

AVATAR HOLDINGS INC

Form DEF 14A

April 22, 2005

SCHEDULE 14A
(Rule 14a-101)
INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
Filed by a Party other than the Registrant o
Check the appropriate box:

- o Preliminary Proxy Statement
- x Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12
- o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

AVATAR HOLDINGS INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- x No fee required.
 - o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
 - (1) Title of each class of securities to which transaction applies:
 - (2) Aggregate number of securities to which transaction applies:
 - (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
 - (4) Proposed maximum aggregate value of transaction:
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 - o Fee paid previously with preliminary materials:
 - o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
 - (1) Amount Previously Paid:
 - (2) Form, Schedule or Registration Statement No.:
 - (3) Filing Party:
 - (4) Date Filed:
-

AVATAR
HOLDINGS INC.
201 Alhambra Circle
Coral Gables, Florida 33134
(305) 442-7000

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held On May 24, 2005

To the Stockholders of Avatar Holdings Inc.:

The Annual Meeting of Stockholders of Avatar Holdings Inc. will be held at the Hyatt Regency Coral Gables, 50 Alhambra Plaza, Coral Gables, Florida, on May 24, 2005, at 10:00 a.m. local time, for the following purposes:

1. To elect eleven directors.
2. To approve the appointment of Ernst & Young LLP, independent registered public accounting firm, to act as auditors for Avatar for the year ending December 31, 2005.
3. To approve the Avatar Holdings Inc. Amended and Restated 1997 Incentive and Capital Accumulation Plan (2005 Restatement).
4. To approve the Avatar Holdings Inc. 2005 Executive Incentive Compensation Plan.
5. To transact such other business as properly may come before the meeting, or any adjournment or adjournments thereof.

The Board of Directors has fixed the close of business on March 31, 2005 as the record date for the determination of stockholders entitled to receive notice of, and to vote at, the Annual Meeting or any adjournment or adjournments thereof.

Please mark your proxy if you wish to attend the Annual Meeting in order that adequate preparations may be made. A meeting attendance card will be mailed promptly to you to facilitate your attendance.

WHETHER OR NOT YOU EXPECT TO BE PRESENT AT THE ANNUAL MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY PROMPTLY IN THE POSTAGE-PREPAID ENVELOPE PROVIDED FOR YOUR CONVENIENCE. IF YOU ATTEND THE ANNUAL MEETING, YOU MAY REVOKE YOUR PROXY AND VOTE YOUR SHARES IN PERSON IF YOU WISH.

By Order of the Board of Directors,

Juanita I. Kerrigan
Vice President and Secretary

Dated: April 22, 2005.

AVATAR HOLDINGS INC., 201 ALHAMBRA CIRCLE, CORAL GABLES, FLORIDA 33134 (305) 442-7000
PROXY STATEMENT FOR ANNUAL MEETING OF STOCKHOLDERS
To Be Held On May 24, 2005

This Proxy Statement and the enclosed form of proxy are furnished to the stockholders of Avatar Holdings Inc., a Delaware corporation (Avatar), in connection with the solicitation of proxies by and on behalf of the Board of Directors of Avatar for use at the Annual Meeting of Stockholders to be held at the place and time and for the purposes set forth in the annexed Notice of Annual Meeting of Stockholders.

VOTING RIGHTS AND PROXY INFORMATION

Record Date; Voting Rights

Pursuant to the By-Laws of Avatar, the Board of Directors has fixed the close of business on March 31, 2005 as the record date for the determination of stockholders entitled to notice of and to vote at the meeting or any adjournment or adjournments thereof.

At the close of business on March 31, 2005, 8,058,129 shares of Common Stock, \$1.00 par value, of Avatar (Common Stock), which constitutes the only class of voting securities of Avatar, were outstanding and entitled to vote. For each share of Common Stock held of record as of the close of business on March 31, 2005, stockholders are entitled to one vote, except in regard to the election of directors, for which there will be cumulative voting as described under the heading Election of Directors. In accordance with Avatar s By-Laws, the holders of a majority of the outstanding shares of Common Stock, present in person or represented by proxy, will constitute a quorum for the transaction of business at the Annual Meeting.

Proxies

When a proxy is received, properly executed, in time for the Annual Meeting, the shares represented thereby will be voted at the meeting as directed. If no such direction is specified, such shares will be voted: (1) FOR the election as directors of Avatar the eleven nominees named therein; (2) FOR approval of the appointment of Ernst & Young LLP, independent registered public accounting firm, as auditors of Avatar for the year ending December 31, 2005; (3) FOR approval of the Avatar Holdings Inc. Amended and Restated 1997 Incentive and Capital Accumulation Plan (2005 Restatement) (the Incentive Plan); (4) FOR approval of the Avatar Holdings Inc. 2005 Executive Incentive Compensation Plan (the 2005 Executive Plan); and (5) in connection with the transaction of such other business as properly may come before the meeting in accordance with the judgment of the person or persons voting the proxy. Generally, Avatar intends to award to eligible persons stock-based incentives under the Incentive Plan and cash-based incentives under the 2005 Executive Plan. Any stockholder who executes a proxy may revoke it at any time prior to its exercise by giving written notice of such revocation to the Secretary of Avatar. In addition, a stockholder who attends the meeting may vote in person, thereby cancelling any proxy previously given by such stockholder.

Nominees for director will be elected by a plurality of the votes cast (i.e., the highest number of votes cast) at the Annual Meeting by the holders of Common Stock present in person or by proxy and entitled to notice of, and to vote at, the Annual Meeting. Consequently, only shares that are voted in favor of a particular nominee will be counted toward such nominee s achievement of a plurality. Shares present at the meeting that are not voted for a particular nominee or shares present by proxy where the stockholder withheld authority to vote for such nominee(s) (including broker non-votes) will not be counted toward such nominee s achievement of a plurality.

The affirmative vote of a majority of the shares of Common Stock present in person or by proxy and entitled to notice of, and to vote at, the Annual Meeting is necessary to ratify the appointment of Ernst & Young LLP as auditors for the year ending December 31, 2005, to approve the 2005 Restatement of the Incentive Plan and to approve the 2005 Executive Plan. Abstentions will have the same effect as votes against such proposals because the shares are considered present at the meeting but are not affirmative votes, and broker non-votes will not be counted in respect of the proposals.

This proxy statement and the form of proxy enclosed herewith, and the accompanying Annual Report of Avatar for the fiscal year ended December 31, 2004, including financial statements, are first being mailed to stockholders of record as of the close of business on March 31, on or about April 22, 2005.

If you plan to attend the meeting, please mark the box provided on your proxy card so that we may send you an attendance card. Stockholders who have beneficial ownership of Common Stock that is held by a bank or broker should bring account statements or letters from their banks or brokers indicating that they owned Avatar Common Stock as of March 31, 2005. Stockholders also may obtain an attendance card by submitting a written request to the Secretary of Avatar.

**PRINCIPAL STOCKHOLDERS AND SECURITY
OWNERSHIP OF MANAGEMENT**

Principal Stockholders

The following table sets forth, as of March 31, 2005, information with respect to each person or entity known by the Board of Directors to be the beneficial owner of more than 5% of the outstanding Common Stock. Except as otherwise indicated, all shares are owned directly.

Name of Beneficial Owner	Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
ODAV LLC	280 Park Ave. New York, NY 10017	2,107,763 ⁽¹⁾⁽²⁾	26.16%
Advisory Research, Inc.	180 North Stetson St., Suite 5500 Chicago, IL 60601	875,249 ⁽³⁾	10.86%
Private Capital Management, L.P.	8889 Pelican Bay Blvd. #500 Naples, FL 34108	1,475,518 ⁽⁴⁾	18.31%
Sterling Capital Management LLC	Two Morrocroft Centre 4064 Colony Road, Suite 300 Charlotte, NC 28211	601,860 ⁽⁵⁾	7.47%
The Estate of Leon Levy	280 Park Ave. New York, NY 10017	706,426 ⁽⁶⁾	8.77%
Third Avenue Management LLC	622 Third Avenue New York, NY 10017	744,915 ⁽⁷⁾	9.24%

(1) Does not include shares owned by Jack Nash, who is a member of the Board of Directors of Avatar and is sole member of Jack Nash LLC, a managing member of ODAV LLC, a Delaware limited liability company (Oдав),

formed in September 2003 to hold the Avatar Common Stock owned by Odyssey Partners, L.P. Jack Nash, the sole member of Jack Nash LLC, has the sole power to vote, direct the voting of, dispose of and direct the disposition of the shares of Common Stock beneficially owned by Odav and, accordingly, may be deemed to own beneficially the Common Stock owned by Odav. Each of Jack Nash and Joshua Nash, sole member of Joshua Nash II LLC, a managing member of Odav, has expressly disclaimed any such beneficial ownership (within the meaning of Exchange Act Rule 13d-3(d)(1)) which exceeds the proportionate interest in the Common Stock which he may be deemed to own as a member of Odav. Avatar has been advised

that no other person exercises (or may be deemed to exercise) any voting or investment control over the Common Stock owned by Odav. Jack Nash's ownership of Common Stock is indicated in the table included in Security Ownership of Management.

(2) By virtue of its present Common Stock ownership, Odav may be deemed to be a control person of Avatar within the meaning of that term as defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended.

(3) Based upon information set forth in Schedule 13G, filed March 1, 2005, Advisory Research, Inc. (ARI) (a registered investment adviser) is deemed to beneficially own 875,249 shares for which ARI has sole voting and dispositive power.

(4) Based upon information set forth in Amendment No. 4 to Schedule 13G, filed on February 14, 2005, by Private Capital Management, L.P. (Private Capital) (a registered investment adviser), the aggregate amount beneficially owned is 1,475,518 shares, of which 1,471,518 shares are held for the benefit of various clients; the CEO and the President of Private Capital share voting and dispositive power with respect to shares managed by Private Capital; and beneficial ownership of such shares is disclaimed.

(5) Does not include shares owned by Eduardo A. Brea, who is a Director of Avatar and is a Partner and Managing Director of Sterling Capital Management LLC (Sterling Capital). Mr. Brea's ownership is indicated in the table included in Security Ownership of Management. The information as to shares of Common Stock was furnished to Avatar by Sterling Capital (a registered investment adviser), which disclaims beneficial ownership of such shares. Based upon information set forth in Amendment No. 5 to Schedule 13G, filed on January 6, 2005, by Sterling Capital, its managing member, Sterling MGT, Inc., and its five individual controlling shareholders, such shares are held for the benefit of various clients; and Sterling Capital shares voting and dispositive power with its managing member and controlling shareholders.

