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0001784567 HCDI:HorseshoebayTexasMember HCDI:PurchaseAndSaleAgreementMember 2021-10-28 2021-11-01 0001784567 HCDI:SemiahmooWashingtonMember HCDI:PurchaseAndSaleAgreementMember 2021-10-28 2021-11-03 0001784567 us-gaap:PreferredClassAMember 2021-10-28 2021-11-05 0001784567 us-gaap:SeriesAPreferredStockMember 2021-10-28 2021-11-05 0001784567 HCDI:BremertonWashingtonMember HCDI:PurchaseAndSaleAgreementMember 2021-10-28 2021-11-08 iso4217:USD xbrli:shares iso4217:USD xbrli:shares xbrli:pure HCDI:Customer utr:acre utr:sqft

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the Quarter ended September 30, 2021

Commission File Number: 000-237507

**HARBOR CUSTOM DEVELOPMENT, INC.**

(Exact name of registrant as specified in its charter)

|  |  |  |
| --- | --- | --- |
| Washington |  | 46-4827436 |
| (State of organization) |  | (I.R.S. Employer Identification No.) |

**11505 Burnham Dr., Suite 301**

**Gig Harbor, Washington 98332**

(Address of principal executive offices)

**(253) 649-0636**

Registrant’s telephone number, including area code

Former address if changed since last report

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Title of each class |  | Trading Symbol(s) |  | Name of each exchange on which registered. |
| Common Stock |  | HCDI |  | The Nasdaq Stock Market LLC |
| 8.0% Series A Cumulative Convertible Preferred Stock |  | HCDIP |  | The Nasdaq Stock Market LLC |
| Warrants |  | HCDIW |  | The Nasdaq Stock Market LLC |
| Warrants |  | HCDIZ |  | The Nasdaq Stock Market LLC |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). ☒Yes ☐ No

Indicate by check mark whether the registrant is a large-accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

|  |  |
| --- | --- |
| Large accelerated filer ☐ | Accelerated filer ☐ |
| Non-accelerated filer ☐ | Smaller reporting company ☒ |
|  | Emerging growth company ☒ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

|  |  |
| --- | --- |
| Indicate by check mark whether the registrant is a shell company  (as defined in Rule 12b-2 of the Exchange Act). | ☐ Yes ☒ No |

There are 14,922,094 shares of common stock outstanding as of November 15, 2021.

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**PART I**–**FINANCIAL INFORMATION**

**ITEM 1. INTERIM FINANCIAL STATEMENTS**

**HARBOR CUSTOM DEVELOPMENT, INC. AND SUBSIDIARIES**

**D/B/A HARBOR CUSTOM HOMES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **September 30, 2021** | |  |  | **December 31, 2020** | |  |
|  |  | (unaudited) | |  |  |  | |  |
| ASSETS |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Real Estate |  | $ | 105,463,700 |  |  | $ | 20,370,300 |  |
| Property, Plant and Equipment, net |  |  | 9,132,900 |  |  |  | 8,176,000 |  |
| Right of Use Assets |  |  | 788,400 |  |  |  | 873,800 |  |
| Cash |  |  | 4,787,700 |  |  |  | 2,396,500 |  |
| Restricted Cash |  |  | 597,600 |  |  |  | - |  |
| Prepaid Expense |  |  | 2,248,100 |  |  |  | 1,658,000 |  |
| Accounts Receivable, net |  |  | 104,800 |  |  |  | 78,200 |  |
| Contract Assets, net |  |  | 4,762,400 |  |  |  | - |  |
| Deferred Offering Costs |  |  | 133,400 |  |  |  | 65,100 |  |
| TOTAL ASSETS |  | $ | 128,019,000 |  |  | $ | 33,617,900 |  |
|  |  |  |  |  |  |  |  |  |
| LIABILITIES AND STOCKHOLDERS’ EQUITY |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| LIABILITIES |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Construction Loans, net of Debt Discount of $878,600 and $502,400 respectively |  | $ | 38,682,100 |  |  | $ | 9,590,100 |  |
| Construction Loans - Related Parties, net of Debt Discount of $1,416,300 and $670,200 respectively |  |  | 11,376,000 |  |  |  | 5,819,700 |  |
| Equipment Loans |  |  | 5,731,800 |  |  |  | 5,595,500 |  |
| Accounts Payable and Accrued Expenses |  |  | 5,875,800 |  |  |  | 2,700,000 |  |
| Operating Lease Liabilities |  |  | 766,900 |  |  |  | 841,700 |  |
| Finance Leases |  |  | 611,300 |  |  |  | 999,400 |  |
| Deferred Revenue |  |  | 21,700 |  |  |  | 896,300 |  |
| Note Payable PPP |  |  | - |  |  |  | 19,300 |  |
| Dividends Payable |  |  | 210,600 |  |  |  | - |  |
| Contract Liability |  |  | 390,900 |  |  |  |  |  |
| Note Payable D&O Insurance |  |  | 1,284,000 |  |  |  | 741,200 |  |
| TOTAL LIABILITIES |  |  | 64,951,100 |  |  |  | 27,203,200 |  |
|  |  |  |  |  |  |  |  |  |
| COMMITMENTS AND CONTINGENCIES - SEE NOTE 11 |  |  | - |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| STOCKHOLDERS’ EQUITY |  |  |  |  |  |  |  |  |
| Preferred Stock, No Par 10,000,000 shares authorized and 1,260,555 issued and outstanding at September 30, 2021 and 0 outstanding and issued at December 31, 2020 |  | $ | 28,661,000 |  |  | $ | - |  |
| Common Stock, No Par 50,000,000 shares authorized and 14,922,094 outstanding at September 30, 2021 and 5,636,548 issued and outstanding at December 31, 2020 |  |  | 37,057,900 |  |  |  | 11,956,900 |  |
| Additional Paid In Capital |  |  | 668,900 |  |  |  | 234,800 |  |
| Accumulated Deficit |  |  | (2,028,300 | ) |  |  | (4,487,100 | ) |
| Total Stockholders’ Equity - Harbor Custom Development, Inc. |  |  | 64,359,500 |  |  |  | 7,704,600 |  |
| Non-Controlling Interest |  |  | (1,291,600 | ) |  |  | (1,289,900 | ) |
| TOTAL STOCKHOLDERS’ EQUITY |  |  | 63,067,900 |  |  |  | 6,414,700 |  |
| TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY |  | $ | 128,019,000 |  |  | $ | 33,617,900 |  |

See accompanying notes to the condensed consolidated financial statements.

(Amounts rounded to the nearest $100)

|  |
| --- |
| 1 |

**HARBOR CUSTOM DEVELOPMENT, INC. AND SUBSIDIARIES**

**D/B/A HARBOR CUSTOM HOMES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | For the Three Months Ended September 30, | | | | | |  |  | For the Nine Months Ended September 30, | | | | | |  |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
|  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |
| Sales |  | $ | 18,010,600 |  |  | $ | 7,806,500 |  |  | $ | 46,017,200 |  |  | $ | 26,077,300 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost of Sales |  |  | 10,866,200 |  |  |  | 7,183,900 |  |  |  | 34,938,300 |  |  |  | 24,448,100 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Gross Profit |  |  | 7,144,400 |  |  |  | 622,600 |  |  |  | 11,078,900 |  |  |  | 1,629,200 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating Expenses |  |  | 3,322,100 |  |  |  | 1,458,200 |  |  |  | 7,639,700 |  |  |  | 3,769,900 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating Income (Loss) |  |  | 3,822,300 |  |  |  | (835,600 | ) |  |  | 3,439,200 |  |  |  | (2,140,700 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Other Income (Expense) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loss on Sale of Equipment |  |  | - |  |  |  | (12,400 | ) |  |  | (35,900 | ) |  |  | (27,900 | ) |
| Forgiveness of Debt |  |  | - |  |  |  | - |  |  |  | 10,000 |  |  |  | - |  |
| Other Income |  |  | 1,200 |  |  |  | - |  |  |  | 113,800 |  |  |  | 13,000 |  |
| Interest Expense |  |  | (115,100 | ) |  |  | (163,900 | ) |  |  | (298,500 | ) |  |  | (254,200 | ) |
| Total Other Income (Expense) |  |  | (113,900 | ) |  |  | (176,300 | ) |  |  | (210,600 | ) |  |  | (269,100 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Income (Loss) Before Income Tax |  |  | 3,708,400 |  |  |  | (1,011,900 | ) |  |  | 3,228,600 |  |  |  | (2,409,800 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Income Tax Benefit |  |  | - |  |  |  | 571,600 |  |  |  | - |  |  |  | 561,500 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net Income (Loss) Attributable to Stockholders |  | $ | 3,708,400 |  |  | $ | (440,300 | ) |  | $ | 3,228,600 |  |  | $ | (1,848,300 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net (Loss) Attributable to Non-controlling interests |  |  |  |  |  |  | (3,200 | ) |  |  | (1,700 | ) |  |  | (228,100 | ) |
| Preferred Dividends |  |  | (631,400 | ) |  |  | - |  |  |  | (771,500 | ) |  |  | - |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net Income (Loss) Attributable to Common Stockholders |  | $ | 3,077,000 |  |  | $ | (437,100 | ) |  | $ | 2,458,800 |  |  | $ | (1,620,200 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net Income (Loss) Per Share - Basic |  | $ | 0.21 |  |  | $ | (0.10 | ) |  | $ | 0.17 |  |  | $ | (0.43 | ) |
| Net Income (Loss) Per Share - Diluted |  | $ | 0.20 |  |  | $ | (0.10 | ) |  | $ | 0.17 |  |  | $ | (0.43 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted Average Common Shares Outstanding - Basic |  |  | 14,898,594 |  |  |  | 4,180,054 |  |  |  | 14,350,143 |  |  |  | 3,737,318 |  |
| Weighted Average Common Shares Outstanding - Diluted |  |  | 15,058,918 |  |  |  | 4,180,054 |  |  |  | 14,515,710 |  |  |  | 3,737,318 |  |

See accompanying notes to the condensed consolidated financial statements.

(Amounts rounded to the nearest $100)

