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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2022**

**OR**

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

**For the transition period from to**

**Commission File Number: 001-39266**

**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.) | | |

**1201 Pacific Avenue, Suite 1200**

**Tacoma, Washington 98402**

(Address of principal executive offices)

**(253) 649-0636**

Registrant’s telephone number, including area code

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

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |
| **Title of each class** | | | **Trading Symbol(s)** | | | **Name of each exchange on which registered.** | | |
| Common Stock | | | HCDI | | | The Nasdaq Stock Market LLC | | |
| 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 14,376,372 shares of common stock outstanding as of November 9, 2022.

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**PART I**

**ITEM 1. FINANCIAL STATEMENTS**

**INDEX TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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1

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

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

**CONDENSED CONSOLIDATED BALANCE SHEETS**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
|  | | | (Unaudited) | | |  | | |  | | |
| ASSETS | | |  | | |  | | |  | | |
| Cash | | | $ | 13,707,900 |  |  | | | $ | 25,629,200 |  |
| Restricted Cash | | | 597,600 | |  |  | | | 597,600 | |  |
| Accounts Receivable, net | | | 5,503,900 | |  |  | | | 1,113,500 | |  |
| Contract Assets, net | | | — | |  |  | | | 2,167,200 | |  |
| Notes Receivable, net | | | 9,754,200 | |  |  | | | 2,000,000 | |  |
| Prepaid Expense and Other Assets | | | 2,911,900 | |  |  | | | 2,778,100 | |  |
| Real Estate | | | 179,932,800 | |  |  | | | 122,136,100 | |  |
| Property, Plant and Equipment, net | | | 10,069,200 | |  |  | | | 9,199,700 | |  |
| Right of Use Assets | | | 2,323,400 | |  |  | | | 3,429,700 | |  |
| Deferred Tax Asset | | | 2,586,800 | |  |  | | | 649,000 | |  |
| TOTAL ASSETS | | | $ | 227,387,700 |  |  | | | $ | 169,700,100 |  |
|  | | |  | | |  | | |  | | |
| LIABILITIES AND STOCKHOLDERS’ EQUITY | | |  | | |  | | |  | | |
|  | | |  | | |  | | |  | | |
| LIABILITIES | | |  | | |  | | |  | | |
| Accounts Payable and Accrued Expenses | | | $ | 13,340,300 |  |  | | | $ | 10,662,800 |  |
| Dividends Payable | | | 634,700 | |  |  | | | 670,900 | |  |
| Contract Liabilities | | | 896,700 | |  |  | | | — | |  |
| Deferred Revenue | | | 63,900 | |  |  | | | 44,800 | |  |
| Note Payable - D&O Insurance | | | 537,500 | |  |  | | | 903,800 | |  |
| Revolving Line of Credit Loan, net of Unamortized Debt Discount of $0.8 million and $0, respectively | | | 24,011,400 | |  |  | | | — | |  |
| Equipment Loans | | | 4,296,100 | |  |  | | | 5,268,500 | |  |
| Finance Leases | | | 188,000 | |  |  | | | 543,400 | |  |
| Construction Loans, net of Unamortized Debt Discount of $2.4 million and $4.4 million, respectively | | | 83,263,500 | |  |  | | | 34,957,100 | |  |
| Construction Loans - Related Party, net of Unamortized Debt Discount of $0.01 million and $1.1 million, respectively | | | 8,926,100 | |  |  | | | 13,426,600 | |  |
| Right of Use Liabilities | | | 3,168,000 | |  |  | | | 3,484,400 | |  |
| TOTAL LIABILITIES | | | 139,326,200 | |  |  | | | 69,962,300 | |  |
|  | | |  | | |  | | |  | | |
| COMMITMENTS AND CONTINGENCIES - SEE NOTE 12 | | |  | | |  | | |  | | |
|  | | |  | | |  | | |  | | |
| STOCKHOLDERS’ EQUITY | | |  | | |  | | |  | | |
| Preferred Stock, no par value per share, 10,000,000 shares authorized and 3,799,799 issued and outstanding at September 30, 2022 and 4,016,955 issued and outstanding at December 31, 2021 | | | 62,912,100 | |  |  | | | 66,507,500 | |  |
| Common Stock, no par value per share, 50,000,000 shares authorized and 14,352,365 issued and outstanding at September 30, 2022 and 13,155,342 issued and outstanding at December 31, 2021 | | | 35,704,700 | |  |  | | | 32,122,700 | |  |
| Additional Paid In Capital | | | 1,224,600 | |  |  | | | 752,700 | |  |
| Retained Earnings (Accumulated Deficit) | | | (11,779,900) | |  |  | | | 1,646,500 | |  |
| Stockholders’ Equity | | | 88,061,500 | |  |  | | | 101,029,400 | |  |
| Non-Controlling Interest | | | — | |  |  | | | (1,291,600) | |  |
| TOTAL STOCKHOLDERS’ EQUITY | | | 88,061,500 | |  |  | | | 99,737,800 | |  |
|  | | |  | | |  | | |  | | |
| TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY | | | $ | 227,387,700 |  |  | | | $ | 169,700,100 |  |

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 OPERATIONS**

**(Unaudited)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Three Months Ended September 30,** | | | | | | | | |  | | | **Nine Months Ended September 30,** | | | | | | | | |
|  | | | **2022** | | |  | | | **2021** | | |  | | | **2022** | | |  | | | **2021** | | |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Sales | | | $ | 11,748,500 |  |  | | | $ | 18,010,600 |  |  | | | $ | 50,616,000 |  |  | | | $ | 46,017,200 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Cost of Sales | | | 11,310,800 | |  |  | | | 10,866,200 | |  |  | | | 46,055,400 | |  |  | | | 34,938,300 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Gross Profit | | | 437,700 | |  |  | | | 7,144,400 | |  |  | | | 4,560,600 | |  |  | | | 11,078,900 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Operating Expenses | | | 4,523,800 | |  |  | | | 3,322,100 | |  |  | | | 12,017,200 | |  |  | | | 7,639,700 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Operating Income (Loss) | | | (4,086,100) | |  |  | | | 3,822,300 | |  |  | | | (7,456,600) | |  |  | | | 3,439,200 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Other Income (Expense) | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Interest Expense | | | (565,800) | |  |  | | | (115,100) | |  |  | | | (1,046,800) | |  |  | | | (298,500) | |  |
| Interest Income | | | 163,900 | |  |  | | | — | |  |  | | | 378,900 | |  |  | | | — | |  |
| Loss on Sale of Equipment | | | (12,600) | |  |  | | | — | |  |  | | | (118,100) | |  |  | | | (35,900) | |  |
| Other Income | | | 18,000 | |  |  | | | 1,200 | |  |  | | | 26,200 | |  |  | | | 123,800 | |  |
| Total Other (Expense) | | | (396,500) | |  |  | | | (113,900) | |  |  | | | (759,800) | |  |  | | | (210,600) | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Income (Loss) Before Income Tax | | | (4,482,600) | |  |  | | | 3,708,400 | |  |  | | | (8,216,400) | |  |  | | | 3,228,600 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Income Tax (Benefit) | | | (1,067,800) | |  |  | | | — | |  |  | | | (1,937,800) | |  |  | | | — | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Net Income (Loss) | | | (3,414,800) | |  |  | | | 3,708,400 | |  |  | | | (6,278,600) | |  |  | | | 3,228,600 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Net Loss Attributable to Non-controlling interests | | | — | |  |  | | | — | |  |  | | | (600) | |  |  | | | (1,700) | |  |
| Preferred Dividends | | | (1,903,700) | |  |  | | | (631,400) | |  |  | | | (5,856,200) | |  |  | | | (771,500) | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Net Income (Loss) Attributable to Common Stockholders | | | $ | (5,318,500) |  |  | | | $ | 3,077,000 |  |  | | | $ | (12,134,200) |  |  | | | $ | 2,458,800 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Earnings (Loss) Per Share - Basic | | | $ | (0.37) |  |  | | | $ | 0.21 |  |  | | | $ | (0.88) |  |  | | | $ | 0.17 |  |
| Earnings (Loss) Per Share - Diluted | | | $ | (0.37) |  |  | | | $ | 0.17 |  |  | | | $ | (0.88) |  |  | | | $ | 0.17 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Weighted Average Common Shares Outstanding - Basic | | | 14,350,899 | |  |  | | | 14,898,594 | |  |  | | | 13,862,865 | |  |  | | | 14,350,143 | |  |
| Weighted Average Common Shares Outstanding - Diluted | | | 14,350,899 | |  |  | | | 22,063,584 | |  |  | | | 13,862,865 | |  |  | | | 14,522,663 | |  |