(6) Information as to shares beneficially owned is based upon Amendment No. 1 to Schedule 13G, dated February 3, 2004, filed by The Estate of Leon Levy.

(7) Based upon information set forth in Amendment No. 8 to Schedule 13G, filed on February 16, 2005, Third Avenue Management LLC (TAM) (a registered investment adviser) is deemed to beneficially own 744,915 shares on behalf of investment advisory clients. TAM has sole voting power with respect to 742,115 shares and sole dispositive power with respect to 744,915 shares.

Security Ownership of Management

The following table sets forth, as of March 31, 2005, information with respect to the outstanding shares of Common Stock owned beneficially by each present director, nominee for director, each of the Named Executive Officers identified herein under the caption Summary Compensation Table, and all present directors and executive officers of Avatar as a group. Except as otherwise indicated, all shares are owned directly.

Name or Group	Amount and Nature of Beneficial Ownership ⁽¹⁾⁽²⁾	Percent of Class ⁽²⁾
Eduardo A. Brea	5,257 ⁽³⁾	*
Milton Dresner	3,644	*
Gerald D. Kelfer	5,113 ⁽⁴⁾	*
Martin Meyerson	2,347 ⁽⁵⁾	*
Jack Nash	2,108,205 ⁽⁶⁾	26.16%
Joshua Nash	2,107,763 ⁽⁷⁾	26.16%
Kenneth T. Rosen	1,000	*
Joel M. Simon	None	*
Fred Stanton Smith	2,949	*
William G. Spears	39,498 ⁽⁸⁾	*
Beth A. Stewart	8,000	*
Jonathan Fels	52,672 ⁽⁹⁾	*

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Michael Levy	57,015 ⁽¹⁰⁾	*
Dennis J. Getman	10,000 ⁽¹¹⁾	*
Charles L. McNairy	None	*
All directors and executive officers as a group (consisting of 16 persons of whom 13 beneficially own shares of Common Stock)	2,295,700 ⁽³⁾⁽⁴⁾⁽⁵⁾⁽⁶⁾⁽⁷⁾⁽⁸⁾⁽⁹⁾⁽¹⁰⁾⁽¹¹⁾	28.11%

* Represents less than one percent.

(1) The information as to securities owned by directors, officers and nominees was furnished to Avatar by such directors, officers and nominees.

(2) Calculated pursuant to Rule 13d-3(d) of the Exchange Act. Under Rule 13d-3(d), shares not outstanding which are subject to options, warrants, rights or conversion privileges exercisable within 60 days are deemed outstanding for the purpose of calculating the number and percentage of shares owned by such person, but are not deemed outstanding for the purpose of calculating the percentage owned by each other person listed. As of March 31, 2005, there were 8,058,129 shares of Common Stock outstanding.

(3) Does not include 601,860 shares beneficially owned by Sterling Capital Management LLC, of which Mr. Brea is a Partner and Managing Director. See Note (5) to the preceding table included in Principal Stockholders.

(4) Includes 2,000 shares owned by his children, over which shares Mr. Kelfer shares voting and dispositive power.

(5) Does not include 847 shares owned by Mr. Meyerson's wife, as to which shares Mr. Meyerson disclaims beneficial ownership.

(6) Includes 2,107,763 shares owned by Odav. Mr. Nash is the sole member of Jack Nash LLC, a managing member of Odav, and therefore may be deemed to own beneficially the shares of Common Stock owned by Odav. See Notes (1) and (2) to the preceding table included in Principal Stockholders.

(7) Represents shares owned by Odav. Mr. Nash is the sole member of Joshua Nash II LLC, a managing member of Odav, and therefore may be deemed to own beneficially the shares of Common Stock owned by Odav. See Notes(1) and (2) to the preceding table included in Principal Stockholders.

(8) Does not include 1,000 shares owned by the Estate of Mr. Spears' deceased wife, as to which shares Mr. Spears disclaimed beneficial ownership. Includes 19,898 shares held by an individual profit sharing plan, a charitable remainder trust and a family foundation, over which shares Mr. Spears has either sole or shared voting and investment power.

(9) Includes 50,000 shares issuable upon exercise of options.

(10) Includes 50,000 shares issuable upon exercise of options and 2,500 shares owned by his children, over which shares Mr. Levy has sole voting and dispositive power.

(11) Represents 10,000 shares issuable upon exercise of options.

CORPORATE GOVERNANCE AND CODES OF BUSINESS CONDUCT AND ETHICS

Corporate Governance Guidelines and Principles

Avatar's Board of Directors has adopted Corporate Governance Guidelines and Principles as a component of the flexible governance framework within which the Board, assisted by its committees, directs Avatar's affairs. The Corporate Governance Guidelines and Principles, which define the role of the Board of Directors, is available on Avatar's website at www.avatarholdings.com.

Director Independence

The Board of Directors has determined that all nominees for election or reelection meet the independence criteria under the rules and regulations of The Nasdaq Stock Market, Inc. (Nasdaq) except for Jack Nash, Joshua Nash and Gerald D. Kelfer, Vice Chairman of the Board, President, Chief Executive Officer and Chairman of the Executive Committee. The Board has further determined that all current members of the Audit Committee meet the more stringent independence requirements of the U.S. Securities and Exchange Commission (SEC) and Nasdaq for Audit Committee membership.

Code of Business Conduct and Ethics

The Board of Directors has adopted a Code of Business Conduct and Ethics applicable to all directors, officers and employees of Avatar and a Supplemental Code of Ethics for the CEO, CFO and other Senior Financial Officers. These Codes of Business Conduct and Ethics are available on Avatar's website at www.avatarholdings.com.

1. ELECTION OF DIRECTORS

Eleven directors are to be elected for the ensuing year and until their respective successors are duly elected and qualified. Stockholders have cumulative voting rights with respect to election of directors. Under cumulative voting, each stockholder is entitled to the same number of votes per share as the number of directors to be elected (or, for purposes of this election, eleven votes per share). A stockholder may cast all such votes for a single nominee or distribute them among the nominees, as such stockholder wishes, either by so marking his ballot at the meeting or by specific voting instructions sent to Avatar with a signed proxy. In connection with the solicitation of proxies, discretionary authority to cumulate votes is being solicited. Unless authority to vote for the nominees for director is withheld, it is the intention of the persons named in the accompanying proxy to vote the proxies in such manner as will elect as directors the nominees named below.

All of the nominees were elected at the May 25, 2004 Annual Meeting of Stockholders except Joshua Nash. The Board of Directors met eight times during 2004, including the annual meeting of directors held immediately following the 2004 Annual Meeting of Stockholders.

The Board of Directors does not contemplate that any of the persons named below will be unable, or will decline, to serve. However, if any of such persons is unable or declines to serve, the persons named in the accompanying proxy may vote for another person or persons in their discretion.

The following table sets forth certain information with respect to each nominee for director. Except as otherwise indicated, each nominee has held his present occupation or occupations for more than the past five years and has not been principally employed by any subsidiary or affiliate of Avatar. There are no family relationships between any nominee, director or executive officer of Avatar except that Jack Nash and Joshua Nash are father and son.

Name	Age	Principal Occupation or Occupations and Directorships
Eduardo A. Brea Director since May 2002	38	Partner and Managing Director of Sterling Capital Management LLC, a registered investment adviser, since 2000; formerly Senior Vice President from 1995 to 2000; formerly Senior Analyst, Wachovia Investment Management, from 1990 to 1995.
Milton Dresner Director since July 1995	79	Founding Partner, The Highland Companies, since 1960, a diversified real estate development and management organization; Director: BioTime, Inc., New Media Lottery Services, Inc.
Gerald D. Kelfer Director since October 1996	59	Vice Chairman of the Board of Avatar since December 1996, Chief Executive Officer since July 31, 1997, President since February 13, 1997 and Chairman of the Executive Committee since May 27, 1999; formerly a principal in Odyssey Partners, L.P., from July 1994 to February 1997; and Executive Vice President, Senior General Counsel and Director of Olympia & York Companies, from 1985 to 1994.
Martin Meyerson Director since May 1981	82	President Emeritus and Professor of Policy and Planning, University of Pennsylvania, since February 1981, and President thereof from 1970 to 1981; also, Chairman, Marconi International Foundation; Director, Panasonic Foundation.
Jack Nash Director since June 2003	76	Chairman of the Board of Avatar from June 2003 to September 2004; sole member of Jack Nash, LLC, a managing member of ODAV LLC, a private investment limited liability company, since its

formation in September 2003; General Partner, Odyssey Partners, L.P., a private investment partnership, since its formation in 1982.

Name	Age	Principal Occupation or Occupations and Directorships
Joshua Nash Director since September 2004	43	Chairman of the Board of Avatar since September 29, 2004; sole member of Joshua Nash II LLC, a managing member of ODAV LLC, a private investment limited liability company, since its formation in September 2003; General Partner, Ulysses Management, L.L.C., a private investment firm, since 1997; General Partner, Odyssey Partners, L.P., a private investment partnership, since 1989.
Kenneth T. Rosen Director since September 1994	56	Professor of Business Administration, since 1979, and Chairman of the Fisher Center for Real Estate and Urban Economics, since 1981, University of California, Berkeley; also Chairman, Rosen Real Estate Securities, LLC, a real estate hedge fund; and Chairman, Rosen Consulting Group, a real estate consulting business; Director: Golden West Financial Corporation, The PMI Group, Inc.
Joel M. Simon Director since May 2004	59	Partner and Principal, XRoads Solutions Group, LLC (f/k/a Crossroads, LLC), a national financial advisory and consulting firm, since July 2000; formerly Chief Executive Officer and President, Starrett Corporation, from March 1998 to December 1998; Executive Vice President, Chief Operating Officer and Director, Olympia & York Companies (U.S.A.), from 1985 to 1996; Senior Partner, Margolin, Winer & Evens, LLP, from 1976 to 1984; Director, Movie Star, Inc.
Fred Stanton Smith Director since September 1980	76	Vice Chairman of the Board, The Keyes Company, a real estate brokerage, financing, management, insurance and development firm, since January 1992; formerly President, The Keyes Company; Director, Eagle National Bank.
William G. Spears Director since May 1999	66	Principal, Spears, Grisanti & Brown LLC, a registered investment adviser, since July 1999; formerly Chairman of the Board, from 1972 to June 1999, Spears, Benzak, Salomon & Farrell, Inc., a registered investment adviser, which in April 1995 became a wholly-owned subsidiary of KeyCorp; also, Chairman of the Board, Key Asset Management (a subsidiary of KeyCorp), a registered investment adviser, from 1996 to 2000; Director, United HealthGroup Incorporated.
Beth A. Stewart Director since May 2001	48	Chief Executive Officer since August 2001 and Co-Chairman since October 1999, Storetrax.com, a real estate internet company; President, Stewart Real Estate Capital, a real estate investment and consulting firm, since January 1993; Adjunct Professor, Columbia University Graduate School of Business, from 1994 to 1996; Director: General Growth Properties Inc., CarMax, Inc.