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**HARBOR CUSTOM DEVELOPMENT, INC. AND SUBSIDIARIES**

**D/B/A HARBOR CUSTOM HOMES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Nine Months Ended September 30, 2021 and 2020 (Unaudited)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | |  |  |  | |  |
|  |  | **September 30, 2021** | |  |  | **September 30, 2020** | |  |
| CASH FLOWS FROM OPERATING ACTIVITIES |  |  |  |  |  |  |  |  |
| Net Income (Loss) |  | $ | 3,228,600 |  |  | $ | (1,848,300 | ) |
| Adjustments to reconcile net income (loss) to net cash from operating activities: |  |  |  |  |  |  |  |  |
| Depreciation |  |  | 783,500 |  |  |  | 419,200 |  |
| Amortization of right of use assets |  |  | 252,200 |  |  |  | 194,700 |  |
| Forgiveness on PPP loan |  |  | (10,000 | ) |  |  | - |  |
| Loss on sale of equipment |  |  | 35,900 |  |  |  | 27,900 |  |
| Stock compensation |  |  | 416,100 |  |  |  | 11,000 |  |
| Net change in assets and liabilities: |  |  |  |  |  |  |  |  |
| Accounts receivable |  |  | (26,600 | ) |  |  | (42,500 | ) |
| Contract assets |  |  | (4,762,400 | ) |  |  | - |  |
| Prepaid expenses |  |  | 820,300 |  |  |  | (255,900 | ) |
| Real estate |  |  | (82,755,400 | ) |  |  | (8,286,200 | ) |
| Deferred revenue |  |  | (874,600 | ) |  |  | 1,297,400 |  |
| Deferred income tax |  |  | - |  |  |  | (561,500 | ) |
| Payments on right of use liability |  |  | (241,600 | ) |  |  | (209,000 | ) |
| Contract Liability |  |  | 390,900 |  |  |  | - |  |
| Accounts payable and accrued expenses |  |  | 3,175,800 |  |  |  | (605,500 | ) |
| NET CASH (USED IN) OPERATING ACTIVITIES |  |  | (79,567,300 | ) |  |  | (9,858,700 | ) |
|  |  |  |  |  |  |  |  |  |
| CASH FLOWS FROM INVESTING ACTIVITIES |  |  |  |  |  |  |  |  |
| Purchase of property and equipment |  |  | (378,100 | ) |  |  | (401,100 | ) |
| Proceeds on the sale of equipment |  |  | 69,500 |  |  |  | 330,400 |  |
| NET CASH (USED IN) INVESTING ACTIVITIES |  |  | (308,600 | ) |  |  | (70,700 | ) |
|  |  |  |  |  |  |  |  |  |
| CASH FLOWS FROM FINANCING ACTIVITIES |  |  |  |  |  |  |  |  |
| Construction loans, net |  |  | 29,468,300 |  |  |  | 8,829,900 |  |
| Financing fees construction loans |  |  | (1,476,900 | ) |  |  | (573,100 | ) |
| Construction loans related parties, net |  |  | 6,302,800 |  |  |  | (6,515,700 | ) |
| Financing fees related party construction loans |  |  | (1,983,900 | ) |  |  | (396,900 | ) |
| Payments on financing leases |  |  | (289,000 | ) |  |  | (380,000 | ) |
| Proceeds from PPP loan |  |  | - |  |  |  | 582,800 |  |
| Payments on PPP loan |  |  | (9,300 | ) |  |  | - |  |
| Due to related party |  |  | - |  |  |  | (8,100 | ) |
| Repayments on note payable D&O insurance |  |  | (867,600 | ) |  |  | - |  |
| Net proceeds from issuance of common stock |  |  | 25,101,000 |  |  |  | 10,789,100 |  |
| Net proceeds from issuance of preferred stock |  |  | 28,661,000 |  |  |  | - |  |
| Repayment on equipment loans |  |  | (1,430,500 | ) |  |  | (476,700 | ) |
| Proceeds from exercise of stock options |  |  | 18,000 |  |  |  | - |  |
| Dividends |  |  | (560,900 | ) |  |  | - |  |
| Deferred offering cost |  |  | (68,300 | ) |  |  | - |  |
| NET CASH PROVIDED BY FINANCING ACTIVITIES |  |  | 82,864,700 |  |  |  | 11,851,300 |  |
|  |  |  |  |  |  |  |  |  |
| NET INCREASE IN CASH AND RESTRICTED CASH |  |  | 2,988,800 |  |  |  | 1,921,900 |  |
|  |  |  |  |  |  |  |  |  |
| CASH AND RESTRICTED CASH AT BEGINNING OF YEAR |  |  | 2,396,500 |  |  |  | 430,000 |  |
|  |  |  |  |  |  |  |  |  |
| CASH AND RESTRICTED CASH AT END OF PERIOD |  | $ | 5,385,300 |  |  | $ | 2,351,900 |  |
|  |  |  |  |  |  |  |  |  |
| SUPPLEMENTAL CASH FLOW INFORMATION |  |  |  |  |  |  |  |  |
| Interest paid |  | $ | 2,165,300 |  |  | $ | 1,266,300 |  |
|  |  |  |  |  |  |  |  |  |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES |  |  |  |  |  |  |  |  |
| Financing of assets additions |  | $ | 1,566,800 |  |  | $ | 2,002,900 |  |
| Dividends declared but not paid |  | $ | 210,600 |  |  | $ | - |  |
| New right of use obligations |  | $ | 166,800 |  |  | $ | - |  |
| Cancellation of finance leases |  | $ | 99,100 |  |  | $ | - |  |
| Amortization of debt discount capitalized |  | $ | 2,338,000 |  |  | $ | 1,323,300 |  |
| Stock issued for conversion of related party interest and principle |  | $ | - |  |  | $ | 497,000 |  |

See accompanying notes to the condensed consolidated financial statements.

(Amounts rounded to the nearest $100)

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| --- |
| 3 |

**HARBOR CUSTOM DEVELOPMENT, INC. AND SUBSIDIARIES**

**D/B/A HARBOR CUSTOM HOMES**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS’ EQUITY (DEFICIT)**

**For the Periods January 1, 2020 through September 30, 2020 and January 1, 2021 through September 30, 2021**

(Unaudited)

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |
|  |  | **Common Stock** | | | | | |  |  | **Preferred Stock** | | | | | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |
|  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  | **Additional** | |  |  |  | |  |  | **Stockholders’** | |  |  | **Non-** | |  |  | **Total** | |  |
|  |  | **Shares**  **Issued** | |  |  | **No**  **Par** | |  |  | **Shares**  **Issued** | |  |  | **No**  **Par** | |  |  | **Paid in Capital** | |  |  | **Accumulated**  **(Deficit )** | |  |  | **Equity (Deficit)** | |  |  | **Controlling**  **Interest** | |  |  | **Equity (Deficit)** | |  |
|  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |  |  | |  |
| **Balance, January 1, 2020** |  |  | **3,513,517** |  |  | **$** | **670,900** |  |  |  | **-** |  |  | **$** | **-** |  |  | **$** | **119,100** |  |  | **$** | **(954,300** | **)** |  | **$** | **(164,300** | **)** |  | **$** | **(1,060,600** | **)** |  | **$** | **(1,224,900** | **)** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds from issuance of common stock |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds from issuance of common stock, shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Conversion of related party debt to common stock |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Conversion of related party debt to common stock, shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Exercise of stock options |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Exercise of stock options, shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds issuance of preferred stock |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds issuance of preferred stock, shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Dividends |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Stock Compensation Expense |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Stock Compensation Expense, shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net Loss |  |  |  |  |  |  | - |  |  |  |  |  |  |  | - |  |  |  | - |  |  |  | (752,000 | ) |  |  | (752,000 | ) |  |  | (221,900 | ) |  |  | (973,900 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, March 31, 2020** |  |  | **3,513,517** |  |  | **$** | **670,900** |  |  |  | **-** |  |  | **$** | **-** |  |  | **$** | **119,100** |  |  | **$** | **(1,706,300** | **)** |  | **$** | **(916,300** | **)** |  | **$** | **(1,282,500** | **)** |  | **$** | **(2,198,800** | **)** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Stock Compensation Expense |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 1,100 |  |  |  |  |  |  |  | 1,100 |  |  |  |  |  |  |  | 1,100 |  |
| Net Loss |  |  |  |  |  |  | - |  |  |  |  |  |  |  | - |  |  |  | - |  |  |  | (431,100 | ) |  |  | (431,100 | ) |  |  | (3,000 | ) |  |  | (434,100 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, June 30, 2020** |  |  | **3,513,517** |  |  | **$** | **670,900** |  |  |  | **-** |  |  |  | **-** |  |  | **$** | **120,200** |  |  | **$** | **(2,137,400** | **)** |  | **$** | **(1,346,300** | **)** |  | **$** | **(1,285,500** | **)** |  | **$** | **(2,631,800** | **)** |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds from issuance of common stock |  |  | 2,031,705 |  |  |  | 10,789,100 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 10,789,100 |  |  |  |  |  |  |  | 10,789,100 |  |
| Conversion of related party debt to common stock |  |  | 82,826 |  |  |  | 497,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 497,000 |  |  |  |  |  |  |  | 497,000 |  |
| Stock Compensation Expense |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 9,900 |  |  |  |  |  |  |  | 9,900 |  |  |  |  |  |  |  | 9,900 |  |
| Net (Loss) |  |  |  |  |  |  |  |  |  |  |  |  |  |  | - |  |  |  |  |  |  |  | (437,100 | ) |  |  | (437,100 | ) |  |  | (3,200 | ) |  |  | (440,300 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, September 30, 2020** |  |  | **5,628,048** |  |  | **$** | **11,957,000** |  |  |  | **-** |  |  | **$** | **-** |  |  | **$** | **130,100** |  |  | **$** | **(2,574,500** | **)** |  | **$** | **9,512,600** |  |  | **$** | **(1,288,700** | **)** |  | **$** | **8,223,900** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, January 1, 2021** |  |  | **5,636,548** |  |  | **$** | **11,956,900** |  |  |  | **-** |  |  | **$** | **-** |  |  | **$** | **234,800** |  |  | **$** | **(4,487,100** | **)** |  | **$** | **7,704,600** |  |  | **$** | **(1,289,900** | **)** |  | **$** | **6,414,700** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds issuance of common stock |  |  | 9,200,000 |  |  |  | 25,101,000 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 25,101,000 |  |  |  |  |  |  |  | 25,101,000 |  |
| Exercise of stock options |  |  | 45,046 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 18,000 |  |  |  |  |  |  |  | 18,000 |  |  |  |  |  |  |  | 18,000 |  |
| Stock Compensation Expense |  |  | 8,500 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 115,100 |  |  |  |  |  |  |  | 115,100 |  |  |  |  |  |  |  | 115,100 |  |
| Net (Loss) Income |  |  |  |  |  |  |  |  |  |  |  |  |  |  | - |  |  |  |  |  |  |  | (1,549,800 | ) |  |  | (1,549,800 | ) |  |  | 600 |  |  |  | (1,549,200 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, March 31, 2021** |  |  | **14,890,094** |  |  | **$** | **37,057,900** |  |  |  | **-** |  |  | **$** | **-** |  |  | **$** | **367,900** |  |  | **$** | **(6,036,900** | **)** |  | **$** | **31,388,900** |  |  | **$** | **(1,289,300** | **)** |  | **$** | **30,099,600** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net proceeds issuance of preferred stock |  |  |  |  |  |  |  |  |  |  | 1,260,555 |  |  |  | 28,661,000 |  |  |  |  |  |  |  |  |  |  |  | 28,661,000 |  |  |  |  |  |  |  | 28,661,000 |  |
| Dividends |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | (140,100 | ) |  |  | (140,100 | ) |  |  |  |  |  |  | (140,100 | ) |
| Stock Compensation Expense |  |  | 8,500 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 115,800 |  |  |  |  |  |  |  | 115,800 |  |  |  | - |  |  |  | 115,800 |  |
| Net Income (Loss) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 1,071,700 |  |  |  | 1,071,700 |  |  |  | (2,300 | ) |  |  | 1,069,400 |  |
| **Balance, June 30, 2021** |  |  | **14,898,594** |  |  | **$** | **37,057,900** |  |  |  | **1,260,555** |  |  | **$** | **28,661,000** |  |  | **$** | **483,700** |  |  | **$** | **(5,105,300** | **)** |  | **$** | **61,097,300** |  |  | **$** | **(1,291,600** | **)** |  | **$** | **59,805,700** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Stock Compensation Expense |  |  | 23,500 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | 185,200 |  |  |  |  |  |  |  | 185,200 |  |  |  |  |  |  |  | 185,200 |  |
| Dividends |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | (631,400 | ) |  |  | (631,400 | ) |  |  |  |  |  |  | (631,400 | ) |
| Net Income (Loss) |  |  |  |  |  |  |  |  |  |  |  |  |  |  | - |  |  |  |  |  |  |  | 3,708,400 |  |  |  | 3,708,400 |  |  |  | - |  |  |  | 3,708,400 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Balance, September 30, 2021** |  |  | **14,922,094** |  |  | **$** | **37,057,900** |  |  |  | **1,260,555** |  |  | **$** | **28,661,000** |  |  | **$** | **668,900** |  |  | **$** | **(2,028,300** | **)** |  | **$** | **64,359,500** |  |  | **$** | **(1,291,600** | **)** |  | **$** | **63,067,900** |  |

See accompanying notes to the consolidated financial statements.

(Amounts rounded to the nearest $100)

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**1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations

The Company’s principal business activity involves acquiring raw land and developed lots for the purpose of building and selling single family and multi-family dwellings in Washington, California, Texas and Florida. It utilizes its heavy equipment resources to develop an inventory of finished lots and provide development infrastructure construction, on a contract basis, for other home builders. Single family construction and infrastructure construction contracts vary but are typically less than one year.

On August 1, 2019, the Company changed its name from Harbor Custom Homes, Inc. to Harbor Custom Development, Inc.

The Company became an effective filer with the Securities and Exchange Commission (“SEC”) and started trading on The Nasdaq Stock Market LLC (“Nasdaq”) on August 28, 2020.

Principles of Consolidation

The consolidated financial statements include the following subsidiaries of Harbor Custom Development, Inc. as of the reporting period ending dates as follows (all entities are formed as Washington LLCs):

SCHEDULE OF STATEMENT OF SUBSIDIARIES

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Names** |  | **Dates of Formation** | |  |  | **Attributable Interest** | | | | | |  |
|  |  |  | |  |  | **September 30,** | |  |  | **December 31,** | |  |
|  |  |  | |  |  | **2021** | |  |  | **2020** | |  |
| Saylor View Estates, LLC |  |  | March 30, 2014 |  |  |  | 51 | % |  |  | 51 | % |
| Belfair Apartments, LLC |  |  | December 3, 2019 |  |  |  | 100 | % |  |  | 100 | % |
| Pacific Ridge CMS, LLC |  |  | May 24, 2021 |  |  |  | 100 | % |  |  | N/A |  |
| Tanglewilde, LLC |  |  | June 25, 2021 |  |  |  | 100 | % |  |  | 100 | % |
| HCDI FL CONDO LLC |  |  | August 3, 2021 |  |  |  | 100 | % |  |  | N/A |  |
| HCDI Mira, LLC |  |  | August 30, 2021 |  |  |  | 100 | % |  |  | N/A |  |
| HCDI Wyndstone, LLC |  |  | September 15, 2021 |  |  |  | 100 | % |  |  | N/A |  |

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All intercompany transactions and balances have been eliminated in consolidation.

