in 2006.
- (2) No stock options were granted in 2006. Prior to 2006, directors have received no stock option awards. The aggregate number of stock awards outstanding at 12/31/06 and their fair value at grant date are shown below:

|                   | <b>Grant Date</b> | <b>Stock<br/>Awards<br/>Outstanding<br/>at 12/31/06<br/>(#)</b> | <b>Grant<br/>Price<br/>(\$)</b> | <b>Grant Date<br/>Fair Value<br/>of Equity<br/>Awards<br/>(\$)</b> |
|-------------------|-------------------|---|---------------------------------|--|
| Norman Chirite    | 7/24/2006         | 3,992   | 5.71                            | 22,794   |
| Socrates Verses   | 7/24/2006         | 3,992   | 5.71                            | 22,794   |
| Clayton Perfall   | 7/21/2006         | 280   | 5.59                            | 1,565  |
|                   | 7/24/2006         | 7,738   | 5.71                            | 44,184   |
| David Guernsey    | 7/24/2006         | 3,992   | 5.71                            | 22,794   |
| James MacCutcheon | 7/24/2006         | 4,132   | 5.71                            | 23,594   |
| Robert Pincus     | 7/24/2006         | 4,132   | 5.71                            | 23,594   |

#### **COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

During the fiscal year ended December 31, 2006, our Compensation Committee consisted of Messrs. Chirite, Guernsey, Martin and Verses. Mr. Martin resigned from the Board of Directors, effective February 28, 2006. Mr. Chirite was appointed to the Compensation Committee on June 1, 2006. None of these individuals had any contractual or other relationships with us during the fiscal year except as directors.

#### **ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

##### **EQUITY COMPENSATION PLAN INFORMATION**



The following table sets forth certain information as of the end of the most recently completed fiscal year with respect to compensation plans (including individual compensation arrangements) under which Comstock equity securities are authorized for issuance.

| <b>Plan Category</b>                                      | <b>Number of Securities<br/>to be Issued Upon<br/>Exercise of<br/>Outstanding<br/>Options, Warrants<br/>and Rights</b> | <b>Weighted<br/>Average<br/>Exercise Price of<br/>Outstanding<br/>Options,<br/>Warrants<br/>and Rights</b> | <b>Number of<br/>Securities<br/>Remaining<br/>Available<br/>for Future<br/>Issuance</b> |
|---|--|--|---|
| Equity compensation plans approved<br>by security holders | 207,144  | \$ 19.81   | 927,005   |

**SECURITY OWNERSHIP OF PRINCIPAL STOCKHOLDERS, DIRECTORS AND OFFICERS**

The following table sets forth certain information regarding the beneficial ownership of our common stock on April 16, 2007, by (1) each director and named executive officer of our Company, (2) all directors and executive officers of our Company as a group, and (3) each person known by us to own more than 5% of our common stock.

Beneficial ownership is determined in accordance with the rules of the SEC. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of Class A common stock subject to options held by that person that are currently exercisable or will become exercisable within 60 days after April 16, 2007, are deemed outstanding, while the shares are not deemed outstanding for purposes of computing percentage ownership of any other person. Unless otherwise indicated in the footnotes below, the persons and entities named in the table have sole voting or investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

| Name of Beneficial Owner                           | Class A                   |                  | Class B                |                  | Beneficial Ownership of Class A and Class B Common Stock Combined |                |
|--|---------------------------|------------------|------------------------|------------------|---|----------------|
|  | Common Stock(1)<br>Number | Percent of Class | Common Stock<br>Number | Percent of Class | Economic (%)  | Voting (%) (1) |
| <b>Executive Officers and Directors</b>            |                           |                  |                        |                  |   |                |
| Christopher Clemente(2)                            | 1,483,715                 | 10.8%            | 1,366,750              | 50.0%            | 17.3%   | 40.1%          |
| Gregory V. Benson(3)                               | 1,142,247                 | 8.3%             | 1,366,750              | 50.0%            | 15.2%   | 39.5%          |
| Bruce J. Labovitz(4)                               | 157,817                   | 1.1%             | *                      | *                | 1.0%  | *              |
| Jason Parikh(5)                                    | 99,444                    | *                | *                      | *                | *   | *              |
| A. Clayton Perfall                                 | 11,774                    | *                | *                      | *                | *   | *              |
| David M. Guernsey                                  | 12,956                    | *                | *                      | *                | *   | *              |
| James A. MacCuthcheon                              | 16,266                    | *                | *                      | *                | *   | *              |
| Robert P. Pincus                                   | 5,312                     | *                | *                      | *                | *   | *              |
| Socrates Verses(7)                                 | 7,214                     | *                | *                      | *                | *   | *              |
| Norman D. Chirite                                  | 15,542                    | *                | *                      | *                | *   | *              |
| All directors and officers as a group (11 persons) | 2,952,291                 | 21.4%            | 2,733,500              | 100%             | 34.4%   | 80.2%          |
| <b>Other 5% Stockholders</b>                       |                           |                  |                        |                  |   |                |
| Hayground Cove Asset Management(7)                 | 867,300                   | 6.3%             | *                      | *                | 5.3%  | 1.6%           |
| Springhouse Asset Management, LLC(7)               | 1,338,762                 | 9.7%             | *                      | *                | 8.1%  | 2.4%           |
| Bonanza Capital, Ltd.(7)                           | 1,075,000                 | 7.8%             | *                      | *                | 6.5%  | 2.0%           |
| Boston Partners Asset Management, L.L.C.(7)        | 701,030                   | 5.1%             | *                      | *                | 4.3%  | 1.3%           |
| Hotchkis and Wiley Capital Management, LLC(7)      | 746,400                   | 5.4%             | *                      | *                | 4.5%  | 1.4%           |
| Royce & Associates, LLC(7)                         | 904,630                   | 6.6%             | *                      | *                | 5.5%  | 1.7%           |

\* Less than 1% of the outstanding shares of common stock

- (1) Does not include shares of Class A common stock issuable upon conversion of Class B common stock. Percentage total voting power represents voting power with respect to all shares of our Class A and Class B common stock, as a single class. Each holder of Class B common stock shall be entitled to fifteen votes per share of Class B common stock and each holder of Class A common stock shall be entitled to one vote per share of Class A common stock on all matters submitted to our stockholders for a vote. The Class A common stock and the Class B common stock vote together as a single class on all matters submitted to a vote of our stockholders, except as may otherwise be provided in our certificate of incorporation or as required by law. The

Class B common stock is convertible at any time by the holder into shares of Class A common stock on a share-for-share basis.

- (2) Includes 10,274 shares issuable upon the exercise of options that are exercisable within 60 days of April 16, 2007. 96,243 shares of Class A common stock are held by Mr. Clemente's wife, Tracy Schar. 69,333 shares of Class A common stock and 1,366,750 shares of Class B common stock are held by FR54, LLC, an entity that is owned by Mr. Clemente and his wife. 5,000 shares are held in various trusts for the benefit Mr. Clemente's children. Mr. Clemente is the custodian for each trust.
- (3) Includes 3,425 shares issuable upon the exercise of options that are exercisable within 60 days of April 16, 2007. 350,083 shares of Class A common stock and 1,366,750 shares of Class B common stock are held by Clareth LLC, an entity that is wholly owned by Mr. Benson.
- (4) Includes 7,877 shares issuable upon the exercise of options that are exercisable within 60 days of April 16, 2007. 1,722 shares are held in various trusts for the benefit of Mr. Labovitz's children. Mr. Labovitz is the custodian for each trust.
- (5) Includes 1,712 shares issuable upon the exercise of options that are exercisable within 60 days of April 17, 2007.
- (6) Includes 2,000 shares of Class A common stock, with respect to which Mr. Verses disclaims beneficial ownership. The shares are held in trust for the benefit of Mr. Verses' children. Mr. Verses' wife is the custodian of these trusts
- (7) This information is based on Schedule 13G, as amended, filed with the Securities and Exchange Commission by the stockholder.

**ITEM 13. *Certain Relationships and Related Party Transactions, and Director Independence***

**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Other than the transactions described under Item 11 Executive Compensation (or with respect to which information is omitted in accordance with SEC regulations) and the transactions described below, since January 1, 2006 there have not been, and there is not currently proposed, any transaction or series of similar transactions to which we were or will be a participant in which the amount involved exceeded or will exceed \$120,000 and in which any director, executive officer, holder of 5% or more of any class of our capital stock or any member of the immediate family of any of the foregoing persons had or will have a direct or indirect material interest.

We believe that all of these transactions are on terms that are comparable to or not less favorable than terms which would or could have been obtainable from unaffiliated third parties. All proposed future related party transactions will be submitted to our Board of Directors for review and will require a majority vote of the independent directors for approval. Ongoing transactions are reviewed annually to ensure that they are still comparable to or not less favorable than terms which would have or could have been obtainable from unaffiliated third parties. Our Chief Financial Officer, assuming he is not party to the proposed transaction, coordinates with the independent directors in evaluating the fairness to us of the proposed transaction.

In December 2006, Merion-Loudoun, LC, an entity wholly-owned by of William Bensten, a former senior vice president of the Company, purchased the 30 remaining undelivered condominium units at the Company's Villas at Countryside condominium project for \$4.2 million. In connection with the purchase of the units, Merion-Loudoun, LC

became the successor declarant of the condominium association and entered into an 18-month fee arrangement with Comstock Countryside, LLC, a wholly-owned subsidiary of the Company, to market and sell the units on its behalf.

In May 2003 and December 2005, we hired a construction company in Mr. Clemente's brother, Louis Clemente, serves as the President and is a significant shareholder, to provide construction services and act as a general contractor at two of the Company's developments. We paid approximately \$6.5 million to this construction company during the year ended December 31, 2006.

In April 2004, we entered into an additional three year \$5 million promissory note agreement, with an entity controlled by Scott Kasprowicz, bearing interest at a rate of 12%. Mr. Kasprowicz became a related party on June 1, 2004 when we hired his son. Under the terms of the note, we were advanced \$2.5 million in April 2004 and an additional \$2.5 million in June 2004. As a result of our consolidation in connection with our initial public offering, the lender was entitled to a premium of up to 10% of the outstanding principal balance. This note was paid in full in June 2005.

On October 1, 2004, we entered into a lease agreement with Comstock Asset Management, L.C., an entity owned by Christopher Clemente, for 20,609 square feet for our corporate headquarters. On August 1, 2005, the lease agreement was amended to add approximately 8,500 square feet of leased space. Total payments made under this lease agreement for 2006 were \$751,000.

In August 2004 we entered into a note agreement in the amount of \$163,000, which accrues interest at a rate of 10% per annum, with Investors Management, LLC. Investors Management, LLC is a related party which was partially owned by Messrs. Clemente, Benson and Labovitz. In February 2005, we received payment in full on this note. In March 2005 all other members assigned their membership rights to Mr. Benson giving him 100% ownership of Investors Management.

Mr. Clemente's mother-in-law, and Gary Martin, a former director who resigned effective February 28, 2006, each invested \$100,000 as minority shareholders in one of our subsidiaries, and the parents of Mr. Labovitz loaned approximately \$300,000 to another of our subsidiaries. During the first quarter 2005, we repurchased the minority interests for an approximate purchase price of \$136,000. In April 2005, the loan to the parents of Mr. Labovitz was paid in full.

During 2003, we entered into agreements with I-Connect, L.C., a company in which Investors Management, LLC holds a 25% interest, for information technology consulting services and the right to use certain customized enterprise software developed with input from us. The intellectual property rights associated with the software solution that was developed by I-Connect along with any improvements made thereto by us remained the property of I-Connect. During the year ended December 31, 2006, we paid \$471,000 to I-Connect.