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**

**(Unaudited)**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Nine Months Ended September 30,** | | | | | | | | |
|  | | | **2022** | | |  | | | **2021** | | |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |  | | |  | | |  | | |
| Net Income (Loss) | | | $ | (6,278,600) |  |  | | | $ | 3,228,600 |  |
| Adjustments to reconcile net income (loss) to net cash from operating activities: | | |  | | |  | | |  | | |
| Depreciation | | | 1,022,200 | |  |  | | | 783,500 | |  |
| Amortization of right of use assets | | | 440,300 | |  |  | | | 252,200 | |  |
| Loss on sale of equipment | | | 119,800 | |  |  | | | 35,900 | |  |
| Provision for loss on contract | | | 421,400 | |  |  | | | — | |  |
| Impairment loss on notes and related interest receivable | | | 898,400 | |  |  | | | — | |  |
| Stock compensation | | | 473,800 | |  |  | | | 416,100 | |  |
| Forgiveness on PPP loan | | | — | |  |  | | | (10,000) | |  |
| Amortization of revolver issuance costs | | | 320,100 | |  |  | | | — | |  |
| Net change in assets and liabilities: | | |  | | |  | | |  | | |
| Accounts receivable | | | (4,390,400) | |  |  | | | (26,600) | |  |
| Contract assets | | | 2,167,200 | |  |  | | | (4,762,400) | |  |
| Notes receivable | | | (8,524,600) | |  |  | | | — | |  |
| Prepaid expenses and other assets | | | (261,700) | |  |  | | | 820,300 | |  |
| Real estate | | | (56,179,400) | |  |  | | | (82,755,400) | |  |
| Deferred tax asset | | | (1,937,800) | |  |  | | | — | |  |
| Accounts payable and accrued expenses | | | 2,677,600 | |  |  | | | 3,175,800 | |  |
| Contract liabilities | | | 475,300 | |  |  | | | 390,900 | |  |
| Deferred revenue | | | 19,100 | |  |  | | | (874,600) | |  |
| Payments on right of use liability, net of incentives | | | 349,600 | |  |  | | | (241,600) | |  |
| NET CASH USED IN OPERATING ACTIVITIES | | | (68,187,700) | |  |  | | | (79,567,300) | |  |
|  | | |  | | |  | | |  | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |  | | |  | | |  | | |
| Purchase of property and equipment | | | (1,808,000) | |  |  | | | (378,100) | |  |
| Proceeds on the sale of equipment | | | 194,400 | |  |  | | | 69,500 | |  |
| NET CASH USED IN INVESTING ACTIVITIES | | | (1,613,600) | |  |  | | | (308,600) | |  |
|  | | |  | | |  | | |  | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |  | | |  | | |  | | |
| Construction loans | | | 65,240,900 | |  |  | | | 39,560,800 | |  |
| Payments on construction loans | | | (16,080,500) | |  |  | | | (10,092,500) | |  |
| Financing fees construction loans | | | (2,304,000) | |  |  | | | (1,476,900) | |  |
| Related party construction loans | | | 8,576,500 | |  |  | | | 15,500,000 | |  |
| Payments on related party construction loans | | | (13,220,500) | |  |  | | | (9,197,200) | |  |
| Financing fees related party construction loans | | | (23,600) | |  |  | | | (1,983,900) | |  |
| Revolving line of credit loan, net of payments | | | 24,788,900 | |  |  | | | — | |  |
| Financing fees revolving line of credit loan | | | (1,097,700) | |  |  | | | — | |  |
| Note payable D&O insurance | | | 590,100 | |  |  | | | — | |  |
| Payments on note payable D&O insurance | | | (956,400) | |  |  | | | (867,600) | |  |
| Payments on equipment loans | | | (1,655,300) | |  |  | | | (1,430,500) | |  |
| Payments on financing leases | | | (70,700) | |  |  | | | (289,000) | |  |
| Payments on PPP loan | | | — | |  |  | | | (9,300) | |  |
| Net proceeds from issuance of common stock | | | — | |  |  | | | 25,101,000 | |  |
| Net proceeds from issuance of preferred stock | | | — | |  |  | | | 28,661,000 | |  |
| Preferred dividends | | | (5,892,400) | |  |  | | | (560,900) | |  |
| Repurchase of common stock | | | (437,700) | |  |  | | | — | |  |
| Proceeds from exercise of stock options | | | 8,600 | |  |  | | | 18,000 | |  |
| Proceeds from exercise of warrants | | | 413,800 | |  |  | | | — | |  |
| Deferred offering cost | | | — | |  |  | | | (68,300) | |  |

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|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | | | 57,880,000 | |  |  | | | 82,864,700 | |  |
|  | | |  | | |  | | |  | | |
| NET INCREASE (DECREASE) IN CASH AND RESTRICTED CASH | | | (11,921,300) | |  |  | | | 2,988,800 | |  |
|  | | |  | | |  | | |  | | |
| CASH AND RESTRICTED CASH AT BEGINNING OF YEAR | | | 26,226,800 | |  |  | | | 2,396,500 | |  |
|  | | |  | | |  | | |  | | |
| CASH AND RESTRICTED CASH AT END OF PERIOD | | | $ | 14,305,500 |  |  | | | $ | 5,385,300 |  |
|  | | |  | | |  | | |  | | |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |  | | |  | | |  | | |
| Interest paid | | | $ | 5,350,400 |  |  | | | $ | 2,165,300 |  |
|  | | |  | | |  | | |  | | |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | |  | | |  | | |  | | |
| Termination of leases | | | $ | 52,100 |  |  | | | $ | — |  |
| Amortization of debt discount capitalized | | | $ | 1,617,300 |  |  | | | $ | 2,338,000 |  |
| Financing of fixed assets additions | | | $ | 110,000 |  |  | | | $ | 1,566,800 |  |
| Conversion of finance lease to equipment loan | | | $ | 394,800 |  |  | | | $ | — |  |
| Cancellation of finance leases | | | $ | — |  |  | | | $ | 99,100 |  |
| New right of use obligations | | | $ | — |  |  | | | $ | 166,800 |  |
| Conversion of preferred to common stock | | | $ | 3,595,400 |  |  | | | $ | — |  |
| Dividends declared but not paid | | | $ | 634,600 |  |  | | | $ | 210,600 |  |

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 CHANGES IN STOCKHOLDERS’ EQUITY (DEFICIT)**

**(Unaudited)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Common Stock** | | | | | | | | |  | | | **Preferred Stock** | | | | | | | | |  | | | **Additional  Paid in Capital** | | |  | | | **Retained Earnings (Accumulated Deficit)** | | |  | | | **Stockholders' Equity (Deficit)** | | |  | | | **Non-Controlling Interest** | | |  | | | **Total Equity (Deficit)** | | |
|  | | | **Shares Issued** | | |  | | | **No Par** | | |  | | | **Shares Issued** | | |  | | | **No Par** | | |  | | |  | | |  | | |  | | |  | | |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, January 1, 2021** | | | **5,636,548** | |  |  | | | **$** | **11,956,900** |  |  | | | **—** | |  |  | | | **$** | **—** |  |  | | | **$** | **234,800** |  |  | | | **$** | **(4,487,100)** |  |  | | | **$** | **7,704,600** |  |  | | | **$** | **(1,289,900)** |  |  | | | **$** | **6,414,700** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Net Proceeds from Issuance of Common Stock | | | 9,200,000 | |  |  | | | 25,101,000 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 25,101,000 | |  |  | | |  | | |  | | | 25,101,000 | |  |
| Exercise of Stock Options | | | 45,046 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 18,000 | |  |  | | |  | | |  | | | 18,000 | |  |  | | |  | | |  | | | 18,000 | |  |
| Stock Compensation Expense | | | 8,500 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 115,100 | |  |  | | |  | | |  | | | 115,100 | |  |  | | |  | | |  | | | 115,100 | |  |
| Net Income (Loss) | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (1,549,800) | |  |  | | | (1,549,800) | |  |  | | | 600 | |  |  | | | (1,549,200) | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, March 31, 2021** | | | **14,890,094** | |  |  | | | **$** | **37,057,900** |  |  | | | **—** | |  |  | | | **$** | **—** |  |  | | | **$** | **367,900** |  |  | | | **$** | **(6,036,900)** |  |  | | | **$** | **31,388,900** |  |  | | | **$** | **(1,289,300)** |  |  | | | **$** | **30,099,600** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Net Proceeds from Issuance of Preferred Stock | | |  | | |  | | |  | | |  | | | 1,260,555 | |  |  | | | 28,661,000 | |  |  | | |  | | |  | | |  | | |  | | | 28,661,000 | |  |  | | |  | | |  | | | 28,661,000 | |  |
| Preferred 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)** |  |  | | | **$** | **59,805,700** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Preferred Dividends | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (631,400) | |  |  | | | (631,400) | |  |  | | |  | | |  | | | (631,400) | |  |
| Stock Compensation Expense | | | 23,500 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 185,200 | |  |  | | |  | | |  | | | 185,200 | |  |  | | |  | | |  | | | 185,200 | |  |
| Net Income (Loss) | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 3,708,400 | |  |  | | | 3,708,400 | |  |  | | |  | | |  | | | 3,708,400 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, September 30, 2021** | | | **14,922,094** | |  |  | | | **$** | **37,057,900** |  |  | | | **1,260,555** | |  |  | | | **$** | **28,661,000** |  |  | | | **$** | **668,900** |  |  | | | **$** | **(2,028,300)** |  |  | | | **$** | **64,359,500** |  |  | | | **$** | **(1,291,600)** |  |  | | | **$** | **63,067,900** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, January 1, 2022** | | | **13,155,342** | |  |  | | | **$** | **32,122,700** |  |  | | | **4,016,955** | |  |  | | | **$** | **66,507,500** |  |  | | | **$** | **752,700** |  |  | | | **$** | **1,646,500** |  |  | | | **$** | **101,029,400** |  |  | | | **$** | **(1,291,600)** |  |  | | | **$** | **99,737,800** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Preferred Dividends | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (2,012,500) | |  |  | | | (2,012,500) | |  |  | | |  | | |  | | | (2,012,500) | |  |
| Exercise of Stock Options | | | 21,623 | |  |  | | | 10,500 | |  |  | | |  | | |  | | |  | | |  | | | (1,900) | |  |  | | |  | | |  | | | 8,600 | |  |  | | |  | | |  | | | 8,600 | |  |
| Stock Compensation Expense | | | 60,214 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 242,400 | |  |  | | |  | | |  | | | 242,400 | |  |  | | |  | | |  | | | 242,400 | |  |
| Dissolution of Non-Controlling Interest | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (1,292,100) | |  |  | | | (1,292,100) | |  |  | | | 1,292,100 | |  |  | | | — | |  |
| Net Income (Loss) | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 1,645,800 | |  |  | | | 1,645,800 | |  |  | | | (500) | |  |  | | | 1,645,300 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, March 31, 2022** | | | **13,237,179** | |  |  | | | **$** | **32,133,200** |  |  | | | **4,016,955** | |  |  | | | **$** | **66,507,500** |  |  | | | **$** | **993,200** |  |  | | | **$** | **(12,300)** |  |  | | | **$** | **99,621,600** |  |  | | | **$** | **—** |  |  | | | **$** | **99,621,600** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Preferred Dividends | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (1,940,000) | |  |  | | | (1,940,000) | |  |  | | |  | | |  | | | (1,940,000) | |  |
| Stock Compensation Expense | | | 17,500 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 112,300 | |  |  | | |  | | |  | | | 112,300 | |  |  | | |  | | |  | | | 112,300 | |  |
| Conversion of Preferred stock | | | 1,206,515 | |  |  | | | 3,595,400 | |  |  | | | (217,156) | |  |  | | | (3,595,400) | |  |  | | |  | | |  | | |  | | |  | | | — | |  |  | | |  | | |  | | | — | |  |
| Exercise of Warrants | | | 139,295 | |  |  | | | 413,800 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 413,800 | |  |  | | |  | | |  | | | 413,800 | |  |
| Share Repurchase | | | (251,934) | |  |  | | | (437,700) | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (437,700) | |  |  | | |  | | |  | | | (437,700) | |  |
| Net Loss | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (4,509,100) | |  |  | | | (4,509,100) | |  |  | | |  | | |  | | | (4,509,100) | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, June 30, 2022** | | | **14,348,555** | |  |  | | | **$** | **35,704,700** |  |  | | | **3,799,799** | |  |  | | | **$** | **62,912,100** |  |  | | | **$** | **1,105,500** |  |  | | | **$** | **(6,461,400)** |  |  | | | **$** | **93,260,900** |  |  | | | **$** | **—** |  |  | | | **$** | **93,260,900** |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Preferred Dividends | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (1,903,700) | |  |  | | | (1,903,700) | |  |  | | |  | | |  | | | (1,903,700) | |  |
| Stock Compensation Expense | | | 3,810 | |  |  | | |  | | |  | | |  | | |  | | |  | | |  | | | 119,100 | |  |  | | |  | | |  | | | 119,100 | |  |  | | |  | | |  | | | 119,100 | |  |
| Net Loss | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | | (3,414,800) | |  |  | | | (3,414,800) | |  |  | | |  | | |  | | | (3,414,800) | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Balance, September 30, 2022** | | | **14,352,365** | |  |  | | | **$** | **35,704,700** |  |  | | | **3,799,799** | |  |  | | | **$** | **62,912,100** |  |  | | | **$** | **1,224,600** |  |  | | | **$** | **(11,779,900)** |  |  | | | **$** | **88,061,500** |  |  | | | **$** | **—** |  |  | | | **$** | **88,061,500** |  |

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**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**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 developed lots and provide development infrastructure construction, on a contract basis, for other home builders.