As of September 30, 2021 and December 31, 2020, the aggregate non-controlling interest was $(1,291,600) and $(1,289,900), respectively.

Basis of Presentation

The unaudited financial information furnished herein reflects all adjustments, consisting solely of normal recurring items, which in the opinion of management are necessary to fairly state the financial position of the Company and the results of its operations for the periods presented. This report should be read in conjunction with the Company’s consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2020 filed with the SEC on March 31, 2021. The Company assumes that the users of the interim financial information herein have read or have access to the audited financial statements for the preceding fiscal year and the adequacy of additional disclosure needed for a fair presentation may be determined in that context. The condensed consolidated balance sheet at December 31, 2020 was derived from the audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the interim periods presented are not necessarily indicative of results for the year ending December 31, 2021.

The Company’s Board of Directors and stockholders approved a 1-for-2.22 reverse split of the Company’s common stock, which was effected on April 15, 2020. The reverse split combined each 2.22 shares of the Company’s outstanding common stock into one share of common stock. No fractional shares were issued in connection with the reverse split, and any fractional shares resulting from the reverse split were rounded up to the nearest whole share. All references to common stock, options to purchase common stock, restricted stock, share data, per share data, and related information, as applicable have been adjusted in the financial statements to reflect the split of the common stock as if it had occurred at the beginning of the earliest period presented.

All numbers in these financial statements are rounded to the nearest $100.

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Use of Estimates

Management uses estimates and assumptions in preparing these financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Stock-Based Compensation

Effective as of November 19, 2018, the Company’s Board of Directors and stockholders approved and adopted the 2018 Incentive and Non-Statutory Stock Option Plan (the “2018 Plan”). The 2018 Plan allows the Administrator (as defined in the 2018 Plan), currently the Board of Directors, to determine the issuance of incentive stock options and non-qualified stock options to eligible employees and outside directors and consultants of the Company. The Company reserved 675,676 shares of common stock for issuance under the 2018 Plan.

Effective as of December 3, 2020, the Company’s Board of Directors and stockholders approved and adopted the 2020 Restricted Stock Plan (the “2020 Plan”). The 2020 Plan allows the Administrator (currently the Compensation Committee) to determine the issuance of restricted stock to eligible officers, directors, and key employees. The Company reserved 700,000 shares of common stock for issuance under the 2020 Plan.

The Company accounts for stock-based compensation in accordance with ASC Topic 718, “*Compensation – Stock Compensation”* (“ASC 718”) which establishes financial accounting and reporting standards for stock-based employee compensation. It defines a fair value-based method of accounting for an employee stock option or similar equity instrument.

The Company recognizes all forms of share-based payments, including stock option grants, warrants and restricted stock grants, at their fair value on the grant date, which is based on the estimated number of awards that are ultimately expected to vest.

Options and warrants are valued using a Black-Scholes option pricing model. Grants of share-based payment awards issued to non-employees for services rendered have been recorded at the fair value of the share-based payment. The grants are amortized on a straight-line basis over the requisite service periods, which is generally the vesting period. If an award is granted, but vesting does not occur, any previously recognized compensation expense is reversed in the period related to the termination of service.

Stock-based compensation expenses are included in selling, general and administrative expenses in the consolidated statement of operations.

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For the nine months ended September 30, 2021 and 2020 when computing fair value of share-based payments, the Company has considered the following variables:

SCHEDULE OF FAIR VALUE ASSUMPTIONS OF SHARE-BASED PAYMENTS

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **September 30, 2021** | |  |  | **September 30, 2020** | |  |
| Risk-free interest rate |  |  | 0.23%-1.11 | % |  |  | 0.47%-1.46 | % |
| Exercise price |  | $ | 2.76-$5.00 |  |  | $ | 2.22 - $7.50 |  |
| Expected life of grants |  |  | 2.50-6.5 years |  |  |  | 2.99 - 6.00 years |  |
| Expected volatility of underlying stock |  |  | 42.63%-56.13 | % |  |  | 32.39% - 43.41 | % |
| Dividends |  |  | 0 |  |  |  | 0 |  |

The expected term is computed using the “simplified” method as permitted under the provisions of ASC 718-10-S99. The Company uses the simplified method to calculate the expected term of share options and similar instruments as the Company does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate the expected term. The share price as of the grant date was determined by an independent third party 409(a) valuation until the Company’s stock became publicly traded. Now the share price is the public trading price at the time of grant. Expected volatility is based on the historical stock price volatility of comparable companies’ common stock, as the stock does not have sufficient historical trading activity. Risk free interest rates were obtained from U.S. Treasury rates for the applicable periods.

*Earnings (Loss) Per Share*

Earnings (Loss) per share (“EPS”) is the amount of earnings attributable to each share of common stock. For convenience, the term is used to refer to either earnings or loss per share. EPS is computed pursuant to Section 260-10-45 of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”). Pursuant to ASC Paragraphs 260-10-45-10 through 260-10-45-16, basic EPS shall be computed by dividing income available to common stockholders (the numerator) by the weighted-average number of common shares outstanding (the denominator) during the period. Income available to common stockholders shall be computed by deducting both the dividends declared in the period on preferred stock (whether or not paid) and the dividends accumulated for the period on cumulative preferred stock (whether or not earned) from income from continuing operations (if that amount appears in the income statement) and also from net income. The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued during the period to reflect the potential dilution that could occur from common shares issuable through contingent shares issuance arrangement, stock options or warrants.

The following table provides a reconciliation of the numerator and denominator used in computing basic and diluted net income (loss) attributable to common stockholders per common share.

|  |
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SCHEDULE OF NET INCOME (LOSS) PER SHARE

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
|  |  | For the Three Months  Ended | | | | | |  |  | For the Nine Months  Ended | | | | | |  |
|  |  | September 30, | | | | | |  |  | September 30, | | | | | |  |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
| Numerator: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net income (loss) attributable to common stockholders |  | $ | 3,077,000 |  |  | $ | (437,100 | ) |  | $ | 2,458,800 |  |  | $ | (1,620,200 | ) |
| Effect of dilutive securities: |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Diluted net income (loss) |  | $ | 3,077,000 |  |  | $ | (437,100 | ) |  | $ | 2,458,800 |  |  | $ | (1,620,200 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Denominator: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average common shares outstanding - basic |  |  | 14,898,594 |  |  |  | 4,180,054 |  |  |  | 14,350,143 |  |  |  | 3,737,318 |  |
| Dilutive securities (a): |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Options |  |  | 140,957 |  |  |  | - |  |  |  | 145,884 |  |  |  | - |  |
| Warrants |  |  | 19,367 |  |  |  | - |  |  |  | 19,683 |  |  |  | - |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average common shares outstanding and assumed |  |  | 15,058,918 |  |  |  | 4,180,054 |  |  |  | 14,515,710 |  |  |  | 3,737,318 |  |
| conversion – diluted |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Basic net income (loss) per common share |  | $ | 0.21 |  |  | $ | (0.10 | ) |  | $ | 0.17 |  |  | $ | (0.43 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Diluted net income (loss) per common share |  | $ | 0.20 |  |  | $ | (0.10 | ) |  | $ | 0.17 |  |  | $ | (0.43 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| (a) - Anti-dilutive securities excluded: |  |  | 9,379,890 |  |  |  | 164,308 |  |  |  | 9,379,890 |  |  |  | 164,308 |  |

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Fair Value of Financial Instruments

For purpose of this disclosure, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. The carrying amount of the Company’s short-term financial instruments approximates fair value due to the relatively short period to maturity for these instruments.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents. There were no cash equivalents as of September 30, 2021 and December 31, 2020.

Restricted Cash

On August 10, 2021, the Company entered a Letter of Credit (“LOC”) agreement with WaFd bank in the amount of $597,600. The Company signed a lease on October 5, 2021 for a new office space. The landlord of the property, University Street Properties I, LLC, is the beneficiary of the LOC. The amount of funds that cover this LOC were moved by the WaFd bank to a controlled account on August 13, 2021. See footnote 7.

Accounts Receivable

Accounts receivables are reported at the amount the Company expects to collect from outstanding balances. The Company provides an allowance for doubtful accounts based upon a review of the outstanding accounts receivable, historical collection information and existing economic conditions. The Company determines if receivables are past due based on days outstanding, and amounts are written off when determined to be uncollectible by management. The allowance for doubtful accounts was $11,000 and $0 as of September 30, 2021 and December 31, 2020, respectively.

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Property and Equipment and Depreciation

Property and equipment are recorded at cost. Expenditures for major additions and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. Depreciation is computed by the straight-line method (after considering their respective estimated residual values) over the estimated useful lives:

SCHEDULE OF PROPERTY AND EQUIPMENT ESTIMATED USEFUL LIVES

|  |  |
| --- | --- |
| Construction Equipment | 5-10 years |
| Leasehold Improvements | The lesser of 10 years or the remaining life of the lease |
| Furniture and Fixtures | 5 years |
| Computers | 3 years |
| Vehicles | 10 years |

Real Estate Assets

Real estate assets are recorded at cost, except when real estate assets are acquired that meet the definition of a business combination in accordance with FASB ASC 805, “Business Combinations,” where acquired assets are recorded at fair value. Interest, property taxes, insurance and other incremental costs (including salaries) directly related to a project are capitalized during the construction period of major facilities and land improvements. The capitalization period begins when activities to develop the parcel commence and ends when the asset constructed is completed. The capitalized costs are recorded as part of the asset to which they relate and are expensed when the underlying asset is sold.

The Company capitalized interest from related party borrowings of $152,800 and $203,600 for the three months ended September 30, 2021 and 2020, respectively. The Company capitalized interest from related party borrowings of $557,200 and $840,000 for the nine months ended September 30, 2021 and 2020, respectively. The Company capitalized interest from third-party borrowings of $298,200 and $783,100 for the three months ended September 30, 2021 and 2020, respectively. The Company capitalized interest from third-party borrowings of $774,000 and $1,834,000 for the nine months ended September 30, 2021 and 2020, respectively.

A property is classified as “held for sale” when all the following criteria for a plan of sale have been met:

(1) Management, having the authority to approve the action, commits to a plan to sell the property;

(2) The property is available for immediate sale in its present condition, subject only to terms that are usual and customary;

(3) An active program to locate a buyer and other actions required to complete the plan to sell, have been initiated;

(4) The sale of the property is probable and is expected to be completed within one year of the contract date;

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(5) The property is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and

(6) Actions necessary to complete the plan of sale indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

When all these criteria have been met, the property is classified as “held for sale.”

In addition to the annual assessment of potential triggering events in accordance with ASC 360, the Company applies a fair value-based impairment test to the net book value assets on an annual basis and on an interim basis if certain events or circumstances indicate that an impairment loss may have occurred.

As of September 30, 2021 and December 31, 2020, the Company did not have any projects that qualified for an impairment charge.

Revenue and Cost Recognition

ASC 606, Revenue from Contracts with Customers (“ASC 606”), establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity’s contract to provide goods or services to customers.

In accordance with ASC 606, revenue is recognized when a customer obtains control of the promised good or service. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods or services. The provision of ASC 606 includes a five-step process by which the Company determines revenue recognition, depicting the transfer of goods or services to customers in amounts reflecting the payment to which the Company expects to be entitled in exchange for those goods or services.

ASC 606 requires the Company to apply the following steps: (1) identify the contract with the customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, performance obligations are satisfied.

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A detailed breakdown of the five-step process for the revenue recognition of Entitled Land Revenue is as follows:

*1. Identify the contract with a customer.*

The Company signs an agreement with a buyer to purchase the parcel of entitled land.

*2. Identify the performance obligations in the contract.*

Performance obligations of the Company include delivering entitled land to the customer, which are required to meet certain specifications outlined in the contract.

*3. Determine the transaction price.*

The transaction price is fixed and specified in the contract. Any subsequent change orders or price changes are required to be approved by both parties.

*4. Allocation of the transaction price to performance obligations in the contract.*

The parcel is a separate performance obligation for which the specific price is in the contract.

*5. Recognize revenue when (or as) the entity satisfies a performance obligation.*

The Company recognizes revenue when title is transferred. The Company does not have any further performance obligations once title is transferred.

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A detailed breakdown of the five-step process for the revenue recognition of Developed Lots Revenue is as follows:

*1. Identify the contract with a customer.*

The Company signs an agreement with the buyer to purchase lots that have completed infrastructure.

*2. Identify the performance obligations in the contract.*

Performance obligations of the Company include delivering developed lots to the customer, which are required to meet certain specifications that are outlined in the contract.

*3. Determine the transaction price.*

The transaction price is fixed and specified in the contract. Any subsequent change orders or price changes are required to be approved by both parties.

