HORTON D R INC /DE/
Form 10-Q
July 26, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From To
Commission file number 1-14122

D.R. Horton, Inc.
(Exact name of registrant as specified in its charter)

Delaware	75-2386963
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
301 Commerce Street, Suite 500, Fort Worth, Texas	76102
(Address of principal executive offices)	(Zip Code)

(817) 390-8200
(Registrant’s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, $.01 par value – 372,285,773 shares as of July 20, 2016

D.R. HORTON, INC. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
D.R. HORTON, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2016	September 30, 2015
	(In millions)	
	(Unaudited)	
ASSETS		
Homebuilding:		
Cash and cash equivalents	$862.9	$ 1,355.9
Restricted cash	11.8	9.7
Inventories:		
Construction in progress and finished homes	4,371.4	3,501.2
Residential land and lots — developed and under development	3,948.6	4,065.3
Land held for development	155.5	202.3
Land held for sale	28.7	38.2
	8,504.2	7,807.0
Deferred income taxes, net of valuation allowance of $9.2 million and $10.1 million at June 30, 2016 and September 30, 2015, respectively	505.1	558.1
Property and equipment, net	151.7	144.0
Other assets	422.8	456.2
Goodwill	87.2	87.2
	10,545.7	10,418.1
Financial Services:		
Cash and cash equivalents	43.9	27.9
Mortgage loans held for sale	634.5	631.0
Other assets	109.1	74.0
	787.5	732.9
Total assets	$11,333.2	$ 11,151.0
LIABILITIES		
Homebuilding:		
Accounts payable	$568.2	$ 473.0
Accrued expenses and other liabilities	909.8	929.2
Notes payable	2,797.1	3,333.6
	4,275.1	4,735.8
Financial Services:		
Accounts payable and other liabilities	41.1	41.9
Mortgage repurchase facility	504.2	477.9
	545.3	519.8
Total liabilities	4,820.4	5,255.6
Commitments and contingencies (Note K)		
EQUITY		
Preferred stock, $.10 par value, 30,000,000 shares authorized, no shares issued	—	—
Common stock, $.01 par value, 1,000,000,000 shares authorized, 379,371,827 shares issued and 372,171,756 shares outstanding at June 30, 2016 and 375,847,442 shares issued and 368,647,371 shares outstanding at September 30, 2015	3.8	3.8
Additional paid-in capital	2,839.3	2,733.8

Retained earnings	3,803.4	3,289.6
Treasury stock, 7,200,071 shares at June 30, 2016 and September 30, 2015, at cost	(134.3)	(134.3)
Accumulated other comprehensive income	—	1.4
Stockholders’ equity	6,512.2	5,894.3
Noncontrolling interests	0.6	1.1
Total equity	6,512.8	5,895.4
Total liabilities and equity	$11,333.2	$ 11,151.0

See accompanying notes to consolidated financial statements.

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D.R. HORTON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2016	2015	2016	2015
	(In millions, except per share data) (Unaudited)			
Homebuilding:				
Revenues:				
Home sales	$3,118.7	$2,857.9	$8,145.6	$7,417.4
Land/lot sales and other	30.1	18.5	65.2	50.6
	3,148.8	2,876.4	8,210.8	7,468.0
Cost of sales:				
Home sales	2,486.5	2,288.9	6,512.1	5,948.8
Land/lot sales and other	28.4	16.1	56.2	44.1
Inventory and land option charges	8.1	15.4	16.0	34.0
	2,523.0	2,320.4	6,584.3	6,026.9
Gross profit:				
Home sales	632.2	569.0	1,633.5	1,468.6
Land/lot sales and other	1.7	2.4	9.0	6.5
Inventory and land option charges	(8.1)	(15.4)	(16.0)	(34.0)
	625.8	556.0	1,626.5	1,441.1
Selling, general and administrative expense	280.4	257.8	782.0	738.2
Other (income)	(3.8)	(3.9)	(16.8)	(13.9)
Homebuilding pre-tax income	349.2	302.1	861.3	716.8
Financial Services:				
Revenues	83.1	74.4	205.4	183.6
General and administrative expense	56.4	46.0	153.5	124.6
Interest and other (income)	(2.7)	(3.3)	(7.2)	(8.8)
Financial services pre-tax income	29.4	31.7	59.1	67.8
Income before income taxes	378.6	333.8	920.4	784.6
Income tax expense	128.8	112.4	317.8	272.8
Net income	$249.8	$221.4	$602.6	$511.8
Other comprehensive income, net of income tax:				
Debt securities collateralized by residential real estate:				
Net change in unrealized gain	—	—	1.2	—
Reclassification adjustment for net gain realized in net income	—	—	(2.6)	—
Comprehensive income	$249.8	$221.4	$601.2	$511.8
Basic net income per common share	$0.67	$0.60	$1.63	$1.40
Net income per common share assuming dilution	$0.66	$0.60	$1.61	$1.39
Cash dividends declared per common share	$0.08	$0.0625	$0.24	$0.1875

See accompanying notes to consolidated financial statements.

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D.R. HORTON, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended June 30,	
	2016	2015
	(In millions) (Unaudited)	
OPERATING ACTIVITIES		
Net income	$602.6	$511.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	41.4	39.7
Amortization of discounts and fees	4.1	4.1
Stock based compensation expense	36.8	31.7
Excess income tax benefit from employee stock awards	(6.3)	(7.3)
Deferred income taxes	46.7	20.7
Inventory and land option charges	16.0	34.0
Gain on sale of debt securities collateralized by residential real estate	(4.5)	—
Changes in operating assets and liabilities:		
Increase in construction in progress and finished homes	(879.1)	(252.1)
Decrease (increase) in residential land and lots – developed, under development, held for development and held for sale	151.3	(120.7)
Increase in other assets	(4.6)	(3.2)
Increase in mortgage loans held for sale	(3.5)	(91.5)
Increase in accounts payable, accrued expenses and other liabilities	87.7	21.4
Net cash provided by operating activities	88.6	188.6
INVESTING ACTIVITIES		
Purchases of property and equipment	(65.2)	(43.3)
Increase in restricted cash	(2.1)	(1.7)
Net principal decrease (increase) of other mortgage loans and real estate owned	4.3	(6.3)
Proceeds from sale (purchases) of debt securities collateralized by residential real estate	35.8	(14.8)
Payments related to acquisition of a business	—	(68.7)
Net cash used in investing activities	(27.2)	(134.8)
FINANCING ACTIVITIES		
Proceeds from notes payable	26.3	1,560.8
Repayment of notes payable	(543.9)	(1,433.5)
Proceeds from stock associated with certain employee benefit plans	61.8	24.0
Excess income tax benefit from employee stock awards	6.3	7.3
Cash dividends paid	(88.9)	(68.6)
Net cash (used in) provided by financing activities	(538.4)	90.0
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(477.0)	143.8
Cash and cash equivalents at beginning of period	1,383.8	661.8
Cash and cash equivalents at end of period	$906.8	$805.6
Supplemental disclosures of non-cash activities:		
Notes payable issued for inventory	$4.2	$8.1
Stock issued under employee incentive plans	$19.9	$8.3
Accrual for holdback payment related to acquisition	$—	$2.0