In October 2004, we entered into an agreement with Comstock Asset Management Inc. to provide management services to us for a fee of \$20,000 a month. Comstock Asset Management Inc. is a related party wholly owned by Mr. Clemente. For the year ended December 31, 2006, we earned \$240,000 in revenue and recorded no receivable from this entity. Also, in November 2004, we entered into an agreement with Comstock Asset Management to sell retail condo units #1 through #5 at Potomac Yard for \$14.5 million. In connection with this sale, we received a deposit of \$8 million upon execution of this agreement. The agreement was modified in 2005 to reduce the deposit amount to \$6 million.

During the course of 2006, we provided bookkeeping services to related party entities at no charge.

In August 2004, we entered into a \$2.4 million promissory note agreement with Belmont Models I, L.C., an unrelated entity managed by Investors Management, LLC. The note bears an interest rate of 12%, which is payable monthly and matured in July 2005. In March 2005, we sold four condominium units to Belmont Models I, L.C. under a sale and leaseback arrangement. The four condominium units were delivered for a total purchase price of \$2 million and leased back at a rate of \$20,000 per month. We expect the lease to continue for a period of twenty-four months. As a result of the deliveries, the promissory note was reduced by the total purchase price. At December 31, 2006 the note was paid in full.

During 2005 we entered into sales contracts to sell homes to certain of our employees. We maintain a home ownership benefit program in order to attract, retain, and motivate employees. Under the home ownership benefits, an employee receives certain cost benefits provided by us when purchasing a home or having one built by us. Sales of homes to employees for investment purposes are conducted at market prices.

In September 2005, Comstock Foundation, Inc., an affiliate, was created. Comstock Foundation is a not-for-profit organization organized exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code. The affairs of Comstock Foundation are managed by a five person board of directors with Messrs. Clemente, Benson and Labovitz and Tracy Schar (employee of the Company and spouse of

Mr. Clemente) being four of the five. We also provide bookkeeping services to the affiliate. In October 2005 we made a \$100,000 cash donation to Comstock Foundation and granted the right to use 27 units at our Penderbrook condominium conversion project in Fairfax, Virginia for a period of six months. Comstock Foundation will provide these units to the victims of Hurricane Katrina. The fair market value of the rental units donated is \$237,000.

### **Procedures for Approval of Related Person Transactions**

Our policy for the review and approval of transactions between us and related persons is set forth in the charter of our Audit Committee. Pursuant to the charter of our Audit Committee, it is the responsibility of our Audit Committee, unless specifically delegated by our Board of Directors to another committee of the Board of Directors, to review and approve all transactions or arrangements to which we were or will be a participant in which the amount involved exceeded or will exceed \$120,000 and in which any director, executive officer, holder of 5% or more of any class of our capital stock or any member of the immediate family of any of the foregoing persons had or will have a direct or indirect material interest. Additionally, it is the responsibility of our Audit Committee, unless specifically delegated by our Board of Directors to another committee of the Board of Directors, to review and make recommendations to the Board of Directors, or approve, any contracts or other transactions with current or former executive officers of Comstock, including consulting arrangements, employment agreements, change-in-control agreements, termination arrangements, and loans to employees made or guaranteed by us.

### **Director Independence**

Our Board of Directors has determined, after considering all the relevant facts and circumstances, that each of Messrs. Chirite, Guernsey, MacCutcheon, Perfall, Pincus and Verses are independent directors, as independence is defined under the listing standards of the Nasdaq Global Market.

### **ITEM 14. *Principal Accountant Fees and Services***

The firm of PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited our consolidated financial statements for the fiscal year ended December 31, 2006. The aggregate fees billed to us by PricewaterhouseCoopers LLP for the fiscal years ended December 31, 2005 and 2006 are as follows:

|  | <b>2006</b>  | <b>2005</b> |
|--|--------------|-------------|
| Audit-Related Fees(1)                                | \$ 1,105,000 | \$ 948,800  |
| Tax Fees(2)  | \$ 110,000   | \$ 145,979  |
| Other Fees-Compensation and Peer Comparison Study(3) | \$ 66,051    | \$ 5,560    |

- (1) Includes fees related to the annual independent audit of the Company's financial statements and various fees related to services provided in connection with the Company's filing of Registration Statements with the Securities and Exchange Commission and related comfort letters.
- (2) Tax Fees represent amounts billed for tax compliance and advisory services.
- (3) Represents fees related to advisory services rendered in connection with the Company's study of compensation practices of peer companies.



The charter of our Audit Committee provides that the duties and responsibilities of our Audit Committee include the pre-approval of all audit, audit-related, tax, and other services permitted by law or applicable SEC regulations (including fee and cost ranges) to be performed by our independent registered public accounting firm. Any pre-approved services that will involve fees or costs exceeding pre-approved levels will also require specific pre-approval by the Audit Committee. Unless otherwise specified by the Audit Committee in pre-approving a service, the pre-approval will be effective for the 12-month period following pre-approval. The Audit Committee will not approve any non-audit services prohibited by applicable SEC regulations or any services in connection with a transaction initially recommended by the independent registered public accounting firm, the purpose of which may be tax avoidance and the tax treatment of which may not be supported by the Internal Revenue Code and related regulations.

To the extent deemed appropriate, the Audit Committee may delegate pre-approval authority to the Chairman of the Audit Committee or any one or more other members of the Audit Committee provided that any member of the Audit Committee who has exercised any such delegation must report any such pre-approval decision to the Audit Committee at its next scheduled meeting. The Audit Committee will not delegate to management the pre-approval of services to be performed by the independent registered public accounting firm.

Our Audit Committee requires that our independent registered public accounting firm, in conjunction with our Chief Financial Officer, be responsible for seeking pre-approval for providing services to us and that any request for pre-approval must inform the Audit Committee about each service to be provided and must provide detail as to the particular service to be provided.

All of the services provided by PricewaterhouseCoopers LLP described above under the captions Audit-Related Fees, Tax Fees and Other Fees were approved by our Audit Committee.

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## **Report of Independent Registered Public Accounting Firm**

### **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of Comstock Homebuilding Companies, Inc.

We have completed integrated audits of Comstock Homebuilding Companies, Inc.'s 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, and an audit of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

#### **Consolidated financial statements**

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Comstock Homebuilding Companies, Inc. at December 31, 2006 and December 31, 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

#### **Internal control over financial reporting**

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable

assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

McLean, Virginia

March 16, 2007

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**COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands, except per share data)

|  | <b>December 31,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|------------------------------|------------------------------|
| <b>ASSETS</b>  |                              |                              |
| Cash and cash equivalents  | \$ 21,263                    | \$ 42,167                    |
| Restricted cash  | 12,326                       | 10,800                       |
| Receivables  | 4,555                        | 6,365                        |
| Note receivables   |                              | 1,250                        |
| Due from related parties   | 4,053                        | 2,899                        |
| Real estate held for development and sale  | 405,144                      | 263,802                      |
| Inventory not owned - variable interest entities   | 43,234                       | 89,890                       |
| Property, plant and equipment, net   | 2,723                        | 605                          |
| Investment in real estate partnership  | (171)                        | (35)                         |
| Deferred income tax  | 10,188                       | 2,545                        |
| Other assets   | 14,114                       | 11,031                       |
| <b>TOTAL ASSETS</b>  | <b>\$ 517,429</b>            | <b>\$ 431,319</b>            |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                              |                              |
| Accounts payable and accrued liabilities   | 55,680                       | 59,131                       |
| Due to related parties   | 1,140                        | 40                           |
| Obligations related to inventory not owned   | 40,950                       | 83,015                       |
| Notes payable  | 265,403                      | 142,994                      |
| Junior subordinated debt   | 30,000                       |                              |
| Notes payable - related parties  |                              | 663                          |
| <b>TOTAL LIABILITIES</b>   | <b>393,173</b>               | <b>285,843</b>               |
| Commitments and contingencies (Note 15)  |                              |                              |
| Minority interest  | 371                          | 400                          |
| <b>SHAREHOLDERS' EQUITY</b>  |                              |                              |
| Class A common stock, \$0.01 par value, 77,266,500 shares authorized, 14,129,081 and 11,532,442 issued and outstanding, respectively | 141                          | 115                          |
| Class B common stock, \$0.01 par value, 2,733,500 shares authorized, 2,733,500 issued and outstanding                                | 27                           | 27                           |
| Additional paid-in capital   | 147,528                      | 126,461                      |
| Treasury stock, at cost (391,400 Class A common stock)   | (2,439)                      |                              |
| (Accumulated deficit) retained earnings  | (21,372)                     | 18,473                       |

|  |                   |                   |
|--|-------------------|-------------------|
| TOTAL SHAREHOLDERS EQUITY                        | 123,885           | 145,076           |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b> | <b>\$ 517,429</b> | <b>\$ 431,319</b> |

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

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**COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

(Amounts in thousands, except per share data)

|  | <b>Twelve Months Ended December 31,</b> |                  |                  |
|--|---|------------------|------------------|
|  | <b>2006</b>                             | <b>2005</b>      | <b>2004</b>      |
| <b>Revenues</b>  |   |                  |                  |
| Sale of real estate - Homes  | \$ 240,093                              | \$ 216,265       | \$ 87,003        |
| Other revenue  | 5,788                                   | 8,040            | 9,042            |
| <b>Total revenue</b>   | <b>245,881</b>                          | <b>224,305</b>   | <b>96,045</b>    |
| <b>Expenses</b>  |   |                  |                  |
| Cost of sales of real estate   | 211,408                                 | 152,886          | 57,339           |
| Cost of sales of other   | 5,249                                   | 3,604            | 6,654            |
| Impairments and write-offs   | 57,426                                  | 1,216            |                  |
| Selling, general and administrative  | 37,500                                  | 24,190           | 11,940           |
| <b>Operating (loss) income</b>   | <b>(65,702)</b>                         | <b>42,409</b>    | <b>20,112</b>    |
| Other (income) expense, net  | (1,487)                                 | (1,450)          | 908              |
| <b>(Loss) income before minority interest and equity in (loss) earnings of real estate partnership</b> | <b>(64,215)</b>                         | <b>43,859</b>    | <b>19,204</b>    |
| Minority interest  | 15                                      | 30               | 5,260            |
| <b>(Loss) income before equity in (loss) earnings of real estate partnership</b>                       | <b>(64,230)</b>                         | <b>43,829</b>    | <b>13,944</b>    |
| Equity in (loss) earnings of real estate partnership   | (135)                                   | 99               | 118              |
| <b>Total pre tax (loss) income</b>   | <b>(64,365)</b>                         | <b>43,928</b>    | <b>14,062</b>    |
| Income taxes (benefit) provision   | (24,520)                                | 16,366           | (241)            |
| <b>Net (loss) income</b>   | <b>\$ (39,845)</b>                      | <b>\$ 27,562</b> | <b>\$ 14,303</b> |
| <b>Basic (loss) earnings per share</b>   | <b>\$ (2.63)</b>                        | <b>\$ 2.14</b>   | <b>\$ 1.95</b>   |
| Basic weighted average shares outstanding  | 15,148                                  | 12,870           | 7,347            |
| <b>Diluted (loss) earnings per share</b>   | <b>\$ (2.63)</b>                        | <b>\$ 2.12</b>   | <b>\$ 1.95</b>   |
| Diluted weighted average shares outstanding  | 15,148                                  | 13,022           | 7,351            |