*4. Allocation of the transaction price to performance obligations in the contract.*

All lots are a single performance obligation for the specific price in the contract.

*5. Recognize revenue when (or as) the entity satisfies a performance obligation.*

The Company recognizes revenue when title is transferred. The Company does not have any further performance obligations once title is transferred.

A detailed breakdown of the five-step process for the revenue recognition of Fee Build Revenue is as follows:

*1. Identify the contract with a customer.*

The Company signs an agreement with a customer to construct the required infrastructure so that houses can be developed on the lots.

*2. Identify the performance obligations in the contract.*

Performance obligations of the Company include delivering developed lots which are required to meet certain specifications that are outlined in the contract.

*3. Determine the transaction price.*

The transaction price is fixed and specified in the contract. Any subsequent change orders or price changes are required to be approved by both parties.

*4. Allocation of the transaction price to performance obligations in the contract.*

The nature of the industry involves a number of uncertainties that can affect the current state of the contract. Variable considerations are the estimates made due to a contract modification in the contractual service. Change orders, claims, extras, or back charges are common in contractual services activity as a form of variable consideration. If there is going to be a contract modification, judgment by management will need to be made to determine if the variable consideration is enforceable. The following factors are considered in determining if the variable consideration is enforceable:

|  |  |  |
| --- | --- | --- |
|  | 1. | The customer’s written approval of the scope of the change order; |
|  | 2. | Current contract language that indicates clear and enforceable entitlement relating to the change order; |
|  | 3. | Separate documentation for the change order costs that are identifiable and reasonable; and |
|  | 4. | The Company’s experience in negotiating change orders, especially as it relates to the specific type of contract and change order being evaluated. |

Once the Company receives a contract, it generates a budget of projected costs for the contract based on the contract price. If the scope of the contract during the contractual period needs to be modified, the Company files a change order. The Company does not continue to perform services until the change modification is agreed upon with documentation by both the Company and the customer. There are few times that claims, extras, or back charges are included in the contract.

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If there are multiple performance obligations to the contract, the costs must be allocated appropriately and consistently to each performance obligation. In the Company’s experience, usually only one performance obligation is stated per contract. If there are multiple services provided for one customer, the Company has a policy of splitting out the services over multiple contracts.

*5. Recognize revenue when (or as) the entity satisfies a performance obligation.*

The Company uses the total costs incurred on the project relative to the total expected costs to satisfy the performance obligation. The input method involves measuring the resources consumed, labor hours expended, costs incurred, time lapsed, or machine hours used relative to the total expected inputs to the satisfaction of the performance obligation. Costs incurred prior to actual contract (i.e., design, engineering, procurement of material, etc.) should not be recognized as the Company does not have control of the good/service provided. When the estimate on a contract indicates a loss or claims against costs incurred reduce the likelihood of recoverability of such costs, the Company records the entire estimated loss in the period the loss becomes known. Project contracts typically provide for a schedule of billings or invoices to the customer based on the Company’s job to date percentage of completion of specific tasks inherent in the fulfillment of its performance obligation(s). The schedules for such billings usually do not precisely match the schedule on which costs are incurred. As a result, contract revenue recognized in the statement of operations can and usually does differ from amounts that can be billed or invoiced to the customer at any point during the contract. Amounts by which cumulative contract revenue recognized on a contract as of a given date exceed cumulative billings and unbilled receivables to the customer under the contract are reflected as a current asset in the Company’s balance sheet under the caption “Contract Asset” which is further disclosed in Note 15. Amounts by which cumulative billings to the customer under a contract as of a given date exceed cumulative contract revenue recognized on the contract are reflected as a current liability in the Company’s balance sheet under the caption “Billings in excess of costs and estimated earnings.”

A detailed breakdown of the five-step process for the revenue recognition of Home Revenue is as follows:

*1. Identify the contract with a customer.*

The Company signs an agreement with a home buyer to purchase a lot with a completed house.

*2. Identify the performance obligations in the contract.*

Performance obligations of the Company include delivering a developed lot with a completed house to the customer, which is required to meet certain specifications that are outlined in the contract.

*3. Determine the transaction price.*

The transaction price is fixed and specified in the contract. Any subsequent change orders or price changes are required to be approved by both parties.

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*4. Allocation of the transaction price to performance obligations in the contract.*

Each lot with a completed house is a separate performance obligation, for which the specific price in the contract is allocated.

*5. Recognize revenue when (or as) the entity satisfies a performance obligation.*

The Company recognizes revenue when title is transferred. The Company does not have any further performance obligations once title is transferred.

A detailed breakdown of the five-step process for the revenue recognition of Construction Materials sold to or received from contractors is as follows:

*1. Identify the contract with a customer.*

There are no signed contracts. Each transaction is verbally agreed to with the customer.

*2. Identify the performance obligations in the contract.*

The Company delivers or receives materials from customers based on the verbal agreement reached.

*3. Determine the transaction price.*

The Company has a set price list for receiving approved fill materials to recycle or provides customers with a combination of said materials.

*4. Allocation of the transaction price to performance obligations in the contract.*

There is only one performance obligation, which is to pick up or deliver the materials. The entire transaction price is therefore allocated to the performance obligation.

*5. Recognize revenue when (or as) the entity satisfies a performance obligation.*

The performance obligation is fulfilled, and revenue is recognized when the materials have been received or delivered by the Company.

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Revenues from contracts with customers are summarized by category as follows for the three and nine months ended September 30:

SCHEDULE OF REVENUES FROM CONTRACTS WITH CUSTOMERS

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
|  |  | For the Three Months Ended | | | | | |  |  | For the Nine Months Ended | | | | | |  |
|  |  | September 30, | | | | | |  |  | September 30, | | | | | |  |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
| Entitled Land |  | $ | 10,440,000 |  |  | $ | - |  |  | $ | 19,750,000 |  |  | $ | - |  |
| Developed Lots |  |  | 770,000 |  |  |  | - |  |  |  | 7,770,000 |  |  |  | - |  |
| Fee Build |  |  | 2,871,300 |  |  |  | - |  |  |  | 4,219,500 |  |  |  | - |  |
| Homes |  |  | 3,762,000 |  |  |  | 7,704,300 |  |  |  | 13,947,900 |  |  |  | 25,625,300 |  |
| Construction Materials |  |  | 167,300 |  |  |  | 102,200 |  |  |  | 329,800 |  |  |  | 452,000 |  |
| Total Revenue |  | $ | 18,010,600 |  |  | $ | 7,806,500 |  |  | $ | 46,017,200 |  |  | $ | 26,077,300 |  |

Disaggregation of Revenue from Contracts with Customers

The following table disaggregates the Company’s revenue based on the type of sale or service and the timing of satisfaction of performance obligations for the three and nine months ended September 30, 2021 and 2020:

 DISAGGREGATION OF REVENUE FROM CONTRACTS WITH CUSTOMERS

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
|  |  | For the Three Months Ended | | | | | |  |  | For the Nine Months Ended | | | | | |  |
|  |  | September 30, | | | | | |  |  | September 30, | | | | | |  |
|  |  | **2021** | |  |  | **2020** | |  |  | **2021** | |  |  | **2020** | |  |
| Performance obligations satisfied at a point in time |  | $ | 15,139,300 |  |  | $ | 7,806,500 |  |  | $ | 41,797,700 |  |  | $ | 26,077,300 |  |
| Performance obligations satisfied over time |  |  | 2,871,300 |  |  |  | - |  |  |  | 4,219,500 |  |  |  | - |  |
| Total Revenue |  | $ | 18,010,600 |  |  | $ | 7,806,500 |  |  | $ | 46,017,200 |  |  | $ | 26,077,300 |  |

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Cost of Sales

Land acquisition costs are allocated to each lot based on the size of the lot in relation to the size of the total project. Development cost and capitalized interest are allocated to lots sold based on the same criteria.

Costs relating to the handling of recycled construction materials and converting items into usable construction materials for resale are charged to cost of sales as incurred.

Advertising

Costs for designing, producing and communicating advertising are expensed as incurred. Advertising expense for the three months ended September 30, 2021 and 2020 was $15,600 and $0, respectively.

Advertising expense for the nine months ended September 30, 2021 and 2020 was $27,600 and $8,500, respectively.

Leases

On January 1, 2019, the Company adopted ASU 2016-02 “*Leases”* (Topic 842) which amended guidance for lease arrangements to increase transparency and comparability by providing additional information to users of financial statements regarding an entity’s leasing activities.

As part of the adoption the Company elected the practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the Company to:

|  |  |  |
| --- | --- | --- |
|  | 1. | Not separate non-lease components from lease components and instead to account for each separate lease component and the non-lease components associated with that lease component as a single lease; |
|  |  |  |
|  | 2. | Not to apply the recognition requirements in ASC 842 to short-term leases; and |
|  |  |  |
|  | 3. | Not record a right of use asset or right of use liability for leases with an asset or liability balance that would be considered immaterial. |

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Income Taxes

Deferred income tax assets and liabilities are determined based on the estimated future tax effects of net operating loss, credit carryforwards and temporary differences between the tax basis of assets and liabilities and their respective financial reporting amounts measured at the current enacted tax rates. Management applies the criteria established in the FASB released Accounting Standards Update No. 2019-12, Income taxes (Topic 740) (the Update) to determine if any valuation allowances are needed each year.

The Company recognizes a tax benefit for an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. There are no uncertain tax positions as of September 30, 2021 and December 31, 2020.

Recent Accounting Pronouncements

On December 18, 2019, the FASB released Accounting Standards Update No. 2019-12, Income taxes (Topic 740) (the Update). The Board issued this update as part of its initiative to reduce complexity in accounting standards. The Standard is effective for fiscal years beginning after December 15, 2020. The adoption did not have a material impact on the Company.

In August 2020, the FASB issued Accounting Standards Update 2020-06, Debt — Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity’s Own Equity (Subtopic 815-40) (“ASU 2020-06”) to simplify accounting for certain financial instruments. ASU 2020-06 eliminates the current models that require separation of beneficial conversion and cash conversion features from convertible instruments and simplifies the derivative scope exception guidance pertaining to equity classification of contracts in an entity’s own equity. The new standard also introduces additional disclosures for convertible debt and freestanding instruments that are indexed to and settled in an entity’s own equity. ASU 2020-06 amends the diluted earnings per share guidance, including the requirement to use the if-converted method for all convertible instruments. ASU 2020-06 is effective January 1, 2022 and should be applied on a full or modified retrospective basis, with early adoption permitted beginning on January 1, 2021. The Company adopted ASU 2020-06 on January 1, 2021. The adoption of ASU 2020-06 did not have an impact on the Company.

On May 3, 2021, the FASB released Accounting Standards Update No. 2021-04, Compensation – Earning Per Share (Topic 260), Debt - Modifications and Extinguishments (subtopic 470-50), Compensation - Stock compensation (Topic 718), Contracts in Entity’s Own Equity (Subtopic 815-40) Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options. FASB issued this update to clarify and reduce diversity in an issuer’s accounting for modifications or exchanges of freestanding equity-classified written call options (for example warrants) that remain equity classified after modification or exchange. The Standard is effective for fiscal years beginning after December 15, 2021. The Company does not believe the adoption will have a material impact on the Company.

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Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or circumstances indicate that the carrying value of such assets may not be fully recoverable. Impairment is present when the sum of estimated undiscounted future cash flow expected to result from use of the assets is less than carrying value. If impairment is present, the carrying value of the impaired asset is reduced to its fair value. Fair value is determined based on discounted cash flow or appraised values, depending on the nature of the assets. As of September 30, 2021 and December 31, 2020, there were no impairment losses recognized for long-lived assets.

Offering Costs Associated with a Public Offering

The Company complies with the requirements of FASB ASC 340-10-S99-1 and SEC Staff Accounting Bulletin (“SAB”) Topic 5A — “*Expenses of Offering.”*

On January 15 and 20, 2021, the Company closed on a follow-on public offering and over-allotment option, respectively, of common stock. During 2020, the Company incurred approximately $65,100 of capitalizable costs associated with the follow-on public offering, which were netted against the proceeds received in 2021. These costs were capitalized as of December 31, 2020 and are shown on the Balance Sheet as Deferred Offering Costs.

As of September 30, 2021, the Company incurred approximately $133,400 of capitalizable costs associated with a preferred stock offering which will be netted against proceeds of the offering and is discussed in footnote 16 subsequent events.

**2. CONCENTRATION, RISKS, AND UNCERTAINTIES**

Cash Concentrations

The Company maintains cash balances at various financial institutions. These balances are secured by the Federal Deposit Insurance Corporation. These balances generally exceed the federal insurance limits. Uninsured cash balances were $4,264,400 and $2,146,000 as of September 30, 2021 and December 31, 2020, respectively.