See accompanying notes to consolidated financial statements.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
June 30, 2016

NOTE A – BASIS OF PRESENTATION

The accompanying unaudited, consolidated financial statements include the accounts of D.R. Horton, Inc. and all of its 100% owned, majority-owned and controlled subsidiaries (which are collectively referred to as the Company, unless the context otherwise requires). All intercompany accounts, transactions and balances have been eliminated in consolidation. The financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, these financial statements reflect all adjustments considered necessary to present fairly the results for the interim periods shown, including normal recurring accruals and other items. These financial statements, including the consolidated balance sheet as of September 30, 2015, which was derived from audited financial statements, do not include all of the information and notes required by GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2015.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an initial maturity of three months or less when purchased to be cash equivalents. Proceeds from home closings held for the Company's benefit at title companies are included in homebuilding cash and cash equivalents in the consolidated balance sheets.

Cash balances of the Company's captive insurance subsidiary, which are expected to be used to fund the subsidiary's operations and pay future anticipated legal claims, were $41.1 million and $40.5 million at June 30, 2016 and September 30, 2015, respectively, and are included in homebuilding cash and cash equivalents in the consolidated balance sheets.

Seasonality

Historically, the homebuilding industry has experienced seasonal fluctuations; therefore, the operating results for the three and nine months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2016 or subsequent periods.

D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which is a comprehensive new revenue recognition model that will replace most existing revenue recognition guidance. The core principle of this guidance is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. The guidance is effective for the Company beginning October 1, 2018 and allows for full retrospective or modified retrospective methods of adoption. The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements - Going Concern," which provides guidance about management's responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern and to provide related footnote disclosures. This guidance is intended to reduce the diversity in the timing and content of footnote disclosures. The guidance is effective for the Company in its fiscal year ending September 30, 2017 and is not expected to have any impact on its consolidated financial position, results of operations or cash flows.

In February 2015, the FASB issued ASU 2015-02, "Consolidation," which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The guidance is effective for the Company beginning October 1, 2016 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory," which simplifies the subsequent measurement of inventory, excluding inventory measured using the last-in, first-out or retail inventory methods. The guidance specifies that inventory currently measured at the lower of cost or market, where market could be determined with different methods, should now be measured at the lower of cost or net realizable value. The guidance is effective for the Company beginning October 1, 2017 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

In September 2015, the FASB issued ASU 2015-16, "Business Combinations: Simplifying the Accounting for Measurement-Period Adjustments," which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The guidance is effective for the Company beginning October 1, 2016 and is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU 2016-02, "Leases," which requires that lease assets and liabilities be recognized on the balance sheet, and that key information about leasing arrangements be disclosed. The guidance is effective for the Company beginning October 1, 2019, although early adoption is permitted. The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation," which simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The guidance is effective for

the Company beginning October 1, 2017, although early adoption is permitted. The Company is currently evaluating the impact of this guidance on its consolidated financial position, results of operations and cash flows.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

NOTE B – SEGMENT INFORMATION

The Company is a national homebuilder that is primarily engaged in the acquisition and development of land and the construction and sale of residential homes, with operations in 78 markets in 26 states across the United States. The Company designs, builds and sells single-family detached homes on lots it develops and on fully developed lots purchased ready for home construction. To a lesser extent, the Company also builds and sells attached homes, such as townhomes, duplexes, triplexes and condominiums. Periodically, the Company sells land and lots to other developers and homebuilders where it has excess land and lot positions or for other strategic reasons. The homebuilding segments generate most of their revenues from the sale of completed homes and to a lesser extent from the sale of land and lots.

The Company’s financial services segment primarily provides mortgage financing and title agency services to homebuyers in many of the Company’s homebuilding markets. The Company sells substantially all of the mortgages it originates and the related servicing rights to third-party purchasers. The financial services segment primarily generates its revenues from originating and selling mortgages and collecting fees for title insurance agency and closing services.

The Company’s 39 homebuilding operating divisions and its financial services operations are its operating segments. The homebuilding operating segments are aggregated into six reporting segments and the financial services operating segment is its own reporting segment. The Company’s reportable homebuilding segments are: East, Midwest, Southeast, South Central, Southwest and West. These reporting segments have homebuilding operations located in the following states:

East:	Delaware, Georgia (Savannah only), Maryland, New Jersey, North Carolina, Pennsylvania, South Carolina and Virginia
Midwest:	Colorado, Illinois and Minnesota
Southeast:	Alabama, Florida, Georgia, Mississippi and Tennessee
South Central:	Louisiana, Oklahoma and Texas
Southwest:	Arizona and New Mexico
West:	California, Hawaii, Nevada, Oregon, Utah and Washington

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

The accounting policies of the reporting segments are described throughout Note A included in the Company's annual report on Form 10-K for the fiscal year ended September 30, 2015. Financial information relating to the Company's reporting segments is as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2016	2015	2016	2015
	(In millions)			
Revenues				
Homebuilding revenues:				
East	$391.2	$367.4	$998.3	$946.9
Midwest	179.9	205.4	465.2	480.3
Southeast	913.3	775.5	2,436.9	2,041.0
South Central	816.1	715.1	2,123.4	1,923.1
Southwest	93.0	96.7	246.8	243.0
West	755.3	716.3	1,940.2	1,833.7
Homebuilding revenues	3,148.8	2,876.4	8,210.8	7,468.0
Financial services revenues	83.1	74.4	205.4	183.6
Total revenues	$3,231.9	$2,950.8	$8,416.2	$7,651.6
Inventory Impairments				
East	$4.2	$2.1	$7.4	$2.1
Midwest	—	—	—	—
Southeast	—	1.4	0.2	8.7
South Central	1.0	0.8	1.0	1.4
Southwest	—	—	—	—
West	—	7.4	0.3	11.4
Total inventory impairments	$5.2	$11.7	$8.9	$23.6
Income Before Income Taxes (1)				
Homebuilding pre-tax income:				
East	$40.4	$30.3	$90.9	$69.7
Midwest	13.5	21.5	29.5	36.5
Southeast	107.8	80.7	279.5	197.4
South Central	109.5	78.9	263.1	205.1
Southwest	0.9	5.2	5.6	8.3
West	77.1	85.5	192.7	199.8
Homebuilding pre-tax income	349.2	302.1	861.3	716.8
Financial services pre-tax income	29.4	31.7	59.1	67.8
Income before income taxes	$378.6	$333.8	$920.4	$784.6

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(1) Expenses maintained at the corporate level consist primarily of interest and property taxes, which are capitalized and amortized to cost of sales or expensed directly, and the expenses related to operating the Company's corporate office. The amortization of capitalized interest and property taxes is allocated to each segment based on the segment's cost of sales, while those expenses associated with the corporate office are allocated to each segment

based on the segment's inventory balances.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

	June 30, 2016	September 30, 2015
	(In millions)	
Homebuilding Inventories (1)		
East	$879.6	$ 817.3
Midwest	457.4	474.5
Southeast	2,046.9	1,876.7
South Central	2,125.8	1,909.0
Southwest	363.9	312.4
West	2,372.3	2,165.3
Corporate and unallocated (2)	258.3	251.8
Total homebuilding inventories	$8,504.2	$ 7,807.0

(1) Homebuilding inventories are the only assets included in the measure of homebuilding segment assets used by the Company's chief operating decision makers.
(2) Corporate and unallocated consists primarily of capitalized interest and property taxes.