INFORMATION REGARDING THE BOARD OF DIRECTORS
AND ITS COMMITTEES

Certain Committees of the Board

To assist it in carrying out its duties, the Board of Directors has established various committees. Current committees and current members thereof are as follows:

Executive Committee	Audit Committee	Nominating and Corporate Governance Committee	Compensation Committee
Gerald D. Kelfer ⁽¹⁾⁽²⁾ Joshua Nash Fred Stanton Smith	Kenneth T. Rosen ⁽¹⁾ Eduardo A. Brea Milton Dresner Joel M. Simon Beth A. Stewart	Martin Meyerson ⁽¹⁾ Kenneth T. Rosen William G. Spears	William G. Spears ⁽¹⁾ Milton Dresner Martin Meyerson Kenneth T. Rosen

(1) Chairman

(2) Officer of Avatar

Executive Committee

The Executive Committee of the Board of Directors has authority to exercise most powers of the full Board of Directors in connection with matters which arise during the intervals between meetings of the Board of Directors. The Executive Committee did not meet during 2004.

Audit Committee

The Audit Committee assists the Board of Directors in fulfilling its responsibility to oversee management regarding: (i) the conduct and integrity of Avatar's financial reporting; (ii) Avatar's systems of internal accounting and financial and disclosure controls; (iii) the qualifications, engagement, compensation, independence and performance of the independent auditors, their conduct of the annual audit and their engagement for any other services; (iv) Avatar's legal and regulatory compliance; (v) codes of ethics as established by management and the Board; and (vi) the preparation of the audit committee report for inclusion in the annual proxy statement. The Audit Committee may also perform such other tasks as are assigned to it from time to time by the Board of Directors. The Audit Committee has the authority to obtain advice and assistance from, and receive adequate resources and funding from Avatar for, outside counsel, independent auditors or other advisors. The Audit Committee met ten times during the fiscal year ended December 31, 2004. The Audit Committee is governed by a written charter approved by the Board of Directors. The charter is available on Avatar's website at www.avatarholdings.com.

All members of the Audit Committee have been determined to be independent (see Director Independence). The Board of Directors has also determined that all members of the Audit Committee are financially literate under Nasdaq's listing standards and Joel M. Simon is the Committee's audit committee financial expert, as defined in the rules of the SEC and for purposes of Nasdaq's listing standards.

Audit Committee Report

The following is the report of Avatar's Audit Committee with respect to Avatar's audited financial statements for the fiscal year ended December 31, 2004:

The Committee has reviewed and discussed Avatar's audited financial statements with management.

The Committee has discussed with Ernst & Young LLP, Avatar's independent auditors, the matters required to be discussed by SAS 61 (Communication with Audit Committees), as amended,

regarding the auditors' judgments about the quality of Avatar's accounting principles as applied in its financial reporting.

The Committee has also received written disclosures within the letter from Ernst & Young required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with Ernst & Young their independence.

Based on the review and discussions referred to above, the Committee recommended to Avatar's Board of Directors that its audited financial statements be included in Avatar's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 for filing with the Securities and Exchange Commission.

March 3, 2005

AUDIT COMMITTEE

Kenneth T. Rosen, Chairman
Eduardo A. Brea
Milton Dresner
Joel M. Simon
Beth A. Stewart

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee assists the Board of Directors in: (i) identifying, screening and reviewing individuals to serve as directors and recommending candidates for nomination for election at the annual meeting of stockholders or to fill Board vacancies; (ii) overseeing Avatar's policies and procedures for receipt of stockholder suggestions regarding composition of the Board and recommendations of candidates for nomination; (iii) overseeing implementation of Avatar's Corporate Governance Guidelines and Principles; and (iv) reviewing Avatar's overall corporate governance and recommending changes when necessary or desirable. The Committee may also perform such additional tasks as assigned to it by the Board of Directors. The Committee has the authority to obtain advice and assistance from, and receive adequate resources and funding from Avatar for, outside counsel, consultants and other advisors. The Committee met three times during the fiscal year ended December 31, 2004.

All members of the Committee have been determined to be independent (see "Director Independence"). The Committee is governed by a written charter approved by the Board of Directors. The charter is available on Avatar's website at www.avatarholdings.com.

The Nominating and Corporate Governance Committee assesses the appropriate size of the board, evaluates the membership and determines whether any vacancies are anticipated. The Committee considers candidates for Board membership based upon various criteria, including their business and professional skills and experience, personal integrity and judgment, commitment to representing the long-term interests of stockholders and availability to participate in Board activities. The Committee will consider candidates suggested by its members, other Board members, management and stockholders, and may, if necessary or appropriate, utilize the services of a professional search firm. In order to be considered, a recommendation from a stockholder must include the stockholder's name and contact information, the candidate's name and contact information, a brief description of the candidate's background and qualifications and a statement by the candidate that he or she is willing and able to serve on the Board. The Committee may also require candidates to provide such other information as it may request.

Avatar's By-Laws establish advance notice procedures with respect to nominations for election for an annual meeting (see "Stockholders' Proposals and Nominations of Board Members").

Joshua Nash, who was elected to the Board on September 29, 2004, was recommended by Avatar's former Chairman of the Board, Jack Nash.

Compensation Committee

The Compensation Committee assists the Board of Directors in overseeing management compensation policies and practices, including (i) determination and approval of the compensation of the Chief Executive Officer; (ii) review and approval of compensation levels for Avatar's other executive officers; (iii) review and approval of management incentive compensation policies and programs; (iv) review and approval of equity compensation programs for employees and the exercise of discretion in the administration of such programs; and (v) preparation of an annual report on executive compensation for inclusion in the proxy statement. The Compensation Committee may perform such other tasks as assigned to it by the Board of Directors. The Compensation Committee has the authority to obtain advice and assistance from, and receive adequate resources and funding from Avatar for, outside counsel, compensation consultants and other advisors. The Compensation Committee met five times during the fiscal year ended December 31, 2004.

The Compensation Committee is governed by a written charter approved by the Board of Directors. The charter is available on Avatar's website at www.avatarholdings.com.

Directors' Compensation

Compensation of directors who are not salaried employees of Avatar is \$32,500 per annum. A member of the Executive Committee who is not a salaried employee of Avatar receives a retainer of \$2,000 per annum. Members and the Chairman of the Audit Committee receive additional compensation of \$12,000 and \$14,000 per annum, respectively. Members and the Chairman of the Nominating and Corporate Governance Committee receive additional compensation of \$4,000 and \$7,000 per annum, respectively. Members and the Chairman of the Compensation Committee receive additional compensation of \$4,000 and \$5,000 per annum, respectively. In connection with its current review of Avatar's non-employee director compensation, the Nominating and Corporate Governance Committee is considering permitting non-employee directors the ability to defer a portion of their cash compensation into stock units. The committee is also considering annual awards of restricted stock units to all non-employee directors.

Directors' Attendance

In fiscal year 2004 all of the incumbent directors attended 75% or more of the aggregate of their respective Board and Committee meetings, except Jack Nash whose absences were attributable to illness.

Directors' Attendance at Annual Meetings of Stockholders

The Board encourages each member of the Board to attend each annual meeting of stockholders, but recognizes that unavoidable circumstances may prevent attendance. All members of the Board who were standing for election or reelection, except Jack Nash, attended the 2004 Annual Meeting of Stockholders.

Communication with the Board of Directors

A stockholder who wishes to communicate with the Board, or specific individual directors, may direct written communication addressed to the Board or such director or directors in care of the Corporate Secretary, Avatar Holdings Inc., 201 Alhambra Circle, Coral Gables, Florida 33134.

EXECUTIVE COMPENSATION AND OTHER INFORMATION

Summary Compensation Table

The following table sets forth information with respect to compensation of the Chief Executive Officer and the four other highest paid executive officers of Avatar whose total salary and accrued bonus was \$100,000 or more for the year ended December 31, 2004, hereinafter referred to as the Named Executive Officers.

Name and Principal Position(s)	Year	Annual Compensation		Long-Term Compensation Awards				All Other Compensation ⁽⁷⁾
		Salary	Bonus	Other ⁽¹⁾	Restricted	Securities	LTIP	
				Annual	Stock	Underlying	Payouts	
			Compensation	Awards(\$)	Options(#)	(\$)		
Gerald D. Kelfer	2004	\$ 500,000 ⁽²⁾	\$ 500,000 ⁽²⁾				\$ 1,563,349 ⁽⁵⁾	\$ 2,783
Chairman of the Executive Committee, Chief Executive Officer and President	2003	500,000 ⁽²⁾	500,000 ⁽²⁾		\$ 3,162,500 ⁽³⁾		1,412,651 ⁽⁶⁾	3,000
	2002	500,000 ⁽²⁾	500,000 ⁽²⁾					
Jonathan Fels	2004	\$ 500,000 ⁽²⁾	\$ 250,000 ⁽²⁾				\$ 1,858,667 ⁽⁵⁾	\$ 2,783
President, Avatar Properties Inc.	2003	500,000 ⁽²⁾	250,000 ⁽²⁾		632,500 ⁽⁴⁾	60,000	1,059,488 ⁽⁶⁾	3,000
	2002	400,000 ⁽²⁾	250,000					0
Michael Levy	2004	\$ 500,000 ⁽²⁾	\$ 250,000 ⁽²⁾				\$ 1,858,667 ⁽⁵⁾	\$ 2,783
Executive Vice President and Chief Operating Officer, Avatar Properties Inc.	2003	500,000 ⁽²⁾	250,000 ⁽²⁾		632,500 ⁽⁴⁾	60,000	1,059,488 ⁽⁶⁾	3,000
	2002	400,000 ⁽²⁾	250,000					0
Dennis J. Getman	2004	\$ 350,000 ⁽²⁾	\$ 14,964 ⁽²⁾					\$ 2,783
Executive Vice President and General Counsel	2003	350,000 ⁽²⁾	76,021 ⁽²⁾		500,004 ⁽⁴⁾			3,000
	2002	250,000	217,368					0