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Revenue Concentrations

Homes

For the three months ended September 30, 2021, five customers each represented 19% of homes revenue. For the nine months ended September 30, 2021, there were no concentrations in relation to the homes revenue segment. For the three and nine months ended September 30, 2020, there were no concentrations in relation to the homes revenue segment.

Completed Lots

For the three months ended September 30, 2021, three customers represented 38%, 38%, and 24% of completed lots revenue, respectively. For the three months ended September 30, 2020, there were no concentrations in relation to the completed lots revenue segment. For the nine months ended September 30, 2021 and 2020, Lennar Northwest, Inc. (“Lennar”) represented 90% and 0% of the completed lots revenue, respectively.

Entitled Land

For the three months ended September 30, 2021 and 2020, Lennar represented 100% and 0% of entitled land revenue, respectively. For the nine months ended September 30, 2021 and 2020, Lennar represented 100% and 0% of entitled land revenue, respectively.

Fee Build

For the three months ended September 30, 2021 and 2020, Lennar represented 100% and 0% of fee build revenue, respectively. For the nine months ended September 30, 2021 and 2020, Lennar represented 100% and 0% of fee build revenue, respectively.

COVID-19

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (“*COVID-19*”) as a pandemic which continues to spread throughout the United States and the world. The Company is monitoring the outbreak of COVID-19 and the related business and travel restrictions and changes to behavior intended to reduce its spread, in addition to the impact on its employees. Due to the rapid development and fluidity of this situation, the magnitude and duration of the pandemic and its impact on the Company’s operations and liquidity are uncertain as of the date of this report.

The COVID-19 Pandemic has had the following effect on the Company’s business:

|  |  |
| --- | --- |
| 1. | Construction not related to safety, spoliation, or critical infrastructure was halted by Washington State Governor Inslee (the “Governor”) on March 23, 2020. Some operations could continue based on the aforementioned exceptions to the shutdown order, but the Company did experience a significant operational slowdown. |
| 2. | Soundview Estates (a large Harbor Custom Development, Inc. site) continued selective activities that yielded rock byproduct, considered an essential material, needed for critical infrastructure projects for an Amazon distribution center and a local hospital. |
| 3. | On April 24, 2020, the Governor approved the restart of most residential housing projects, deeming them essential, as long as they adhered to certain safety measures. Under this order, most existing permitted residential homes or projects were considered essential. The order allowed the Company to resume near full construction activities on all permitted lots. |
| 4. | On May 1, 2020, the Governor established a four-phase plan for Washington businesses to follow. All Harbor Custom Development, Inc. development sites were in Phase 3 of the plan where construction was able to continue, and new construction was allowed, as long as the Company created a safety plan adhering to certain safety practices, which the Company had done. |
| 5. | As of June 30, 2021, Washington State reopened the state under the Washington Ready plan. All industry sectors previously covered by the Roadmap to Recovery or the Safe Start Plan (which included all Harbor Custom Development, Inc. operational activities) returned to usual capacity and operations. |

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The Company has not, at this time, experienced any cancelled sales contracts. The Company has experienced some supply-chain issues with both cabinetry and appliances related to COVID-19. As of the date of this report, the Company’s projects are on-schedule and operations are not being materially impacted by the COVID-19 pandemic. While there could ultimately be a material impact on operations and liquidity of the Company, at the time of issuance of this report, the ultimate impact could not be determined.

**3. PROPERTY AND EQUIPMENT**

Property and equipment stated at cost, less accumulated depreciation and amortization, consisted of the following:

SCHEDULE OF PROPERTY AND EQUIPMENT

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **September 30, 2021** | |  |  | **December 31, 2020** | |  |
|  |  |  | |  |  |  | |  |
| Machinery and Equipment |  | $ | 10,557,100 |  |  | $ | 8,908,000 |  |
| Vehicles |  |  | 71,800 |  |  |  | 73,500 |  |
| Furniture and Fixtures |  |  | 147,500 |  |  |  | 136,300 |  |
| Leasehold Improvements |  |  | 7,000 |  |  |  | 7,000 |  |
|  |  |  |  |  |  |  |  |  |
| Total Fixed Assets |  |  | 10,783,400 |  |  |  | 9,124,800 |  |
|  |  |  |  |  |  |  |  |  |
| Less Accumulated Depreciation |  |  | (1,650,500 | ) |  |  | (948,800 | ) |
|  |  |  |  |  |  |  |  |  |
| Fixed Assets, Net |  | $ | 9,132,900 |  |  | $ | 8,176,000 |  |

Depreciation expense was $300,400 and $133,400 for the three months ended September 30, 2021 and 2020, respectively.

Depreciation expense was $783,500 and $419,200 for the nine months ended September 30, 2021 and 2020, respectively.

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**4. REAL ESTATE**

Real Estate consisted of the following components:

SCHEDULE OF REAL ESTATE

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **September 30, 2021** | |  |  | **December 31, 2020** | |  |
|  |  |  | |  |  |  | |  |
| Land Held for Development |  | $ | 77,841,100 |  |  | $ | 9,532,800 |  |
| Construction in Progress |  |  | 23,620,300 |  |  |  | 9,042,700 |  |
| Held for Sale |  |  | 4,002,300 |  |  |  | 1,794,800 |  |
| Real estate |  | $ | 105,463,700 |  |  | $ | 20,370,300 |  |

**5. EQUIPMENT LOANS**

Consists of the following:

SCHEDULE OF EQUIPMENT LOANS

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **September 30, 2021** | |  |  | **December 31, 2020** | |  |
|  |  |  | |  |  |  | |  |
| Various notes payable to banks and financial institutions with interest rates varying from 0.00% to 13.89%, collateralized by equipment with monthly payments ranging from $400 to $11,600 through 2026: |  | $ | 5,731,800 |  |  | $ | 5,595,500 |  |
| Book value of collateralized equipment: |  | $ | 7,840,900 |  |  | $ | 6,475,600 |  |

Future equipment loan maturities are as follows:

For the twelve months ended September 30:

SCHEDULE OF FUTURE EQUIPMENT LOAN MATURITIES

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  |  |  |  |
| 2022 |  | $ | 1,876,900 |  |
| 2023 |  |  | 1,787,700 |  |
| 2024 |  |  | 1,652,200 |  |
| 2025 |  |  | 410,200 |  |
| 2026 |  |  | 4,800 |  |
|  |  |  |  |  |
| Equipment Loans |  | $ | 5,731,800 |  |

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**6. CONSTRUCTION LOANS**

The Company has various construction loans with private individuals and finance companies. The loans are collateralized by specific construction projects. All loans have a one-year term but will be refinanced if the project is not completed within one year and will be due upon the completion of the project. Interest accrues on the loans and is included with the payoff of the loan. Interest ranges from 5% to 39%. Interest expense and amortization of debt discount are capitalized when incurred and expensed as cost of goods sold when the corresponding property is sold. The loan balances related to third party lenders as of September 30, 2021 and December 31, 2020, were $39,560,700 and $10,092,500, respectively. The book value of collateralized real estate as of September 30, 2021 and December 31, 2020 was $105,463,700 and $20,370,300, respectively.

**7. LINE OF CREDIT**

The Company entered into a Line of credit (“LOC”) agreement with WaFd bank of $597,600 on August 10, 2021. There was no borrowing against the LOC as of September 30, 2021. The LOC expires February 1, 2032. The interest rate of the LOC is Prime plus 1%. The LOC has been established for the purpose of collateralizing the Company’s lease obligations with their new landlord, the landlord is the beneficiary of the LOC. As of September 30, 2021, there was $0 outstanding on the LOC.

**8. NOTE PAYABLE D&O INSURANCE**

The Company purchased D&O insurance on August 28, 2020 for $1,531,900. A down payment of $306,400 was made and the remaining balance of $1,225,500 was financed over ten months. The interest rate on the loan is 4.74%. The loan balance as of September 30, 2021 and December 31, 2020 was $0 and $741,200, respectively.

The Company purchased D&O insurance on September 1, 2021 for $1,541,400. A down payment of $131,100 was made and the remaining balance of $1,410,300 was financed over ten months. The interest rate on the loan is 4.42%. The loan balance as of September 30, 2021 and December 31, 2020 was $1,284,000 and $0, respectively.

**9. NOTE PAYABLE PPP**

On April 11, 2020, the Company entered into a term note with Timberland Bank, with a principal amount of $582,800 pursuant to the Paycheck Protection Program (“PPP Loan”) under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). The PPP Loan is evidenced by a promissory note (“PPP Term Note”). The PPP Term Note bears interest at a fixed annual rate of 1.00%, with the first six months of interest deferred. Beginning in November 2020, 18 equal monthly payments of principal and interest were due with the final payment due in April 2022. The PPP Term Note may be accelerated upon the occurrence of an event of default.

The PPP Term Note is unsecured and guaranteed by the United States Small Business Administration. The Company may apply for forgiveness of the PPP Term Note, with the amount which may be forgiven equal to the sum of payroll costs, covered rent and mortgage obligations, and covered utility payments incurred by the Company during the applicable period beginning upon receipt of PPP Term Note funds, calculated in accordance with the terms of the CARES Act.

On November 9, 2020 and February 1, 2021, the SBA forgave $562,300 and $10,000, respectively, on the PPP Loan.

As of September 30, 2021 and December 31, 2020, the balance of the PPP Loan was $0 and $19,300, respectively.

**10. DEFINED CONTRIBUTION PLAN**

Effective January 1, 2016, the Company established a 401(k) plan for qualifying employees; employee contributions are voluntary. Company contributions to the plan for the three months ended September 30, 2021 and 2020 were $24,900 and $0, respectively. Company contributions to the plan for the nine months ended September 30, 2021 and 2020 were $74,500 and $0, respectively.

**11. COMMITMENTS**

From time to time the Company is subject to compliance audits by federal, state and local authorities relating to a variety of regulations including wage and hour laws, taxes, and workers’ compensation. There are no significant or pending litigation or regulatory proceedings known at this time.

On September 17, 2020, the Company entered into a purchase and sale agreement for the acquisition of 9.6 acres of land in Port Orchard, Washington for $1,440,000. Closing is contingent on permit approval and is expected to take place on or before November 28, 2021.

On June 15, 2020, the Company entered into a purchase and sale agreement to acquire property for the construction of 30 townhomes located in East Bremerton, Washington for $2,040,000. Closing is expected to take place on or before June 30, 2022.

On August 8, 2021, the Company entered into a purchase and sale agreement to acquire property for the construction of 75 condominiums units located in Yelm, Washington for $3,250,000. Closing took place on October 4, 2021. See subsequent event footnote 16.

On August 30, 2020, the Company entered into a purchase and sale agreement for the acquisition of 67 lot in Auburn, California. Closing is expected to take place on or before August 30, 2022.

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**12. RELATED PARTY TRANSACTIONS**

Notes Payable

The Company entered into construction loans with Sound Equity, LLC of which Robb Kenyon, a former director and minority shareholder, is a partner. These loans were originated between April 2019 and January 2021; all of the loans have a one-year maturity with interest rates ranging between 8.49% and 12.00%. For the three months ended September 30, 2021 and 2020, the Company incurred loan origination fees of $0 and $178,500, respectively. For the nine months ended September 30, 2021 and 2020, the Company incurred loan origination fees of $552,800 and $283,300, respectively. These fees are recorded as debt discount and amortized over the life of the loan. The amortization is capitalized to real estate. As of September 30, 2021, and December 31, 2020, there were $292,600 and $202,500 of remaining debt discounts, respectively. During the three months ended September 30, 2021 and 2020 the Company incurred prepaid interest of $0 and $296,100, respectively. During the nine months ended September 30, 2021 and 2020 the Company incurred prepaid interest of $1,431,100 and $840,000, respectively. This interest is recorded as debt prepaid interest and amortized over the life of the loan. The interest is capitalized to real estate. As of September 30, 2021, and December 31, 2020 there were $1,123,700 and $466,600 of remaining prepaid interest reserves, respectively. As of September 30, 2021, and December 31, 2020 the outstanding loan balances were $12,792,300 and $6,489,900, respectively.

The Company entered into a construction loan with Curb Funding, LLC of which Robb Kenyon a former director and minority shareholder, is 100% owner. The loan originated on August 13, 2020. The loan has a one-year maturity with an interest rate of 12%. As of September 30, 2021 and December 31, 2020, the Company incurred loan fees of $0 and $3,500, respectively. These fees are recorded as debt discount and amortized over the life of the loan. The amortization is capitalized to real estate. As of September 30, 2021, and December 31, 2020, there were $0 and $1,100 of remaining debt discounts, respectively. As of September 30, 2021, and December 31, 2020, the outstanding loan balances were $0, and $51,800, respectively. The Company incurred interest expense of $2,800 and $0 for the nine months ended September 30, 2021 and 2020, respectively.

Robb Kenyon resigned as a director of the Company on July 8, 2021.