NOTE C – INVENTORY

At June 30, 2016, the Company reviewed the performance and outlook for all of its land inventories and communities for indicators of potential impairment and performed detailed impairment evaluations and analyses when necessary. The Company performed detailed impairment evaluations of communities and land inventories with a combined carrying value of $201.9 million and recorded impairment charges of $5.2 million during the three months ended June 30, 2016, primarily related to the expected sale of a parcel of land in the East region. During the nine months ended June 30, 2016, impairment charges totaled $8.9 million. There were $11.7 million and $23.6 million of impairment charges recorded in the three and nine months ended June 30, 2015, respectively.

During the three and nine months ended June 30, 2016, the Company wrote off $2.9 million and $7.1 million, respectively, of earnest money deposits and pre-acquisition costs related to land option contracts that the Company expects to terminate. During the three and nine months ended June 30, 2015, the Company wrote off $3.7 million and $10.4 million, respectively, of these deposits and costs.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

NOTE D – NOTES PAYABLE

The Company’s notes payable at their principal amounts, net of any unamortized discounts and debt issuance costs, consist of the following:

	June 30, 2016	September 30, 2015
	(In millions)	
Homebuilding:		
Unsecured:		
Revolving credit facility, maturing 2020	$—	$ —
5.625% senior notes due 2016	—	170.1
6.5% senior notes due 2016	—	372.5
4.75% senior notes due 2017	349.3	348.7
3.625% senior notes due 2018	398.7	398.2
3.75% senior notes due 2019	497.8	497.3
4.0% senior notes due 2020	497.0	496.4
4.375% senior notes due 2022	347.6	347.4
4.75% senior notes due 2023	298.1	297.9
5.75% senior notes due 2023	397.2	397.0
Other secured notes	11.4	8.1
	$2,797.1	$ 3,333.6
Financial Services:		
Mortgage repurchase facility, maturing 2017	$504.2	$ 477.9

Debt issuance costs that were deducted from the carrying amounts of the senior notes totaled $14.3 million and $17.3 million at June 30, 2016 and September 30, 2015, respectively.

Homebuilding:

The Company has a $975 million senior unsecured revolving credit facility with an uncommitted accordion feature that could increase the size of the facility to $1.25 billion, subject to certain conditions and availability of additional bank commitments. The facility also provides for the issuance of letters of credit with a sublimit equal to approximately 50% of the revolving credit commitment. Letters of credit issued under the facility reduce the available borrowing capacity. The interest rate on borrowings under the revolving credit facility may be based on either the Prime Rate or London Interbank Offered Rate (LIBOR) plus an applicable margin, as defined in the credit agreement governing the facility. The maturity date of the facility is September 7, 2020. At June 30, 2016, there were no borrowings outstanding and $93.2 million of letters of credit issued under the revolving credit facility.

The Company’s revolving credit facility imposes restrictions on its operations and activities, including requiring the maintenance of a minimum level of tangible net worth, a maximum allowable ratio of debt to tangible net worth and a borrowing base restriction if the Company’s ratio of debt to tangible net worth exceeds a certain level. These covenants are measured as defined in the credit agreement governing the facility and are reported to the lenders quarterly. A failure to comply with these financial covenants could allow the lending banks to terminate the availability of funds

under the revolving credit facility or cause any outstanding borrowings to become due and payable prior to maturity. In addition, the credit agreement governing the facility and the indentures governing the senior notes impose restrictions on the creation of secured debt and liens. At June 30, 2016, the Company was in compliance with all of the covenants, limitations and restrictions of its revolving credit facility and public debt obligations.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

The Company has an automatically effective universal shelf registration statement, filed with the Securities and Exchange Commission (SEC) in August 2015, registering debt and equity securities that the Company may issue from time to time in amounts to be determined.

On January 15, 2016, the Company repaid the $170.2 million principal amount of its 5.625% senior notes, which were due on that date. On April 15, 2016, the Company repaid the $372.7 million principal amount of its 6.5% senior notes, which were due on that date.

Effective August 1, 2015, the Board of Directors authorized the repurchase of up to $500 million of the Company's debt securities effective through July 31, 2016. All of the $500 million authorization was remaining at June 30, 2016. In July 2016, the Board of Directors authorized the repurchase of up to $500 million of the Company's debt securities through July 31, 2017, which replaced the previous authorization.

Financial Services:

The Company's mortgage subsidiary, DHI Mortgage, has a mortgage repurchase facility that is accounted for as a secured financing. The mortgage repurchase facility provides financing and liquidity to DHI Mortgage by facilitating purchase transactions in which DHI Mortgage transfers eligible loans to the counterparties against the transfer of funds by the counterparties, thereby becoming purchased loans. DHI Mortgage then has the right and obligation to repurchase the purchased loans upon their sale to third-party purchasers in the secondary market or within specified time frames from 45 to 60 days in accordance with the terms of the mortgage repurchase facility. In February 2016, the mortgage repurchase facility was amended and its maturity date was extended to February 24, 2017. Additionally, new commitments were obtained from banks that increased the total capacity of the facility to $475 million. The amendment allows for the capacity to be increased further, without requiring additional commitments, from $475 million to $550 million during the last five days of any fiscal quarter and the first twenty-five days of the following fiscal quarter. The capacity of the facility can also be increased to $650 million subject to the availability of additional commitments. At June 30, 2016, the capacity of the facility was $600 million as a result of obtaining an increase in commitments for the period from June 24, 2016 through September 23, 2016.

As of June 30, 2016, $589.2 million of mortgage loans held for sale with a collateral value of $569.3 million were pledged under the mortgage repurchase facility. As a result of advance paydowns totaling $65.1 million, DHI Mortgage had an obligation of $504.2 million outstanding under the mortgage repurchase facility at June 30, 2016 at a 2.6% annual interest rate.