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 SEC and started trading on The Nasdaq Stock Market LLC ("Nasdaq”) on August 28, 2020.

Principles of Consolidation

The condensed consolidated financial statements include the following subsidiaries of Harbor Custom Development, Inc. as of the reporting period ending dates as follow:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Names** | | |  | | | **Dates of Formation** | | |  | | | **Attributable Interest** | | | | | | | | |
|  | | |  | | |  | | |  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Saylor View Estates, LLC\* | | |  | | | March 30, 2014 | | |  | | | N/A | | |  | | | 51 | | % |
| Harbor Materials, LLC\*\* | | |  | | | July 5, 2018 | | |  | | | N/A | | |  | | | N/A | | |
| Belfair Apartments, LLC | | |  | | | December 3, 2019 | | |  | | | 100 | | % |  | | | 100 | | % |
| Pacific Ridge CMS, LLC | | |  | | | May 24, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| Tanglewilde, LLC | | |  | | | June 25, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| HCDI FL CONDO LLC | | |  | | | July 30, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| HCDI Mira, LLC | | |  | | | August 31, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| HCDI Bridgeview, LLC | | |  | | | October 28, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| HCDI Wyndstone, LLC | | |  | | | September 15, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| HCDI Semiahmoo, LLC | | |  | | | December 17, 2021 | | |  | | | 100 | | % |  | | | 100 | | % |
| Mills Crossing, LLC | | |  | | | July 21, 2022 | | |  | | | 100 | | % |  | | | N/A | | |
| Broadmoor Ventures, LLC | | |  | | | August 24, 2022 | | |  | | | 100 | | % |  | | | N/A | | |

\*Saylor View Estates, LLC was voluntarily dissolved with the State of Washington as of January 20, 2022.

\*\*Harbor Materials, LLC was voluntarily dissolved with the State of Washington as of January 29, 2021.

As of September 30, 2022 and December 31, 2021, the aggregate non-controlling interest was $0 and $(1.3) million, respectively.

Basis of Presentation

The unaudited consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements included in the Company’s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2021. The accompanying unaudited condensed consolidated financial statements include all adjustments that are of a normal recurring nature and necessary for the fair presentation of the results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

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All numbers in the financial statements are rounded to the nearest $100, except for Earnings (Loss) per Share (“EPS”) data, and numbers in the notes to the financial statements are rounded to the nearest million.

Reclassification

Certain prior year amounts have been reclassified for consistency with the current year presentation. These reclassifications had no effect on the reported results of operations.

Use of Estimates

Management uses estimates and assumptions in preparing these financial statements in accordance with GAAP. 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 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. On June 1, 2022, the stockholders of the Company voted to approve an amendment to the 2018 Plan to increase, by 2,000,000, the authorized number of shares of common stock reserved for issuance as options under the 2018 Plan.

Effective 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. On June 1, 2022, the stockholders of the Company voted to approve an amendment to the 2020 Plan to increase, by 2,000,000, the authorized number of shares of common stock available for awards under the 2020 Plan.

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) Topic 718, “Compensation – Stock Compensation”(“ASC 718”) which establishes financial accounting and reporting standards for stock-based employee and non-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.

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. The Company accounts for forfeitures of stock options as they occur. When forfeitures occur, the unvested portion of the previously recognized compensation cost is reversed in the period of the forfeiture.

Stock-based compensation expenses are included in operating expenses in the condensed consolidated statement of operations.

For the nine months ended September 30, 2022 and 2021 when computing fair value of share-based payments, the Company has considered the following range of assumptions:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **September 30, 2021** | | |
| Risk-free interest rate | | | 1.73% - 3.54% | | |  | | | 0.23% - 1.11% | | |
| Exercise price | | | $1.12 - $3.00 | | |  | | | $2.76 - $5.00 | | |
| Expected life of grants in years | | | 3.93 - 6.51 | | |  | | | 2.50 - 6.50 | | |
| Expected volatility of underlying stock | | | 42.34% - 48.13% | | |  | | | 42.63% - 56.13% | | |
| Dividends | | | — | | |  | | | — | | |

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The expected term is computed using the “simplified” method as permitted under the provisions of FASB ASC Topic 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 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.

*Repurchase of Equity Securities*

Share repurchases are recorded to common stock at the value of the cash consideration paid, as the Company's common stock has no par value. These shares are being repurchased for the purpose of constructive retirement. See Note 15. Stockholder's Equity for additional information on the share repurchase program.

*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 topic 260-10-45 of the FASB 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 numerator may have to adjust for any dividends and income or loss associated with potentially dilutive securities that are assumed to have resulted in the issuance of shares of common stock and the denominator may have to adjust to include the number of additional shares of common stock that would have been outstanding if the dilutive potential shares of common stock had been issued during the period to reflect the potential dilution that could occur from shares of common stock issuable through a contingent shares issuance arrangement, stock options, warrants, RSUs, or convertible preferred stock. For purposes of determining diluted earnings per common share, the treasury stock method is used for stock options, warrants, and RSUs, and the if-converted method is used for convertible preferred stock as prescribed in FASB ASC Topic 260.

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 share of common stock for the three and nine months ended September 30, 2022 and 2021.

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **For the Three Months Ended September 30,** | | | | | | | | |  | | | **For the Nine Months Ended September 30,** | | | | | | | | |
|  | | | **2022** | | |  | | | **2021** | | |  | | | **2022** | | |  | | | **2021** | | |
| Numerator: | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Net income (loss) attributable to common stockholders | | | $ | (5,318,500) |  |  | | | $ | 3,077,000 |  |  | | | $ | (12,134,200) |  |  | | | $ | 2,458,800 |  |
| Effect of dilutive securities: | | | — | |  |  | | | 631,400 | |  |  | | | — | |  |  | | | — | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Diluted net income (loss) | | | $ | (5,318,500) |  |  | | | $ | 3,708,400 |  |  | | | $ | (12,134,200) |  |  | | | $ | 2,458,800 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Denominator: | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Weighted average common shares outstanding - basic | | | 14,350,899 | | |  | | | 14,898,594 | |  |  | | | 13,862,865 | |  |  | | | 14,350,143 | |  |
| Dilutive securities (a): | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Restricted Stock Awards | | | — | | |  | | | — | | |  | | | — | |  |  | | | 288 | |  |
| Options | | | — | | |  | | | 141,987 | | |  | | | — | |  |  | | | 152,565 | |  |
| Warrants | | | — | | |  | | | 19,359 | | |  | | | — | |  |  | | | 19,667 | |  |
| Convertible Preferred Stock | | | — | |  |  | | | 7,003,644 | | |  | | | — | |  |  | | | — | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Weighted average common shares outstanding and assumed conversion – diluted | | | 14,350,899 | | |  | | | 22,063,584 | |  |  | | | 13,862,865 | |  |  | | | 14,522,663 | |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Basic net earnings (loss) per common share | | | $ | (0.37) |  |  | | | $ | 0.21 |  |  | | | $ | (0.88) |  |  | | | $ | 0.17 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Diluted net earnings (loss) per common share | | | $ | (0.37) |  |  | | | $ | 0.17 |  |  | | | $ | (0.88) |  |  | | | $ | 0.17 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| (a) - Outstanding anti-dilutive securities excluded: | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Unvested restricted stock awards | | | 274,583 | | |  | | | 62,500 | | |  | | | 274,583 | |  |  | | | 62,500 | |  |
| Stock options | | | 800,925 | | |  | | | 298,333 | | |  | | | 800,925 | |  |  | | | 298,333 | |  |
| Warrants to purchase common stock | | | 18,447,564 | | |  | | | 4,664,335 | | |  | | | 18,447,564 | |  |  | | | 4,664,335 | |  |
| Convertible preferred stock\* | | | 3,799,799 | | |  | | | — | |  |  | | | 3,799,799 | |  |  | | | 1,260,555 | |  |
| Warrants to purchase convertible preferred stock\* | | | 12,000 | | |  | | | 12,000 | | |  | | | 12,000 | |  |  | | | 12,000 | |  |

\*Preferred stock and warrants to purchase convertible preferred stock are convertible into common stock on a 5.556 to 1 ratio.

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

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, 2022 and December 31, 2021.

Restricted Cash

On August 10, 2021, the Company entered into a Letter of Credit (“LOC”) agreement with WaFd Bank in the amount of $0.6 million. 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 WaFd Bank to a controlled account on August 13, 2021. (See Note 10. Letter of Credit.)

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Accounts Receivable

Accounts receivables are reported at the amount the Company expects to collect from outstanding balances. The Company provides for 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 $0 as of September 30, 2022 and December 31, 2021.

Notes Receivable

Notes receivables are recorded at amounts due to the Company according to the contractual terms of the loan agreement. The Company's notes receivables are for the sale of real estate properties or financing the development of the properties prior to acquisition and are each secured by the underlying improved real estate properties.

The Company reviews notes receivable for impairment whenever events or circumstances indicate that the note may not be fully recoverable. Impairment is present when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. If management determines an amount to be uncollectible, impairment is measured based on the estimated uncollectible amount less the fair value of the underlying collateral. Impairment is recognized with a valuation allowance against the note receivable with a corresponding charge to bad debt expense under operating expenses. The valuation allowance was $0.8 million for notes receivable and $0.1 million for related interest receivables as of September 30, 2022. No impairment loss was recognized as of December 31, 2021. (See Note 3. Notes Receivable.)

Property and Equipment and Depreciation

Property and equipment are recorded at cost. Expenditures for major additions and betterments are capitalized. Maintenance and repair charges are expensed as incurred. Depreciation is computed by the straight-line method (after considering their respective estimated residual values) over the 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 Topic 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 $0.3 million and $0.2 million for the three months ended September 30, 2022 and 2021, respectively. The Company capitalized interest from related party borrowings of $0.9 million and $0.6 million for the nine months ended September 30, 2022 and 2021, respectively. The Company capitalized interest from third-party borrowings of $1.5 million and $0.3 million for the three months ended September 30, 2022 and 2021, respectively. The Company capitalized interest from third-party borrowings of $3.4 million and $0.8 million for the nine months ended September 30, 2022 and 2021, respectively.

A property is classified as “held for sale” when all of 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;

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

(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.