On April 19, 2019, the Company entered into a construction loan with Olympic Views, LLC of which the Company’s Chief Executive Officer and President previously owned a 50% interest. The loan amount was $442,000 with an interest rate of 12% and a maturity date of April 19, 2020. The loan was collateralized by a deed of trust on the land. The amounts outstanding were $0 and $0 as of September 30, 2021 and December 31, 2020, respectively. The interest expense was $0 and $8,900 for the three months ended September 30, 2021 and 2020 and was capitalized as part of Real Estate The interest expense was $0 and $41,900 for the nine months ended September 30, 2021 and 2020 and was capitalized as part of Real Estate. In May 2020, the Company entered into an agreement with Olympic Views, LLC to convert this debt and accrued interest of $55,000 to common stock at the Initial Public Offering price of $6.00. This conversion was effected on August 28, 2020 simultaneous with the Initial Public Offering. This transaction resulted in 82,826 shares of common stock being issued to Olympic Views, LLC.

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Due to Related Party

The Company utilizes a quarry to process waste materials from the completion of raw land into sellable/buildable lots. The quarry is located on land owned by SGRE, LLC which is 100% owned by the Company’s Chief Executive Officer and President. The materials produced by the quarry and sold by the Company to others are subject to a 25% commission payable to SGRE, LLC. On September 30, 2021 and December 31, 2020, the commission payable was $8,200 and $0, respectively. The commission expense for the three months ended September 30, 2021 and 2020, was $17,100 and $209,100, respectively. The commission expense for the nine months ended September 30, 2021 and 2020, was $72,800 and $209,100, respectively.

Richard Schmidtke, a Company director, provided accounting services in 2021 and 2020 to the Company. On September 30, 2021 and December 31, 2020, the fees payable to Mr. Schmidtke were $0 and $500, respectively. The accounting expense incurred by the Company for Mr. Schmidtke’s services for the three months ended September 30, 2021 and 2020 was $500 and $6,000, respectively. The accounting expense incurred by the Company for Mr. Schmidtke’s services for the nine months ended September 30, 2021 and 2020 was $1,000 and $40,300, respectively.

Land Purchase from a Related Party

On September 2, 2020, the Company purchased 99 unfinished lots for $3,430,000 from Olympic Views, LLC. The Company’s Chief Executive Officer and President owned a 50% interest in this LLC at the date of purchase. He currently has no ownership interest in this LLC.

**13. STOCKHOLDERS’ EQUITY**

Common Stock

The Company is authorized to issue 50,000,000 shares of common stock, at no par value per share. At September 30, 2021, the Company has 14,922,094 shares of common stock issued and outstanding.

Each share of common stock has one vote per share for all purposes. Common stock does not provide any preemptive, subscription or conversion rights and there are no redemption or sinking fund provisions or rights. Common stockholders are not entitled to cumulative voting for purposes of electing members to the Board of Directors.

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Preferred Stock

At September 30, 2021, the Company is authorized to issue 10,000,000 shares of preferred stock, at no par value per share. As of September 30, 2021, the Company has 1,260,555 shares of Series A Cumulative Convertible Preferred Stock (“Series A Preferred Shares”) issued and outstanding. The holders of the Series A Preferred Shares are entitled to receive dividends at a rate of 8% per annum payable monthly in arrears starting June 30, 2021 and are entitled to a liquidation preference equal to $25.00 per share plus all accrued and unpaid dividends. Beginning on June 9, 2024, the Company may, at its option, redeem the Series A Preferred Shares, in whole or in part, by paying $25.00 per share, plus any accrued and unpaid dividends to but not including the date of redemption. To the extent declared by the board of Directors, dividends will be payable not later than 20 days after the end of each calendar month. Dividends on the Series A Preferred Shares will accumulate whether or not the Company has earnings, whether or not there are funds legally available for the payment of such dividends, and whether or not such dividends are declared by the Board of Directors.

*Conversion at Option of Holder*. Each Series A Preferred Share, together with accrued but unpaid dividends, is convertible into common stock at a conversion price of $4.50 per share of common stock, which initially equals 5.556 shares of common stock at any time at the option of the holder.

Dividends

*Preferred Stock*. The holders of the Series A Preferred Shares are entitled to receive dividends at a rate of 8% per annum payable monthly in arrears. The Company has accrued dividends of $210,600 as of September 30, 2021 which were paid to the shareholders on October 20, 2021.

*Common Stock.* The declaration of any future cash dividends is at the discretion of the board of directors and depends upon the Company’s earnings, if any, capital requirements and financial position, general economic conditions, and other pertinent conditions. It is the Company’s present intention not to pay any cash dividends on the Company’s common stock in the foreseeable future, but rather to reinvest earnings, if any, in business operations.

Public Offering and Conversion of Debt

The registration statement for the Company’s initial public offering (the “Initial Public Offering”) became effective on August 28, 2020. On September 1, 2020, the Company closed on the Initial Public Offering of 2,031,705 shares of its common stock at the public offering price of $6.00 per share, which included 265,005 shares of common stock sold upon full exercise of the underwriters’ option to purchase additional shares of common stock for gross proceeds of $12,190,200. The net proceeds from the Initial Public Offering after deducting the underwriting discount and the underwriters’ fees and expenses were $10,789,000.

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In addition, upon closing of the Initial Public Offering, the Company issued to the underwriters warrants to purchase an aggregate of 88,335 shares of common stock exercisable at a per share price of $7.50 for a term of four years beginning on August 28, 2021. The fair value of these warrants is $167,400.

Also, upon closing of the Initial Public Offering, the Company issued to Olympic Views, LLC (“Olympic”), 82,826 shares of its common stock as a result of the conversion of debt owed to Olympic in the amount of $442,000 and accrued interest of $55,000 at the public offering price per share of $6.00.

2021 Common Stock Offering

On January 15 and 20, 2021, the Company closed on an offering (the “Follow-On Offering”) of 9,200,000 shares of common stock at the public offering price of $3.00 per share, which includes 1,200,000 shares of common stock sold upon full exercise of the underwriters’ option to purchase additional shares of common stock for gross proceeds of $27,600,000. The net proceeds after deducting stock issuance costs were $25,101,000.

In addition, upon closing of the Follow-On Offering the Company issued to the underwriters, warrants to purchase an aggregate of 400,000 shares of common stock exercisable at a per share price of $3.75 for a term of five years beginning on January 12, 2021 which vest on July 12, 2021. The fair value of these warrants is $453,800.

Preferred Stock Offering

On June 11, 2021, the Company closed an offering (the “Preferred Stock Offering”) for 1,200,000 Series A Preferred Shares and warrants to purchase 4,140,000 shares of common stock at an exercise price of $5.00 per share, which included 540,000 warrants pursuant to the underwriter’s partial exercise of their over-allotment option, for gross proceeds of $30,005,400. On June 30, 2021, the underwriters made another partial exercise of their over-allotment option and purchased an additional 60,555 Series A Preferred Shares for additional gross proceeds of $1,406,200. The net proceeds from the Preferred Stock Offering after deducting stock issuance costs was $28,661,000.

In addition, upon closing of the Preferred Stock Offering, the Company issued to the underwriters two warrants, including (i) warrants to purchase 12,000 Series A Preferred Shares; and (ii) warrants to purchase 36,000 shares of common stock at an exercise price of $5.00.

The warrants issued to investors in this offering have an exercise price of $5.00 with a life of five years from the date of issue. The fair value of the warrants was $3,701,600, which was valued using the Black Scholes Model.

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**(A) Options**

The following is a summary of the Company’s option activity:

 SCHEDULE OF STOCK OPTIONS ACTIVITY

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Options** | |  |  | **Weighted**  **Average**  **Exercise Price** | |  |
| **Outstanding – December 31, 2020** |  |  | 442,172 |  |  | $ | 2.53 |  |
| **Exercisable – December 31, 2020** |  |  | 219,085 |  |  | $ | 1.31 |  |
| Granted |  |  | 150,000 |  |  | $ | 3.23 |  |
| Exercised |  |  | (45,046 | ) |  | $ | 0.40 |  |
| Forfeited/Cancelled |  |  | (33,114 | ) |  | $ | 3.18 |  |
| **Outstanding – September 30, 2021** |  |  | 514,012 |  |  | $ | 2.88 |  |
| **Exercisable – September 30, 2021** |  |  | 363,361 |  |  | $ | 2.84 |  |

 SCHEDULE OF STOCK OPTIONS OUTSTANDING AND EXERCISABLE

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | |  |  | **Options Outstanding** | | | | |  |  | |  |  | **Options Exercisable** | | | | |
| **Exercise Price** | |  |  | **Number**  **Outstanding** |  | **Weighted**  **Average**  **Remaining**  **Contractual**  **Life**  **(in years)** | |  |  | **Weighted**  **Average**  **Exercise Price** | |  |  | **Number**  **Exercisable** |  | **Weighted**  **Average**  **Exercise Price** | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| $ | 0.40 - $6.50 |  |  | 514,012 |  |  | 6.73 |  |  | $ | 2.88 |  |  | 363,361 |  | $ | 2.84 |  |

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During the nine months ended September 30, 2021, the Company issued 150,000 options to employees. The options have an exercise price between $2.76 and $3.41 per share, a term of 10 years, and vest over two or three years. The options have an aggregated fair value of approximately $192,900 that was calculated using the Black-Scholes option-pricing model based on the assumptions discussed above in Note 1 under *Stock-Based Compensation.*

During the nine months ended September 30, 2021, the Company had 45,046 options exercised by a former employee. These shares were exercised at $0.40 per share for a total of $18,000.

The Company recognized share-based compensation net of forfeitures related to options of $90,700 and $9,900 for the three months ended September 30, 2021 and 2020, respectively.

The Company recognized share-based compensation net of forfeitures related to options of $246,200 and $11,000 for the nine months ended September 30, 2021 and 2020, respectively.

As of September 30, 2021, unrecognized share-based compensation was $170,300.

The intrinsic value for outstanding and exercisable options as of September 30, 2021 was $333,400 and $306,500.

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**(B) Warrants**

The following is a summary of the Company’s Common Stock Warrant activity:

 SCHEDULE OF WARRANTS ACTIVITY

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Warrants** | |  |  | **Weighted**  **Average**  **Exercise Price** | |  |
| **Outstanding – December 31, 2020** |  |  | 110,859 |  |  | $ | 6.06 |  |
| **Exercisable – December 31, 2020** |  |  | 22,524 |  |  | $ | 0.40 |  |
| Granted |  |  | 4,036,000 |  |  | $ | 4.88 |  |
| Exercised |  |  | - |  |  | $ | - |  |
| Forfeited/Cancelled |  |  | - |  |  | $ | - |  |
| **Outstanding – September 30, 2021** |  |  | 4,146,859 |  |  | $ | 4.91 |  |
| **Exercisable – September 30, 2021** |  |  | 3,710,859 |  |  | $ | 5.03 |  |

 SCHEDULE OF WARRANTS OUTSTANDING AND EXERCISABLE

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | |  |  | **Warrants Outstanding** | | | | |  |  | |  |  | **Warrants Exercisable** | | | | |
| **Exercise Price** | |  |  | **Number**  **Outstanding** |  | **Weighted**  **Average**  **Remaining**  **Contractual**  **Life**  **(in years)** | |  |  | **Weighted**  **Average**  **Exercise Price** | |  |  | **Number**  **Exercisable** |  | **Weighted**  **Average**  **Exercise Price** | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | $ 0.40 - $7.50 |  |  | 4,146,859 |  |  | 4.66 |  |  | $ | 4.91 |  |  | 3,710,859 |  | $ | 5.03 |  |

The intrinsic value for outstanding and exercisable warrants as of September 30, 2021 was $43,900 and $43,900, respectively.

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The following is a summary of the Company’s Preferred Stock Warrant activity:

SCHEDULE OF WARRANTS ACTIVITY

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Warrants** | |  |  | **Weighted**  **Average**  **Exercise Price** | |  |
| **Outstanding – December 31, 2020** |  |  | - |  |  | $ | - |  |
| **Exercisable – December 31, 2020** |  |  | - |  |  | $ | - |  |
| Granted |  |  | 12,000 |  |  | $ | 24.97 |  |
| Exercised |  |  | - |  |  | $ | - |  |
| Forfeited/Cancelled |  |  | - |  |  | $ | - |  |
| **Outstanding – September 30, 2021** |  |  | 12,000 |  |  | $ | 24.97 |  |
| **Exercisable – September 30, 2021** |  |  | - |  |  | $ | - |  |

SCHEDULE OF WARRANTS OUTSTANDING AND EXERCISABLE

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | |  |  | **Warrants Outstanding** | | | | |  |  | |  |  | **Warrants Exercisable** | | | | |
| **Exercise  Price** | |  |  | **Number Outstanding** |  | **Weighted  Average Remaining Contractual  Life  (in years)** | |  |  | **Weighted  Average  Exercise Price** | |  |  | **Number Exercisable** |  | **Weighted  Average Exercise Price** | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| $ | 24.97 |  |  | 12,000 |  |  | 4.69 |  |  | $ | 24.97 |  |  | 12,000 |  | $ | 24.97 |  |

The intrinsic value for outstanding and exercisable warrants as of September 30, 2021 was $0 and $0, respectively.