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Charles L. McNairy	2004	\$ 250,000	\$ 25,000	523,125 ⁽⁴⁾	\$ 2,783
Executive Vice President, Treasurer and Chief Financial Officer	2003	225,000	25,000		3,000
	2002	225,000	5,000		0

- (1) Each Named Executive Officer received an automobile allowance or used a company-leased automobile. The aggregate value of this benefit did not exceed the lesser of \$50,000 or 10% of the total annual salary and bonus reported for each of the Named Executive Officers. Avatar also provides group life, health, hospitalization and medical reimbursement plans which do not discriminate in scope, terms or operation in favor of officers and are available to all full-time employees.
- (2) For discussion of Avatar's employment agreements with Messrs. Kelfer, Fels, Levy and Getman, see Employment and Other Agreements.
- (3) On March 27, 2003, fully vested options previously granted to Mr. Kelfer were cancelled, and he was granted an opportunity to receive an aggregate of 75,000 performance conditioned restricted stock units. Also on March 27, 2003, Mr. Kelfer was granted an opportunity to receive an additional 50,000 performance conditioned restricted stock units. See Employment and Other Agreements below. The dollar amount reported in the table has been calculated by multiplying the closing price of Avatar Common Stock on the date of the awards by 125,000. Mr. Kelfer is not entitled to receive dividends on the units.
- (4) The dollar amounts reported in the table were calculated by multiplying the respective closing price of Avatar common stock on the respective dates of the awards by 25,000 for each of Mr. Fels and Mr. Levy, by 15,504 for Mr. Getman and by 12,500 for Mr. McNairy. Messrs. Fels, Levy, Getman and McNairy are not entitled to receive dividends on the units.
- (5) Represents \$1,087,349, \$1,477,667 and \$1,477,667 paid or accrued for the 2004 fiscal year to Mr. Kelfer, Mr. Fels and Mr. Levy, respectively, under Cash Bonus Award Agreements entered into on October 20, 2000; and \$476,000, \$381,000 and \$381,000 accrued for the 2004 fiscal year to Mr. Kelfer, Mr. Fels and Mr. Levy, respectively, under Earnings Participation Award Agreements entered into on March 27, 2003. See Employment and Other Agreements below.
- (6) Represents amounts paid or accrued for the 2003 fiscal year to Mr. Kelfer, Mr. Fels and Mr. Levy, respectively, under Cash Bonus Award Agreements entered into on October 20, 2000. See Employment and Other Agreements below.
- (7) Reflects Avatar's contribution to the 401(k) Plan. Avatar did not have a matching contribution in effect for the year ended December 31, 2002.

Option/SAR Grants in 2004

No options or SARs were granted to any Named Executive Officer during 2004.

Aggregated Option Exercises in 2004 and Option Values at December 31, 2004

During 2004, no options were exercised by any Named Executive Officer. Options held by Named Executive Officers were in-the-money at December 31, 2004.

Name	Number of Securities Underlying Unexercised Options at December 31, 2004(#)		Value of Unexercised In-the-Money Options at December 31, 2004(\$) ⁽¹⁾	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Gerald D. Kelfer	0	0	\$ 0	\$ 0
Jonathan Fels	50,000	60,000	1,155,000	1,386,000
Michael Levy	50,000	60,000	1,155,000	1,386,000
Dennis J. Getman	10,000	0	231,000	0
Charles L. McNairy	0	0	0	0

(1) Represents the difference between the \$48.10 closing price of Avatar Common Stock on December 31, 2004 and the exercise price of the options.

Equity Compensation Plan Information

The following table summarizes information about the options, warrants and rights and other equity compensation under Avatar's equity plans as of December 31, 2004.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	639,004 ⁽¹⁾	\$ 25.00 ⁽²⁾	210,996
Equity compensation plans not approved by security holders	none		none
Total	639,004 ⁽¹⁾	\$ 25.00 ⁽²⁾	210,996

- (1) Includes 379,004 performance-conditioned restricted stock units, the actual grant of which is conditioned on certain criteria but which are not subject to payment of an exercise price.
- (2) Not applicable to restricted stock units.

Employment and Other Agreements

On April 15, 2005, we conditionally entered into amended and restated employment agreements and amended and restated earnings participation award agreements with three of our executives Messrs. Kelfer, Fels and Levy. On the same day, we also conditionally entered into change in control award agreements, 2008-2010 earnings participation award agreements and restricted stock unit award agreements with each of them. These agreements will not become effective unless stockholders of Avatar approve the 2005 Restatement of the Incentive Plan and the 2005 Executive Plan at the Annual Meeting (but not later than June 30, 2005) and the executive is employed by us on the date of stockholder approval. If these agreements do not become effective, they will terminate, but existing compensation agreements, including their existing amended and restated employment agreements and earnings participation award agreements, will continue in effect in accordance with their terms. The following description of employment and other agreements for Messrs. Kelfer, Fels and Levy assumes that stockholder approvals are obtained at the Annual Meeting and that the

agreements will become effective (however, if stockholder approvals are not obtained, we refer you to our description of the existing compensation and other agreements set forth in Avatar's proxy statement relating to last year's annual meeting of stockholders).

Agreements with Gerald Kelfer

Amended and Restated Employment Agreement

As of March 27, 2003, Avatar entered into an amended and restated employment agreement with Mr. Kelfer, President, Chief Executive Officer, Chairman of the Executive Committee and Vice Chairman of the Board, which was conditionally amended and restated as of April 15, 2005. As amended, the employment agreement expires on June 30, 2011. Pursuant to the agreement, Mr. Kelfer continues to receive an annual base salary of \$500,000 and an annual bonus of \$500,000.

If Mr. Kelfer resigns for good reason or is terminated without cause, he is entitled to receive his base annual salary and annual bonus through the earlier of June 30, 2011 and the second anniversary of the date of termination, subject to certain mitigation provisions. If Mr. Kelfer's employment terminates on June 30, 2011 or he is terminated prior thereto without cause or resigns for good reason, he will be entitled to annual payments of \$250,000 for four years. If his employment is terminated due to his death or disability or he terminates his employment as a result of a change in control (as defined in the employment agreement), Mr. Kelfer or his estate shall be entitled to receive an annual payment for four years equal to the amount derived by multiplying \$250,000 by a fraction, the numerator of which is the number of completed whole months of employment from November 30, 2000 and the denominator of which is 97 (the number of whole months until December 31, 2008, the expiration date of the agreement prior to the conditional April 15, 2005 amendment and restatement). In addition, if Mr. Kelfer terminates his employment as a result of a change in control, he is entitled to receive his base salary and annual bonus through the earlier of June 30, 2011 and the first anniversary of the date of termination. If Mr. Kelfer resigns without good reason or is terminated for cause, he is entitled to receive his base salary and prorated bonus through the date of termination.

Cash Bonus Award Agreement

On October 20, 2000, Avatar entered into a cash bonus award agreement with Mr. Kelfer pursuant to which Mr. Kelfer was granted an award relating to parcels 1, 8, 9 of Avatar's Harbor Islands community development project (the Harbor Islands Project). The award entitles Mr. Kelfer to receive quarterly cash bonus payments equal to 8% of the cash flow of the Harbor Islands Project. In determining cash flow, there is a deduction for a cost of capital that Avatar would charge to the project to the extent the project is funded by Avatar, such charge to be not less than 10% per annum. Prior to the payment of any bonus, Avatar must first receive cumulative cash flow equal to \$17 million (the approximate value of the land that Avatar has contributed to the project), plus a 10% return thereon compounded monthly (the Minimum Return). Mr. Kelfer has been paid or accrued \$1,087,349 and \$1,412,651 for 2004 and 2003, respectively, under the award and is no longer entitled to receive any future payments under the award.

The award also provides for repayment to Avatar by Mr. Kelfer at the end of the project, on an after-tax basis, of any excess payment, plus interest, should the Compensation Committee determine that the aggregate amount of bonus payments exceeds the aggregate amount that would have been paid if the bonus payment had been made at the end of the project.

Amended and Restated Earnings Participation Award Agreement

As of March 27, 2003, Avatar entered into an earnings participation award agreement with Mr. Kelfer, pursuant to which he was granted a cash award and a stock award relating to the achievement of performance goals. This agreement was conditionally amended and restated as of April 15, 2005. As amended, the cash award entitles Mr. Kelfer to a cash payment with respect to

each fiscal year beginning 2003 and ending 2007 equal to two and one-half percent of Avatar's gross profit over preestablished levels as determined by the Compensation Committee. For purposes of the Amended and Restated Earnings Participation Award Agreement and the Change in Control Award Agreement (see below), gross profit generally means Avatar's net income, plus taxes and minus certain excluded amounts. Under the provisions of the Executive Incentive Compensation Plan, total awards are limited to a maximum of \$5,000,000 per individual. Therefore, Mr. Kelfer may receive a maximum aggregate amount of \$5,000,000 under the cash bonus award relating to the Harbor Islands Project and the amended and restated earnings participation award agreement. Mr. Kelfer has been paid or accrued \$476,000 pursuant to the cash award for 2004. No cash award was paid or accrued for 2003.

The stock award entitles Mr. Kelfer to receive a number of shares of Avatar Common Stock having a fair market value (as defined) equal to two and one-half percent of the excess of actual gross profit (as defined) from January 1, 2003 through December 31, 2007 over the established target gross profit of approximately \$187,000,000. Under the provisions of the Amended and Restated 1997 Incentive and Capital Accumulation Plan, as amended by the 2005 Restatement (the Incentive Plan), the aggregate number of shares that may be granted to any one individual would be 750,000. Mr. Kelfer would not be eligible to receive any shares of Common Stock pursuant to the amended and restated earnings participation award unless the 2005 Restatement to the Incentive Plan is approved by the Avatar stockholders.