In addition to the annual assessment of potential triggering events in accordance with FASB ASC Topic 360, the Company applies a fair value-based impairment test to the net book value of 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, 2022 and December 31, 2021, the Company did not identify any triggering events that would require further investigation under ASC 360.

Revenue and Cost Recognition

FASB ASC Topic 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 contracts 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.

A detailed breakdown of the five-step process for revenue recognitions is as follows:

***Homes, Developed Lots, and Entitled Land***

*1. Identify the contract with a customer.*

The Company signs an agreement with a buyer to purchase the parcel of entitled land, developed lots that have completed infrastructure, or completed homes.

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

Performance obligations of the Company include delivering entitled land, developed lots, and completed homes 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, lots, and homes are separate performance obligations 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 material performance obligations once title is transferred.

***Fee Build***

*1. Identify the contract with a customer.*

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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.

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 contract asset in the Company’s balance sheet. Amounts by which cumulative billings to the customer under a contract as of a given date exceed cumulative contract revenue recognized on the contract would be reflected as a current contract liability in the Company’s balance sheet. (See Note 17. Uncompleted Contracts.)

Revenues from contracts with customers are summarized by category as follows for the three and nine months ended September 30, 2022 and 2021:

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **For the Three Months Ended September 30,** | | | | | | | | |  | | | **For the Nine Months Ended September 30,** | | | | | | | | |
|  | | | **2022** | | |  | | | **2021** | | |  | | | **2022** | | |  | | | **2021** | | |
| Homes | | | $ | 4,693,900 |  |  | | | $ | 3,762,000 |  |  | | | $ | 25,758,100 |  |  | | | $ | 13,947,900 |  |
| Developed Lots | | | — | |  |  | | | 770,000 | |  |  | | | 9,080,000 | |  |  | | | 7,770,000 | |  |
| Entitled Land | | | 3,400,000 | |  |  | | | 10,440,000 | |  |  | | | 7,880,000 | |  |  | | | 19,750,000 | |  |
| Fee Build | | | 3,623,500 | |  |  | | | 2,871,300 | |  |  | | | 7,825,300 | |  |  | | | 4,219,500 | |  |
| Multifamily | | | 27,200 | |  |  | | | — | |  |  | | | 27,200 | |  |  | | | — | |  |
| Construction Materials | | | 3,900 | |  |  | | | 167,300 | |  |  | | | 45,400 | |  |  | | | 329,800 | |  |
| Total Revenue | | | $ | 11,748,500 |  |  | | | $ | 18,010,600 |  |  | | | $ | 50,616,000 |  |  | | | $ | 46,017,200 |  |

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, 2022 and 2021:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **For the Three Months Ended September 30,** | | | | | | | | |  | | | **For the Nine Months Ended September 30,** | | | | | | | | |
|  | | | **2022** | | |  | | | **2021** | | |  | | | **2022** | | |  | | | **2021** | | |
| Performance obligations satisfied at a point in time | | | $ | 8,125,000 |  |  | | | $ | 15,139,300 |  |  | | | $ | 42,790,700 |  |  | | | $ | 41,797,700 |  |
| Performance obligations satisfied over time | | | 3,623,500 | |  |  | | | 2,871,300 | |  |  | | | 7,825,300 | |  |  | | | 4,219,500 | |  |
| Total Revenue | | | $ | 11,748,500 |  |  | | | $ | 18,010,600 |  |  | | | $ | 50,616,000 |  |  | | | $ | 46,017,200 |  |

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 costs and capitalized interest are allocated to lots sold based on the same criteria.

Fee build costs are charged to cost of sales as incurred. See the revenue recognition criteria above.

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.

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 under FASB ASC Topic 740, Income Taxes, to determine whether 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, 2022 and December 31, 2021.

On August 16, 2022, the Inflation Reduction Act of 2022 (“IRA”) was signed into law. The IRA includes a 15% Corporate Alternative Minimum Tax (“Corporate AMT”) for tax years beginning after December 31, 2022. The Company does not expect the Corporate AMT to have a material impact on its consolidated financial statements. Additionally, the IRA imposes a 1% excise tax on net repurchases of stock by certain publicly traded corporations. The excise tax is imposed on the value of the net stock repurchased or treated as repurchased. The new law will apply to stock repurchases occurring after December 31, 2022.

Recent Accounting Pronouncements

On June 16, 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurements of Credit Losses on Financial Instruments (“ASU 2016-13”), which changes the impairment model for most financial assets. This update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and

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other financial instruments held by financial institutions and other organizations. The underlying premise of the update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management’s current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. Pursuant to ASU No. 2019-10, Financial Instruments ‒ Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2022 for small reporting companies, non-SEC filers, and all other companies. The Company has not yet adopted ASU 2016-13 and will continue to evaluate any impact from this accounting standard on its notes receivables.

On March 12, 2020, the FASB issued ASU No. 2020-04, Reference Rate Reform (ASC 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting. ASC 848 contains optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform. The amendments in this update are elective and apply to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference London Interbank Offered Rate (LIBOR) or another reference rate expected to be discontinued because of reference rate reform. The expedients and exceptions provided by the amendments do not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, except for hedging relationships existing as of December 31, 2022, for which an entity has applied certain optional expedients that are retained through the end of the hedging relationship. The Company continues to evaluate the impact of the guidance and may apply elections as applicable.

On May 3, 2021, the FASB released ASU 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. The 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 adopted ASU 2021-04 on January 1, 2022, however the adoption did not have an impact on the Company’s Financial Statements.

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, 2022 and December 31, 2021, there were no impairment losses recognized for long-lived assets.

**2. CONCENTRATIONS**

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 $12.7 million and $24.5 million as of September 30, 2022 and December 31, 2021, respectively.

Revenue Concentrations

**Homes**

For the three months ended September 30, 2022, three customers each represented 32%, 33%, and 34% of the home revenue, respectively. For the three months ended September 30, 2021, five customers each represented 19% of the home revenue.

There were no concentrations in relation to the homes revenue segment for the nine months ended September 30, 2022 and 2021.

**Developed Lots**

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There were no concentrations in relation to the developed lots segment for the three months ended September 30, 2022. For the three months ended September 30, 2021, three customers each represented 38%, 38%, and 24% of the developed lots revenue, respectively.

For the nine months ended September 30, 2022, two customers represented 62% and 26%, respectively, of the developed lots revenue segment. Lennar Northwest, Inc. represented 90% of the developed lots revenue for the nine months ended September 30, 2021.

**Entitled Land**

For the three months ended September 30, 2022, 1031 Services, Inc. represented 100% of the entitled land revenue.

For the three months ended September 30, 2021, Lennar Northwest, Inc. represented 100% of the entitled land revenue.

Two customers represented 57% and 43% of the entitled land revenue for the nine months ended September 30, 2022. Lennar Northwest, Inc., represented 100% for the nine months ended September 30, 2021.

**Fee Build**

Lennar Northwest, Inc. represented 100% of fee build revenue for the three and nine months ended September 30, 2022 and 2021.

**3. NOTES RECEIVABLE**

As of September 30, 2022, the total principal balance of notes receivable amounted to $9.8 million. These notes arose as financing by the Company for the sale of real estate properties or financing the development of the properties prior to acquisition. These notes are secured by the underlying improved real estate properties and accrue interest at annual rates ranging from 5% to 9%. All payments of principal and interest are due in full between March 30, 2023 and December 20, 2024. The outstanding balance of the notes amounted to $9.8 million and $2.0 million at September 30, 2022 and December 31, 2021, respectively. Interest income was $0.2 million and $0 for the three months ended September 30, 2022 and 2021, respectively. Interest income was $0.4 million and $0 for the nine months ended September 30, 2022 and 2021, respectively.

In March 2022, the Company entered into a promissory note with Rocklin Winding Lane 22, LLC for $4.8 million ("the note") for the sale of developed lots. In the third quarter of 2022, Rocklin Winding Lane 22, LLC defaulted on the note due to a missed interest payment on June 30, 2022. As a result, the Company issued a letter of default in August 2022 and began foreclosure proceedings on the underlying real estate asset in October 2022. Pursuant to the subordination agreement, the underlying real estate asset has a $1.0 million senior loan to a third party that is prioritized over the note. The Company has performed an impairment analysis by reviewing the difference between the carrying amount of the note and the estimated fair value of the collateralized properties and determined that the note is not fully collectible. As of September 30, 2022, the Company recorded a valuation allowance against the note and related bad debt expense within operating expenses of $0.8 million.

The details of notes receivables, net of a valuation allowance are as follows:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | |  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Broadmoor Commons LLC | | |  | | | $ | 942,100 |  |  | | | $ | 500,000 |  |
| Modern Homestead LLC | | |  | | | 1,500,000 | |  |  | | | 1,500,000 | |  |
| Rocklin Winding Lane 22, LLC | | |  | | | 4,032,100 | |  |  | | | — | |  |
| Noffke Horizon View, LLC | | |  | | | 3,280,000 | |  |  | | | — | |  |
| Total Notes Receivable | | |  | | | $ | 9,754,200 |  |  | | | $ | 2,000,000 |  |

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**4. PROPERTY AND EQUIPMENT**

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

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Machinery and Equipment | | | $ | 10,613,100 |  |  | | | $ | 10,577,600 |  |
| Vehicles | | | 104,000 | |  |  | | | 71,800 | |  |
| Furniture and Fixtures | | | 695,600 | |  |  | | | 420,300 | |  |
| Leasehold Improvements | | | 1,471,300 | |  |  | | | 81,200 | |  |
| Total Fixed Assets | | | 12,884,000 | |  |  | | | 11,150,900 | |  |
| Less Accumulated Depreciation | | | (2,814,800) | |  |  | | | (1,951,200) | |  |
| Fixed Assets, Net | | | $ | 10,069,200 |  |  | | | $ | 9,199,700 |  |

Depreciation expense was $0.4 million and $0.3 million for the three months ended September 30, 2022 and 2021, respectively.

Depreciation expense was $1.0 million and $0.8 million for the nine months ended September 30, 2022 and 2021, respectively.