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**(C) Restricted Stock Plan**

The following is a summary of the Company’s restricted stock activity:

SCHEDULE OF RESTRICTED STOCK UNIT ACTIVITY

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Restricted Stock** | |  |  | **Weighted**  **Average**  **Exercise Price** | |  |
| **Outstanding – December 31, 2020** |  |  | 34,000 |  |  | $ | 4.53 |  |
| **Exercisable – December 31, 2020** |  |  | 8,500 |  |  | $ | 4.53 |  |
| Granted |  |  | 70,000 |  |  | $ | 3.12 |  |
| Exercised |  |  | - |  |  | $ | - |  |
| Forfeited/Cancelled |  |  | - |  |  | $ | - |  |
| **Outstanding – September 30, 20201** |  |  | 104,000 |  |  | $ | 3.58 |  |
| **Exercisable – September 30, 2021** |  |  | 51,500 |  |  | $ | 4.05 |  |

The Company periodically grants restricted stock awards to the board of directors and certain employees pursuant to the 2020 Plan. These typically are awarded by the board of directors at one time and from time to time, to vest in four equal installments on the last day of a fiscal quarter. The Company recognized $93,100 and $0 of share-based compensation expense during the three months ended September 30, 2021 and 2020, respectively. The Company recognized $170,100 and $0 of share-based compensation during the nine months ended September 30, 2021 and 2020, respectively. On September 30, 2021, there was $163,800 of unrecognized compensation related to non-vested restricted stock.

**14. SEGMENTS**

The Company’s business is organized into four material reportable segments which aggregate 99% of revenue:

1) Homes

2) Completed lots

3) Entitled land

4) Fee build

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The reporting segments follow the same accounting policies used in the preparation of the Company’s consolidated financial statements. The following represents selected information for the Company’s reportable segments for the three months ended September 30, 2021 and 2020 and the nine months ended September 30, 2021 and 2020. Immaterial construction materials revenues and costs are included in the homes segment.

SCHEDULE OF COMPANY’S REPORTABLE SEGMENT

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **2021** |  |  |  | **2020** |  |  |  | **2021** |  |  |  | **2020** |  |
|  |  | **For the Three Months Ended** | | | | | |  |  | **For the Nine Months Ended** | | | | | |  |
|  |  | **September 30,** | | | | | |  |  | **September 30,** | | | | | |  |
|  |  |  | **2021** |  |  |  | **2020** |  |  |  | **2021** |  |  |  | **2020** |  |
| **Revenue by segment** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Homes |  | $ | 3,929,300 |  |  | $ | 7,806,500 |  |  | $ | 14,277,700 |  |  | $ | 26,077,300 |  |
| Completed lots |  |  | 770,000 |  |  |  | - |  |  |  | 7,770,000 |  |  |  | - |  |
| Entitled land |  |  | 10,440,000 |  |  |  | - |  |  |  | 19,750,000 |  |  |  | - |  |
| Fee Build |  |  | 2,871,300 |  |  |  | - |  |  |  | 4,219,500 |  |  |  | - |  |
| Revenue |  | $ | 18,010,600 |  |  | $ | 7,806,500 |  |  | $ | 46,017,200 |  |  | $ | 26,077,300 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Cost of goods sold by segment** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Homes |  | $ | 3,498,000 |  |  | $ | 7,183,900 |  |  | $ | 12,378,200 |  |  | $ | 24,448,100 |  |
| Completed lots |  |  | 495,400 |  |  |  | - |  |  |  | 7,541,700 |  |  |  | - |  |
| Entitled land |  |  | 4,492,600 |  |  |  | - |  |  |  | 11,449,400 |  |  |  | - |  |
| Fee Build |  |  | 2,380,200 |  |  |  | - |  |  |  | 3,569,000 |  |  |  | - |  |
| Cost of Revenue |  | $ | 10,866,200 |  |  | $ | 7,183,900 |  |  | $ | 34,938,300 |  |  | $ | 24,448,100 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Gross profit (loss) by segment** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Homes |  | $ | 431,300 |  |  | $ | 622,600 |  |  | $ | 1,899,500 |  |  | $ | 1,629,200 |  |
| Completed lots |  |  | 274,600 |  |  |  | - |  |  |  | 228,300 |  |  |  | - |  |
| Entitled land |  |  | 5,947,400 |  |  |  | - |  |  |  | 8,300,600 |  |  |  | - |  |
| Fee Build |  |  | 491,100 |  |  |  | - |  |  |  | 650,500 |  |  |  | - |  |
| Gross Profit |  | $ | 7,144,400 |  |  | $ | 622,600 |  |  | $ | 11,078,900 |  |  | $ | 1,629,200 |  |

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**15. UNCOMPLETED CONTRACTS**

Costs, estimated earnings and billings on uncompleted contracts are summarized as follows at September 30, 2021 and December 31, 2020:

SUMMARY OF COST, ESTIMATED EARNINGS AND BILLINGS ON UNCOMPLETED CONTRACTS

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **September 30, 2021** | |  |  | **December 31, 2020** | |  |
| Costs incurred on uncompleted contracts |  | $ | 3,717,000 |  |  | $ | - |  |
| Estimated earnings |  |  | 723,700 |  |  |  | - |  |
| Costs and estimated earnings on uncompleted contracts |  |  | 4,440,700 |  |  |  | - |  |
| Billings to date |  |  | 4,207,600 |  |  |  | - |  |
| Costs and estimated earnings in excess of billings on uncompleted contracts |  |  | 624,000 |  |  |  | - |  |
| Costs and earnings in excess of billings on completed contracts |  |  | (390,900) |  |  |  | - |  |
| Total |  | $ | 233,100 |  |  | $ | - |  |
|  |  |  |  |  |  |  |  |  |
| Costs in excess of billings |  | $ | 624,000 |  |  | $ | - |  |
| Billings in excess of cost |  |  | (390,900) |  |  |  | - |  |
| Total |  | $ | 233,100 |  |  | $ | - |  |

The contract asset of $4,762,400 consists of uncollected billings of $4,138,400 and costs in excess of billings of $624,000.

**16. SUBSEQUENT EVENTS**

On August 8, 2021, the Company entered into a purchase and sale agreement to acquire property for the construction of 75 condominiums units located in Yelm, Washington for $3,250,000 which closed on October 4, 2021.

On October 7, 2021, the Company closed an offering (the “Preferred Stock Offering”) for 2,400,000 Series A Preferred Shares and warrants to purchase 13,800,000 shares of common stock at an exercise price of $2.97 per share, which included 1,380,000 warrants pursuant to the underwriter’s exercise of their over-allotment option, for gross proceeds of $33,076,700.

On October 14, 2021, the Company entered into a purchase and sale agreement to sell 20 lots in Semiahmoo, Washington for $3,800,000, closing on or before December 8, 2021.

On October 27, 2021, the Company entered into a purchase and sale agreement to sell 24 lots in Semiahmoo, Washington for $4,800,000, closing on or before December 21, 2021.

On October 29, 2021, the Company’s Board of Directors (the “Board”) appointed Lance Brown as the Company’s Chief Financial Officer and Principal Financial Officer, effective as of November 1, 2021. Mr. O’Sullivan ceased to be the Company’s interim Chief Financial Officer effective as of the same date. Pursuant to Mr. Brown’s employment agreement, Mr. Brown receives a salary of $280,000 per annum. In addition, Mr. Brown will receive a one-time sign on bonus of $75,000 and is eligible to participate in the Company’s annual bonus plan. The Company also granted Mr. Brown 100,000 shares of common stock pursuant to the 2020 Plan, 33,333 shares of which will vest on November 8, 2022, and thereafter, the remaining 66,666 shares will vest on a quarterly basis in eight equal installments, whereby all shares shall be vested by November 8, 2024.

On November 1, 2021, the Company entered into a purchase and sale agreement to sell 30 lots in Horseshoe Bay, Texas for $6,045,500, closing on or before December 21, 2021.

On November 3, 2021, the Company entered into a purchase and sale agreement to sell 27 lots in Semiahmoo, Washington for $4,860,000, closing on or before December 15, 2021.

On November 5, 2021, the Company closed on the Underwriter’s exercise of its over-allotment option to purchase 360,000 Series A Preferred Shares from the Preferred Stock Offering and received net proceeds of $5,005,300.

On November 8, 2021, the Company entered into a purchase and sale agreement to sell one house in Bremerton, Washington for $739,000, closing on or before December 15, 2021.

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**ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FORWARD LOOKING STATEMENTS**

Statements made in this Form 10-Q that are not historical or current facts are “forward-looking statements” made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933 (the “Act”) and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”). These statements often can be identified by the use of terms including, but not limited to “may,” “expect,” “believe,” “anticipate,” “estimate,” “approximate” or “continue,” or the negative thereof. We intend that such forward-looking statements be subject to the safe harbors for such statements. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date made. Any forward-looking statements represent management’s best judgment as to what may occur in the future. However, forward-looking statements are subject to risks, uncertainties, and important factors beyond our control that could cause actual results and events to differ materially from historical results of operations and events and those presently anticipated or projected. We disclaim any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statement or to reflect the occurrence of anticipated or unanticipated events.

**Overview and Outlook**

We are a real estate development company involved in all aspects of the land development cycle including land acquisition, entitlements, construction of project infrastructure, home building, marketing, and sales of various single-family and condominium projects in Washington, California, Texas, and Florida. We have constructed single-family communities and homes in Gig Harbor, Bremerton, Silverdale, Bainbridge Island, Belfair, Allyn, and Port Orchard in the state of Washington, and have single-family homes in various early stages of plan development and construction in California, Texas, and Florida. Our business strategy is focused on the acquisition of land to develop property for the construction and sale of residential lots, home communities, or condominium properties within a 30 to 60-minute commute to major metropolitan employment corridors.

With $9,132,900 in heavy equipment, our infrastructure development division efficiently constructs a diverse range of residential communities and improved lots in a cost-effective manner. We utilize heavy equipment to develop raw land and create residential subdivisions and multi-family communities. The development process includes land clearing, site development, public and private road improvements, and installation of wet utilities such as sewer, water, and storm sewer lines, in addition to construction of dry utilities lines for power, gas, telephone, and cable service providers.

As of September 30, 2021, we own or control 25 communities in Washington, Texas, California, and Florida, containing an aggregate of 1,246 lots and 485.12 acres in various stages of development.

The core of our business plan is to acquire and develop land strategically, based on our understanding of population growth patterns, geo-economic forces, entitlement restrictions, and infrastructure development. We focus on locations within our target markets with convenient access to metropolitan areas that are generally characterized by diverse economic and employment bases and increasing populations. We believe that these conditions create strong demand for new housing and these locations represent what we believe to be attractive opportunities for long-term and sustainable growth.

Our business strategy is focused on the acquisition of land for development purposes and the design, construction, and sale of residential lots, single-family homes, townhomes, and condominiums in the Puget Sound region of Western Washington, with further expansion underway into similar markets in California, Texas, and Florida.

Our strategy is driven by the following: (i) to provide superior quality and homeowner experience and service; (ii) expansion into new and complementary markets; (iii) adherence to our core operating principles to drive consistent long-term performance; and (iv) focus on efficient operations.

It is customary for us to sign purchase and sale agreements that contain a due diligence period which allows us time, often between 30 and 60 days, to evaluate the acquisition. At times, through our due diligence efforts, we find that the property is not suitable for purchase due to economic forces, zoning issues, or other matters. If we determine that the property is not suitable for our desired purposes, we terminate the purchase and sale agreement. After termination within the due diligence period, our earnest money is returned to us. On February 21, 2021, we terminated a purchase and sale agreement for 44 acres of undeveloped land near Austin, Texas, which we had announced on January 22, 2021. After our termination of the agreement, our earnest money was returned. A $1,000 option contract fee included in the purchase and sale agreement was nonrefundable.