If Mr. Kelfer's employment is terminated for cause or upon resignation for other than good reason, rights to future cash payments or Common Stock issuances accruing after the date of termination are forfeited. If Mr. Kelfer's employment is terminated other than for cause or upon resignation for good reason, he will continue to receive future cash payments and Common Stock issuances. If his termination is due to his death or disability, he or his estate would receive a prorated cash payment for the fiscal year in which his employment was terminated and prorated Common Stock issuances based upon the number of months actually employed during the performance period. Upon the occurrence of a change in control (as defined), Mr. Kelfer would receive a prorated cash payment for the fiscal year in which the change in control occurs and future cash awards and stock awards would be cancelled. Under the Change in Control Award Agreement conditionally entered into on April 15, 2005, Mr. Kelfer would be entitled to a cash payment equal to two and one-half percent of the excess of actual gross profit from April 1, 2005 through the change in control date over the established target gross profit of approximately \$141,995,000. The payment pursuant to the change in control award may not exceed \$3,750,000.

2008-2010 Earnings Participation Award Agreement

As of April 15, 2005, Avatar conditionally entered into an earnings participation award agreement with Mr. Kelfer, pursuant to which he was granted an annual and cumulative cash award relating to the achievement of performance goals during the 2008-2010 fiscal years. The annual cash award entitles Mr. Kelfer to a cash payment with respect to each fiscal year beginning 2008 and ending 2010 equal to two and one-quarter percent of Avatar's gross profit over preestablished levels as determined by the Compensation Committee. For purposes of the 2008-2010 Earnings Participation Award Agreement, gross profit generally means Avatar's net income, plus taxes and incentive compensation paid to Messrs. Kelfer, Fels and Levy under their respective 2008-2010 Earnings Participation Award Agreements with Avatar and minus certain excluded amounts. The payments pursuant to the annual cash award may not exceed \$1,800,000 for each of the first two fiscal years of the performance period and up to \$2,200,000 for the third fiscal year of the performance period. However, the aggregate payments pursuant to the annual cash award for the three years may not exceed \$5,400,000.

The cumulative cash award entitles Mr. Kelfer to receive a cash payment equal to one and one-half percent of the excess of actual gross profit (as defined) from January 1, 2008 through

December 31, 2010 over the established target gross profit of \$390,000,000. The payment pursuant to the cumulative cash award may not exceed \$1,200,000.

If Mr. Kelfer's employment is terminated for cause or upon resignation for other than good reason, rights to future cash payments accruing after the date of termination are forfeited. If Mr. Kelfer's employment is terminated other than for cause or upon resignation for good reason, he will continue to receive future cash payments. If his termination is due to his death or disability, he or his estate would receive a prorated annual cash award for the fiscal year in which his employment was terminated and a prorated cumulative cash award, in each case based upon the number of months actually employed during the performance period. Upon the occurrence of a change in control (as defined), Mr. Kelfer would receive a prorated annual cash award for the fiscal year in which the change in control occurs and a cash payment not to exceed \$1,200,000 equal to one and one-half percent of the excess of actual gross profit (as defined) from January 1, 2008 through the change in control date over the established target gross profit of \$390,000,000. Future cash awards would be cancelled.

Restricted Stock Unit Agreements

Mr. Kelfer has been awarded over time the opportunity to receive a total of 365,000 performance conditioned restricted stock units, consisting of 100,000 units awarded on December 7, 1998, 50,000 units awarded on October 20, 2000, an aggregate of 125,000 units awarded on March 27, 2003 and an aggregate of 90,000 units conditionally awarded on April 15, 2005.

Each of the restricted stock awards to Mr. Kelfer is conditioned upon (i) the closing price of Avatar Common Stock being at least equal to a specified hurdle price for 20 trading days out of 30 consecutive trading days during the period beginning on the award date and ending on the vesting date and (ii) the continued employment of Mr. Kelfer at the time the foregoing condition is satisfied.

If Mr. Kelfer's employment is terminated due to his disability or death after a hurdle price condition is met, Mr. Kelfer will receive the greater of a pro rata portion based on the number of whole months which have elapsed from January of the year in which Mr. Kelfer received the award to the date of Mr. Kelfer's disability or death or one-half of the units. If Mr. Kelfer's employment is terminated other than for cause or upon resignation for good reason, all units that satisfy the hurdle price condition shall vest on the date of such termination or resignation and, with respect to those units conditionally awarded on April 15, 2005, such units that satisfy the hurdle price condition on or prior to June 30, 2011 shall vest on the date such condition is satisfied. If Mr. Kelfer resigns without good reason or is terminated for cause, all of the units will be forfeited. Otherwise, units that have satisfied the hurdle price condition immediately vest in full upon the vesting date or upon a change in control, in each case so long as Mr. Kelfer is employed by Avatar as of such date.

The table below sets forth the award date, number of units awarded, hurdle price per share and vesting date for units awarded to Mr. Kelfer.

Award Date	# RSUs	Hurdle Price ⁽¹⁾	Vesting Date ⁽²⁾
12/07/1998 ⁽³⁾	100,000	\$ 25.00	12/31/2005
10/20/2000	50,000	\$ 25.00	12/31/2005
3/27/2003	50,000	\$ 34.00	12/31/2008
3/27/2003 ⁽⁴⁾	23,700	\$ 38.00	12/31/2008
3/27/2003 ⁽⁴⁾	20,000	\$ 42.00	12/31/2008
3/27/2003 ⁽⁴⁾	15,000	\$ 46.00	12/31/2008
3/27/2003 ⁽⁴⁾	16,300	\$ 50.00	12/31/2008
4/15/2005 ⁽⁵⁾	30,000	\$ 65.00	6/30/2011
4/15/2005 ⁽⁵⁾	30,000	\$ 72.50	6/30/2011
4/15/2005 ⁽⁵⁾	30,000	\$ 80.00	6/30/2011

(1) Since being awarded, the performance condition for 258,700 of the units have been met (*i.e.*, the \$25, \$34, \$38, \$42 and \$46 hurdle prices were satisfied on 5/25/2001, 12/29/2003, 2/6/2004, 9/13/2004, and 12/3/2004, respectively), and such units have been granted subject to vesting.

(2) Subject to earlier vesting as described above.

(3) On December 7, 1998, Avatar entered into a restricted stock unit agreement with Mr. Kelfer, which was amended and restated as of October 20, 2000 and further amended on March 27, 2003.

(4) On March 27, 2003, Mr. Kelfer's fully vested nonqualified stock options to purchase 225,000 shares of Avatar Common Stock were cancelled and Mr. Kelfer was granted an opportunity to receive 75,000 performance-conditioned restricted stock units.

(5) See *New Plan Benefits* table below.

Agreements with Jonathan Fels and Michael Levy

Amended and Restated Employment Agreement

As of January 1, 2003, Avatar entered into amended and restated employment agreements with Jonathan Fels, as President of Avatar Properties Inc. (*Properties*), and Michael Levy, as Executive Vice President and Chief Operating Officer of *Properties*, which were conditionally amended and restated as of April 15, 2005. Pursuant to their respective employment agreements, as amended, the terms of employment for each of Mr. Fels and Mr. Levy have been extended to December 31, 2010. Each of Mr. Fels and Mr. Levy receives an annual base salary of \$500,000, subject to review and increase by the Board, and effective as of January 1, 2005, a calendar year annual cash bonus of \$400,000 (in 2003 and 2004 the bonus had been \$250,000). If the employment of Mr. Fels or Mr. Levy, as the case may be, is terminated due to disability, death or resignation without good reason or terminated by Avatar for cause, then he or his estate (in the event of his death) will receive his accrued but unpaid base salary through the date of termination. In the event of termination due to death or disability, Mr. Fels or Mr. Levy, or his respective estate, will also receive his annual bonus prorated to the date of termination. If Mr. Fels or Mr. Levy resigns for good reason or is terminated without cause, he is entitled to receive his base salary and annual bonus through the earlier of December 31, 2010 and the second anniversary of the date of termination, subject to certain mitigation provisions.

In the event of a change in control of Avatar prior to December 31, 2010, the term of employment for each of Messrs. Fels and Levy shall be reduced or extended, as applicable, depending on the date of the change in control, to expire upon the earlier of June 30, 2011 and the first anniversary of the change in control. For the period following a change in control, Messrs. Fels and Levy shall cease to receive their base salary and annual bonus and Avatar shall deposit \$1,800,000 (the *Retention Amount*) with respect to each of Messrs. Fels and Levy (subject to

pro rata adjustment in the event of a change in control after June 30, 2010) into a custodial account to be disbursed to the executive upon expiration of the employment term if the executive is continuously employed by Avatar (or its successor) or any of its subsidiaries through such date. If the employment of Mr. Fels or Mr. Levy, as the case may be, is terminated due to death or disability, Mr. Fels or Mr. Levy, or his respective estate, will receive a prorated portion of the Retention Amount based on the number of days between the change in control and the date of termination. If Mr. Fels or Mr. Levy resigns for good reason or is terminated without cause, he is entitled to receive the full Retention Amount. If Mr. Fels or Mr. Levy resigns without good reason or is terminated for cause, the right to receive the Retention Amount will be forfeited and the Retention Amount will be donated to one or more charitable not-for-profit organizations designated by the board of Avatar.

Cash Bonus Award Agreements

On October 20, 2000, Avatar entered into cash bonus award agreements with Mr. Fels and Mr. Levy, pursuant to which each was granted an award relating to the Harbor Islands Project. The awards entitle each of Mr. Fels and Mr. Levy to receive quarterly cash bonus payments equal to 6% of the cash flow of the Harbor Islands Project. In determining cash flow, there is a deduction for a cost of capital that Avatar would charge to the project to the extent the project is funded by Avatar, such charge to be not less than 10% per annum. Prior to the payment of any bonus, Avatar must first receive the Minimum Return. Messrs. Fels and Levy were each paid or accrued \$1,477,667 and \$1,059,488 for 2004 and 2003, respectively, pursuant to the awards.

The awards also provide for repayment at the end of the project, on an after-tax basis, of any excess payment, plus interest, should the Compensation Committee determine that the aggregate amount of bonus payments exceeds the aggregate amount that would have been paid if the bonus payments had been made at the end of the project.

If either Mr. Fels or Mr. Levy's employment is terminated other than for cause or upon resignation for good reason, he will continue to receive future bonus payments. If either Mr. Fels or Mr. Levy's termination is due to his permanent disability or death, he or his estate would continue to receive prorated bonus payments based upon the number of months actually employed.