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

**COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN  
SHAREHOLDERS' EQUITY**

(Amounts in thousands, except per share data)

|  | <b>The Comstock<br/>Companies</b> |               | <b>Class A</b> |               | <b>Class B</b> |               | <b>Additional</b>          | <b>Treasury</b> | <b>Retained</b>               | <b>Total</b>    |
|--|-----------------------------------|---------------|----------------|---------------|----------------|---------------|----------------------------|-----------------|-------------------------------|-----------------|
|  | <b>Shares</b>                     | <b>Amount</b> | <b>Shares</b>  | <b>Amount</b> | <b>Shares</b>  | <b>Amount</b> | <b>paid-in<br/>capital</b> | <b>stock</b>    | <b>earnings<br/>(deficit)</b> |                 |
| <b>Balance at<br/>December 31,<br/>2003</b>  | <b>3,558</b>                      | <b>\$ 3</b>   |                | <b>\$</b>     |                | <b>\$</b>     | <b>\$ 1,493</b>            | <b>\$</b>       | <b>\$ 5,529</b>               | <b>\$ 7,025</b> |
| Distributions  |                                   |               |                |               |                |               |                            |                 | (5,668)                       | (5,668)         |
| Issuance of<br>common stock<br>in<br>Homebuilding<br>on June 7, 2004   |                                   |               |                |               |                |               |                            |                 |                               |                 |
| Recapitalization<br>by virtue of<br>merger   | (3,558)                           | (3)           | 4,333          | 43            | 2,733          | 27            | 4                          |                 |                               | 71              |
| Acquisition of<br>Comstock<br>Service on<br>December 17,<br>2004   |                                   |               |                |               |                |               | 4,756                      |                 |                               | 4,756           |
| Issuance of<br>common stock<br>of<br>Homebuilding<br>on<br>December 17,<br>2004 (less<br>transaction<br>costs) |                                   |               | 3,960          | 40            |                |               | 56,012                     |                 |                               | 56,052          |
| Issuance of<br>common stock<br>overallotment   |                                   |               | 594            | 6             |                |               | 8,833                      |                 |                               | 8,839           |
| Distribution<br>following IPO  |                                   |               |                |               |                |               |                            |                 | (23,253)                      | (23,253)        |
| Issuance of<br>restricted<br>common stock  |                                   |               | 275            | 3             |                |               | (3)                        |                 |                               |                 |

|   |                  |               |              |              |                   |                   |                    |                   |
|---|------------------|---------------|--------------|--------------|-------------------|-------------------|--------------------|-------------------|
| Stock compensation and issuances  |                  |               |              |              | 101               |                   |                    | 101               |
| Net income  |                  |               |              |              |                   |                   | 14,303             | 14,303            |
| <b>Balance at December 31, 2004</b>   | <b>9,162</b>     | <b>92</b>     | <b>2,733</b> | <b>27</b>    | <b>71,196</b>     |                   | <b>(9,089)</b>     | <b>62,226</b>     |
| Stock compensation and issuances  | 3                | 0             |              |              | 2,346             |                   |                    | 2,346             |
| Issuance of common stock under employee stock purchase plans                              | 8                | 0             |              |              | 133               |                   |                    | 133               |
| Issuances of common stock in follow on offering on June 22, 2005 (less transaction costs) | 2,360            | 23            |              |              | 52,786            |                   |                    | 52,809            |
| Net income  |                  |               |              |              |                   |                   | 27,562             | 27,562            |
| <b>Balance at December 31, 2005</b>   | <b>11,533</b>    | <b>115</b>    | <b>2,733</b> | <b>27</b>    | <b>126,461</b>    |                   | <b>18,473</b>      | <b>145,076</b>    |
| Stock compensation and issuances  | 457              | 5             |              |              | 2,386             |                   |                    | 2,391             |
| Issuance of common stock under employee stock purchase plans                              | 18               |               |              |              | 142               |                   |                    | 142               |
| Treasury stock purchases  |                  |               |              |              |                   |                   | (2,439)            | (2,439)           |
| Share issuance private placement of equity (less transaction costs)                       | 2,121            | 21            |              |              | 18,539            |                   |                    | 18,560            |
| Net loss  |                  |               |              |              |                   |                   | (39,845)           | (39,845)          |
| <b>Balance at December 31, 2006</b>   | <b>\$ 14,129</b> | <b>\$ 141</b> | <b>2,733</b> | <b>\$ 27</b> | <b>\$ 147,528</b> | <b>\$ (2,439)</b> | <b>\$ (21,372)</b> | <b>\$ 123,885</b> |

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

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**COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Amounts in thousands, except per share data)

|  | <b>Twelve Months Ended December 31,</b> |             |             |
|--|---|-------------|-------------|
|  | <b>2006</b>                             | <b>2005</b> | <b>2004</b> |
| Cash flows from operating activities:  |   |             |             |
| Net (loss) income  | \$ (39,845)                             | \$ 27,562   | \$ 14,303   |
| Adjustment to reconcile net (loss) income to net cash (used in) provided by operating activities |   |             |             |
| Amortization and depreciation  | 1,080                                   | 172         | 106         |
| Write-down of land, deposits and pre-acquisition costs   | 57,426                                  |             |             |
| Loss on disposal of assets   | 24                                      | 9           | 1           |
| Minority interest  | 15                                      | 30          | 5,260       |
| Equity in (loss) earnings of real estate partnership   | 136                                     | (99)        | (118)       |
| Distributions from investment in real estate partnership   |   | 163         |             |
| Amortization of stock compensation   | 2,390                                   | 2,346       | 101         |
| Deferred income tax  | (21,816)                                | (1,724)     | (531)       |
| Changes in operating assets and liabilities:   |   |             |             |
| Restricted cash  | (1,526)                                 | (3,300)     | (7,500)     |
| Receivables  | 3,593                                   | (7,376)     | 2,107       |
| Due from related parties   | (1,154)                                 | (1,452)     | 1,693       |
| Real estate held for development and sale  | (71,444)                                | (159,476)   | (23,081)    |
| Other assets   | 1,338                                   | (11,141)    | (5,428)     |
| Accounts payable and accrued liabilities   | (14,247)                                | 23,599      | 24,025      |
| Income tax payable   |   | (290)       | 290         |
| Due to related parties   | (2,333)                                 | (108)       | (82)        |
| Net cash (used in) provided by operating activities  | (86,363)                                | (131,085)   | 11,146      |
| Cash flows from investing activities:  |   |             |             |
| Purchase of property, plant and equipment  | (2,392)                                 | (298)       | (372)       |
| Distributions of capital from investment in real estate partnership                              |   | 1,000       | 120         |
| Business acquisitions, net of cash acquired  | (15,490)                                |             | 1,215       |
| Net cash (used in) provided by investing activities  | (17,882)                                | 702         | 963         |
| Cash flows from financing activities:  |   |             |             |
| Proceeds from notes payable  | 216,551                                 | 212,408     | 81,747      |
| Proceeds from junior subordinated debt   | 30,000                                  |             |             |
| Proceeds from related party notes payable  | 4,200                                   | 444         | 4,646       |
| Payments on notes payable  | (182,199)                               | (135,098)   | (78,716)    |
| Payments on related party notes payable  | (1,430)                                 | (10,725)    | (6,000)     |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Contribution from minority shareholders                        |           | 87        |           |
| Payment of distribution payable                                |           | (12,655)  |           |
| Distributions paid to minority shareholders                    | (44)      | (2,412)   | (14,181)  |
| Distributions paid to shareholders                             |           |           | (14,168)  |
| Proceeds from shares issued under employee stock purchase plan | 141       | 133       |           |
| Purchase of treasury stock                                     | (2,438)   |           |           |
| Net proceeds from equity offerings                             | 18,561    | 52,809    | 64,962    |
| Net cash provided by financing activities                      | 83,342    | 104,991   | 38,290    |
| Net (decrease) increase in cash and cash equivalents           | (20,904)  | (25,392)  | 50,399    |
| Cash and cash equivalents, beginning of period                 | 42,167    | 67,559    | 17,160    |
| Cash and cash equivalents, end of period                       | \$ 21,263 | \$ 42,167 | \$ 67,559 |
| Supplemental cash flow information:                            |           |           |           |
| Interest paid (net of interest capitalized)                    | \$        | \$        | \$        |
| Income taxes paid  | \$ 45     | \$ 22,274 |           |
| Supplemental disclosure for non-cash activity:                 |           |           |           |
| Interest incurred but not paid in cash                         | \$ 13,689 | \$ 8,036  | \$ 2,760  |

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

## COMSTOCK HOMEBUILDING COMPANIES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

(Amounts in thousands, except per share data)

#### 1. ORGANIZATION

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

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

The mergers of Sunset Investment Corp., Inc. and subsidiaries and Comstock Homes, Inc. and subsidiaries with and into Comstock Holdings (collectively the Comstock Companies or Predecessor) and the Company's acquisition of Comstock Holdings was accounted for using the Comstock Companies' historical carrying values of accounting as these mergers were not deemed to be substantive exchanges. The merger of Comstock Service was accounted for using the purchase method of accounting (see Note 2) as this was deemed to be a substantive exchange due to the disparity in ownership.

Our Class A common stock is traded on the NASDAQ National market under the symbol CHCI. We have no public trading history prior to December 17, 2004.

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

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies and practices used in the preparation of the consolidated financial statements is as follows:

##### *Basis of presentation*

As discussed in Note 1, the Company and the Predecessor effected the Consolidation on December 17, 2004. The Company and the Predecessor were entities that had a high degree of common ownership, common management and common corporate governance as they were owned by the same individuals each holding substantially the same ownership. As a result, the Company has determined that, based on the high degree of common ownership that

resulted in substantially the same ownership interests before and after the transaction, the common nature of the businesses, the long-term business relationships between the companies and other related factors, the exchange lacked substance, and therefore, they accounted for the consolidation on a historical cost basis in accordance with FASB Technical Bulletin FTB 85-5, *Issues Related to Accounting for Business Combinations*. Further, Statement of Financial Accounting Standards No. 141, *Business Combinations* ( SFAS 141 ) states that, in transactions between parties under common control, the receiving entity should account for the assets and liabilities received at their historical carrying values. Additionally, such transfers should be accounted for by the receiving entity as of the beginning of the period in which the transaction occurs. Accordingly, the Company has reflected the assets and liabilities acquired in the transaction at their historical carrying values and the results of operations are presented as if the transaction occurred on January 1, 2004.



As further discussed in Note 4, the Predecessor merged with Comstock Service on December 17, 2004. Due to a disparity in ownership as compared to the other entities which comprised the Predecessor, Comstock Service was not under common control with the Predecessor and as such the consolidation transaction was considered a substantive exchange. Accordingly, the Company has accounted for the consolidation of Comstock Service as an acquisition using the purchase method of accounting as required by SFAS 141. As a result, the assets and liabilities acquired have been recorded at fair value in the accompanying financial statements on the date of the transaction. No goodwill was recognized in connection with this transaction.

### ***Principles of consolidation***

The consolidated financial statements include all controlled subsidiaries. In addition, the Company reviews its relationships with other entities to assess whether the Company is the primary beneficiary of a variable interest entity. If the determination is made that the Company is the primary beneficiary, then that entity is consolidated in accordance with FASB Interpretation No. 46-R: *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51* ( FIN 46-R ). See Note 3 for additional discussion on the consolidation of variable interest entities. Minority interest reflects third parties' ownership interest in entities the Company has consolidated. All material inter-company balances and transactions are eliminated in consolidation.

### ***Reclassification***

Certain amounts in the prior years' financial statements have been reclassified to conform to the current year's presentation. For the twelve months ended December 31, 2005 on the consolidated statement of operations, \$1,216 was reclassified from cost of sales real estate into the impairments and write-offs. This reclassification has no impact on previously reported net income.