**5. REAL ESTATE**

Real Estate consisted of the following components:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Land Held for Development | | | $ | 47,311,900 |  |  | | | $ | 73,524,400 |  |
| Construction in Progress | | | 101,894,900 | |  |  | | | 43,362,700 | |  |
| Held for Sale | | | 30,726,000 | |  |  | | | 5,249,000 | |  |
| Total Real Estate | | | $ | 179,932,800 |  |  | | | $ | 122,136,100 |  |

**6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

Accounts payable and accrued liabilities consisted of the following:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Trade Accounts Payable | | | $ | 10,853,600 |  |  | | | $ | 5,558,400 |  |
| Income Tax Payable | | | — | |  |  | | | 2,415,900 | |  |
| Accrued Compensation, Bonuses, and Benefits | | | 671,900 | |  |  | | | 1,071,700 | |  |
| Accrued Quarry Reclamation Costs | | | 154,600 | |  |  | | | 500,000 | |  |
| Retainage Payable | | | 1,029,200 | |  |  | | | 445,800 | |  |
| Other Accruals | | | 631,000 | |  |  | | | 671,000 | |  |
| Total Accounts Payable and Accrued Expenses | | | $ | 13,340,300 |  |  | | | $ | 10,662,800 |  |

**7. REVOLVING LINE OF CREDIT**

On March 7, 2022, the Company entered into a senior secured revolving credit facility (“the credit facility”) with BankUnited, N.A. (the "Lender") for $25.0 million. The credit facility has a two year term, with a maturity date of March 7, 2024. The unpaid principal bears interest at a fluctuating rate of interest per annum equal to the daily simple secured overnight financing rate (SOFR) plus the applicable margin of 4.75%. The credit facility is used to fund the Company’s general working capital needs and interest is expensed as incurred. For the three and nine months ended September 30, 2022, the Company capitalized debt issuance costs of $0 and $1.1 million, respectively. These costs are recorded as debt discount and amortized ratably over the life of the loan. The credit facility is collateralized by all of the Company's assets wherein the Lender is granted a junior priority interest in all collateralized Company assets that Lender has previously identified as a permitted lien or other encumbrance that the Company regularly incurs through its ordinary

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course of business; in all other Company assets, Lender maintains a first priority security interest. The credit facility also contains specific financial covenants. As of September 30, 2022, the Company was in compliance with these covenants except for its minimum interest coverage ratio requirement. The Company is actively engaged with the Lender to come to terms on a restructured financing arrangement, potentially including revised financial covenants for future periods. The discussions are on-going and there has been no formal revised agreement as of the date hereof. Interest expense was $0.5 million and $0 for the three months ended September 30, 2022 and 2021, respectively. Interest expense was $0.9 million and $0 for the nine months ended September 30, 2022 and 2021, respectively.

As of September 30, 2022, the revolving line of credit loan balance was $24.8 million and the unamortized debt discount balance was $0.8 million.

**8. EQUIPMENT LOANS**

Equipment loans consists of the following:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Various notes payable to banks and financial institutions with interest rates varying from 0% to 13.89%, collateralized by equipment with monthly payments ranging from $400 to $11,600 through 2025: | | | $ | 4,296,100 |  |  | | | $ | 5,268,500 |  |
| Book value of collateralized equipment: | | | 6,944,800 | |  |  | | | 7,229,000 | |  |

Future equipment loan maturities at September 30, 2022 are as follows:

**Year Ending December 31,**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |
| 2022 (three months) | | | $ | 502,600 |  |
| 2023 | | | 1,896,800 | |  |
| 2024 | | | 1,673,200 | |  |
| 2025 | | | 223,500 | |  |
| Total | | | $ | 4,296,100 |  |

Interest expense was $0.04 million and $0.05 million for the three months ended September 30, 2022 and 2021, respectively.

Interest expense was $0.1 million and $0.1 million for the nine months ended September 30, 2022 and 2021, respectively.

**9. CONSTRUCTION LOANS**

The Company has various construction loans with private individuals and finance companies. The loans are collateralized by specific construction projects. Most loans are generally on one to two year terms but will be refinanced if the project is not completed within one to two years 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 10%. 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, 2022 and December 31, 2021 were $85.6 million and $39.4 million, respectively. The unamortized debt discounts related to these construction loans as of September 30, 2022 and December 31, 2021 were $2.4 million and $4.4 million, respectively. The book value of collateralized real estate as of September 30, 2022 and December 31, 2021 was $165.9 million and $122.1 million, respectively.

**10. LETTER OF CREDIT**

The Company entered into a letter of credit agreement with WaFd Bank of $0.6 million on August 10, 2021. The letter of credit expires February 1, 2032. The interest rate of the letter of credit is Prime plus 1%. The letter of credit has been established for the purpose of collateralizing the Company’s new Tacoma office lease obligations with the landlord which is the beneficiary of the letter of credit. (See Note 1. Restricted Cash.)

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**11. NOTE PAYABLE DIRECTORS & OFFICERS INSURANCE**

The Company purchased Directors & Officers (D&O) insurance on August 28, 2022 for $0.6 million. A down payment of $0.1 million was made and the remaining balance was financed over 11 months. The interest rate on the loan is 4.75%. The loan balance as of September 30, 2022 and December 31, 2021 was $0.5 million and $0.9 million, respectively.

**12. COMMITMENTS AND CONTINGENCIES**

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 June 15, 2020, the Company entered into a purchase and sale agreement to acquire property for the construction of 33 townhomes located in East Bremerton, Washington for $2.0 million. Closing is expected to take place in Q4 2022.

On December 2, 2021, the Company entered into a purchase and sale agreement for the acquisition of 438 acres in Blaine, Washington for $13.5 million. Closing is expected to take place in Q4 2023.

On April 21, 2022, the Company entered into a purchase and sale agreement for the purchase of 4.81 acres in Port Orchard, Washington for $2.6 million. Closing is expected to take place in Q4 2022.

**13. 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 June 2021; the loans generally have a 12 to 18 month maturity, including those that have been extended. The interest rates range between 7.99% and 9.99%. As of September 30, 2022, and December 31, 2021, the outstanding loan balances were $8.9 million and $14.5 million, respectively. For the three months ended September 30, 2022 and 2021, the Company capitalized loan fees of $0.01 million and $0, respectively. For the nine months ended September 30, 2022 and 2021, the Company capitalized loan fees of $0.02 million and $0.6 million, 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, 2022 and December 31, 2021, there were $0.01 million and $0.2 million of remaining debt discounts, respectively. The interest is capitalized to real estate as incurred. During the three months ended September 30, 2022 and 2021, the Company incurred interest of $0.3 million and $0.2 million, respectively. During the nine months ended September 30, 2022 and 2021, the Company incurred interest of $0.9 million and $0.6 million, respectively.

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

Due to Related Party

The Company utilizes a quarry to process waste materials from the completion of raw land into sellable/buildable lots. The materials produced by the quarry and sold by the Company to others are subject to a 25% commission payable to SGRE, LLC, which is 100% owned by the Company’s Chief Executive Officer and President. The commission expense is recorded in operating expenses. On September 30, 2022 and December 31, 2021, the commission payable was $0 and $0.01 million, respectively. The commission expense for the three months ended September 30, 2022 and 2021, was $0.01 million and $0.02 million, respectively. The commission expense for the nine months ended September 30, 2022 and 2021, was $0.04 million and $0.1 million, respectively.

**14. INCOME TAX**

The Company’s effective tax rate for the nine months ended September 30, 2022 was a benefit of 23.6%, compared to 0% for the nine months ended September 30, 2021. The Company calculated the effective tax rate for the nine months ended September 30, 2022 based on the actual effective tax rate for the year-to-date period compared to the estimate of the annual effective tax rate for the nine months ended September 30, 2021. The increase in the effective tax rate for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021 is driven by the release of the valuation allowance at December 31, 2021 and nondeductible incentive stock options.

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**15. 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, 2022, the Company has 14,352,365 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.

Preferred Stock

At September 30, 2022, the Company is authorized to issue 10,000,000 shares of preferred stock, no par value per share. As of September 30, 2022, the Company has 3,799,799 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 $2.00 per share per annum which are paid monthly in arrears starting June 30, 2021. 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 5.556 shares of common stock (subject to adjustment) 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 in the amount of $2.00 per share per annum, which is equivalent to 8% of the $25.00 liquidation preference per share. The Company has accrued dividends of $0.6 million as of September 30, 2022 which were paid on October 17, 2022.

*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.

Repurchase of Equity Securities

On May 10, 2022, the Board of Directors approved a stock repurchase program authorizing the repurchase of up to $5.0 million worth of shares of common stock. The amount of the repurchase program represented approximately 15% of the outstanding shares of the Company’s common stock valued at the closing price on May 10, 2022. During the nine months ended September 30, 2022, the Company repurchased 251,934 shares of common stock under this repurchase program at an average price of $1.76 per share for a total of $0.4 million.

**(A) Options**

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

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Options** | | |  | | | **Weighted Average Exercise Price** | | |
| **Outstanding – January 1, 2022** | | | 463,251 | | |  | | | $ | 2.82 |  |
| **Exercisable – January 1, 2022** | | | 343,724 | | |  | | | $ | 2.77 |  |
| Granted | | | 392,000 | | |  | | | $ | 1.19 |  |
| Exercised | | | (21,623) | |  |  | | | $ | 0.40 |  |
| Forfeited/Cancelled | | | (32,703) | |  |  | | | $ | 1.90 |  |
| **Outstanding – September 30, 2022** | | | 800,925 | | |  | | | $ | 2.05 |  |
| **Exercisable – September 30, 2022** | | | 383,049 | | |  | | | $ | 2.76 |  |

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | |  | | | **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 | | |  | | | 800,925 | | |  | | | 8.28 | | |  | | | $ | 2.05 |  |  | | | 383,049 | | |  | | | $ | 2.76 |  |

During the nine months ended September 30, 2022, the Company issued 392,000 options to employees. The options have an exercise price between $1.12 and $2.09 per share, a term of ten years, and vest over one or three years. The options have an aggregated fair value of approximately $0.2 million 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, 2022, the Company had 21,623 options exercised by former employees. These options were exercised at $0.40 per share for a total of $0.01 million.

The Company recognized share-based compensation net of forfeitures related to options of $0.02 million and $0.1 million for the three months ended September 30, 2022 and 2021, respectively.

The Company recognized share-based compensation net of forfeitures related to options of $0.1 million and $0.2 million for the nine months ended September 30, 2022 and 2021, respectively.

On September 30, 2022, unrecognized share-based compensation was $0.3 million.

The intrinsic value for outstanding and exercisable options as of September 30, 2022 was $0.1 million and $0.1 million.

**(B) Warrants**

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

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Warrants** | | |  | | | **Weighted Average Exercise Price** | | |
| **Outstanding – January 1, 2022** | | | 18,486,859 | | |  | | | $ | 3.46 |  |
| **Exercisable – January 1, 2022** | | | 18,486,859 | | |  | | | $ | 3.46 |  |
| Granted | | | 100,000 | | |  | | | $ | 3.00 |  |
| Exercised | | | (139,295) | |  |  | | | $ | 2.97 |  |
| Forfeited/Cancelled | | | — | | |  | | | $ | — |  |
| **Outstanding – September 30, 2022** | | | 18,447,564 | | |  | | | $ | 3.47 |  |
| **Exercisable – September 30, 2022** | | | 18,372,564 | | |  | | | $ | 3.47 |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | |  | | | **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 | | |  | | | 18,447,564 | | |  | | | 3.93 | | |  | | | $ | 3.47 |  |  | | | 18,372,564 | | |  | | | $ | 3.47 |  |

During the nine months ended September 30, 2022, the Company issued 100,000 warrants in connection with investor relation services being performed. The warrants have an exercise price of $3.00 per share, a term of five years, and vest over three years. The fair value of these warrants is $0.1 million as of September 30, 2022.