The mortgage repurchase facility is not guaranteed by D.R. Horton, Inc. or any of the subsidiaries that guarantee the Company's homebuilding debt. The facility contains financial covenants as to the mortgage subsidiary's minimum required tangible net worth, its maximum allowable ratio of debt to tangible net worth and its minimum required liquidity. These covenants are measured and reported to the lenders monthly. At June 30, 2016, DHI Mortgage was in compliance with all of the conditions and covenants of the mortgage repurchase facility.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

NOTE E – CAPITALIZED INTEREST

The Company capitalizes interest costs incurred to inventory during active development and construction (active inventory). Capitalized interest is charged to cost of sales as the related inventory is delivered to the buyer. During periods in which the Company’s active inventory is lower than its debt level, a portion of the interest incurred is reflected as interest expense in the period incurred. During the first three quarters of fiscal 2016 and in fiscal 2015, the Company’s active inventory exceeded its debt level and all interest incurred was capitalized to inventory.

The following table summarizes the Company’s interest costs incurred, capitalized and expensed during the three and nine months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2016	2015	2016	2015
	(In millions)			
Capitalized interest, beginning of period	$214.5	$212.2	$208.0	$198.5
Interest incurred (1)	35.4	43.2	118.0	126.2
Interest charged to cost of sales	(43.3)	(42.8)	(119.4)	(112.1)
Capitalized interest, end of period	$206.6	$212.6	$206.6	$212.6

(1) Interest incurred includes interest incurred on the Company's financial services mortgage repurchase facility of $2.4 million and $5.9 million in the three and nine months ended June 30, 2016, respectively, and $2.1 million and $5.2 million in the same periods of 2015.

NOTE F – MORTGAGE LOANS

Mortgage Loans Held for Sale

Mortgage loans held for sale consist primarily of single-family residential loans collateralized by the underlying property. At June 30, 2016, mortgage loans held for sale had an aggregate fair value of $634.5 million and an aggregate outstanding principal balance of $609.3 million. At September 30, 2015, mortgage loans held for sale had an aggregate fair value of $631.0 million and an aggregate outstanding principal balance of $608.9 million. During the nine months ended June 30, 2016 and 2015, mortgage loans originated totaled $4.0 billion and $3.6 billion, respectively, and mortgage loans sold totaled $4.0 billion and $3.5 billion, respectively. The Company had gains on sales of loans and servicing rights of $59.8 million and $143.6 million during the three and nine months ended June 30, 2016, respectively, compared to $52.2 million and $125.7 million in the prior year periods. Net gains on sales of loans and servicing rights are included in financial services revenues in the consolidated statements of operations. Approximately 92% of the mortgage loans sold by DHI Mortgage during the nine months ended June 30, 2016 were sold to four major financial entities, one of which purchased 27% of the total loans sold.

To manage the interest rate risk inherent in its mortgage operations, the Company hedges its risk using derivative instruments, generally forward sales of mortgage-backed securities (MBS), which are referred to as “hedging instruments” in the following discussion. The Company does not enter into or hold derivatives for trading or

speculative purposes.

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Newly originated loans that have been closed but not committed to third-party purchasers are hedged to mitigate the risk of changes in their fair value. Hedged loans are committed to third-party purchasers typically within three days after origination. The notional amounts of the hedging instruments used to hedge mortgage loans held for sale vary in relationship to the underlying loan amounts, depending on the movements in the value of each hedging instrument relative to the value of the underlying mortgage loans. The fair value change related to the hedging instruments generally offsets the fair value change in the mortgage loans held for sale. The net fair value change, which for the three and nine months ended June 30, 2016 and 2015 was not significant, is recognized in financial services revenues in the consolidated statements of operations. At June 30, 2016 and September 30, 2015, the Company's mortgage loans held for sale that were not committed to third-party purchasers totaled $403.8 million and $385.3 million, respectively, and the notional amounts of the hedging instruments related to those loans totaled $403.6 million and $383.8 million, respectively.

Other Mortgage Loans and Loss Reserves

Mortgage loans are sold with limited recourse provisions derived from industry-standard representations and warranties in the relevant agreements. These representations and warranties primarily involve the absence of misrepresentations by the borrower or other parties, the appropriate underwriting of the loan and in some cases, a required minimum number of payments to be made by the borrower. The Company generally does not retain any other continuing interest related to mortgage loans sold in the secondary market. The majority of other mortgage loans consists of loans repurchased due to these limited recourse obligations. Typically, these loans are impaired and some become real estate owned through the foreclosure process. At June 30, 2016 and September 30, 2015, the Company's total other mortgage loans and real estate owned, before loss reserves, were as follows:

	June 30, 2016	September 30, 2015
	(In millions)	
Other mortgage loans	$40.7	$ 49.0
Real estate owned	0.5	0.6
	$41.2	$ 49.6

The Company has recorded reserves for estimated losses on other mortgage loans, real estate owned and future loan repurchase obligations due to the limited recourse provisions, all of which are recorded as reductions of financial services revenue. The loss reserve for loan repurchase and settlement obligations is estimated based on an analysis of loan repurchase requests received, actual repurchases and losses through the disposition of such loans or requests, discussions with mortgage purchasers and analysis of mortgages originated. The reserve balances at June 30, 2016 and September 30, 2015 were as follows:

	June 30, 2016	September 30, 2015
	(In millions)	
Loss reserves related to:		
Other mortgage loans	$3.9	$ 1.5
Real estate owned	—	0.1
Loan repurchase and settlement obligations – known and expected	2.2	9.8
	$6.1	$ 11.4

The decrease in the reserve balance is primarily due to the payment of a full settlement with a significant third-party purchaser for loans previously sold to them. Other mortgage loans and real estate owned net of the related loss reserves are included in financial services other assets, while loan repurchase obligations are included in financial services accounts payable and other liabilities in the accompanying consolidated balance sheets.

Loan Commitments and Related Derivatives

The Company is party to interest rate lock commitments (IRLCs), which are extended to borrowers who have applied for loan funding and meet defined credit and underwriting criteria. At June 30, 2016 and September 30, 2015, the notional amount of IRLCs, which are accounted for as derivative instruments recorded at fair value, totaled $645.8 million and $370.9 million, respectively.

The Company manages interest rate risk related to its IRLCs through the use of best-efforts whole loan delivery commitments and hedging instruments. These instruments are considered derivatives in an economic hedge and are accounted for at fair value with gains and losses recognized in financial services revenues in the consolidated statements of operations. At June 30, 2016 and September 30, 2015, the notional amount of best-efforts whole loan delivery commitments totaled $46.8 million and $37.7 million, respectively, and the notional amount of hedging instruments related to IRLCs not yet committed to purchasers totaled $532.4 million and $297.2 million, respectively.