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**Results of Operations for the Three Months Ended September 30, 2021 as Compared to the Three Months Ended September 30, 2020**

The following table sets forth the summary statements of operations for the three months ended September 30, 2021 and 2020.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | For the Three Months Ended | | | | | |  |
|  |  | September 30, | | | | | |  |
|  |  | **2021** | |  |  | **2020** | |  |
|  |  |  | |  |  |  | |  |
| Sales |  | $ | 18,010,600 |  |  | $ | 7,806,500 |  |
| Cost of sales |  |  | 10,866,200 |  |  |  | 7,183,900 |  |
| Gross profit |  |  | 7,144,400 |  |  |  | 622,600 |  |
| Operating expenses |  |  | 3,322,100 |  |  |  | 1,458,200 |  |
| Other income (expense) |  |  | (113,900 | ) |  |  | (176,300 | ) |
| Income tax benefit |  |  | - |  |  |  | 571,600 |  |
| Net income (loss) |  | $ | 3,708,400 |  |  | $ | (440,300 | ) |

***Sales***

Our sales increased by 130.7% to $18,010,600 for the three months ended September 30, 2021 as compared to $7,806,500 for the three months ended September 30, 2020. Sales increased in 2021 due to the sale of entitled land of $10,440,000 to Lennar and fee build revenue of $2,871,300, which was partially offset by a decrease in home sales of ($3,877,200).

***Gross Profit***

Our overall gross profit margin was 39.7% for the three months ended September 30, 2021 compared to 8.0% for the three months ended September 30, 2020. For the three months ended September 30, 2021 and 2020, the average gross margin for homes closed was 11.0% and 8.0%, respectively. Gross margin on finished entitled land to Lennar for the three months ended September 30, 2021 and 2020, respectively, was 57.0% and 0%. For the three months ended September 30, 2021 and 2020, the gross margin for fee build was 17.1% and 0%, respectively. For the three months ended September 30, 2021 and 2020, the gross margin for sale of lots was 35.7% and 0%, respectively.

***Operating Expenses***

Our operating expenses increased by 127.8% to $3,322,100 for the three months ended September 30, 2021, as compared to $1,458,200 for the three months ended September 30, 2020. The increase in total operating expenses is primarily attributable to the following:

|  |  |  |
| --- | --- | --- |
|  | 1) | Payroll and related benefits increased by $996,000 due to an increase in staff for increased corporate compliance; |
|  | 2) | Professional fees increased by $263,200, primarily driven by corporate compliance; |
|  | 3) | Additional depreciation expense of $167,000 related to equipment additions; |
|  | 4) | Investor relations costs increased by $124,600, primarily driven by establishing and maintaining public company infrastructure and oversight; and |
|  | 5) | Stock compensation costs increased by $120,700, primarily driven by options and restricted stock issued to directors. |

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***Other Income (Expense)***

Other expense decreased by 35.4% to $113,900 for the three months ended September 30, 2021 as compared to $176,300 for the three months ended September 30, 2020, primarily the decrease was driven by a reduction in interest cost.

***Net Income (Loss)***

For the three months ended September 30, 2021 and 2020, we incurred net income (loss) of $3,708,400 and ($440,300), respectively. The increase in net income was primarily attributable to an increase in revenue and improved profit margins in 2021 as explained above.

**Results of Operations for the Nine Months Ended September 30, 2021 as Compared to the Nine Months Ended September 30, 2020**

The following table sets forth the summary statements of operations for the nine months ended September 30, 2021 and 2020.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | For the Nine Months Ended | | | | | |  |
|  |  | September 30, | | | | | |  |
|  |  | **2021** | |  |  | **2020** | |  |
|  |  |  | |  |  |  | |  |
| Sales |  | $ | 46,017,200 |  |  | $ | 26,077,300 |  |
| Cost of sales |  |  | 34,938,300 |  |  |  | 24,448,100 |  |
| Gross profit |  |  | 11,078,900 |  |  |  | 1,629,200 |  |
| Operating expenses |  |  | 7,639,700 |  |  |  | 3,769,900 |  |
| Other (expense) |  |  | (210,600 | ) |  |  | (269,100 | ) |
| Income Tax Benefit |  |  | - |  |  |  | 561,500 |  |
| Net Income (loss) |  | $ | 3,228,600 |  |  | $ | (1,848,300 | ) |

***Sales***

Our sales increased by 76.5% to $46,017,200 for the nine months ended September 30, 2021 as compared to $26,077,300 for the nine months ended September 30, 2020. Sales increased in 2021 due to a land development sale of $7,000,000 to Lennar, sale of entitled land of $19,750,000 to Lennar, and fee build income of $4,219,500 which were partially offset by a decrease in home sales of $(11,799,600).

***Gross Profit***

Our overall gross profit margin was 24.1% for the nine months ended September 30, 2021 compared to 6.2% for the nine months ended September 30, 2020. For the nine months ended September 30, 2021 and 2020, the average gross margin for homes closed was 13.3% and 6.2%, respectively. Gross margin on finished lot sales for the nine months ended September 30, 2021 and 2020, was 2.94% and 0%, respectively. Gross margin on finished entitled land to Lennar for the nine months ended September 30, 2021 and 2020, was 42.0% and 0%, respectively. For the nine months ended September 30, 2021 and 2020, the gross margin for fee build was 15.4% and 0%, respectively

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***Operating Expenses***

Our operating expenses increased by 102.7% to $7,639,700 for the nine months ended September 30, 2021, as compared to $3,769,900 for the nine months ended September 30, 2020. The increase in total operating expenses is primarily attributable to the following:

|  |  |  |
| --- | --- | --- |
|  | 1) | Payroll and related benefits increased by $1,328,300 due to increase in staff for increased compliance issues; |
|  | 2) | Insurance costs increased by $537,100, primarily driven by the purchase of director’s and officer’s insurance; |
|  | 3) | Additional depreciation expense of $364,300 related to equipment additions; |
|  | 4) | Stock compensation costs increased by $350,400, primarily driven by options and restricted stock issued to directors; and |
|  | 5) | Investor relations costs increased by $326,600, primarily driven by establishing and maintaining public company infrastructure and oversight. |

***Other Income (Expense)***

Other expense decreased by 21.7% to $210,600 for the nine months ended September 30, 2021 as compared to $269,100 for the nine months ended September 30, 2020. For the nine months ended September 30, 2021, we incurred $298,500 of interest expense related to our financing arrangements as compared to $254,200 for the nine months ended September 30, 2020. In addition, we recorded $35,900 of loss on sales of equipment for the nine months ended September 30, 2021 as compared to $27,900 for the nine months ended September 30, 2020. For the nine months ended September 30, 2021, other income increased for mainly due to timber sales of $135,800 as compared to $3,000 for the nine months ended September 30, 2020.

***Net Income (Loss)***

Our net income (loss) increased by 274.7% to $3,228,600 for the nine months ended September 30, 2021 as compared to a loss of ($1,848,300) for the nine months ended September 30, 2020. The increase in net income was primarily attributable to an increase in revenue and improved gross margins in 2021 as explained above.

**Liquidity and Capital Resources**

***Real Estate Assets***

Our real estate assets have increased to $105,463,700 as of September 30, 2021 from $20,370,300 as of December 31, 2020. This increase was due to an increase in the number of houses and condominiums under construction and the purchase of additional developed and undeveloped lots.

***Liabilities***

Liabilities increased to $64,951,100 as of September 30, 2021 from $27,203,200 as of December 31, 2020. This increase is primarily attributable to the following:

|  |  |  |
| --- | --- | --- |
|  | 1. | An increase in construction loans of $29,092,000 due to purchases of real estate; |
|  | 2. | An increase in construction loans related-party of $5,556,300 due to purchases of real estate; and |
|  | 3. | An increase in accounts payable and accrued expenses of $3,175,800 due to the increase of real estate projects in process. |

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***Cash & Restricted Cash Balance***

As of September 30, 2021, our cash balance was $5,385,300 compared to $2,396,500 as of December 31, 2020.

***Operating Activities***

Net cash used in operating activities for the nine months ended September 30, 2021 and 2020 was $79,567,300 and $9,858,700, respectively. The increase is primarily due to the acquisition and development of real estate assets of $82,755,400. The net income (loss) for the nine months ended September 30, 2021 and 2020 was $3,228,600 and ($1,848,300), respectively.

***Investing Activities***

Net cash used in investing activities for the nine months ended September 30, 2021 and 2020 was $308,600 and $70,700, respectively. During the nine months ended September 30, 2021, $378,100 was used for the acquisition of new property and equipment and there were proceeds from the sale of equipment of $69,500. During the nine months ended September 30, 2020, $401,100 was used for the acquisition of new property and equipment and there were proceeds from the sale of equipment of $330,400.

***Financing Activities***

Net cash provided from investing activities for the nine months ended September 30, 2021 and 2020 was $82,864,700 and $11,851,300, respectively. During the nine months ended September 30, 2021, there was net proceeds from common stock issuances of $25,101,000, net proceeds from the Preferred Stock issuances of $28,661,000, net increase in construction loans of $29,468,300 and net increase in construction loans related party of $6,302,800. Also, during the nine months ended September 30, 2020, there were net proceeds from a common stock offering of $10,789,100, a net increase in construction loans of $8,829,900 and a net decrease in construction loans related party of ($6,515,700).

***Cash Resources***

Although the expected revenue growth and control of expenses leads management to believe that it is probable that our cash resources will be sufficient to meet cash requirements through the fiscal year ending December 31, 2022, we may require additional funding to finance the growth of our current and expected future operations as well as to achieve our strategic objectives. There can be no assurance that financing will be available in amounts or terms acceptable to us, if at all. In that event, we would be required to change our growth strategy and seek funding on that basis, though there is no guarantee we will be able to do so.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, financings, or other relationships with unconsolidated entities or other persons, also known as “special purpose entities” (SPEs).

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**Inflation**

Our homebuilding operations can be adversely impacted by inflation, primarily from higher land, financing, labor, material, and construction costs. In addition, inflation can lead to higher mortgage rates which can significantly affect the affordability of mortgage financing to homebuyers. While we attempt to pass on cost increases to customers through increased prices, when weak housing market conditions exist, we may be unable to offset cost increases with higher selling prices.

**Critical Accounting Policies**

Our condensed consolidated financial statements and related public financial information are based on the application of accounting principles generally accepted in the United States (“GAAP”). GAAP requires the use of estimates, assumptions, judgments, and subjective interpretations of accounting principles that have an impact on the assets, liabilities, revenues, and expense amounts reported. These estimates can also affect supplemental information contained in our external disclosures including information regarding contingencies, risk, and financial condition. We believe our use of estimates and underlying accounting assumptions adhere to GAAP and are consistently and conservatively applied. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions. We continue to monitor significant estimates made during the preparation of our financial statements.

Our significant accounting policies are summarized in Note 1 of our condensed consolidated financial statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As a “smaller reporting company” as defined by Item 10 of Regulation S-K, we are not required to provide information required by this Item.

**ITEM 4. CONTROLS AND PROCEDURES**

***Evaluation of Disclosure Controls and Procedures***

Our management, under the supervision of our Chief Executive Officer and President and Chief Financial Officer performed an evaluation (the “Evaluation”) of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Disclosure controls and procedures include, without limitation, controls and procedures designed to provide a reasonable level of assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms, and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Based on the Evaluation, our Chief Executive Officer and President and Chief Financial Officer concluded that our disclosure controls and procedures are operating effectively.

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**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

None.

**ITEM 1A. RISK FACTORS**

As a “smaller reporting company” as defined by Item 10 of Regulation S-K, we are not required to provide information required by this Item.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS FROM REGISTERED SECURITIES**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

|  |  |  |
| --- | --- | --- |
| Exhibit No. |  | Description |
|  |  |  |
| 31.1 |  | [Certification of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](ex31-1.htm) |
|  |  |  |
| 31.2 |  | [Certification of Principal Financial Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](ex31-2.htm) |
|  |  |  |
| 32 |  | [Certification of Principal Executive Officer and Principal Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](ex32.htm) |
|  |  |  |
| 101. INS |  | XBRL Instance Document |
|  |  |  |
| 101. SCH |  | XBRL Taxonomy Extension Schema Document |
|  |  |  |
| 101. CAL |  | XBRL Taxonomy Extension Calculation Linkbase Document |
|  |  |  |
| 101. DEF |  | XBRL Taxonomy Extension definition Linkbase Document |
|  |  |  |
| 101. LAB |  | XBRL Taxonomy Extension Label Linkbase Document |
|  |  |  |
| 101. PRE |  | XBRL Taxonomy Extension Presentation Linkbase Document |
|  |  |  |
| 104 |  | Cover Page Interactive Data File (embedded within the Inline XBRL document) |

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**SIGNATURES**

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

|  |  |  |
| --- | --- | --- |
|  | **HARBOR CUSTOM DEVELOPMENT, INC.** | |
|  |  |  |
| Date: November 15, 2021 | By | */s/ Sterling Griffin* |
|  |  | Sterling Griffin |
|  |  | Chief Executive Officer and President |
|  |  | (Principal Executive Officer) |
|  |  |  |
| Date: November 15, 2021 | By | */s/ Lance Brown* |
|  |  | Lance Brown  Chief Financial Officer  (Principal Financial and Accounting Officer) |

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