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The intrinsic value for outstanding and exercisable warrants as of September 30, 2022 was $0.01 million and $0.01 million, respectively.

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

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Warrants** | | |  | | | **Weighted Average Exercise Price** | | |
| **Outstanding – January 1, 2022** | | | 12,000 | | |  | | | $ | 24.97 |  |
| **Exercisable – January 1, 2022** | | | 12,000 | | |  | | | $ | 24.97 |  |
| Granted | | | — | |  |  | | | $ | — |  |
| Exercised | | | — | | |  | | | $ | — |  |
| Forfeited/Cancelled | | | — | | |  | | | $ | — |  |
| **Outstanding – September 30, 2022** | | | 12,000 | | |  | | | $ | 24.97 |  |
| **Exercisable – September 30, 2022** | | | 12,000 | | |  | | | $ | 24.97 |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | |  | | | **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 | | |  | | | 3.69 | | |  | | | $ | 24.97 |  |  | | | 12,000 | | |  | | | $ | 24.97 |  |

The intrinsic value for outstanding and exercisable preferred warrants as of September 30, 2022 was $0.

**(C) Restricted Stock Plan**

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

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **Restricted Stock** | | |  | | | **Weighted Average Fair Value** | | |
| **Non Vested Balance - January 1, 2022** | | | 145,000 | | |  | | | $ | 2.45 |  |
| Granted | | | 231,100 | | |  | | | $ | 1.96 |  |
| Vested | | | 101,517 | | |  | | | $ | 2.66 |  |
| Forfeited/Cancelled | | | — | | |  | | | $ | — |  |
| **Non Vested Balance - September 30, 2022** | | | 274,583 | | |  | | | $ | 1.96 |  |

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 Compensation Committee at one time and from time to time, to vest over one to three years, unless otherwise determined by the Compensation Committee.

The Company recognized $0.05 million and $0.1 million of share-based compensation during the three months ended September 30, 2022 and 2021, respectively.

The Company recognized $0.4 million and $0.2 million of share-based compensation during the nine months ended September 30, 2022 and 2021, respectively.

On September 30, 2022, there was $0.4 million of unrecognized compensation related to non-vested restricted stock.

**16. SEGMENTS**

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In accordance with FASB ASC Topic 280, Segment Reporting, an operating segment is defined as a component of an enterprise for which discrete financial information is available and reviewed regularly by the chief operating decision maker (“CODM”), or decision making group, to evaluate performance and make operating decisions.

The Company identified its CODM group as its three executive officers, the Chief Executive Officer, Chief Financial Officer, and Chief Operating Officer. In determining the reportable segments, the CODM group considers similar economics and characteristics including product types, construction processes, customer type, regulatory environments, and underlying demand and supply.

The Company’s business is organized into five material reportable segments which aggregate 99.9% of revenue for the nine months ended September 30, 2022:

1) Homes

2) Developed lots

3) Entitled land

4) Multi-family

5) Fee Build

The reporting segments follow the same accounting policies used in the preparation of the Company’s condensed consolidated financial statements. The following represents revenue, cost of goods sold, and gross profit (loss) information for the Company’s reportable segments for the three and nine months ended September 30, 2022 and 2021:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **For the Three Months Ended September 30,** | | | | | | | | |  | | | **For the Nine Months Ended September 30,** | | | | | | | | |
|  | | | **2022** | | |  | | | **2021** | | |  | | | **2022** | | |  | | | **2021** | | |
| **Revenue by segment** | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Homes | | | $ | 4,693,900 |  |  | | | $ | 3,929,300 |  |  | | | $ | 25,758,100 |  |  | | | $ | 14,277,700 |  |
| Developed lots | | | — | |  |  | | | 770,000 | |  |  | | | 9,080,000 | |  |  | | | 7,770,000 | |  |
| Entitled land | | | 3,400,000 | |  |  | | | 10,440,000 | |  |  | | | 7,880,000 | |  |  | | | 19,750,000 | |  |
| Multi-family | | | 27,200 | |  |  | | | — | |  |  | | | 27,200 | |  |  | | | — | |  |
| Fee Build | | | 3,623,500 | |  |  | | | 2,871,300 | |  |  | | | 7,825,300 | |  |  | | | 4,219,500 | |  |
| Other | | | 3,900 | |  |  | | | — | |  |  | | | 45,400 | |  |  | | | — | |  |
|  | | | $ | 11,748,500 |  |  | | | $ | 18,010,600 |  |  | | | $ | 50,616,000 |  |  | | | $ | 46,017,200 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Cost of goods sold by segment** | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Homes | | | $ | 3,805,000 |  |  | | | $ | 3,498,000 |  |  | | | $ | 21,461,100 |  |  | | | $ | 12,378,200 |  |
| Developed lots | | | 87,300 | |  |  | | | 495,400 | |  |  | | | 8,144,300 | |  |  | | | 7,541,700 | |  |
| Entitled land | | | 3,347,900 | |  |  | | | 4,492,600 | |  |  | | | 4,060,800 | |  |  | | | 11,449,400 | |  |
| Multi-family | | | 25,100 | |  |  | | | — | |  |  | | | 27,300 | |  |  | | | — | |  |
| Fee Build | | | 3,791,200 | |  |  | | | 2,380,200 | |  |  | | | 11,010,600 | |  |  | | | 3,569,000 | |  |
| Other | | | 254,300 | |  |  | | | — | |  |  | | | 1,351,300 | |  |  | | | — | |  |
|  | | | $ | 11,310,800 |  |  | | | $ | 10,866,200 |  |  | | | $ | 46,055,400 |  |  | | | $ | 34,938,300 |  |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| **Gross profit (loss) by segment** | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| Homes | | | $ | 888,900 |  |  | | | $ | 431,300 |  |  | | | $ | 4,297,000 |  |  | | | $ | 1,899,500 |  |
| Developed lots | | | (87,300) | |  |  | | | 274,600 | |  |  | | | 935,700 | |  |  | | | 228,300 | |  |
| Entitled land | | | 52,100 | |  |  | | | 5,947,400 | |  |  | | | 3,819,200 | |  |  | | | 8,300,600 | |  |
| Multi-family | | | 2,100 | |  |  | | | — | |  |  | | | (100) | |  |  | | | — | |  |
| Fee Build | | | (167,700) | |  |  | | | 491,100 | |  |  | | | (3,185,300) | |  |  | | | 650,500 | |  |
| Other | | | (250,400) | |  |  | | | — | |  |  | | | (1,305,900) | |  |  | | | — | |  |
|  | | | $ | 437,700 |  |  | | | $ | 7,144,400 |  |  | | | $ | 4,560,600 |  |  | | | $ | 11,078,900 |  |

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The following represents total assets for the Company’s reportable segments at September 30, 2022 and December 31, 2021:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | | |  |  |  | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Homes | | |  |  |  | $ | 27,009,200 |  |  | | | $ | 36,615,600 |  |
| Developed lots | | |  |  |  | 42,983,800 | |  |  | | | 8,219,500 | |  |
| Entitled land | | |  |  |  | 9,911,500 | |  |  | | | 28,157,800 | |  |
| Multi-family | | |  |  |  | 111,291,300 | |  |  | | | 47,679,400 | |  |
| Fee Build | | |  |  |  | 5,768,500 | |  |  | | | 3,325,300 | |  |
| Unallocated (Shared) | | |  |  |  | 30,423,400 | |  |  | | | 45,702,500 | |  |
| **Total Assets** | | |  |  |  | $ | 227,387,700 |  |  | | | $ | 169,700,100 |  |

**17. UNCOMPLETED CONTRACTS**

Costs, estimated earnings, and billings on uncompleted contracts are summarized as follows at September 30, 2022 and December 31, 2021:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **September 30, 2022** | | |  | | | **December 31, 2021** | | |
| Costs incurred on uncompleted contracts | | | $ | 16,580,500 |  |  | | | $ | 5,991,300 |  |
| Estimated earnings (loss) | | | (1,944,600) | |  |  | | | 811,600 | |  |
| Costs and estimated earnings on uncompleted contracts | | | 14,635,900 | |  |  | | | 6,802,900 | |  |
| Billings to date | | | 15,111,200 | |  |  | | | 4,635,700 | |  |
| Costs and estimated earnings in excess of billings on uncompleted contracts | | | — | |  |  | | | 2,167,200 | |  |
| Billings in excess of costs and estimated earnings on uncompleted contracts | | | (475,300) | |  |  | | | — | |  |
| Provision for loss on contract | | | (421,400) | |  |  | | | — | |  |
| Contract Assets (Liabilities), net | | | $ | (896,700) |  |  | | | $ | 2,167,200 |  |

At September 30, 2022, the contract liability of $0.9 million consists of a net loss of $1.9 million and provision for loss on contract of $0.4 million, partially offset by costs in excess of billings of $1.4 million. The uncollected billings as of September 30, 2022 were $5.5 million. At December 31, 2021, the contract asset of $2.2 million consisted of estimated earnings of $0.8 million and costs in excess of billings of $1.4 million. The uncollected billings as of December 31, 2021 were $1.0 million.

**18. SUBSEQUENT EVENTS**

On October 10, 2022, the board of directors of the Company declared a monthly cash dividend on the Company’s Series A Preferred Shares of $0.167 per share. The cash dividend is payable on November 20, 2022 to stockholders of record on October 31, 2022.

On October 20, 2022, the Company entered into a purchase and sale agreement for the sale of 56.63 acres in Punta Gorda, Florida for $7.3 million. Closing is expected to take place in Q4 2022.

On November 10, 2022, the board of directors of the Company declared a monthly cash dividend on the Company’s Series A Preferred Shares of $0.167 per share. The cash dividend is payable on December 20, 2022 to stockholders of record on November 30, 2022.