NOTE G – INCOME TAXES

The Company's income tax expense for the three and nine months ended June 30, 2016 was $128.8 million and $317.8 million, respectively, compared to $112.4 million and $272.8 million, respectively, in the same periods of fiscal 2015. The effective tax rate was 34.0% and 34.5% for the three and nine months ended June 30, 2016, respectively, compared to 33.7% and 34.8% in the prior year periods. The effective tax rates for all periods include an expense for state income taxes that was reduced by a tax benefit for the domestic production activities deduction and federal energy tax credits.

At June 30, 2016 and September 30, 2015, the Company had deferred tax assets, net of deferred tax liabilities, of $514.3 million and $568.2 million, respectively, partially offset by valuation allowances of $9.2 million and $10.1 million, respectively. The accounting for deferred taxes is based upon estimates of future results. Differences between the anticipated and actual outcomes of these future results could have a material impact on the Company's consolidated results of operations or financial position. Also, changes in existing federal and state tax laws and tax rates could affect future tax results and the valuation of the Company's deferred tax assets.

When assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of its deferred tax assets will not be realized. The realization of deferred tax assets is dependent upon the generation of sufficient taxable income in future periods. The Company records a valuation allowance when it determines it is more likely than not that a portion of the deferred tax assets will not be realized. The valuation allowance for both periods relates to the Company's state deferred tax assets for net operating loss (NOL) carryforwards. The valuation allowance as of September 30, 2015 also relates to certain state tax credit carryforwards. As of June 30, 2016, the Company believes it is more likely than not that a portion of its state NOL carryforwards will not be realized because some state NOL carryforward periods are too brief to realize the related deferred tax assets. The Company will continue to evaluate both the positive and negative evidence in determining the need for a valuation allowance with respect to its remaining state NOL carryforwards.

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NOTE H – EARNINGS PER SHARE

The following table sets forth the numerators and denominators used in the computation of basic and diluted earnings per share. Options to purchase 8.6 million shares of common stock were excluded from the computation of diluted earnings per share for the 2015 periods because their effect would have been antidilutive.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2016	2015	2016	2015
	(In millions)			
Numerator:				
Net income	$249.8	$221.4	$602.6	$511.8
Denominator:				
Denominator for basic earnings per share — weighted average common shares	371.8	366.8	370.4	365.9
Effect of dilutive securities:				
Employee stock awards	4.1	3.5	4.0	3.4
Denominator for diluted earnings per share — adjusted weighted average common shares	375.9	370.3	374.4	369.3
Basic net income per common share	$0.67	$0.60	$1.63	$1.40
Net income per common share assuming dilution	$0.66	$0.60	$1.61	$1.39

NOTE I – STOCKHOLDERS' EQUITY

The Company has an automatically effective universal shelf registration statement, filed with the SEC in August 2015, registering debt and equity securities that it may issue from time to time in amounts to be determined.

Effective August 1, 2015, the Board of Directors authorized the repurchase of up to $100 million of the Company's common stock effective through July 31, 2016. All of the $100 million authorization was remaining at June 30, 2016, and no common stock has been repurchased subsequent to June 30, 2016. In July 2016, the Board of Directors authorized the repurchase of up to $100 million of the Company's common stock through July 31, 2017, which replaced the previous authorization.

During the three months ended June 30, 2016, the Board of Directors approved a quarterly cash dividend of $0.08 per common share, which was paid on May 27, 2016 to stockholders of record on May 13, 2016. In July 2016, the Board of Directors approved a quarterly cash dividend of $0.08 per common share, payable on August 19, 2016 to stockholders of record on August 8, 2016. Quarterly cash dividends of $0.0625 per common share were approved and paid in the comparable quarters of fiscal 2015.

NOTE J – EMPLOYEE BENEFIT PLANS

Restricted Stock Units (RSUs)

The Company's Stock Incentive Plan provides for the granting of stock options and restricted stock units to executive officers, other key employees and non-management directors. Restricted stock unit awards may be based on performance (performance-based) or on service over a requisite time period (time-based). Performance-based and time-based RSU equity awards represent the contingent right to receive one share of the Company's common stock per RSU if the vesting conditions and/or performance criteria are satisfied. The RSUs have no dividend or voting rights until vested.

In November 2015, a total of 330,000 performance-based RSU equity awards were granted to the Company's Chairman, its Chief Executive Officer and its Chief Operating Officer. These awards vest at the end of a three-year performance period ending September 30, 2018. The number of units that ultimately vest depends on the Company's relative position as compared to its peers at the end of the three-year period in achieving certain performance criteria and can range from 0% to 200% of the number of units granted. The performance criteria are total shareholder return; return on investment; selling, general and administrative expense containment; and gross profit. The grant date fair value of these equity awards was $30.81 per unit. Compensation expense related to these grants was $1.3 million and $3.6 million in the three and nine months ended June 30, 2016, respectively, based on the Company's performance against the peer group, the elapsed portion of the performance period and the grant date fair value of the award.

During the nine months ended June 30, 2016, a total of 2.1 million time-based RSUs were granted to the Company's executive officers, other key employees and non-management directors (collectively, approximately 570 recipients). The weighted average grant date fair value of these equity awards was $23.14 per unit, and they vest annually in equal installments over periods of three to five years. Compensation expense related to these grants was $2.4 million and $6.3 million in the three and nine months ended June 30, 2016, respectively.

NOTE K – COMMITMENTS AND CONTINGENCIES

Warranty Claims

The Company typically provides its homebuyers with a ten-year limited warranty for major defects in structural elements such as framing components and foundation systems, a two-year limited warranty on major mechanical systems, and a one-year limited warranty on other construction components. The Company's warranty liability is based upon historical warranty cost experience in each market in which it operates and is adjusted as appropriate to reflect qualitative risks associated with the types of homes built and the geographic areas in which they are built.

Changes in the Company's warranty liability during the three and nine months ended June 30, 2016 and 2015 were as follows:

	Three Months Ended	Nine Months Ended

	June 30,		June 30,	
	2016	2015	2016	2015
	(In millions)			
Warranty liability, beginning of period	$87.9	$71.6	$82.0	$65.7
Warranties issued	14.3	12.9	37.2	33.3
Changes in liability for pre-existing warranties	2.4	2.3	5.6	3.0
Settlements made	(10.9)	(9.4)	(31.1)	(24.6)
Warranty liability, end of period	$93.7	$77.4	$93.7	$77.4

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Legal Claims and Insurance

The Company is named as a defendant in various claims, complaints and other legal actions in the ordinary course of business. At any point in time, the Company is managing several hundred individual claims related to construction defect matters, personal injury claims, employment matters, land development issues and contract disputes. The Company has established reserves for these contingencies based on the estimated costs of pending claims and the estimated costs of anticipated future claims related to previously closed homes. The estimated liabilities for these contingencies were $426.4 million and $451.0 million at June 30, 2016 and September 30, 2015, respectively, and are included in homebuilding accrued expenses and other liabilities in the consolidated balance sheets. At both June 30, 2016 and September 30, 2015, approximately 99% of these reserves related to construction defect matters. Expenses related to the Company's legal contingencies were $34.2 million and $32.5 million in the nine months ended June 30, 2016 and 2015, respectively.