### ***Cash and cash equivalents and restricted cash***

Cash and cash equivalents are comprised of cash and short-term investments with maturities when purchased of three months or less. At times, the Company may have deposits with institutions in excess of federally insured limits. Banking institutions with which the Company does business are considered credit worthy; therefore, credit risk associated with cash and cash equivalents is considered low.

At December 31, 2006 and 2005, the Company had restricted cash of \$12,326 and \$10,800, respectively, which primarily includes certain customer deposits related to future home sales.

### ***Receivables***

Receivables include amounts in transit or due from title and settlement companies for residential property closings. The Company has determined that all amounts are collectible at December 31, 2006 and 2005 based on a review of the individual accounts.

### ***Real estate held for development and sale***

Real estate held for development and sale includes land, land development costs, interest and other construction costs and is stated at cost or, when circumstances or events indicate that the real estate held for development or sale is impaired, at estimated fair value.

Land, land development and indirect land development costs are accumulated by specific area and allocated to various lots or housing units based upon the relative sales value, unit or area methods. Direct construction costs are assigned to housing units based on specific identification. Construction costs primarily include direct construction costs and capitalized field overhead. Other costs are comprised of prepaid local government fees and capitalized interest and real estate taxes, and are assigned based upon the relative sales value, unit or area methods. Selling costs are expensed as incurred.

Estimated fair value is based on comparable sales of real estate in the normal course of business under existing and anticipated market conditions. The evaluation takes into consideration the current status of the property, various restrictions, carrying costs, costs of disposition and any other circumstances, which may affect fair value including

management's plans for the property. Due to the large acreage of certain land holdings, disposition in the normal course of business is expected to extend over a number of years. A write-down to estimated fair value is recorded when the carrying value of the property exceeds its estimated fair value. These evaluations are made on a property-by-property basis. The Company assesses the impairment of real estate assets whenever events or changes in circumstances indicate that the net book value may not be recoverable. (See Note 5)

### ***Capitalized interest and real estate taxes***

Interest and real estate taxes incurred relating to the development of lots and parcels are capitalized to real estate held for development and sale during the active development period, which generally commences when borrowings are used to acquire real estate assets and ends when the properties are substantially complete. Interest is capitalized based on the interest rate applicable to specific borrowings or the weighted average of the rates applicable to other borrowings during the period. Interest and real estate taxes capitalized to real estate held for development and sale are expensed as a component of cost of sales as related units are sold.

The following table is a summary of interest incurred and capitalized:

|   | <b>Years Ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2006</b>                     | <b>2005</b> | <b>2004</b> |
| Total interest incurred   | \$ 27,758                       | \$ 12,272   | \$ 4,686    |
| Beginning interest capitalized  | \$ 11,590                       | \$ 4,524    | \$ 1,428    |
| Plus: Interest incurred on notes payable and junior subordinated debt | 27,718                          | 11,752      | 2,847       |
| Plus: Interest incurred on related party notes payable                | 40                              | 310         | 1,461       |
| Less: Interest expensed as a component of cost of sales               | (12,094)                        | (4,996)     | (1,212)     |
| Ending interest capitalized   | \$ 27,254                       | \$ 11,590   | \$ 4,524    |

### ***Property, plant and equipment***

Property, plant and equipment are carried at cost less accumulated depreciation and are depreciated on the straight-line method over their estimated useful lives as follows:

|   |                       |
|---|-----------------------|
| Furniture and fixtures                      | 7 years               |
| Office equipment                            | 5 years               |
| Computer equipment and capitalized software | 3 years               |
| Leasehold improvements                      | Life of related lease |

When assets are retired or otherwise disposed of, the cost and accumulated depreciation are removed from their separate accounts and any gain or loss on sale is reflected in operations. Expenditures for maintenance and repairs are charged to expense as incurred.

### ***Investment in real estate partnerships***

Real estate partnerships in which the Company has significant influence but has less than a controlling interest, and is not the primary beneficiary under FIN 46-R, are accounted for under the equity method. Under the equity method, the Company's initial investment is recorded at cost and is subsequently adjusted to recognize its share of earnings and losses. Distributions received reduce the carrying amount of the investment. (See Note 5).

***Warranty reserve***

Warranty reserves for houses sold are established to cover potential costs for materials and labor with regard to warranty-type claims expected to arise during the one-year warranty period provided by the Company or within the five-year statutorily mandated structural warranty period. Since the Company subcontracts its homebuilding work, subcontractors are required to provide the Company with an indemnity and a certificate of insurance prior to receiving payments for their work. Claims relating to workmanship and materials are generally the primary

responsibility of the subcontractors and product manufacturers. The warranty reserve is established at the time of closing, and is calculated based upon historical warranty cost experience and current business factors. Variables used in the calculation of the reserve, as well as the adequacy of the reserve based on the number of homes still under warranty, are reviewed on a periodic basis. Warranty claims are directly charged to the reserve as they arise. The following table is a summary of warranty reserve activity which is included in accounts payable and accrued liabilities:

|                                  | <b>Years Ended December 31,</b> |             |             |
|----------------------------------|---------------------------------|-------------|-------------|
|                                  | <b>2006</b>                     | <b>2005</b> | <b>2004</b> |
| Balance at beginning of period   | \$ 1,206                        | \$ 916      | \$ 541      |
| Additions(a)                     | 1,524                           | 888         | 823         |
| Releases and/or charges incurred | (1,061)                         | (598)       | (448)       |
| Balance at end of period         | \$ 1,669                        | \$ 1,206    | \$ 916      |

(a) As discussed in Note 4, 2006 includes additions of \$360, assumed in connection with the acquisition of Parker Chandler Homes, Inc. and Capitol Homes Inc.

### ***Revenue recognition***

The Company recognizes revenues and related profits from the sale of residential properties, including multiple units to the same buyer, and finished lots when closing has occurred, full payment has been received, title and possession of the property transfer to the buyer and the Company has no significant continuing involvement in the property.

Other revenues include revenue from land sales and from management and administrative support services provided to related parties, which are recognized as the services are provided.

### ***Advertising costs***

The total amount of advertising costs charged to general, selling and administrative expense was \$4,223, \$1,602 and \$863 for the years ended December 31, 2006, 2005 and 2004, respectively.

### ***Stock compensation***

As discussed in Note 14, the Company currently sponsors stock option plans and restricted stock award plans. Prior to December 14, 2004, the Company did not sponsor any such plans. Effective January 1, 2004, the Company prospectively adopted Statement of Financial Accounting Standards No. 123R (revised 2004), *Share-Based Payment* ( SFAS 123R ), which supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements over the vesting period based on their fair values at the date of grant. A portion of the costs associated with stock-based compensation is capitalized to real estate held for development and sale and the remainder is allocated to selling, general and administrative expenses.

### ***Income taxes***

Prior to December 17, 2004, the Predecessor company had elected to be treated as an S corporation under Subchapter S of the Internal Revenue Code and therefore was not subject to income taxes. Taxable income or loss was passed through to and reported by the individual shareholders. Subsequent to the consolidation the company was reorganized as a C corporation under which income taxes are accounted for under the asset and liability method in accordance with Statement of Financial Accounting Standards No. 109 *Accounting for Income Taxes*. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on the deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

***Earnings per share***

The following weighted average shares and share equivalents are used to calculate basic and diluted EPS for the years ended December 31, 2006, 2005 and 2004:

| <b>Basic earnings per share</b>              | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2006</b>                    | <b>2005</b> | <b>2004</b> |
| Net (loss) income                            | \$ (39,845)                    | \$ 27,562   | \$ 14,303   |
| Basic weighted-average shares outstanding    | 15,148                         | 12,870      | 7,347       |
| Per share amounts                            | \$ (2.63)                      | \$ 2.14     | \$ 1.95     |
| <b>Dilutive Earnings Per Share</b>           |                                |             |             |
| Net (loss) income                            | \$ (39,845)                    | \$ 27,562   | \$ 14,303   |
| Basic weighted-average shares outstanding    | 15,148                         | 12,870      | 7,347       |
| Stock options and restricted stock grants    |                                | 152         | 4           |
| Dilutive weighted-average shares outstanding | 15,148                         | 13,022      | 7,351       |
| Per share amounts                            | \$ (2.63)                      | \$ 2.12     | \$ 1.95     |

For the year ended December 31, 2006 stock grant issuances in the amount of 587 shares and options and warrants to purchase 843 shares of Class A common stock were excluded from the calculation of dilutive earnings per share. The exclusion was due to the options and warrants having an exercise price greater than the average market price of the common shares. In addition, as a result of a net loss for the year ended December 31, 2006, stock grant issuances were excluded from the computation of dilutive earnings per share, because their inclusion would have been anti-dilutive. For the year ended December 31, 2005, options to purchase 107 shares of Class A common stock were excluded from the calculation of dilutive earnings per share. There were no equity instruments which were excluded from the computation of diluted earnings per share for the year ended December 31, 2004

***Comprehensive income***

For the years ended December 31, 2006, 2005 and 2004, comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying consolidated financial statements.

***Segment reporting***

Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS 131 ) establishes standards for the manner in which companies report information about operating segments. The Company determined it provides one single type of business activity, homebuilding, which operates in multiple geographic or economic environments. In addition, as a result of the Company's acquisitions in Georgia and North Carolina, which became fully integrated in the fourth quarter of 2006, the Company modified how it analyzes its business during the fourth quarter of 2006. *As such*, the Company has determined that its homebuilding operations

now primarily involve three reportable geographic segments: Washington DC Metropolitan Area, North and South Carolina, and Georgia. The aggregation criteria is based on the similar economic characteristics of the projects located in each of these regions.

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The table below summarizes revenue and operating (loss) income for each of the Company's geographic segments:

|  | <b>Year ended December 31,</b> |                   |                  |
|--|--------------------------------|-------------------|------------------|
|  | <b>2006</b>                    | <b>2005</b>       | <b>2004</b>      |
| Revenues:  |                                |                   |                  |
| Washington DC Metropolitan Area                        | \$ 181,058                     | \$ 212,973        | \$ 96,045        |
| North and South Carolina(a)                            | 32,297                         | 11,332            |                  |
| Georgia(b)   | 32,526                         |                   |                  |
| <b>Total</b>   | <b>\$ 245,881</b>              | <b>\$ 224,305</b> | <b>\$ 96,045</b> |
| Operating (loss) income                                |                                |                   |                  |
| Washington DC Metropolitan Area                        | (10,729)                       | 57,738            | 22,940           |
| North and South Carolina                               | (7,811)                        | (1,022)           |                  |
| Georgia  | (29,121)                       |                   |                  |
| <b>Segment operating (loss) income</b>                 | <b>(47,661)</b>                | <b>56,716</b>     | <b>22,940</b>    |
| Corporate expenses unallocated                         | (18,041)                       | (14,307)          | (2,828)          |
| <b>Total operating (loss) income</b>                   | <b>(65,702)</b>                | <b>42,409</b>     | <b>20,112</b>    |
| Other income (loss)                                    | 1,487                          | 1,450             | (908)            |
| Equity in (losses) earnings of real estate partnership | (135)                          | 99                | 118              |
| Minority interest expense                              | (15)                           | (30)              | (5,260)          |
| <b>(Loss) income before income taxes</b>               | <b>\$ (64,365)</b>             | <b>\$ 43,928</b>  | <b>\$ 14,062</b> |

(a) As discussed in Note 1, the Company entered the North and South Carolina market on December 14, 2004 as a result of the merger with Comstock Service. Due to their immateriality, the results of the North and South Carolina region, for the period December 14, 2004 to December 31, 2004 have been included in the Washington DC Metropolitan Area. In May of 2006, the Company acquired Capital Homes Inc. and expanded its presence in the North and South Carolina region.

(b) In January of 2006, the Company entered the Georgia region, by acquiring Parker Chandler Homes Inc.