Amended and Restated Earnings Participation Award Agreements

On March 6, 2003, Avatar entered into earnings participation award agreements with Mr. Fels and Mr. Levy, pursuant to which each was granted a cash award and a stock award relating to the achievement of performance goals under Avatar's business plan. These agreements were conditionally amended and restated as of April 15, 2005. As amended, the cash awards entitle each of Mr. Fels and Mr. Levy to a cash payment with respect to each fiscal year beginning 2003 and ending 2007 equal to two percent of Avatar's gross profit over preestablished levels as determined by the Compensation Committee. For purposes of the Amended and Restated Earnings Participation Award Agreements and the Change in Control Award Agreements (see below), gross profit generally means Avatar's net income, plus taxes and minus certain excluded amounts. Under the provisions of the Executive Incentive Compensation Plan, total cash awards are limited to a maximum of \$5,000,000 per individual. Therefore, each of Mr. Fels and Mr. Levy may receive a maximum of \$5,000,000 under the cash bonus award relating to the Harbor Islands Project and the earnings participation award agreement. Each of Messrs. Fels and Levy have been paid or accrued \$381,000 pursuant to the cash award for 2004. No cash awards were paid or accrued for 2003.

The stock awards entitle each of Mr. Fels and Mr. Levy to receive a number of shares of Avatar Common Stock having a fair market value (as defined) equal to two percent of the excess of actual gross profit (as defined) from January 1, 2003 through December 31, 2007 over the established target gross profit of approximately \$187,000,000.

If either Mr. Fels or Mr. Levy's employment is terminated for cause or upon resignation for other than good reason, rights to future cash payments or Common Stock issuances accruing after

the date of termination are forfeited. If either Mr. Fels or Mr. Levy's employment is terminated other than for cause or upon resignation for good reason, he will continue to receive future cash payments and Common Stock issuances. If either Mr. Fels or Mr. Levy's termination is due to his permanent disability or death, he or his estate would receive a prorated cash payment for the fiscal year in which his employment was terminated and prorated Common Stock issuances based upon the number of months actually employed during the performance period. Upon the occurrence of a change in control (as defined), Mr. Fels and Mr. Levy would receive prorated cash payments for the fiscal year in which the change in control occurs and future cash awards and stock awards would be cancelled. Under the Change in Control Award Agreement entered into on April 15, 2005, each of Messrs. Fels and Levy would be entitled to a cash payment equal to two percent of the excess of actual gross profit from April 1, 2005 through the change in control date over the established target gross profit of approximately \$141,995,000. The payment pursuant to the change in control award may not exceed \$3,000,000.

2008-2010 Earnings Participation Award Agreement

As of April 15, 2005, Avatar conditionally entered into an earnings participation award agreement with each of Messrs. Fels and Levy, pursuant to which each was granted an annual and cumulative cash award relating to the achievement of performance goals. The annual cash award entitles the executive to a cash payment with respect to each fiscal year beginning 2008 and ending 2010 equal to two percent of Avatar's gross profit over preestablished levels as determined by the Compensation Committee. For purposes of the 2008-2010 Earnings Participation Award Agreements, gross profit generally means Avatar's net income, plus taxes and incentive compensation paid to Messrs. Kelfer, Fels and Levy pursuant to their respective 2008-2010 Earnings Participation Award Agreements with Avatar and minus certain excluded amounts. The payments pursuant to the annual cash award may not exceed \$1,600,000 for each of the first two fiscal years of the performance period and up to \$2,000,000 for the third fiscal year of the performance period. However, the aggregate payments pursuant to the annual cash award may not exceed \$4,800,000.

The cumulative cash award entitles each of Messrs. Fels and Levy to receive a cash payment equal to one and one-quarter percent of the excess of actual gross profit (as defined) from January 1, 2008 through December 31, 2010 over the established target gross profit of \$390,000,000. The payment pursuant to the cumulative cash award may not exceed \$900,000.

If either Mr. Fels or Mr. Levy's employment is terminated for cause or upon resignation for other than good reason, rights to future cash payments accruing after the date of termination are forfeited. If either Mr. Fels or Mr. Levy's employment is terminated other than for cause or upon resignation for good reason, he will continue to receive future cash payments. If either Mr. Fels or Mr. Levy's termination is due to his death or disability, he or his estate would receive a prorated annual cash award for the fiscal year in which his employment was terminated and a prorated cumulative cash award, in each case based upon the number of months actually employed during the performance period. Upon the occurrence of a change in control (as defined), each of Mr. Fels and Mr. Levy would receive a prorated annual cash award for the fiscal year in which the change in control occurs. In addition, a cash payment not to exceed \$900,000 equal to one and one-quarter percent of the excess of actual gross profit (as defined) from January 1, 2008 through the change in control date over the established target gross profit of \$390,000,000 would be deposited in a custodial account on the date of the change in control and would constitute and be disbursed as part of the Retention Amount (as described above). Future cash awards would be cancelled.

Nonqualified Stock Option Agreements

On February 19, 1999, Messrs. Fels and Levy were each granted options to purchase 50,000 shares of Avatar Common Stock under the Incentive Plan, at an exercise price of \$25.00 per share. The options granted to each of Messrs. Fels and Levy were fully vested as of February 19, 2002.

If the employment of Mr. Fels or Mr. Levy, as the case may be, is terminated due to his disability or death, the options will remain exercisable for one year following the date of termination. If either Mr. Fels or Mr. Levy, as the case may be, resigns without good reason or is terminated for cause, any unexercised options become null and void upon such termination. Otherwise, the options will remain exercisable until February 19, 2009.

On March 13, 2003, Messrs. Fels and Levy were each granted additional options to purchase 60,000 shares of Avatar Common Stock under the Incentive Plan, at an exercise price of \$25.00 per share. The options vest and become exercisable on December 31, 2007.

If the employment of Mr. Fels or Mr. Levy, as the case may be, is terminated due to his disability or death, the options will vest pro rata based on the amount of time elapsed between January 1, 2003 and December 31, 2007, and such options will become immediately exercisable and expire one year following the date of termination. If either Mr. Fels or Mr. Levy, as the case may be, resigns without good reason or is terminated for cause, any unexercised options become null and void upon such termination. Otherwise, the options will remain exercisable until March 13, 2013.

Restricted Stock Unit Agreements

As of March 27, 2003, Avatar entered into restricted stock unit agreements with each of Messrs. Fels and Levy, pursuant to which each has been awarded an opportunity to receive 25,000 performance conditioned restricted stock units representing 25,000 shares of Avatar Common Stock. As of April 15, 2005, Avatar conditionally entered into restricted stock unit agreements with each of Messrs. Fels and Levy, pursuant to which each has been awarded an opportunity to receive 75,000 performance-conditioned restricted stock units representing 75,000 shares of Avatar Common Stock.

Each of the restricted stock awards to Messrs. Fels and Levy is conditioned upon (i) the closing price of Avatar Common Stock being at least a specified hurdle price per share for 20 trading days out of 30 consecutive trading days during the period beginning on the award date and ending on the vesting date, and (ii) the continued employment of Mr. Fels or Mr. Levy, as the case may be, at the time the foregoing condition is satisfied.

If Mr. Fels or Mr. Levy's employment is terminated due to his disability or death after a hurdle price condition is met, Mr. Fels or Mr. Levy will receive the greater of a pro rata portion of the units based on the number of whole months which have elapsed from January 1, 2003 to the date of Mr. Fels or Mr. Levy's disability or death or half of the units. If Mr. Fels or Mr. Levy's employment is terminated other than for cause or upon resignation for good reason, all units that satisfy the performance condition shall vest on the date of such termination or resignation and, with respect to those units awarded on April 15, 2005, such units that satisfy the hurdle price condition on or prior to December 31, 2010, shall vest on the date such condition is satisfied. If either Mr. Fels or Mr. Levy resigns without good reason or is terminated for cause, all of the executive's units will be forfeited. Otherwise, the units granted to either Mr. Fels or Mr. Levy immediately vest in full upon the vesting date or upon a change in control, in each case so long as the executive is employed by Avatar or any of its subsidiaries as of such date.

The table below sets forth the award date, number of units awarded, hurdle price and vesting date for units awarded to each of Messrs. Fels and Levy.

Award Date	# RSUs	Hurdle Price	Vesting Date⁽¹⁾
3/27/2003 ⁽²⁾	25,000	\$ 34.00	12/31/2007
4/15/2005 ⁽³⁾	25,000	\$ 65.00	12/31/2010
4/15/2005 ⁽³⁾	25,000	\$ 72.50	12/31/2010
4/15/2005 ⁽³⁾	25,000	\$ 80.00	12/31/2010

(1) Subject to earlier vesting as described above.

(2) Since being awarded, the performance condition for 25,000 of the units has been met (i.e., the \$34 hurdle price was satisfied on 12/29/2003), and such units have been granted subject to vesting.

(3) See New Plan Benefits table below.

Agreements with Dennis J. Getman

Employment Agreement

On September 11, 2003, Avatar entered into an Employment Agreement with Dennis J. Getman, Executive Vice President and General Counsel, effective as of January 1, 2003, for a term of four years at an annual base salary of \$350,000, subject to review and increase by the Board, and additional compensation of specified percentages of net sale proceeds on certain designated asset sales. Over the term of the Agreement, maximum aggregate additional compensation payable to Mr. Getman is \$1,600,000.

If Mr. Getman's employment is terminated due to his disability or death, Mr. Getman or his estate will receive his accrued but unpaid base salary and any additional compensation to which he may be entitled. If Mr. Getman is terminated without cause, he is entitled to receive his accrued but unpaid base salary, any additional compensation to which he may be entitled and a lump sum payment of \$350,000 in lieu of any other payments or benefits. If Mr. Getman is terminated for cause or resigns, he is entitled to receive his accrued but unpaid base salary.

Nonqualified Stock Option Agreement

On February 19, 1999, Mr. Getman was granted options to purchase 10,000 shares of Avatar Common Stock under the Incentive Plan, at an exercise price of \$25.00 per share. The options granted to Mr. Getman were fully vested as of February 19, 2002.

If Mr. Getman's employment is terminated due to his disability or death, the options will remain exercisable for one year following the date of termination. If Mr. Getman resigns without good reason or is terminated for cause, any unexercised options become null and void upon such termination. Otherwise, the options will remain exercisable until February 19, 2009.