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

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q (“Report”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical fact included in this Report are forward-looking statements. These forward-looking statements may include projections and estimates concerning the timing and success of specific projects and our future construction, revenues, income, cost of sales, expenses, and capital spending. Our forward-looking statements are generally accompanied by words such as “estimate,” “project,” “predict,” “believe,” “expect,” “intend,” “anticipate,” “potential,” “plan,” “goal,” “foresee,” “likely,” “target,” “may,” “should,” “could,” or other words that convey the uncertainty of future events or outcomes. The forward-looking statements in this Report speak only as of the date of this document and we disclaim any obligation to update these statements unless required by law and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory, and other risks, contingencies, and uncertainties, most of which are difficult to predict and many of which are beyond our control. The following factors, among others, may cause our actual results, performance, or achievements to differ materially from any future results, performance, or achievements expressed or implied by these forward-looking statements:

•economic changes either nationally or in the markets in which we operate, including declines in employment, volatility of mortgage interest rates, and inflation;

•downturn in the homebuilding industry;

•changes in assumptions used to make industry forecasts;

•volatility and uncertainty in the credit markets and broader financial markets;

•our future operating results and financial condition;

•our business operations;

•changes in our business and investment strategy;

•availability of land to acquire and our ability to acquire such land on favorable terms or at all;

•availability, terms, and deployment of capital;

•shortages of or increased prices for labor, land, or raw materials used in housing construction;

•delays in land development or home construction resulting from adverse weather conditions or other events outside our control;

•the cost and availability of insurance and surety bonds;

•changes in, or the failure or inability to comply with, governmental laws and regulations;

•the timing of receipt of regulatory approvals and the opening of projects;

•the degree and nature of our competition;

•our leverage and debt service obligations;

•general volatility of the capital markets;

•availability of qualified personnel and our ability to retain our key personnel;

•our financial performance;

•our expectations regarding the period during which we qualify as an emerging growth company under the JOBS Act;

•the extent to which the COVID-19 pandemic continues to impact our business; and

•additional factors discussed under Part I - Item 1A. Risk Factors in our Annual Report on Form 10-K/A for the year ended December 31, 2021 (the “Annual Report on Form 10-K/A”) as such factors may be updated from time to time in our periodic filings with the Securities and Exchange Commission (the “SEC”) which are accessible on the SEC’s website at http://www.sec.gov.

These forward-looking statements reflect our management’s beliefs and views with respect to future events and are based on estimates and assumptions as of the date of this Report and are subject to risks and uncertainties. Moreover, we operate in a very highly competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. Given these uncertainties, you should not place undue reliance on forward-looking statements contained herein.

You should read this Report and the documents that we reference and have filed as exhibits with the understanding that our actual future results, levels of activity, performance, and achievements may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

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The forward-looking statements made in this Report relate only to events as of the date on which such statements are made. We undertake no obligation to update any forward-looking statements after the date of this Report or to conform such statements to actual results or revised expectations, except as required by law.

**Overview**

Harbor Custom Development, Inc. is a real estate development company involved in all aspects of the land development cycle including land acquisition, entitlements, development, construction of project infrastructure, single and multi-family vertical construction, marketing, sales, and management of various residential projects in Washington, California, Texas, and Florida.

As a land developer and builder of single-family homes, luxury homes, townhomes, and apartments, our business strategy is to acquire and develop land strategically based on an understanding of population growth patterns, entitlement restrictions and land use evaluation, infrastructure development, and geo-economic forces. We endeavor to acquire land with scenic views to develop and sell residential lots, new home communities, townhomes, and multi-story condominium or apartment properties within a 20- to 60-minute commute of some of the nation's fastest-growing metro employment corridors.

We are leading the real estate industry as the first national land developer and home builder accepting payment in the form of cryptocurrency for our properties.

Our portfolio of land, lots, home plans, and finishing options, coupled with a historic low inventory of residential and multi-family housing in our principal geographic areas, provide an opportunity for us to increase revenue and overall market share. In addition to our single-family residential projects, we plan to build and sell townhomes, and apartments. In an effort to strategically control the expanding needs of our corporate team, we signed a lease on October 5, 2021 for a new office space in Tacoma, Washington and moved our headquarters in April 2022. This office space is designed with a hybrid workforce in mind and takes into account employment trends that arose after the COVID-19 global pandemic, specifically the increase in hybrid or remote employees.

It is customary for us to sign purchase and sale agreements that contain a due diligence period which allows us time, usually between 30 and 60 days, to evaluate the acquisition. At times, through our due diligence efforts, we find that a property is not suitable for purchase due to economic forces, zoning issues, or other matters. If we determine that a 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.

Our infrastructure development division constructs a diverse range of residential communities and improved lots. We own and lease heavy equipment which we utilize to build and develop residential subdivisions and multi-family communities. The equipment is primarily used for land clearing, site development, public and private road improvements, installation of wet utilities such as sewer, water, and storm sewer lines, in addition to construction of dry utility lines for power, gas, telephone, and cable service providers.

We are a general contractor and construct single-family homes, townhomes, and apartments utilizing a base of employees in conjunction with third-party subcontractors.

As of November 9, 2022, we own or control 21 communities in Washington, Texas, California, and Florida, containing approximately 2,500 lots or units in various stages of development.

**Results of Operations**

**Three Months Ended September 30, 2022 as Compared to the Three Months Ended September 30, 2021**

The following table sets forth the summary statements of operations for the three months ended September 30, 2022 and 2021.

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|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **2022** | | |  | | | **2021** | | |
|  | | |  | | |  | | |  | | |
| Sales | | | $ | 11,748,500 |  |  | | | $ | 18,010,600 |  |
| Cost of sales | | | (11,310,800) | |  |  | | | (10,866,200) | |  |
| Gross profit | | | 437,700 | |  |  | | | 7,144,400 | |  |
| Operating expenses | | | (4,523,800) | |  |  | | | (3,322,100) | |  |
| Other income (expense) | | | (396,500) | |  |  | | | (113,900) | |  |
| Income tax benefit | | | 1,067,800 | |  |  | | | — | |  |
| Net income (loss) | | | $ | (3,414,800) |  |  | | | $ | 3,708,400 |  |

***Sales***

Our sales decreased by 34.8% to $11.7 million for the three months ended September 30, 2022 as compared to $18.0 million for the three months ended September 30, 2021. Sales decreased in 2022 primarily due to a decrease in the sale of entitled land of $7.0 million and decrease in the sale of developed lots of $0.8 million, partially offset by increases in home sales of $0.8 million and fee build revenue of $0.8 million. There was a large sale of entitled land to Lennar Northwest, Inc. ("Lennar") in the third quarter of 2021 compared to a less significant entitled land sale in the third quarter of 2022.

***Gross Profit***

Our overall gross profit for the quarter decreased by 93.9% to $0.4 million for the three months ended September 30, 2022 as compared to $7.1 million for the three months ended September 30, 2021. Gross margin was 3.7% for the three months ended September 30, 2022 compared to 39.7% for the three months ended September 30, 2021. The $6.7 million decrease in gross profit and 35.9% decrease in gross margin were primarily due to the non-recurrence of higher margin entitled land sales in 2022 and a decrease in fee build gross profit and gross margin due to significant cost overruns. The entitled land sales in the third quarter 2021 provided $5.9 million gross profit dollars at a gross margin of 57.0% that did not recur in the third quarter 2022.

***Operating Expenses***

Our operating expenses increased by 36.2% to $4.5 million for the three months ended September 30, 2022, as compared to $3.3 million for the three months ended September 30, 2021. The increase in total operating expenses is primarily attributable to a bad debt expense of $0.9 million relating to notes and interest receivables from the sale of Winding Lanes developed lots in March 2022 and $0.5 million in pre-acquisition due diligence costs associated with the cancelation of the Westry Village project, partially offset by a reduction in 2022 incentive bonus compensation of $0.6 million. Individually less significant increases in payroll expenses, marketing and advertising, right of use expense for a new corporate office, and depreciation expense, partially offset by a decrease in stock compensation also contributed to the change over the prior year period.

***Other Income (Expense)***

Other income (expense) was $(0.4) million for the three months ended September 30, 2022 as compared to $(0.1) million for the three months ended September 30, 2021. This change is primarily due to $(0.6) million of interest expense incurred for the three months ended September 30, 2022, offset by $0.2 million of interest income incurred. The interest expense increased due to borrowings on the revolving line of credit loan we entered into on March 7, 2022.

***Net Income (Loss)***

Our net income (loss) decreased by 192.1% to $(3.4) million for the three months ended September 30, 2022 as compared to $3.7 million for the three months ended September 30, 2021. The decrease in net income was primarily attributable to a decrease in revenue and gross margins, and increases in cost of sales and operating expenses in the third quarter of 2022 as explained above.

**Nine Months Ended September 30, 2022 as Compared to the Nine Months Ended September 30, 2021**

The following table sets forth the summary statements of operations for the nine months ended September 30, 2022 and 2021.

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|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | | | **2022** | | |  | | | **2021** | | |
|  | | |  | | |  | | |  | | |
| Sales | | | $ | 50,616,000 |  |  | | | $ | 46,017,200 |  |
| Cost of sales | | | (46,055,400) | |  |  | | | (34,938,300) | |  |
| Gross profit | | | 4,560,600 | |  |  | | | 11,078,900 | |  |
| Operating expenses | | | (12,017,200) | |  |  | | | (7,639,700) | |  |
| Other income (expense) | | | $ | (759,800) |  |  | | | $ | (210,600) |  |
| Income tax benefit | | | 1,937,800 | |  |  | | | — | |  |
| Net income (loss) | | | $ | (6,278,600) |  |  | | | $ | 3,228,600 |  |

***Sales***

Our sales increased by 10.0% to $50.6 million for the nine months ended September 30, 2022 as compared to $46.0 million for the nine months ended September 30, 2021. Sales increased in 2022 due to the increases in home sales of $11.5 million, fee build revenue of $3.6 million, and developed lot sales of $1.3 million, partially offset by a decrease in entitled land sales of $11.9 million. The home sales largely increased due to continued expansion into a new geographic location with $15.1 million of homes sold in Texas. The decrease in entitled land sales was due to two large entitled land sales to Lennar, which occurred in 2021 and did not reoccur in 2022.

***Gross Profit***

Our overall gross profit decreased by 58.8% to $4.6 million for the nine months ended September 30, 2022 as compared to $11.1 million for the nine months ended September 30, 2021. Gross margin was 9.0% for the nine months ended September 30, 2022 compared to 24.1% for the nine months ended September 30, 2021. The $(6.5) million decrease in gross profit was primarily due to decreases in entitled land gross profit of $(4.5) million and fee build gross profit of $(3.8) million, which was partially offset by an increase in home sales gross profit of $2.4 million. The 15.1% decrease in gross margin was primarily driven by significant cost overruns with our fee build projects resulting in a 56.1% gross margin decline. The fee build gross margin decline was partially offset by gross margin increases from homes, developed lots, and entitled land sales.

For the nine months ended September 30, 2022 and 2021, gross margins on land sales were 48.5% and 42.0%, developed lot sales were 10.3% and 2.9%, homes closed were 16.7% and 13.3%, and fee build was (40.7)% and 15.4%, respectively.

***Operating Expenses***

Our operating expenses increased by 57.3% to $12.0 million for the nine months ended September 30, 2022 as compared to $7.6 million for the nine months ended September 30, 2021. The increase in total operating expenses is primarily attributable to the following:

1)Payroll expenses increased by $1.2 million due to increase in staff from the investment we made in our public company infrastructure and to support our future growth plan;

2)We incurred a bad debt expense of $0.9 million associated with the Winding Lane notes and interest receivable from the sale of developed lots in March 2022;

3)We incurred $0.5 million in pre-acquisition due diligence costs associated with the Westry Village project that we decided not to purchase;

4)Professional fees increased by $0.5 million primarily driven by establishing and maintaining public company infrastructure and oversight;

5)We incurred additional right of use expense of $0.3 million from leasing an office space in Tacoma, Washington for our new corporate headquarters;

6)We incurred additional depreciation expense of $0.2 million related to furniture, fixtures, and leasehold improvements for the new corporate office and equipment additions; and

7)Advertising and marketing increased by $0.2 million as a result of increased marketing activities to promote our company and real estate projects.