The table below summarizes total assets for each of the Company's segments at December 31,

| <b>Total Assets</b>             | <b>2006</b> | <b>2005</b> |
|---------------------------------|-------------|-------------|
| Washington DC Metropolitan Area | \$ 317,349  | \$ 350,970  |
| North and South Carolina        | 61,617      | 19,930      |
| Georgia                         | 94,133      |             |

|              |            |            |
|--------------|------------|------------|
| Corporate    | 44,330     | 60,419     |
| Total Assets | \$ 517,429 | \$ 431,319 |

*Use of estimates*

The preparation of the financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates are utilized in the valuation of real estate held for development and sale, capitalization of costs, consolidation of variable interest entities and warranty reserves.

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### ***Recent accounting pronouncements***

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently reviewing the effect of SFAS 157 on its consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109, Accounting for Income Taxes* ( FIN 48 ), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of January 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to the opening balance of retained earnings and is not expected to have a significant impact on the Company's consolidated financial position. The adoption of FIN 48 may cause greater volatility in the effective tax rate going forward. The Company expects to record a benefit of approximately \$1,194 to opening retained earnings as a result of the adoption of FIN 48.

### **3. CONSOLIDATION OF VARIABLE INTEREST ENTITIES**

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

The Company also does not share in an allocation of either the profit earned or loss incurred by any of these entities with which the Company has fixed price purchase agreements. The Company has concluded that whenever it options land or lots from an entity and pays a significant non-refundable deposit as described above, a variable interest entity is created under the provisions of FIN 46-R. This is because the Company has been deemed to have provided subordinated financial support, which creates a variable interest which limits the equity holders' returns and may absorb some or all of an entity's expected theoretical losses if they occur. The Company, therefore, examines the entities with which it has fixed price purchase agreements for possible consolidation by the Company under FIN 46-R. This requires the Company to compute expected losses and expected residual returns based on the probability of future cash flows as outlined in FIN 46-R. This calculation requires substantial management judgments and estimates. In addition, because the Company does not have any contractual or ownership interests in the entities with which it contracts to buy the land, the Company does not have the ability to compel these development entities to provide financial or other data to assist the Company in the performance of the primary beneficiary evaluation.

The Company has evaluated all of its fixed price purchase agreements and has determined that it is the primary beneficiary of some of those entities. As a result, at December 31, 2006 and 2005, the Company has consolidated 9 entities and 5 entities, respectively in the accompanying consolidated balance sheets. The effect of the consolidation

at December 31, 2006 and 2005 was the inclusion of \$39,634 and \$89,890, respectively, in Inventory not owned Variable Interest Entities with a corresponding inclusion of \$37,350 (net of land deposits paid of \$2,284) and \$83,015 (net of land deposits paid of \$6,875), respectively, to Obligations related to inventory not owned. Creditors, if any, of these Variable Interest Entities have no recourse against the Company.

As discussed in Note 12, the company has consolidated an entity that is wholly owned and controlled by a former executive of the Company.

#### **4. ACQUISITIONS**

On January 19, 2006, the Company acquired all of the issued and outstanding capital stock of Parker Chandler Homes, Inc., a homebuilder in the Atlanta, Georgia metropolitan market, for a cash purchase price of \$10,400 (including transaction costs) and the assumption of \$63,800 in liabilities. The results of Parker Chandler Homes are included in the accompanying consolidated financial statements beginning January 19, 2006. The Company accounted for this transaction in accordance with SFAS 141. Approximately \$700 of the purchase price was allocated to intangibles with a weighted average life of 4.6 years. The intangibles are related to the Parker Chandler trade name, employment and non-compete agreements entered into with certain selling shareholders. The remainder of the purchase price was allocated to real estate held for development and sale and land option agreements. There was no goodwill associated with the transaction.

On May 5, 2006, the Company acquired all of the issued and outstanding capital stock of Capitol Homes, Inc., a homebuilder in North Carolina, for a cash purchase price of \$7,500 (including transaction costs) and the assumption of \$20,600 in liabilities. The results of Capitol Homes are included in the accompanying financial statements beginning May 5, 2006. The Company also accounted for this transaction in accordance with SFAS 141. Approximately \$251 of the purchase price was allocated to intangibles with a weighted average life of 2.7 years. The intangibles are related to the Capitol Homes trade name, employment and non-compete agreements entered into with certain selling shareholders. The remainder of the purchase price was allocated to real estate held for development and sale and land option agreements. There was no goodwill associated with the transaction. In accordance with SFAS 141, and as part of the initial purchase accounting, the Company recorded, an earn-out payable in the amount \$2,463. Subsequent to the acquisition, employment with certain selling shareholders terminated and the Company negotiated a release of all earn-out provisions. As a result, the original purchase accounting entry recorded as a step-up to the basis of real estate held for development and sale was reversed.

Subsequent to each acquisition, as a result of the Company releasing the restrictive terms under the employment and non-complete agreements and the decision to no longer use the respective trade names, all amounts assigned to intangibles were written off.

#### **5. REAL ESTATE HELD FOR DEVELOPMENT AND SALE**

During 2006, the Company continued to experience a slowdown in demand for homes at several of the Company's communities. This slowdown in demand resulted in low overall sales volume, reduced selling prices, cost overruns and increases in concessions being offered to our customers. Where deemed appropriate, the Company evaluated its projects to determine if recorded carrying amounts were recoverable. This evaluation resulted in impairment charges of \$51,200 and \$1,200 million for the years ended December 31, 2006 and 2005. Of the \$51,200 in impairment charges during 2006, \$39.9 was incurred during the fourth quarter of 2006. The impairment charge was calculated using a discounted cash flow analysis model which is dependent on several subjective factors, including the selection of an appropriate discount rate, estimated future selling prices, estimated costs and estimated absorption rates. The estimates used by the Company are based on the best available information at the time the estimates are made. Adverse changes to these estimates in future periods could cause additional impairment amounts to be recorded.

Total impairments by our reportable segments were as follows:

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|                                 |           |
|---------------------------------|-----------|
| Washington DC Metropolitan Area | \$ 19,900 |
| North and South Carolina        | \$ 4,800  |
| Georgia                         | \$ 15,200 |

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Real estate held for development and sale consists of the following:

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2006</b>         | <b>2005</b> |
| Land and land development costs   | \$ 232,693          | \$ 119,530  |
| Cost of construction (including capitalized interest and real estate taxes) | 172,451             | 144,272     |
| Total   | \$ 405,144          | \$ 263,802  |

## **6. PROPERTY, PLANT AND EQUIPMENT, NET**

Property, plant and equipment consist of the following:

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2006</b>         | <b>2005</b> |
| Computer equipment and capitalized software | \$ 2,228            | \$ 540      |
| Furniture and fixtures                      | 371                 | 296         |
| Office equipment                            | 282                 | 243         |
| Leasehold improvements                      | 640                 |             |
|   | 3,521               | 1,079       |
| Less: accumulated depreciation              | (798)               | (474)       |
|   | \$ 2,723            | \$ 605      |

Depreciation expense, included in selling, general, and administrative in the consolidated and combined financial statements of operations, amounted to \$357, \$172 and \$106 for the years ended December 31, 2006, 2005 and 2004, respectively.

During 2006 the Company capitalized costs totaling approximately \$1,195 related to software and related implementation costs, of the Company's new enterprise wide accounting and production management system. The costs were capitalized in accordance with Statement of Position 98-1 Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. At December 31, 2006 all of these costs were unamortized as a result of the software go-live date occurring in January 2007.

## **7. INVESTMENT IN REAL ESTATE PARTNERSHIP**

In 2001, prior to the Company's acquisition of Comstock Service in December of 2004, Comstock Service had invested \$41 in North Shore Investors, LLC ( North Shore ) for a 50% ownership interest. North Shore was formed to acquire and develop residential lots and construct single family and townhouse units. In 2002, as a result of recognizing its share of net losses incurred by North Shore, Comstock Service reduced its investment in North Shore, to \$0. The Company, as part of the acquisition of Comstock Service in December 2004, recorded this investment in North Shore at \$0.

On June 28, 2005 the Company received a capital call from North Shore in the amount of \$719 so that North Shore could comply with certain debt repayments. Because the Company may be obligated to provide future financial support to cover certain debt repayments, the Company is recording its share of losses incurred by North Shore in the accompanying financial statements in the amount of \$(171) and \$(35) for the years ended December 31, 2006 and 2005, respectively.

During the third quarter of 2005, the Company, as manager of an affiliated entity, exercised its option rights to purchase the project acquisition, development and construction loan made for the benefit of North Shore. The Company finalized the purchase of the loans on or about September 8, 2005, and issued a notice of default under the acquisition and development loan at maturity on September 30, 2005. The Company then filed suit for collection of the loans against one of the individual guarantors under the loan on or about October 21, 2005 and initiated foreclosure proceedings on or about November 18, 2005. On or about December 22, 2005, the individual guarantor



subject to the earlier suit filed a countersuit against two of the officers of the Company who were also individual guarantors under the acquisition and development loan.

The Company has agreed to indemnify these officers. The Company, as manager of an affiliated entity, set and held a foreclosure sale on March 24, 2006 in which it was the highest bidder. However, transfer of title to the property has been delayed pending judicial resolution of a suit filed on March 24, 2006 by the non-affiliated 50% owner of North Shore. On June 30, 2006, the Company, on its own behalf and on behalf of affiliates, filed an additional lawsuit expanding the number of party defendants, demanding equitable relief, and demanding \$33,000 in damages. A meeting of the parties to the lawsuit is scheduled for March 2007 to discuss an acceptable resolution to the matter.

As of December 31, the Company carried the following amounts in its financial statements related to North Shore:

|  | <b>2006</b> | <b>2005</b> |
|--|-------------|-------------|
| Investment in real estate partnership        | \$ (171)    | \$ (35)     |
| Development and construction loan receivable | \$ 3,477    | \$ 2,835    |

The Company has evaluated the carrying value of its investment in and receivables from North Shore. At this time, the Company does not believe an impairment reserve is warranted. However, it is possible this may change in future periods. In addition, based on results of negotiations, the Company may, in the future be required to consolidate the North Shore entity.

The condensed combined balance sheets and the statements of operations for the real estate property partnerships accounted for using the equity method are as follows:

|   | <b>December 31,</b> |                  |
|---|---------------------|------------------|
|   | <b>2006</b>         | <b>2005</b>      |
| Real estate held for development and sale     | \$ 13,081           | \$ 11,263        |
| Other assets                                  | 22                  | 75               |
| <b>Total assets</b>                           | <b>\$ 13,103</b>    | <b>\$ 11,338</b> |
| Mortgage notes payable                        | \$ 14,353           | \$ 10,921        |
| Notes payable to related parties              | 350                 | 1,547            |
| Other liabilities                             | 64                  | 143              |
| <b>Total liabilities</b>                      | <b>14,767</b>       | <b>12,611</b>    |
| Partners deficit                              | (1,664)             | (1,273)          |
| <b>Total liabilities and partners deficit</b> | <b>\$ 13,103</b>    | <b>\$ 11,338</b> |

### Condensed Combined Statements of Operations

|                                      | <b>Years Ended December 31,</b> |             |             |
|--------------------------------------|---------------------------------|-------------|-------------|
|                                      | <b>2006</b>                     | <b>2005</b> | <b>2004</b> |
| Revenues                             | \$                              | \$ 3,920    | \$ 22,157   |
| Operating (loss) income              | \$ (241)                        | 111         | 4,573       |
| Other expense                        | 141                             | 7           | 99          |
| Net (loss) income                    | \$ (382)                        | \$ 104      | \$ 4,474    |
| Company's share of net (loss) income | \$ (135)                        | \$ 99       | \$ 118      |

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**8. OTHER ASSETS**

Other assets consist of the following:

|                                 | <b>December 31,</b> |             |
|---------------------------------|---------------------|-------------|
|                                 | <b>2006</b>         | <b>2005</b> |
| Contract land deposits          | \$ 2,528            | \$ 2,825    |
| Restricted escrow deposits      | 2,231               | 1,915       |
| Prepaid income taxes(1)         | 4,460               | 4,708       |
| Miscellaneous prepaid and other | 4,895               | 1,583       |
|                                 | \$ 14,114           | \$ 11,031   |

(1) Prepaid income taxes includes approximately \$2,705 in expected tax benefits as a result of a taxable loss incurred for the twelve months ended December 31, 2006. The company expects to carry back this benefit and apply it against 2005 taxable income.