Restricted Stock Unit Agreement

As of September 11, 2003, Avatar entered into a restricted stock unit agreement with Mr. Getman, pursuant to which he has been granted 15,504 restricted stock units representing 15,504 shares of Avatar Common Stock. The units vest in full on January 2, 2007, provided that Mr. Getman is employed by Avatar on December 31, 2006.

If Mr. Getman's employment is terminated due to his disability or death, Mr. Getman or his estate will be entitled to receive 7,752 units. If his employment is terminated for cause, all units will be forfeited. If he is terminated without cause, Mr. Getman will be entitled to receive all units granted to him.

Agreements with Charles L. McNairy

Restricted Stock Unit Agreement

On July 22 2004, Avatar entered into a restricted stock unit agreement with Mr. McNairy pursuant to which Mr. McNairy was awarded an opportunity to receive 12,500 performance conditioned restricted stock units representing 12,500 shares of Avatar Common Stock. The actual grant of the units was conditional upon (i) the closing price of Avatar Common Stock being at least \$45.00 per share for 20 trading days out of 30 consecutive trading days during the period beginning July 22, 2004 and ending December 31, 2008, and (ii) the continued employment of Mr. McNairy at the time the foregoing condition is satisfied. This hurdle price performance condition was satisfied on December 1, 2004.

If Mr. McNairy's employment is terminated due to his disability or death, Mr. McNairy will receive the greater of a pro rata portion of the 12,500 units based on the number of whole months which have elapsed from January 1, 2004 to the date of Mr. McNairy's disability or death or 6,250 units. If Mr. McNairy resigns without good reason or is terminated for cause, all of the units will be forfeited. Otherwise, the units granted to him immediately vest in full upon termination of Mr. McNairy's employment.

As of July 22, 2004, Avatar entered into a letter agreement with Mr. McNairy which provides that upon the earlier of his termination of employment and the conversion of the above-referenced Restricted Stock Units (the Award) into shares of Avatar Common Stock, Mr. McNairy will receive the greater of the Award to the extent the fair market value (as defined) of the Award is greater than the cash amounts he is entitled to receive as severance (the Cash Payments) or the Cash Payments.

Compensation Committee Report on Executive Compensation

The duties and responsibilities of the Compensation Committee of the Board of Directors include determining the compensation of Avatar's CEO and certain other executive officers and administering Avatar's incentive compensation plans.

Avatar's executive compensation is intended to reward, retain and motivate management and to align the interests of Avatar's stockholders and management. The principal components of Avatar's executive compensation program are: salaries, cash bonuses and performance-based cash and equity awards.

In determining salary levels and bonuses for the executive officers, primary consideration is given to each executive's level of responsibility and individual performance, as well as compensation generally received by executives of companies engaged in similar type activities. In 2004, certain executives (other than Avatar's CEO) received discretionary bonuses based on subjective factors.

The Committee made awards of performance-conditioned restricted stock units to certain of Avatar's executive officers in 2004 pursuant to a plan approved by stockholders. These awards provide that if Avatar's common stock attains a specified market price per share (the hurdle price) for 20 trading days out of 30 consecutive trading days, such executive will be entitled to receive shares of Common Stock on a future date (the vesting date) if the executive is then employed by Avatar (subject to earlier vesting under certain circumstances).

Also in 2004, certain executive officers received cash payouts from performance-based awards made in prior years by the Committee, which were based on the cash flow of Avatar's Harbor Islands community development project and Avatar's gross profit over preestablished levels.

CEO Compensation

In 2004 there were no changes in the compensation arrangements of Gerald D. Kelfer, Avatar's CEO, and therefore his compensation reflected payments and awards established by the Compensation Committee in prior years.

He was paid salary and cash bonus in accordance with his employment agreement, which had been approved by the Compensation Committee in 2003. The salary and bonus earned in 2004 under the employment agreement were not discretionary or otherwise related to the financial performance of Avatar.

In 2004, Mr. Kelfer earned the right to receive payments under the Harbor Islands cash bonus award (which was made by the Committee in 2000) and the cash Earnings Participation Award that covered the 2004 fiscal year (which was made by the Committee in 2003). These awards were made pursuant to a plan approved by stockholders. The amount of cash Mr. Kelfer earned under the awards during 2004 was determined by a preestablished formula and based on financial perform-

ance during 2004: the cash flow of Avatar's Harbor Islands community development project and Avatar's gross profit over preestablished levels.

In addition, during 2004, the hurdle price performance conditions of an aggregate of 58,700 restricted stock units previously awarded to Mr. Kelfer by the Committee under a stockholder approved plan were satisfied. These units are subject to continued vesting prior to being paid out in shares of Avatar Common Stock.

April 15, 2005

COMPENSATION COMMITTEE

William G. Spears, Chairman
 Milton Dresner
 Martin Meyerson
 Kenneth T. Rosen

Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee are Messrs. Dresner, Meyerson, Rosen and Spears, none of whom are executive officers of Avatar.

Performance Graph

The following graph provides a comparison of the cumulative total returns based on an investment of \$100 after the close of the market on December 31, 1999 in Avatar's Common Stock, The Nasdaq Market Index and the Real Estate Development and Residential Construction Indexes published by CoreData for the periods indicated, in each case assuming reinvestment of any dividends. The cumulative total returns for The Nasdaq Market Index were prepared by CoreData.

	1999	2000	2001	2002	2003	2004
Avatar Holdings Inc.	100.00	116.55	129.99	126.90	203.75	265.38
Nasdaq	100.00	62.85	50.10	34.95	52.55	56.97
Real Estate Development Index	100.00	78.66	90.52	62.91	105.00	182.97
Residential Construction Index	100.00	164.30	228.66	220.65	389.93	521.27

Certain Relationships and Related Transactions

In connection with the underwritten public offering in 1998 of Avatar's 7% Notes, Avatar entered into a registration rights agreement with Leon Levy, Avatar's Chairman of the Board from January 1981 to his death on April 6, 2003. The Estate of Leon Levy is the successor to Leon Levy under the registration rights agreement.

Jack Nash, Director and former Chairman of the Board, and Joshua Nash, director and present Chairman of the Board, are father and son.

Jack Nash received \$100,000 per annum for serving as Avatar's Chairman of the Board from June 2003 through September 2004.

Lynn Getman, wife of Named Executive Officer Dennis J. Getman, is employed as a senior officer of a subsidiary of Avatar. Ms. Getman was paid an aggregate salary and bonus of \$124,985 during 2004. On December 8, 2004, Ms. Getman was granted 250 restricted stock units under the Incentive Plan which vest on December 8, 2007.

2. APPOINTMENT OF AUDITORS

Ernst & Young LLP, independent registered public accounting firm, audited the financial statements of Avatar for the fiscal year ended December 31, 2004. Such audit services consisted of the firm's examination of and report on the annual financial statements and assistance and consultation in connection with filings with the Securities and Exchange Commission and other matters.

Representatives of Ernst & Young LLP are expected to attend the Annual Meeting, will have the opportunity to make a statement if they desire to do so and will be available to respond to appropriate questions.

Subject to approval by the stockholders, the Audit Committee has appointed Ernst & Young LLP, independent registered public accounting firm, as auditors of Avatar for the fiscal year ending December 31, 2005. Approval by the stockholders will require the affirmative vote of a majority of the votes present at the meeting in person or by proxy and entitled to be cast. The Board of Directors recommends that the accompanying proxy be voted FOR such approval and it is intended that the proxies will be voted in such manner unless otherwise directed.

Audit Fees

The following table sets forth the approximate amount of fees paid, or estimated to be paid, to Ernst & Young LLP for professional services during the fiscal years ended December 31, 2004 and 2003:

	2004	2003
Audit services	\$ 986,000	\$ 400,000
Audit-related services	103,000	73,000
Tax services	14,000	5,000
All other services		
	\$ 1,103,000	\$ 478,000

Audit services generally include the audit of the annual financial statements for Avatar and its consolidated subsidiaries and review of quarterly financial statements. Audit services for 2004 include \$419,000 related to the audit of internal controls over financial reporting as required by the Sarbanes-Oxley Act of 2002 and \$130,000 in connection with registration of the 4.50% Convertible Senior Notes due 2024.

Audit-related services generally include audits of employee benefit plans, review of cash awards under incentive compensation plans and advisory services in connection with implementation of certain procedures to comply with the Sarbanes-Oxley Act of 2002. Tax services, which are estimated, generally relate to review of the consolidated tax return.

The Audit Committee adopted a policy requiring preapproval of audit and non-audit services provided by the principal independent accountants. The Audit Committee approved all audit and non-audit services provided by Ernst & Young LLP during the 2004 fiscal year.

3. APPROVAL OF AMENDED AND RESTATED 1997 INCENTIVE AND CAPITAL ACCUMULATION PLAN (2005 RESTATEMENT)

Background

Avatar's stockholders previously approved Avatar's Amended and Restated 1997 Incentive and Capital Accumulation Plan and an amendment thereto. On April 15, 2005, the Compensation Committee of the Board of Directors adopted, subject to stockholder approval, amendments to the plan that are reflected in the proposed 2005 Restatement of the Incentive Plan. The principal amendments would:

increase the aggregate number of shares of Common Stock that may be subject to Benefits (as defined below) granted from 900,000 shares to 1,300,000 shares;

increase the aggregate number of shares that could be granted to any individual over the term of the Incentive Plan from 500,000 to 750,000 shares;

permit non-employee directors of Avatar to be granted Benefits;

modify the list of performance-based criteria that may be used in order to satisfy the performance-based compensation exception in Section 162(m) of the Internal Revenue Code of 1986; and

extend the term of the Incentive Plan until April 15, 2015.

Several other changes are reflected in the 2005 Restatement of the Incentive Plan, a copy of which is annexed to this Proxy Statement as Annex A and has been marked to indicate changes to the Incentive Plan as currently in effect. The locations of proposed deletions are indicated by carets (^) and proposed additions are indicated as underlined text.

As of April 15, 2005, of the 900,000 shares of Common Stock authorized under the Incentive Plan, there remained available (without giving effect to the proposed 2005 Restatement and restricted stock unit awards conditionally made on April 15, 2005), 210,996 shares of Common Stock for issuance. However, this amount does not reflect the number of shares of Common Stock which may become issuable to each of Messrs. Kelfer, Fels and Levy pursuant to stock awards made in 2003 under Earnings Participation Award Agreements. This amount is not presently determinable, as the number is dependent upon Avatar's achievement of gross profit from January 1, 2003 through December 31, 2007 in excess of a target gross profit, and the market price of Avatar Common Stock at the time of determination. See Employment and Other Agreements.