The Company's reserves for construction defect claims include the estimated costs of both known claims and anticipated future claims. As of June 30, 2016, no individual existing claim was material to the Company's financial statements, and the majority of the Company's total construction defect reserves consisted of the estimated exposure to future claims on previously closed homes. The Company has closed a significant number of homes during recent years and may be subject to future construction defect claims on these homes. Although regulations vary from state to state, construction defect issues can generally be reported for up to ten years after the home has closed in many states in which the Company operates. Historical data and trends regarding the frequency of claims incurred and the costs to resolve claims relative to the types of products and markets where the Company operates are used to estimate the construction defect liabilities for both existing and anticipated future claims. These estimates are subject to ongoing revision as the circumstances of individual pending claims and historical data and trends change. Adjustments to estimated reserves are recorded in the accounting period in which the change in estimate occurs.

Historical trends in construction defect claims have been inconsistent, and the Company believes they will continue to fluctuate. Housing market conditions have been volatile across most of the Company's markets over the past ten years, and the Company believes such conditions can affect the frequency and cost of construction defect claims. If the ultimate resolution of construction defect claims resulting from the Company's home closings in prior years varies from current expectations, it could significantly change the Company's estimates regarding the frequency and timing of claims incurred and the costs to resolve existing and anticipated future claims, which would impact the construction defect reserves in the future. If the frequency of claims incurred or costs of existing and future legal claims significantly exceed the Company's current estimates, they will have a significant negative impact on its future earnings and liquidity.

The Company's reserves for legal claims decreased from $451.0 million at September 30, 2015 to $426.4 million at June 30, 2016 due to payments made for legal claims during the period, net of reimbursements received from subcontractors. Changes in the Company's legal claims reserves during the nine months ended June 30, 2016 and 2015 were as follows:

	Nine Months Ended June 30,	
	2016	2015

	(In millions)	
Reserves for legal claims, beginning of period	$451.0	$456.9
Increase in reserves	15.2	31.2
Payments	(39.8)	(37.4)
Reserves for legal claims, end of period	$426.4	$450.7

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The Company estimates and records receivables under its applicable insurance policies related to its estimated contingencies for known claims and anticipated future construction defect claims on previously closed homes and other legal claims and lawsuits incurred in the ordinary course of business when recovery is probable. Additionally, the Company may have the ability to recover a portion of its losses from its subcontractors and their insurance carriers when the Company has been named as an additional insured on their insurance policies. The Company's receivables related to its estimates of insurance recoveries from estimated losses for pending legal claims and anticipated future claims related to previously closed homes totaled $97.5 million, $126.5 million and $129.6 million at June 30, 2016, September 30, 2015 and June 30, 2015, respectively, and are included in homebuilding other assets in the consolidated balance sheets.

The estimation of losses related to these reserves and the related estimates of recoveries from insurance policies are subject to a high degree of variability due to uncertainties such as trends in construction defect claims relative to the Company's markets and the types of products built, claim frequency, claim settlement costs and patterns, insurance industry practices and legal interpretations, among others. Due to the high degree of judgment required in establishing reserves for these contingencies, actual future costs and recoveries from insurance could differ significantly from current estimated amounts, and it is not possible for the Company to make a reasonable estimate of the possible loss or range of loss in excess of its reserves.

Land and Lot Option Purchase Contracts

The Company enters into land and lot option purchase contracts to acquire land or lots for the construction of homes. Under these contracts, the Company will fund a stated deposit in consideration for the right, but not the obligation, to purchase land or lots at a future point in time with predetermined terms. Under the terms of many of the option purchase contracts, the option deposits are not refundable in the event the Company elects to terminate the contract. Option deposits are included in homebuilding other assets in the consolidated balance sheets.

At June 30, 2016, the Company had total deposits of $136.8 million, consisting of cash deposits of $130.6 million and promissory notes and letters of credit of $6.2 million, to purchase land and lots with a total remaining purchase price of approximately $3.4 billion. The majority of land and lots under contract are currently expected to be purchased within three years. A limited number of the land and lot option purchase contracts at June 30, 2016, representing $34.6 million of remaining purchase price, were subject to specific performance provisions which may require the Company to purchase the land or lots upon the land sellers meeting their contractual obligations.

Option purchase contracts can result in the creation of a variable interest in the entity holding the land parcel under option. There were no variable interest entities reported in the consolidated balance sheets at June 30, 2016 and September 30, 2015 because the Company determined it did not control the activities that most significantly impact the variable interest entity's economic performance, and it did not have an obligation to absorb losses of or the right to receive benefits from the entity. The maximum exposure to losses related to the Company's variable interest entities is limited to the amounts of the Company's related option deposits. At June 30, 2016 and September 30, 2015, the option deposits related to these contracts totaled $119.6 million and $74.4 million, respectively.

Other Commitments

At June 30, 2016, the Company had outstanding surety bonds of $929.6 million and letters of credit of $96.1 million to secure performance under various contracts. Of the total letters of credit, $93.2 million were issued under the Company's revolving credit facility and were cash collateralized to receive better pricing. This unrestricted cash can be withdrawn by the Company at its discretion. The remaining $2.9 million of letters of credit were issued under a secured letter of credit agreement requiring the Company to deposit cash as collateral with the issuing bank, and the cash restricted for this purpose is included in homebuilding restricted cash in the consolidated balance sheets.

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NOTE L – OTHER ASSETS AND ACCRUED EXPENSES AND OTHER LIABILITIES

The Company’s homebuilding other assets at June 30, 2016 and September 30, 2015 were as follows:

	June 30, 2016	September 30, 2015
	(In millions)	
Insurance receivables	$97.5	$ 126.5
Earnest money and refundable deposits	194.2	137.2
Accounts and notes receivable	34.2	49.2
Prepaid assets	25.7	40.9
Rental properties	54.6	47.1
Debt securities collateralized by residential real estate	—	33.9
Other assets	16.6	21.4
	$422.8	$ 456.2

The Company’s homebuilding accrued expenses and other liabilities at June 30, 2016 and September 30, 2015 were as follows:

	June 30, 2016	September 30, 2015
	(In millions)	
Reserves for legal claims	$426.4	$ 451.0
Employee compensation and related liabilities	159.7	172.7
Warranty liability	93.7	82.0
Accrued interest	40.1	30.7
Federal and state income tax liabilities	35.5	36.1
Inventory related accruals	28.8	30.0
Homebuyer deposits	67.5	58.9
Accrued property taxes	22.8	32.0
Other liabilities	35.3	35.8
	$909.8	$ 929.2

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NOTE M – FAIR VALUE MEASUREMENTS

Fair value measurements are used for the Company’s mortgage loans held for sale, debt securities collateralized by residential real estate, IRLCs and other derivative instruments on a recurring basis, and are used for inventories, other mortgage loans, rental properties and real estate owned on a nonrecurring basis, when events and circumstances indicate that the carrying value may not be recoverable. The fair value hierarchy and its application to the Company’s assets and liabilities is as follows:

- Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities. The Company does not currently have any assets or liabilities measured at fair value using Level 1 inputs.
- Level 2 – Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant inputs are observable in the market. The Company’s assets and liabilities measured at fair value using Level 2 inputs on a recurring basis are as follows:
  mortgage loans held for sale;
  IRLCs; and
  loan sale commitments and hedging instruments.
- Level 3 – Valuation is typically derived from model-based techniques in which at least one significant input is unobservable and based on the Company’s own estimates about the assumptions that market participants would use to value the asset or liability.