**9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities consist of the following:

|                   | <b>December 31,</b> |             |
|-------------------|---------------------|-------------|
|                   | <b>2006</b>         | <b>2005</b> |
| Trade payables    | \$ 32,990           | \$ 35,163   |
| Warranty          | 1,672               | 1,206       |
| Customer deposits | 14,932              | 17,817      |
| Other             | 6,086               | 4,945       |
|                   | \$ 55,680           | \$ 59,131   |

**10. NOTES PAYABLE, JUNIOR SUBORDINATED DEBT AND COVENANTS**

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

| <b>Debt</b>  | <b>Due</b> | <b>December 31,</b> |             |
|--|------------|---------------------|-------------|
|  |            | <b>2006</b>         | <b>2005</b> |
| Secured acquisition, development and construction notes(a) | Various    | \$ 218,461          | \$ 138,097  |
| Secured revolving credit line(b)                           | May 2009   | 39,981              | 2,046       |

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|                                   |           |            |            |
|-----------------------------------|-----------|------------|------------|
| Junior subordinated note(c)       | June 2036 | 30,000     |            |
| Unsecured term loans(d)           | Various   | 6,764      |            |
| Subordinate secured notes(e)      | Various   | 197        | 2,851      |
| <b>Sub-total</b>                  |           | 295,403    | 142,994    |
| Other notes payable related party |           |            | 663        |
| <b>Total</b>                      |           | \$ 295,403 | \$ 143,657 |

**(a) Secured acquisition, development and construction notes**

We have several loans with various banks that provide us with specific project financing. These loans are secured by specific project assets and are used for land acquisition, development and construction. The loans bear interest at various rates, based on Prime or LIBOR benchmarks with a certain amount of additional basis points added. At December 31, 2006 the weighted average stated rate was approximately 9.21%. The Company is required to maintain certain financial covenants with these various institutions. Under the terms of the agreement, the

Company is required to maintain a specified EBITDA to debt service ratio, a minimum tangible net worth, a maximum leverage ratio and a global sold to unsold ratio. At December 31, 2006, the Company was not in compliance with the covenants. In February and March of 2007 the Company successfully re-negotiated all covenants for the period covering December 31, 2006 and all future periods. The Company is in compliance with all covenants as revised. The notes mature at various times between March 2007 and December 2007.

**(b) Secured revolving credit lines**

In May 2006 the Company entered into a \$40 million borrowing base revolving credit agreement secured by certain project assets. The interest rate is 30 day LIBOR plus 2.25% maturing May 2009. At December 31, 2006 the interest rate was 7.57%. Under the terms of the agreement, the Company is required to maintain a specified EBITDA to debt service ratio, a minimum tangible net worth, a maximum leverage ratio and a global sold to unsold ratio. At December 31, 2006, the Company was not in compliance with the covenants as defined. In March of 2007 the Company successfully re-negotiated all covenants for the period covering December 31, 2006 and entered into a forbearance agreement against existing and future defaults through March 2008. The Company is in compliance with all covenants of the forbearance agreement. The forbearance agreement provides that the bank will not enforce any remedies that are available to it, for a period up to March 2008, in the event of a default by the Company.

**(c) Junior subordinated note**

In May 2006 the company closed on a \$30 million junior subordinated note offering. The term of the note was thirty years, maturing June 2036, and could have been retired after five years with no penalty. The interest rate was fixed at 9.72% for the first five years after which it converted to a floating rate of LIBOR plus 4.2% for the remaining twenty-five years. The Company was required to maintain certain financial covenants under the terms of the indenture, including a minimum tangible net worth, fixed charge coverage ratio and maximum leverage ratio. At December 31, 2006, the Company was not in compliance with the fixed charge coverage ratio. In March of 2007, the Company retired the notes and closed on a new Senior Unsecured note offering with the same lender in the same amount at the same rate of interest. The new \$30 million note has a term of 10 years and requires a lower fixed charge coverage ratio and a lower tangible net worth with a phased increase to levels consistent with the original junior subordinated note. The new notes also require the Company to create and maintain an interest reserves in the amount equivalent to three quarters of interest payments until the original fixed charge coverage ratio is sustained for four consecutive quarters. The original purchasers of the newly issued note have a right, at their option, to force a \$2,000 pay down on or after September 30, 2007 for so long as they are the owners of the notes.

**(d) Unsecured term loans**

At December 31, 2006 we had \$6,764 outstanding under unsecured term loan agreements with two financial institutions. These unsecured loans have a weighted average stated rate of interest of approximately 8.37%. There are no financial covenants associated with these loans. The notes mature at various times between March 2007 and December 2007.

**(e) Subordinated secured notes**

The Company's subordinated second trust loans are collateralized by subordinate liens on specific assets held for development and construction. These subordinate liens are subject to inter-creditor agreements with the senior lenders and are used by the Company to satisfy all or a portion of the equity requirements of its senior lenders. The interest rates range from 8.0% to 8.4% with various maturity dates. At December 31, 2006 the weighted average stated rate was approximately 9.21%. There are no financial covenants associated with these loans. These notes mature at various times between June 2007 and March 2008.



The Company expects to comply with the financial covenants under the amended credit agreements for the next twelve months. Non-compliance with such covenants would allow the lenders to demand immediate repayment of all outstanding borrowings under the facility. The inability of the Company to comply with its financial covenants, obtain waivers for non-compliance or obtain alternative financing to replace the current credit facility could have a material adverse effect on the Company's financial position, results of operations and cash flows.

As of December 31, 2006, future maturities of our borrowings are as follows:

|                          |                   |
|--------------------------|-------------------|
| Year ending December 31, |                   |
| 2007                     | \$ 205,922        |
| 2008                     | 16,986            |
| 2009                     | 39,981            |
| 2010                     | 2,514             |
| 2011 and thereafter      | 30,000            |
| <b>Total</b>             | <b>\$ 295,403</b> |

For the years ended December 31, 2006, 2005 and 2004, aggregate debt had a weighted average annual effective interest rate of 9.7%, 9.2%, and 6.9%, respectively.

## 11. COMMON STOCK

As discussed in Note 1, the Company immediately prior to the IPO as a result of its merger with Comstock Holdings, had 4,333 and 2,734 shares Class A and B Common Stock outstanding. Class A and B Common Stock shares bear the same economic rights. However for voting purposes, Class A stock holders are entitled to one vote for each share held while Class B stock holders are entitled to fifteen votes for each share held.

As a result of the IPO, the Company sold 3,960 Class A shares of Common Stock. The Company also sold an additional 594 shares of Class A Common Stock pursuant to the underwriters' exercise of their over-allotment option.

On June 22, 2005 the Company completed a follow-on offering in which 2,360 shares of Class A Common stock were sold to the public.

On May 12, 2006 (the Closing Date), the Company completed a private placement (the PIPE) to institutional and other accredited investors of 2,121,048 shares of Class A common stock and warrants exercisable into 636,316 shares of Class A common stock. The Company sold the securities for \$9.43 per share for total proceeds of approximately \$20,000 and net proceeds of approximately \$18,700. The per share price of \$9.43 represented a premium of approximately 14.6% to the closing price of the Company's common stock on the date the purchase was completed. The net proceeds were used for general corporate purposes. The warrants issued in connection with the PIPE were five-year warrants exercisable at any time after November 10, 2006 with an exercise price of \$11.32 per share.

Under EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the fair value of the warrants issued under the PIPE have been reported as equity instruments because the liquidated damages, which are capped at 10%, reasonable represent the difference between the value of a registered share and an unregistered share of the Company's common stock.

In February 2006 the Company's Board of Directors authorized the Company to purchase up to 1,000,000 shares of the Company's Class A Common stock in the open market or in privately negotiated transactions. The authorization did not include a specified time period in which the shares repurchase would remain in effect. During the twelve months ended December 31, 2006, the Company repurchased an aggregate of 391,000 shares of Class A common stock for a total of \$2,439 or \$6.23 per share. The Company has no other repurchase programs at this time

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## 12. RELATED PARTY TRANSACTIONS

In June 2002, the Predecessor entered into a promissory note agreement with TCG Fund I, LC to fund development projects. TCG Fund I, LC, is a related party in which the Company has an equity investment. The promissory note agreement allows for the Company to borrow up to \$4,000. The note, which had interest at 12% per annum, was paid in full during June 2005.

In September 2004, the Predecessor entered into a promissory note agreement with TCG Fund II, LC to fund development projects. TCG Fund II, LC is an affiliate which the company manages as a non-member. The promissory note agreement allows the Company to borrow up to \$10,000. The note, which had interest at 12% per annum, was paid in full during November 2005.

In April 2002 and January 2004, the Predecessor entered into lease agreements for approximately 7.7 and 8.8 square feet, respectively, for its corporate headquarters at 11465 Sunset Hills Road, Reston, Virginia from Comstock Partners, L.C., an affiliate of our Predecessor in which executive officers of the Company, Christopher Clemente, Gregory Benson, and others are principals. Christopher Clemente owns a 45% interest, Gregory Benson owns a 5% interest, an entity which is owned or controlled by Christopher Clemente's father-in-law, Dwight Schar, owns a 45% interest, and an unrelated third party owns a 5% interest in Comstock Partners. For the nine months ended September 30, 2004, total payments made under these lease agreements were \$231. On September 30, 2004, the lease agreements were canceled and replaced with a new lease for a total of 20.6 square feet with Comstock Asset Management, L.C., an entity wholly owned by Christopher Clemente. Total payments made under this lease agreement were \$142 as of December 31, 2004. On August 1, 2005, the lease agreement was amended for an additional 8.4 square feet. Total payments made under this amended lease agreement were \$751 and \$629 for the year ended December 31, 2006 and 2005, respectively.

In May 2003, the Predecessor hired a construction company, in which Christopher Clemente's brother, Louis Clemente, serves as the President and is a significant shareholder, to provide construction services and act as a general contractor at two of the Company's developments. The Company paid \$6,523, \$10,038, and \$4,352 to this construction company during the year ended December 31, 2006, 2005, and 2004, respectively.

Christopher Clemente's mother-in-law and Gary Martin (formerly one of the Company's directors) each invested \$100 as minority shareholders in one of our subsidiaries, respectively. The parents of Bruce Labovitz loaned approximately \$300 to another of our subsidiaries. During the first quarter of 2005, the Company repurchased the minority shareholders' interests referenced above for an approximate purchase price of \$136. In April 2005, the Company paid the \$300 loan in full.

During 2003, the Predecessor entered into agreements with I-Connect, L.C., a company in which Investors Management, LLC ( Investors Management ), an entity wholly owned by Gregory Benson, holds a 25% interest, for information technology consulting services and the right to use certain customized enterprise software developed with input from the Company. The intellectual property rights associated with the software solution developed by I-Connect, along with any improvements made thereto by the Company, remain the property of I-Connect. For the years ended December 31, 2006, 2005 and 2004, the Company paid \$471, \$485, and \$434, respectively, to I-Connect.