Summary

The following summary describes the material features of the 2005 Restatement of the Incentive Plan but is not intended to be complete and is qualified in its entirety by reference to Annex A to this Proxy Statement.

Purpose

The Incentive Plan is intended to provide incentives which will attract, retain and motivate highly competent persons as directors, officers and employees of Avatar and its subsidiaries, by providing them with opportunities to acquire shares of stock or to receive monetary payments based on the value of such shares pursuant to the Benefits described herein.

Shares Available

The Incentive Plan makes available for Benefits an aggregate of 1,300,000 shares of Avatar Common Stock, subject to certain adjustments. During the term of the Incentive Plan, the maximum number of shares of Avatar Common Stock with respect to which Benefits may be granted (or measured) to any individual participant may not exceed 750,000. Any shares of Common Stock subject to a stock option or stock appreciation right which for any reason is cancelled or terminated without having been exercised and any shares subject to stock awards, performance awards or stock units which are forfeited, any shares subject to performance awards settled in cash, any shares delivered to Avatar as part or full payment for the exercise of a stock option or stock appreciation right, or any shares withheld to satisfy tax withholding shall again be available for Benefits under the Incentive Plan.

Administration

The Incentive Plan provides for administration by a committee or committees of the Board of Directors or a subcommittee of a committee of the Board (the *Committee*), which shall be comprised, unless otherwise determined by the Board, solely of not less than two members who shall be (i) *Non-Employee Directors* within the meaning of Rule 16b-3(b)(3) (or any successor rule) promulgated under the Securities Exchange Act of 1934, as amended, and (ii) *outside directors* within the meaning of Treasury Regulation § 1.162-27(e)(3) under Section 162(m) of the Internal Revenue Code of 1986, as amended (the *Code*). The Committee is authorized, subject to the provisions of the Incentive Plan, to make such determinations and interpretations and to take such action in connection with the Incentive Plan and any Benefits granted as it deems necessary or advisable. Thus, among the Committee's powers are the authority to select the directors, officers and employees of Avatar and its subsidiaries to receive Benefits, and to determine the form, amount and other terms and conditions of Benefits. The Committee also has the power to modify or waive restrictions on Benefits, to amend Benefits, to grant extensions and accelerations of Benefits, and to determine the extent to which any Benefit under the Incentive Plan is required to comply, or not comply, with Section 409A of the Code. Benefits granted to non-employee directors of Avatar will be made by the Nominating and Corporate Governance Committee of the Board (or such other committee as may be determined by the Board).

Eligibility for Participation

Directors, officers and employees of Avatar or any of its subsidiaries are eligible to participate in the Incentive Plan. The selection of participants from eligible directors, officers and employees is within the discretion of the Committee. It is expected that non-employee directors (currently, ten persons), executive officers (currently, six persons) and certain other employees (currently, forty-one persons) will be eligible to participate.

Types of Benefits

The Incentive Plan provides for the grant of any or all of the following types of benefits: (1) stock options, including incentive stock options and non-qualified stock options; (2) stock appreciation rights; (3) stock awards; (4) performance awards; and (5) stock units (collectively, *Benefits*). Benefits may be granted singly or in combination as determined by the Committee.

Stock awards, performance awards and stock units may, as determined by the Committee in its discretion, constitute Performance-Based Awards, as described below.

Under the Incentive Plan, the Committee may grant awards in the form of options to purchase shares of Avatar Common Stock. Options may either be incentive stock options, qualifying for special tax treatment, or non-qualified options. The Committee will, with regard to each stock option, determine the number of shares subject to the option, the manner and time of the option's exercise (but in no event later than ten years after the date of grant) and vesting, and the exercise price per share of stock subject to the option; however, the exercise price shall not be less than 100% of the Fair Market Value of the Avatar Common Stock on the date the stock option is granted. For purposes of the Incentive Plan, Fair Market Value means the closing price of Avatar's Common Stock on the date of calculation (or on the last preceding trading date if Common Stock was not traded on such date) if the Common Stock is readily tradeable on a national securities exchange or other market system, and if the Common Stock is not readily tradeable, Fair Market Value means the amount determined in good faith by the Committee as the fair market value of the Common Stock.

The Incentive Plan authorizes the Committee to grant stock appreciation rights (SARs). An SAR is a right to receive a payment, in cash, Avatar Common Stock, or a combination thereof, equal to the excess of (x) the Fair Market Value, or other specified valuation (which shall not be greater than the Fair Market Value), of a specified number of shares of Avatar Common Stock on the date the right is exercised over (y) the fair market value, or other specified valuation (which shall not be less than Fair Market Value), of such shares of Avatar Common Stock on the date the right is granted, all as determined by the Committee. Each SAR shall be subject to such terms and conditions as that Committee shall impose from time to time.

The Committee may, in its discretion, grant stock awards or stock units to participants. Such grants may be subject to such terms and conditions as the Committee determines appropriate. The Committee, in its discretion, may grant performance awards which may take the form of shares of Avatar Common Stock or stock units, or any combination thereof, and which may constitute Performance-Based Awards. Such performance awards will be contingent upon the attainment over a period to be determined by the Committee of certain performance targets. The length of the performance period, the performance targets to be achieved and the measure of whether and to what degree such targets have been achieved will be determined by the Committee.

Performance-Based Awards

Certain Benefits granted under the Incentive Plan may be granted in a manner such that the Benefit qualifies for the performance-based compensation exemption to Section 162(m) of the Code (Performance-Based Awards). As determined by the Committee in its sole discretion, either the granting or vesting of such Performance-Based Awards will be based on achievement of hurdle rates, growth rates, and/or reductions in one or more business criteria that apply to the individual participant, one or more geographic or business segments, or one or more business units of Avatar or Avatar as a whole. The business criteria shall be as follows, individually or in combination: net sales, pretax income before allocation of corporate overhead and bonus, budget, earnings per share, net income, division, group or corporate financial goals, return on stockholders' equity, return on assets, attainment of strategic and operational initiatives, appreciation in and/or maintenance of the price of the Common Stock or any other publicly-traded securities of the Company, market share, gross profits, earnings before interest and taxes, earnings before interest, taxes, depreciation and amortization, net income before taxes, taxes, economic value-added models or reductions in costs. In addition, Performance-Based Awards may include comparisons to the performance of other companies or to market indices, such performance to be measured by one or more of the foregoing business criteria. Furthermore, the measurement of performance against goals may exclude the impact of charges for restructurings, discontinued operations, extraordinary items and other unusual or non-recurring items, and the cumulative effects of accounting changes,

each as defined by generally accepted accounting principles as identified in the financial statements, notes to the financial statements or management's discussion and analysis.

Other Terms of Benefits

The Incentive Plan provides that Benefits shall not be transferable other than by will or the laws of descent and distribution. The Committee shall determine the treatment to be afforded to a participant in the event of termination of employment for any reason including death, disability or retirement. Notwithstanding the foregoing, other than with respect to incentive stock options, the Committee may permit the transferability of an award by a participant to members of the participant's immediate family or trusts for the benefit of such person or family partnerships.

Upon the grant of any Benefit under the Incentive Plan, the Committee may, by way of an agreement with the participant, establish such other terms, conditions, restrictions and/or limitations covering the grant of the Benefit as are not inconsistent with the Incentive Plan. No Benefit shall be granted under the Incentive Plan after April 15, 2015. The Committee reserves the right to amend, suspend or terminate the Incentive Plan at any time, subject to the rights of participants with respect to any outstanding Benefits. No amendment of the plan may be made without approval of the stockholders of Avatar if the amendment will: (i) increase the aggregate number of shares of Common Stock which may be issued under the plan; (ii) increase the maximum number of shares with respect to Benefits that may be granted to any individual under the plan; (iii) change the types of business criteria on which Performance-Based Awards are to be based under the plan; or (iv) modify the requirements as to eligibility for participation in the plan.

The Incentive Plan contains provisions for equitable adjustment of Benefits in the event of a merger, consolidation, reorganization, recapitalization, stock dividend, stock split, reverse stock split, split up, spinoff, combination of shares, exchange of shares, dividend in kind or other like change in capital structure or distribution or any extraordinary dividend or distribution of cash or other assets (other than normal cash dividends) to stockholders of Avatar. The Incentive Plan contains provisions for the acceleration of exercisability or vesting of Benefits in the event of a change in control of Avatar, including the cash settlement of such Benefits.

Certain Federal Income Tax Consequences

The statements in the following paragraphs of the principal federal income tax consequences of stock options under the Incentive Plan are based on statutory authority and judicial and administrative interpretations, as of the date of this Proxy Statement, which are subject to change at any time (possibly with retroactive effect). The law is technical and complex, and the discussion below represents only a general summary.

Incentive Stock Options. Incentive stock options (ISOs) granted under the Incentive Plan are intended to meet the definitional requirements of Section 422(b) of the Code for incentive stock options.

An employee who receives an ISO does not recognize any taxable income upon the grant of such ISO. Similarly, the exercise of an ISO generally does not give rise to federal income tax to the employee, provided that (i) the federal alternative minimum tax, which depends on the employee's particular tax situation, does not apply and (ii) the employee is employed by Avatar from the date of grant of the option until three months prior to the exercise thereof, except where such employment terminates by reason of disability (where the three month-period is extended to one year) or death (where this requirement does not apply). If an employee exercises an ISO, after these requisite periods, the ISO will be treated as an NSO (as defined below) and will be subject to the rules set forth below under the caption

Non-Qualified Stock Options.

Further, if after exercising an ISO, an employee disposes of the Avatar Common Stock so acquired more than two years from the date of grant and more than one year from the date of

transfer of the Avatar Common Stock pursuant to the exercise of such ISO (the applicable holding period), the employee will generally recognize a long-term capital gain or loss equal to the difference, if any, between the amount received for the shares and the exercise price. If, however, an employee does not hold the shares so acquired for the applicable holding period thereby making a disqualifying disposition the employee would recognize ordinary income equal to the excess of the fair market value of the shares at the time the ISO was exercised over the exercise price and the balance, if any, would be long-term capital gain (provided the holding period for the shares exceeded one year and the employee held such shares as a capital asset at such time). If the disqualifying disposition is a sale or exchange that would permi