The Company’s assets measured at fair value using Level 3 inputs on a recurring basis are as follows:
debt securities collateralized by residential real estate; and
a limited number of mortgage loans held for sale with some degree of impairment affecting their marketability.
The Company’s assets measured at fair value using Level 3 inputs that are typically reported at the lower of carrying value or fair value on a nonrecurring basis are as follows:
inventory held and used;
inventory available for sale;
certain other mortgage loans; and
rental properties and real estate owned.

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The following tables summarize the Company’s assets and liabilities measured at fair value on a recurring basis at June 30, 2016 and September 30, 2015, and the changes in the fair value of the Level 3 assets during the nine months ended June 30, 2016 and 2015.

	Balance Sheet Location	Fair Value at June 30, 2016 Level 1	Level 2	Level 3	Total
		(In millions)			
Financial Services:					
Mortgage loans held for sale (b)	Mortgage loans held for sale	$ —	$ 620.1	$ 14.4	$ 634.5
Derivatives not designated as hedging instruments (c):					
Interest rate lock commitments	Other assets	—	14.1	—	14.1
Forward sales of MBS	Other liabilities	—	(9.4)	—	(9.4)
Best-efforts and mandatory commitments	Other liabilities	—	(1.1)	—	(1.1)

	Balance Sheet Location	Fair Value at September 30, 2015 Level 1	Level 2	Level 3	Total
		(In millions)			
Homebuilding:					
Debt securities collateralized by residential real estate (a)	Other assets	$ —	$ —	$33.9	$33.9
Financial Services:					
Mortgage loans held for sale (b)	Mortgage loans held for sale	—	617.1	13.9	631.0
Derivatives not designated as hedging instruments (c):					
Interest rate lock commitments	Other assets	—	3.6	—	3.6
Forward sales of MBS	Other liabilities	—	(6.0)	—	(6.0)
Best-efforts and mandatory commitments	Other liabilities	—	(1.1)	—	(1.1)

	Level 3 Assets at Fair Value for the Nine Months Ended June 30, 2016 Balance at September 30, 2015	Net realized and unrealized gains (losses)	Purchases	Sales and Settlements	Principal Reductions	Net transfers to (out of) Level 3	Balance at June 30, 2016
	(In millions)						
Debt securities collateralized by residential real estate (a)	$33.9	$ 2.2	$ —	$ (35.8)	$ (0.3)	$ —	$ —
Mortgage loans held for sale (b)	13.9	1.2	—	(15.6)	—	14.9	14.4

	Level 3 Assets at Fair Value for the Nine Months Ended June 30, 2015 Balance at	Net realized	Purchases	Sales and Settlements	Principal Reductions	Net transfers	Balance at

	September 30, 2014	and unrealized gains (losses)				to (out of) Level 3	June 30, 2015
	(In millions)						
Debt securities collateralized by residential real estate (a)	$20.8	$ —	$ 14.8	$ —	$ —	$ —	$ 35.6
Mortgage loans held for sale (b)	12.0	0.3	—	(1.7)	—	2.9	13.5

(a) In October 2012, the Company purchased defaulted debt securities, which were secured by residential real estate, for $18.6 million in cash. In fiscal 2015, the Company purchased the residential real estate parcel and all additional defaulted debt securities associated with the parcel for $19.9 million in cash, of which $5.1 million was allocated to the land and $14.8 million was allocated to the debt securities. The Company sold all of the debt securities to a third party for $35.8 million in January 2016. The resulting gain of $4.5 million on the sale is included in homebuilding other income in the consolidated statement of operations for the nine-month period ended June 30, 2016.

(b) Mortgage loans held for sale are reflected at fair value. Interest income earned on mortgage loans held for sale is based on contractual interest rates and included in financial services interest and other income. Mortgage loans held for sale at June 30, 2016 and September 30, 2015 include $14.4 million and $13.9 million, respectively, of loans for which the Company elected the fair value option upon origination and which the Company did not sell into the secondary market. Mortgage loans held for sale totaling $14.9 million and $2.9 million were transferred to Level 3 during the nine months ended June 30, 2016 and 2015, respectively, due to significant unobservable inputs used in determining the fair value of the loans. The fair value of these mortgage loans held for sale is generally calculated considering the secondary market and adjusted for the value of the underlying collateral, including interest rate risk, liquidity risk and prepayment risk. The Company plans to sell these loans as market conditions permit.

(c) Fair value measurements of these derivatives represent changes in fair value, as calculated by reference to quoted prices for similar assets, and are reflected in the balance sheet. Changes in these fair values during the periods presented are included in financial services revenues in the consolidated statements of operations.

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The following table summarizes the Company’s assets measured at fair value on a nonrecurring basis at June 30, 2016 and September 30, 2015:

	Balance Sheet Location	Fair Value at June 30, 2016 Level 3	Fair Value at September 30, 2015 Level 3
		(In millions)	
Homebuilding:			
Inventory held and used (a) (b)	Inventories	$ —	$ 10.1
Inventory available for sale (a) (c)	Inventories	3.9	2.8
Financial Services:			
Other mortgage loans (a) (d)	Other assets	33.9	15.2
Real estate owned (a) (d)	Other assets	0.1	0.5

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(a) The fair values included in the table above represent only those assets whose carrying values were adjusted to fair value in the respective period and were held at the end of the period.
(b) In performing its impairment analysis of communities, discount rates ranging from 12% to 14% were used in the periods presented.
(c) The fair value of inventory available for sale was determined based on recent offers received from outside third parties, comparable sales or actual contracts.
(d) The fair values of other mortgage loans and real estate owned are determined based on the value of the underlying collateral.