In October 2004, the Predecessor entered into an agreement with Comstock Asset Management, L.C. ( CAM ), where CAM assigned the Company first refusal rights to purchase a portion of their Loudoun Station Properties. In partial consideration for the performance of which the Company would provide management services for a fee of \$20 per month. For the year ended December 31, 2006, 2005, and 2004 the Company recorded \$240, \$240, and \$60 in revenue, respectively. For the year ended December 31, 2006 and 2005, the Company recorded a receivable for \$20

and \$0, respectively, from this entity.

In addition, the Company, in November 2004, entered into an agreement with CAM to sell certain retail condominium units at Potomac Yard for a total purchase price of \$14,500. In connection with this sale, the Company received a non-refundable deposit of \$8,000 upon execution of the agreement. The agreement was modified in 2005, which reduced the deposit amount to \$6,000. During the year ended December 31, 2006, the Company incurred \$579 in costs associated with the retail units and recorded a receivable of \$377 which will be reimbursed by CAM.

During the years ended December 31, 2006 and 2005, the Company provided bookkeeping services to related party entities at no charge.

In August 2004, the Predecessor entered into a \$2,400 promissory note agreement with Belmont Models I, L.L.C., an unrelated entity managed by Investors Management. The note had an interest rate of 12%, which was payable monthly and originally matured in August 2006. However the company exercised its right to a three-month extension, and therefore the note matured November 5, 2006. In March 2004, the Company sold four condominium units to Belmont Models I, L.C. under a sale and leaseback arrangement. The four condominium units were delivered for a total purchase price of \$2,000 and leased back at a rate of \$20 per month. The Company expects the lease to continue for a period of twenty-four months and has extension options available at its discretion. As a result of the deliveries, the promissory note was reduced by the total purchase price. As discussed, the promissory note agreement with Belmont Models I, L.L.C., was paid in full during the year ended December 31, 2006. Thus, for the year ended December 31, 2006 and 2005, the Company owed \$0 and \$663, respectively. For the year ended December 31, 2006 and 2005, the accrued interest on the note totaled \$0 and \$6, respectively.

During the years ended December 31, 2006 and 2005, the Company entered into sales contracts to sell homes to certain employees of the Company. The Company, in order to attract, retain, and motivate employees maintains a home ownership benefit program. Under the home ownership benefits, an employee receives certain cost benefits provided by us when purchasing a home or having one built by us. Sales of homes to employees for investment purposes are conducted at market prices.

In September 2005, Comstock Foundation, Inc., was created. Comstock Foundation is a not-for-profit organization organized exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code and is an affiliate of the Company. The affairs of Comstock Foundation are managed by a five-person board of directors with Christopher Clemente, Gregory Benson, Bruce Labovitz and Tracy Schar (employee of the Company and spouse of Christopher Clemente) being four of the five. The Company also provides bookkeeping services to Comstock Foundation at no charge. In October 2005, the Company donated \$100 in cash and the right to use 27 units at our Penderbrook condominium conversion project in Fairfax, VA for a period of six months. The Foundation provided these units to victims of Hurricane Katrina. The fair market value of the rental units donated was \$237. During the year ended December 31, 2006, the Company donated \$59 to Comstock Foundation.

During December of 2006 the Company's executive vice president voluntarily resigned from the Company. As part his voluntary resignation, the former executive vice president negotiated the purchase of the remaining 30 condominium units in the Company's Countryside development for a purchase price of \$4,200, which was approximately \$1,300 below the estimated fair value. The difference between purchase price and the fair value of the units, has been recorded as compensation expense and is included in selling, general and administrative expense in the accompanying consolidated and combined statements of operations. Simultaneously with the purchase, the Company entered into a marketing and sale agreement with the special purpose entity created by the former executive vice president that purchased the units (SPE), whereby the Company would bear the cost associated with marketing and selling the units and pay the SPE a monthly option payment that allows the Company to share in the revenue of the units as they settle. The monthly option payments have created a variable interest in the SPE, and as such the Company has performed an analysis under the provisions of FIN46(R) and has determined that the entity is a variable interest entity and the Company is the primary beneficiary of this entity. As a result, the Company has consolidated the SPE. The SPE had \$3,600 of assets, which are included in inventory not owned-variable interest entities in the accompanying consolidated balance sheets and \$3,600 of third party debt, which is included in obligations related to inventory not owned in the accompanying consolidated balance sheets. The third party lender does not have recourse against the Company as the debt is collateralized by the units purchased by the SPE.

### **13. EMPLOYEE BENEFIT PLANS**

The Company maintains a defined contribution retirement savings plan pursuant to Section 401(k) of the Internal Revenue Code (the Code). Eligible participants may contribute a portion of their compensation to their respective retirement accounts in an amount not to exceed the maximum allowed under the Code. In January 2006, the Company began matching employee contributions. The total amount matched for the twelve months 2006, was \$135. The Company also maintains an Employee Stock Purchase Plan in which eligible employees have the opportunity to purchase common stock of the Company at a discounted price of 85% of the fair market value of the stock on the designated dates of purchase. Under the terms of the plan, the total fair market value of the common stock that an eligible employee may purchase each year is limited to the lesser of 15% of the employee's annual

compensation or \$12,750. Under the plan, employees of the Company purchased 18,231 and 7,817 shares of Class A common stock, for the twelve months ending December 31, 2006 and 2005.

#### 14. RESTRICTED STOCK, STOCK OPTIONS AND OTHER STOCK PLANS

Effective January 1, 2004, the Company adopted the fair value recognition provisions of SFAS 123(R). Prior to December 14, 2004 the Company did not sponsor any stock based plans.

On December 14, 2004 the Company adopted the 2004 Long-Term Compensation Plan ( The Plan ). The plan provides for the issuance of stock options, stock appreciation rights, or SARs, restricted stock, deferred stock, dividend equivalents, bonus stock and awards in lieu of cash compensation, other stock-based awards and performance awards. Any shares issued under the Plan vest typically over service periods that range from one to five years. Stock options issued under the plan expire 10 years from the date they are granted.

The Plan provided for an initial authorization of 1,550 shares of Class A Common stock for issuance thereunder, plus an additional annual authorization effective January 1, 2006 equal to the lesser of (i) 3% of the Class A Common Stock outstanding on the date of determination, (ii) 500,000 shares or (iii) such lesser amount as may be determined by the Company's Board of Directors.

The following equity awards were outstanding at December 31,

|                                 | <b>2006</b> | <b>2005</b> |
|---------------------------------|-------------|-------------|
| Stock options                   | 207,144     | 213,993     |
| Restricted stock grants         | 617,827     | 273,891     |
| Total outstanding equity awards | 824,971     | 487,884     |

On December 31, 2006 the following amounts were available for issuance under the plan:

|  |       |
|--|-------|
| Shares available for issuance at December 31, 2005 | 1,050 |
| Additions to plan                                  | 338   |
| Restricted stock grants Issued                     | (819) |
| Shares issued under employee stock purchase plan   | (18)  |
| Restricted stock grants and options Forfeited      | 376   |
| Shares available for issuance at December 31, 2006 | 927   |

The fair value of each option award is calculated on the date of grant using the Black-Scholes option pricing model and certain subjective assumptions. Because the Company does not have sufficient trading history, expected volatilities are based on historical volatilities of comparable companies within our industry. We estimate forfeitures using a weighted average historical forfeiture rate. Our estimates of forfeitures will be adjusted over the requisite service period based on the extent to which actual forfeitures differ, or are expected to differ, from their estimate. Due to lack of history, the expected lives are based on management's best estimates at the time of grant. The risk-free rate for the periods is based on the U.S. Treasury rates in effect at the time of grant. The following table summarizes the

assumptions used to calculate the fair value of options during 2005. There were no option grants during 2006.

|  | <b>2006</b> | <b>2005</b> |
|--|-------------|-------------|
| Weighted average fair value of options granted | N/A         | \$ 7.61     |
| Dividend yields                                | N/A         | N/A         |
| Expected volatility                            | N/A         | 41-48%      |
| Weighted average expected volatility           | N/A         | 45%         |
| Risk free interest rates                       | N/A         | 3.56- 3.63% |
| Weighted average expected lives (in years)     | N/A         | 2.5         |

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The following table summarizes information about stock options activity:

|                                  | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Intrinsic<br/>Value</b> |
|----------------------------------|---------------|--|---|
| Outstanding at December 31, 2004 | 107,144       | \$ 16.00   |   |
| Granted                          | 106,849       | 23.90  |   |
| Exercised                        |               |  |   |
| Forfeited or expired             |               |  |   |
| Outstanding at December 31, 2005 | 213,993       | 19.94  |   |
| Granted                          |               |  |   |
| Exercised                        |               |  |   |
| Forfeited or expired             | (6,849)       | 23.00  |   |
| Outstanding at December 31, 2006 | 207,144       | \$ 19.81   |   |
| Exercisable at December 31, 2006 | 25,000        | \$ 23.00   | \$  |

A summary of the Company's restricted share activity is presented below:

|  | <b>Shares</b> | <b>Weighted Average<br/>Fair<br/>Value at Date of Grant</b> |
|--|---------------|---|
| Restricted shares outstanding at December 14, 2004 |               |   |
| Granted  | 275,317       | \$ 16.00  |
| Restricted shares outstanding at December 31, 2005 | 275,317       | 16.00   |
| Granted  | 16,188        | 24.55   |
| Vested   | (4,068)       | 18.12   |
| Forfeited  | (13,545)      | 16.28   |
| Restricted shares outstanding at December 31, 2005 | 273,892       | 16.46   |
| Granted  | 597,940       | 9.71  |
| Vested   | (129,800)     | (15.05)   |
| Forfeited  | (155,347)     | 15.62   |
| Restricted shares outstanding at December 31, 2006 | 586,685       | \$ 9.83   |

As of December 31, 2006, there was \$4,242 of total unrecognized compensation cost related to nonvested restricted stock issuances granted under the Plan. This cost is expected to be recognized over a weighted-average period of 4.4 years.

Total compensation expense for share based payment arrangements for the year ended December 31, 2006 and 2005 was \$2,186 and \$2,322 respectively, of which \$347 and \$407 was capitalized to real estate held for development and sale. The total deferred tax benefit related to stock compensation, recorded on the balance sheet as of December 31, 2006 and 2005 amounted to \$ 760 and \$790 respectively.

The Company intends to issue new shares of its common stock upon vesting of restricted stock grants or the exercise of stock options.

## **15. COMMITMENTS AND CONTINGENCIES**

### ***Litigation***

The Company, as manager of an affiliated entity, exercised its option rights to purchase the project acquisition, development and construction loans made for the benefit of North Shore. The Company subsequently issued a notice of default under the acquisition and development loan at maturity on September 30, 2005, thereafter filed suit for collection of the loans against one of the individual guarantors under the loan on or about October 21, 2005. The



Company, as manager of an affiliated entity, set and held a foreclosure sale on March 24, 2006 in which it was the high bidder. However, transfer of title to the property has been delayed pending judicial resolution of a suit filed on March 24, 2006 by the non-affiliated 50% owner of North Shore. On June 30, 2006, the Company, on its own behalf and on behalf of affiliates, filed an additional lawsuit expanding the number of party defendants, demanding equitable relief and demanding \$33,000 in damages. The parties have reached a tentative settlement agreement whereby a company affiliated with the non-affiliated 50% owner of North Shore may purchase the Company's rights to North Shore or conversely, the Company may purchase the rights of the non-affiliated 50% owner upon certain conditions. The final terms and conditions of a definitive settlement agreement have not reached at this time.

On August 11, 2005, the Company was served with a motion to compel arbitration resulting from an allegation of a loan brokerage fee being owed for placement of a \$147,000 project loan for the Eclipse at Potomac Yard project. The claim in the base amount of \$2,000 plus interest and costs is based on breach of contract and equitable remedies of unjust enrichment and quantum meruit. The claims have been denied by the Company. On February 23, 2007, an arbitration award was rendered against the Company in the amount of \$2,039 plus accrued interest of \$348. An additional \$670 was rendered against the Company resulting from an allegation of a loan brokerage fee being owed for another project owned by the Company.

Other than the foregoing, we are not currently subject to any material legal proceedings. From time to time, however, we are named as a defendant in legal actions arising from our normal business activities. Although we cannot accurately predict the amount of our liability, if any, that could arise with respect to legal actions currently pending against us, we do not expect that any such liability will have a material adverse effect on our financial position, operating results or cash flows. We believe that we have obtained adequate insurance coverage or rights to indemnification, or where appropriate, have established reserves in connection with these legal proceedings.

In the normal course of its business, the Company and/or its subsidiaries are named as defendants in certain legal actions arising from its normal business activities. Management believes that none of these litigation matters in which the Company or any subsidiary is involved would have a material adverse effect on the consolidated financial condition or operations of the Company.

#### ***Letters of credit and performance bonds***

The Company has commitments as a result of contracts entered into with certain third parties to meet certain performance criteria as outlined in such contracts. The Company is required to issue letters of credit and performance bonds to these third parties as a way of ensuring that such commitments entered into are met by the Company. At December 31, 2006, the Company has issued \$3,143 in letters of credit and \$20,290 in performance and payment bonds to these third parties. No amounts have been drawn against these letters of credit and performance bonds.

#### ***Operating leases***

The Company leases office space under non-cancelable operating leases. Future minimum annual lease payments under these leases at December 31, 2006 approximate:

| <b>Year Ended:</b> | <b>Amount</b> |
|--------------------|---------------|
| 2007               | \$ 1,231      |
| 2008               | 1,120         |
| 2009               | 903           |
| 2010               | 164           |

|            |          |
|------------|----------|
| 2011       | 5        |
| Thereafter |          |
| Total      | \$ 3,423 |

Operating lease rental expense aggregated \$1,107, \$728 and \$347 respectively, for years ended December 31, 2006, 2005 and 2004.

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**16. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying amounts reported in the combined consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and floating rate debt approximate fair value. The carrying amount and fair value of fixed rate debt are as follows:

|                 | <b>December 31,</b> |             |
|-----------------|---------------------|-------------|
|                 | <b>2006</b>         | <b>2005</b> |
| Carrying amount | \$ 60,097           | \$ 31,609   |
| Fair value      | \$ 61,924           | \$ 36,233   |

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**17. INCOME TAXES**

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

The Company expects to generate a current year (\$7.5) million and (\$7.9) million net operating loss (NOL) for federal and state tax purposes respectively. An NOL carryback claim to 2005 is expected to result in cash refunds of federal and state taxes to the Company of approximately \$2.7 million.

Income Tax provision consists of the following as of December 31,:

|   | <b>2006</b> | <b>2005</b> |
|---|-------------|-------------|
| Current:  |             |             |
| Federal   | \$ (2,281)  | \$ 15,160   |
| State   | (424)       | 2,885       |
|   | (2,705)     | 18,045      |
| Deferred:   |             |             |
| Federal   | (18,833)    | (1,417)     |
| State   | (3,552)     | (262)       |
|   | (22,385)    | (1,679)     |
| Other   |             |             |
| Tax shortfall related to the vesting of equity awards | 570         |             |

|                                    |             |           |
|------------------------------------|-------------|-----------|
| Total income tax (benefit) expense | \$ (24,520) | \$ 16,366 |
|------------------------------------|-------------|-----------|

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Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Components of the Company's deferred tax assets and liabilities at December 31, 2006 and 2005 are as follows:

|                               | <b>2006</b> | <b>2005</b> |
|-------------------------------|-------------|-------------|
| Deferred tax assets:          |             |             |
| Inventory                     | \$ 9,642    | \$ 2,246    |
| Warranty                      | 612         | 417         |
| Investment in affiliates      | 25          | 27          |
| Accrued expenses              | 1,213       | 64          |
| Stock based compensation      | 762         | 790         |
|                               | 12,254      | 3,544       |
| Less valuation allowance      | (470)       | (840)       |
| Net deferred tax assets       | 11,784      | 2,704       |
| Deferred tax liabilities:     |             |             |
| Depreciation and amortization | (1,596)     | (159)       |
| Net deferred tax liabilities  | (1,596)     | (159)       |
| Net deferred tax assets       | \$ 10,188   | \$ 2,545    |

The Company has adequately provided for contingencies related to income taxes in accordance with SFAS No. 5. At December 31, 2006 and 2005, the Company recorded \$1,194 and \$ 802, respectively in income tax reserves. This tax reserve relates predominately to a potential dispute by taxing authorities over tax benefits resulting from additional income tax basis in certain residential housing development projects. The Company has also determined that a valuation allowance of approximately \$470 and \$840 as of December 31, 2006 and 2005 respectively related to a deferred tax asset of approximately \$470 and \$ 840 resulting from additional tax basis in residential real estate development projects. In analyzing the need for the provision of tax contingency reserves and the valuation allowance, management reviewed applicable statutes, rules, regulations and interpretations and established these reserves based on past experiences and judgments about potential actions by taxing jurisdictions. In January 2007, upon the adoption of Fin 48, the Company expects to reverse income tax reserves in the amount of \$1,194 as a benefit to the opening retained deficit balance.

A reconciliation of the statutory rate and the effective tax rate follows:

|   | <b>2006</b> | <b>2005</b> |
|---|-------------|-------------|
| Statutory Rate  | 35.00%      | 35.00%      |
| State income taxes net of federal benefit                     | 4.03%       | 3.95%       |
| Permanent differences   | 0.02%       | (1.75)%     |
| Change in effective tax rate                                  | (0.04)%     | (0.03)%     |
| Tax reserve   | (0.61)%     | 1.67%       |
| Tax shortfall related to the vesting of certain equity awards | (0.88)%     | 0.00%       |

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|                               |        |         |
|-------------------------------|--------|---------|
| Change in valuation allowance | 0.58%  | (1.58)% |
|                               | 38.10% | 37.26%  |

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**18. QUARTERLY RESULTS (unaudited)**

Quarterly results for the years ended December 31, 2006 and 2005 follow (in thousands, except per share amounts):

|                            | <b>Three months ended</b> |                          |                               |                              |
|----------------------------|---------------------------|--------------------------|-------------------------------|------------------------------|
|                            | <b>March 31,<br/>2006</b> | <b>June 30,<br/>2006</b> | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2006</b> |
| Revenues                   | \$ 36,595                 | \$ 50,697                | \$ 35,280                     | \$ 123,309                   |
| Operating income (loss)    | 1,778                     | (11,962)                 | (9,709)                       | (45,808)                     |
| Pretax income              | 1,991                     | (11,645)                 | (9,404)                       | (45,306)                     |
| Net income (loss)          | 1,240                     | (7,123)                  | (5,754)                       | (28,207)                     |
| Basic earnings per share   | 0.09                      | (0.47)                   | (0.36)                        | (1.79)                       |
| Diluted earnings per share | 0.09                      | (0.47)                   | (0.36)                        | (1.79)                       |

|                            | <b>Three months ended</b> |                          |                               |                              |
|----------------------------|---------------------------|--------------------------|-------------------------------|------------------------------|
|                            | <b>March 31,<br/>2005</b> | <b>June 30,<br/>2005</b> | <b>September 30,<br/>2005</b> | <b>December 31,<br/>2005</b> |
| Revenues                   | \$ 28,729                 | \$ 39,911                | \$ 78,437                     | \$ 77,228                    |
| Operating income (loss)    | 6,075                     | 4,636                    | 17,919                        | 13,779                       |
| Pretax income              | 6,140                     | 4,787                    | 18,424                        | 14,578                       |
| Net income (loss)          | 3,809                     | 3,066                    | 11,483                        | 9,204                        |
| Basic earnings per share   | 0.33                      | 0.26                     | 0.82                          | 0.66                         |
| Diluted earnings per share | 0.32                      | 0.26                     | 0.81                          | 0.65                         |

Quarterly and year-to-date computations of per share amounts are made independently. Therefore, the sum of per share amounts for the quarters may not agree with per share amounts for the year.

As discussed in Note 4, the company acquired Parker Chandler Homes Inc., during the first quarter of 2006 and Capitol Homes Inc., during the second quarter of 2006.

During 2006, the Company recorded total impairment and write-off charges of \$57,400. Of this amount, \$9,500, \$5,200 and \$42,700 was recorded during the first, second and third quarter of 2006, respectively.

**19. SUBSEQUENT EVENTS**

In February 2007 we received a ruling from a panel of arbitrators ordering payment of approximately \$3.0 million with respect to an allegation of a loan brokerage fee being owed for placement of a \$147.0 million project loan for the Eclipse at Potomac Yard project and a \$67.0 million project loan at Penderbrook. We are assessing our rights of appeal with respect to this decision.

In February 2007 we entered into a limited recourse \$28.0 million loan agreement with Guggenheim Capital Partners to refinance an existing loan with Corus Bank. The new loan has a term of 3 years and bears a floating interest rate of LIBOR + 500 basis points.

In January 2007 we entered into a contract to sell 110 lots at our Massey Preserve project in Raleigh, NC to another builder in two takedowns. The first closing on 55 lots occurred in February 2007 for proceeds of \$3.6 million. The second takedown is scheduled to occur in July 2007.

On May 4, 2006 we closed on a \$30 million Junior Subordinated Note Offering. The term of the note was thirty years which could be retired after five years with no penalty. The rate was fixed at 9.72% the first five years and LIBOR plus 420 basis points for the remaining twenty-five years. In March 2007 we retired the original Junior Subordinated Note and entered into a new 10-year \$30 million Senior Secured Note Offering with the same lender at the same interest rate.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No. 1 to the annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COMSTOCK HOMEBUILDING COMPANIES, INC.**

Date: April 30, 2007

By: /s/ Christopher Clemente

Christopher Clemente  
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

| <b>Signature</b>                                 | <b>Capacity</b>  | <b>Date</b>    |
|--|--|----------------|
| /s/ Christopher Clemente<br>Christopher Clemente | Chairman of the Board of Directors<br>and Chief Executive Officer (Principal<br>Executive Officer) | April 30, 2007 |
| *  | Regional President, Southeast  | April 30, 2007 |
| Gregory V. Benson                                |  |                |
| /s/ Bruce J. Labovitz<br>Bruce J. Labovitz       | Chief Financial Officer<br>(Principal Financial Officer)   | April 30, 2007 |
| /s/ Jason Parikh<br>Jason Parikh                 | Chief Accounting Officer<br>(Principal Accounting Officer)   | April 30, 2007 |
| *  | Director   | April 30, 2007 |
| A. Clayton Perfal                                |  |                |
| *  | Director   | April 30, 2007 |
| David M. Guernsey                                |  |                |
| *  | Director   | April 30, 2007 |
| James A. MacCutcheon                             |  |                |

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|                   |          |                |
|-------------------|----------|----------------|
| *                 | Director | April 30, 2007 |
| Norman D. Chirite |          |                |
| *                 | Director | April 30, 2007 |
| Robert P. Pincus  |          |                |
| *                 | Director | April 30, 2007 |
| Socrates Verses   |          |                |

By:  
/s/ Bruce J. Labovitz

Bruce J. Labovitz  
*Attorney-in-Fact*  
April 30, 2007