For the financial assets and liabilities that the Company does not reflect at fair value, the following tables present both their respective carrying value and fair value at June 30, 2016 and September 30, 2015:

	Carrying Value	Fair Value at June 30, 2016			
		Level 1	Level 2	Level 3	Total
	(In millions)				
Homebuilding:					
Cash and cash equivalents (a)	$ 862.9	$ 862.9	$ —	$ —	$ 862.9
Restricted cash (a)	11.8	11.8	—	—	11.8
Senior notes (b)	2,785.7	—	2,904.1	—	2,904.1
Other secured notes (a)	11.4	—	—	11.4	11.4
Financial Services:					
Cash and cash equivalents (a)	43.9	43.9	—	—	43.9
Mortgage repurchase facility (a)	504.2	—	—	504.2	504.2

Fair Value at September 30, 2015

	Carrying Value	Level 1	Level 2	Level 3	Total
	(In millions)				
Homebuilding:					
Cash and cash equivalents (a)	$1,355.9	$1,355.9	$ —	$ —	$1,355.9
Restricted cash (a)	9.7	9.7	—	—	9.7
Senior notes (b)	3,325.5	—	3,405.9	—	3,405.9
Other secured notes (a)	8.1	—	—	8.1	8.1
Financial Services:					
Cash and cash equivalents (a)	27.9	27.9	—	—	27.9
Mortgage repurchase facility (a)	477.9	—	—	477.9	477.9

(a) The fair value approximates carrying value due to its short-term nature, short maturity or floating interest rate terms, as applicable.

(b) The fair value is determined based on quoted market prices of recent transactions of the notes, which is classified as Level 2 within the fair value hierarchy.

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

NOTE N – SUPPLEMENTAL GUARANTOR INFORMATION

All of the Company’s senior notes and the unsecured revolving credit facility are fully and unconditionally guaranteed, on a joint and several basis, by substantially all of the Company’s homebuilding subsidiaries (collectively, Guarantor Subsidiaries). Each of the Guarantor Subsidiaries is 100% owned, directly or indirectly, by the Company. The Company’s subsidiaries engaged in the financial services segment and certain other subsidiaries do not guarantee the Company’s senior notes and the unsecured revolving credit facility (collectively, Non-Guarantor Subsidiaries). In lieu of providing separate financial statements for the Guarantor Subsidiaries, consolidating condensed financial statements are presented below. Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that they are not material to investors.

The guarantees by a Guarantor Subsidiary will be automatically and unconditionally released and discharged upon: (1) the sale or other disposition of its common stock whereby it is no longer a subsidiary of the Company; (2) the sale or other disposition of all or substantially all of its assets (other than to the Company or another Guarantor); (3) its merger or consolidation with an entity other than the Company or another Guarantor; or (4) depending on the provisions of the applicable indenture, either (a) its proper designation as an unrestricted subsidiary, (b) its ceasing to guarantee any of the Company’s publicly traded debt securities, or (c) its ceasing to guarantee any of the Company’s obligations under the revolving credit facility.

Consolidating Balance Sheet
June 30, 2016

	D.R. Horton, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
	(In millions)				
ASSETS					
Cash and cash equivalents	$717.0	$ 99.1	$ 90.7	$ —	$906.8
Restricted cash	8.6	3.2	—	—	11.8
Investments in subsidiaries	3,927.7	—	—	(3,927.7)	—
Inventories	2,861.5	5,576.6	66.1	—	8,504.2
Deferred income taxes	166.8	333.1	5.2	—	505.1
Property and equipment, net	66.2	48.5	37.0	—	151.7
Other assets	151.5	257.3	128.3	(5.2)	531.9
Mortgage loans held for sale	—	—	634.5	—	634.5
Goodwill	—	87.2	—	—	87.2
Intercompany receivables	1,864.8	8.1	—	(1,872.9)	—
Total Assets	$9,764.1	$ 6,413.1	$ 961.8	$ (5,805.8)	$11,333.2
LIABILITIES & EQUITY					
Accounts payable and other liabilities	$460.5	$ 939.3	$ 121.1	$ (1.8)	$1,519.1
Intercompany payables	—	1,718.4	154.5	(1,872.9)	—
Notes payable	2,788.0	9.1	504.2	—	3,301.3
Total Liabilities	3,248.5	2,666.8	779.8	(1,874.7)	4,820.4
Stockholders’ equity	6,515.6	3,746.3	181.4	(3,931.1)	6,512.2
Noncontrolling interests	—	—	0.6	—	0.6

Total Equity	6,515.6	3,746.3	182.0	(3,931.1)	6,512.8
Total Liabilities & Equity	$9,764.1	$ 6,413.1	$ 961.8	$ (5,805.8)	$11,333.2

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

NOTE N – SUPPLEMENTAL GUARANTOR INFORMATION - (Continued)

Consolidating Balance Sheet
September 30, 2015

	D.R. Horton, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
	(In millions)				
ASSETS					
Cash and cash equivalents	$1,217.7	$ 94.6	$ 71.5	$ —	$1,383.8
Restricted cash	7.4	2.3	—	—	9.7
Investments in subsidiaries	3,479.7	—	—	(3,479.7)	—
Inventories	2,597.3	5,184.3	25.4	—	7,807.0
Deferred income taxes	179.9	373.0	5.2	—	558.1
Property and equipment, net	54.6	52.7	36.7	—	144.0
Other assets	199.5	240.4	90.3	—	530.2
Mortgage loans held for sale	—	—	631.0	—	631.0
Goodwill	—	87.2	—	—	87.2
Intercompany receivables	1,932.2	—	—	(1,932.2)	—
Total Assets	$9,668.3	$ 6,034.5	$ 860.1	$ (5,411.9)	$11,151.0
LIABILITIES & EQUITY					
Accounts payable and other liabilities	$447.2	$ 872.8	$ 124.1	$ —	$1,444.1
Intercompany payables	—	1,856.7	75.5	(1,932.2)	—
Notes payable	3,326.8	6.8	477.9	—	3,811.5
Total Liabilities	3,774.0	2,736.3	677.5	(1,932.2)	5,255.6
Stockholders' equity	5,894.3	3,298.2	181.5	(3,479.7)	5,894.3
Noncontrolling interests	—	—	1.1	—	1.1
Total Equity	5,894.3	3,298.2	182.6	(3,479.7)	5,895.4
Total Liabilities & Equity	$9,668.3	$ 6,034.5	$ 860.1	$ (5,411.9)	$11,151.0

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D.R. HORTON, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
June 30, 2016

NOTE N – SUPPLEMENTAL GUARANTOR INFORMATION - (Continued)

Consolidating Statement of Operations
Three Months Ended June 30, 2016

	D.R. Horton, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
	(In millions)				
Homebuilding:					
Revenues	$1,040.8	$ 2,118.6	$ —	$ (10.6)	$3,148.8
Cost of sales	836.9	1,693.2	0.8	(7.9)	2,523.0
Gross profit (loss)	203.9	425.4	(0.8)	(2.7)	625.8
Selling, general and administrative expense	126.6	151.5	2.3	—	280.4
Equity in (income) of subsidiaries	(303.3)	—			