***Other Income (Expense)***

Other expense increased for the nine months ended September 30, 2022 to $0.8 million as compared to $0.2 million for the nine months ended September 30, 2021. This is primarily due to $1.0 million of interest expense incurred for the nine

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months ended September 30, 2022, offset by interest income of $0.4 million. The interest expense increased due to the revolving line of credit loan we entered into on March 7, 2022.

***Net Income (Loss)***

Our net income (loss) decreased by 294.5% to a net loss of $(6.3) million for the nine months ended September 30, 2022 as compared to net income of $3.2 million for the nine months ended September 30, 2021. The decrease in net income was primarily attributable to a decrease in gross margins and increased operating expenses as explained above.

**Liquidity and Capital Resources**

**Overview**

Our principal uses of capital were operating expenses, land purchases, land development, single and multi-family construction, the payment of routine liabilities, payments on construction loans and related party construction loans, financing fees for the revolving line of credit and construction loans, and repurchase of company equity securities. We used funds generated by operations and available borrowings to meet our short-term working capital requirements. We remain focused on generating positive margins in land acquisitions and development operations and home construction operations in order to maintain a strong balance sheet and keep us poised for growth.

We employ both debt and equity as part of our ongoing financing strategy to provide us with the financial flexibility to access capital on the best terms available. In that regard, we employ prudent leverage levels to finance the acquisition and development of our lots and construction of our homes, townhomes, and apartments. Our existing indebtedness is recourse to us and we anticipate that future indebtedness will likewise be recourse.

Our management considers a number of factors when evaluating our level of indebtedness and when making decisions regarding the incurrence of new indebtedness, including the purchase price of assets to be acquired with debt financing, the estimated market value of our assets, and the ability of particular assets, and our company as a whole, to generate cash flow to cover the expected debt service costs. Our governing documents do not contain a limitation on the amount of debt we may incur and our board of directors may change our target debt levels at any time without the approval of our shareholders.

We intend to finance future acquisitions and developments with the most advantageous source of capital available to us at the time of the transaction, which may include a combination of common and preferred equity, secured and unsecured corporate level debt, property level debt and mortgage financing, and other public, private, or bank debt.

***Real Estate Assets***

Our real estate assets increased to $179.9 million as of September 30, 2022 from $122.1 million as of December 31, 2021. This increase was due to an increase in development and construction activities for houses, townhomes, and apartments.

***Liabilities***

Liabilities increased to $139.3 million as of September 30, 2022 from $70.0 million as of December 31, 2021. This increase is primarily attributable to the following:

1.An increase in our construction loans, net of related party loans of $43.8 million to fund the development of land and construction of houses, townhomes, and apartments;

2.A new revolving credit facility was entered into with BankUnited from which we have borrowed $24.0 million net of debt discount to fund our general working capital needs; and

3.Accounts payable and accrued expenses increased by $2.7 million, primarily driven by an increase in trade accounts payable due to an increase of real estate projects in process.

***Unrestricted Cash Balance***

As of September 30, 2022, our unrestricted cash balance was $13.7 million compared to $25.6 million as of December 31, 2021.

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***Operating Activities***

Net cash used in operating activities for the nine months ended September 30, 2022 was $68.2 million as compared to $79.6 million for the nine months ended September 30, 2021. The decrease in cash used is primarily attributable to a decrease in real estate assets of $26.6 million and a decrease in contract assets of $6.9 million, partially offset by a decrease in net income of $9.5 million, an increase in notes receivable of $8.5 million, and an increase in accounts receivable of $4.4 million.

***Investing Activities***

Net cash used in investing activities for the nine months ended September 30, 2022 was $1.6 million as compared to net cash used of $0.3 million for the nine months ended September 30, 2021. During the nine months ended September 30, 2022, $1.8 million was used for the furniture, fixtures, and leasehold improvements of the new corporate office and purchase of equipment compared to $0.4 million used for the acquisition of new equipment for the nine months ended September 30, 2021. These purchases were partially offset by the proceeds from the sale of equipment.

***Financing Activities***

Net cash provided by financing activities for the nine months ended September 30, 2022 was $57.9 million as compared to net cash provided of $82.9 million for the nine months ended September 30, 2021. This decrease was primarily caused by net proceeds from a common stock offering of $25.1 million and net proceeds from a preferred stock offering of $28.7 million in 2021 that did not recur in the 2022 comparable period, a decrease in cash received from related party construction loans, net of payments of $10.9 million, and an increase in cash used for 2022 preferred dividends of $5.3 million. This decrease was partially offset by net cash provided by the revolving line of credit loan of $24.8 million in 2022 and an increase in cash provided by construction loans, net of payments of $19.7 million.

***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).

**Inflation**

Our 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 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 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 consolidated financial statements.

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***Implications of Being an Emerging Growth Company***

We are an “emerging growth company” as defined in the JOBS Act and we are eligible to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies.” These provisions include:

•a requirement to present only two years of audited financial statements and only two years of related Management’s Discussion and Analysis of Financial Condition and Results of Operations included in a public offering registration statement;

•an exemption to provide fewer than five years of selected financial data in a public offering registration statement;

•an exemption from the auditor attestation requirement of Section 404 of the Sarbanes-Oxley Act (“SOX”) in the assessment of the emerging growth company’s internal control over financial reporting;

•an exemption from the adoption of new or revised financial accounting standards until they would apply to private companies; and

•an exemption from compliance with any new requirements adopted by the Public Company Accounting Oversight Board requiring mandatory audit partner rotation or a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer.

We have elected to adopt the reduced disclosure requirements available to emerging growth companies. As a result of this election, the information that we provide in this Report may be different than the information you may receive from other public companies in which you hold equity interests.

We will cease to be an “emerging growth company” upon the earliest of: (i) the end of the fiscal year following the fifth anniversary of our initial public offering (December 31, 2025), (ii) the first fiscal year after our annual gross revenues are $1.235 billion or more, (iii) the date on which we have, during the previous three-year period, issued more than $1.0 billion in non-convertible debt securities or (iv) as of the end of any fiscal year in which the market value of our common stock held by non-affiliates exceeded $700 million as of the end of the second quarter of that fiscal year.

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

We borrow from lenders using financial instruments such as term loans, notes payable, and a revolving credit facility. We utilize both fixed and variable interest rates in these financing operations. Interest incurred from our term loans and notes payables is calculated primarily using a fixed rate, whereas interest incurred from our revolving credit facility is calculated using a variable rate. We do not have the obligation to prepay these prior to maturity, and, as a result, interest rate risk and changes in fair market value should not have a significant impact on our fixed-rate debt.

We are exposed to market risks related to fluctuations in interest rates on our outstanding revolving line of credit and construction loan relating to Meadowscape apartments. The interest rate for our variable rate indebtedness as of September 30, 2022 was equal to the daily simple secured overnight financing rate (SOFR) plus an applicable margin of 4.75% for the line of credit and equal to the SOFR one month rate plus an applicable margin of 7.25% for the construction loan. At September 30, 2022, the daily SOFR was 2.98% and one month SOFR was 2.47%. A hypothetical 100 basis point increase in the interest rate on our variable rate indebtedness would increase our annual interest cost by approximately $0.2 million for the line of credit and $0.1 million for the construction loan, respectively. Based on this, we do not believe that the future interest rate risks related to our existing indebtedness will have a material adverse impact on our financial position, results of operations, or liquidity.

At September 30, 2022, we had outstanding fixed-rate borrowings net of debt discount and financing fees of approximately $88.6 million and outstanding variable-rate borrowings net of debt discount and financing fees of approximately $32.6 million.

**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

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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.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

**ITEM 1. LEGAL PROCEEDINGS**

We are not party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, prospects, financial condition, liquidity, or results of operation. However, we may from time to time after the date of this Report become subject to claims and litigation arising in the ordinary course of business. One or more unfavorable outcomes in any claim or litigation against us could have a material adverse effect for the period in which such claim or litigation is resolved. In addition, regardless of their merits or their ultimate outcomes, such matters are costly, divert management’s attention, and may materially adversely affect our reputation, even if favorably resolved.

**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors we previously disclosed in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2021.

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

(a) Sales of Unregistered Securities

None.

(b) Use of Proceeds from Sales of Securities

None.

(c) Repurchases of Our Equity Securities

**2020 Restricted Stock Plan**

The following table sets forth the shares of our common stock we acquired during the quarter as a result of the surrender of shares by employees to satisfy tax withholding obligations in connection with the vesting of restricted shares of common stock awarded under our 2020 Restricted Stock Plan.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Period** | | |  | | | **Total Number of Shares Purchased (1)** | | |  | | | **Average Price Paid per Share** | | |  | | | **Total Number of Shares Purchased as Part of Publicly Announced Plans or Program** | | |  | | | **Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs** | | |
| July 1, 2022 - July 31, 2022 | | |  | | | — | |  |  | | | $ | — |  |  | | | — | |  |  | | | $ | — |  |
| August 1, 2022 - August 31, 2022 | | |  | | | 1,483 | |  |  | | | 1.40 | |  |  | | | 1,483 | |  |  | | | — | |  |
| September 1, 2022 - September 30, 2022 | | |  | | | 124 | |  |  | | | 1.14 | |  |  | | | 124 | |  |  | | | — | |  |
| Total | | |  | | | 1,607 | |  |  | | | — | |  |  | | | 1,607 | |  |  | | | — | |  |

(1) Represents shares surrendered to us by employees to satisfy tax withholding obligations arising in connection with the vesting of 5,417 shares of common stock awarded under our 2020 Restricted Stock Plan.

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**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

We failed to meet a financial covenant of the Loan Agreement with BankUnited, N.A. (the “Lender”), dated March 7, 2022 (the “Loan”). Under the Loan, we covenanted that we would not allow our Interest Coverage Ratio as of the last day of each fiscal quarter to be less than 2.50. The Interest Coverage Ratio is defined as the ratio of EBITDA for the trailing four quarters to Interest Expense for the trailing four quarters. We had an Interest Coverage Ratio of 1.4 on September 30, 2022. Under the Loan, a failure to maintain the required Interest Coverage Ratio financial covenant is defined as an “Event of Default.” For such Event of Default, the Lender may accelerate all amounts due under the Loan. The Lender has informed us that the Lender is sending the Loan to its restructuring department for potential restructuring, and, to date, has not provided us with a Notice of Default or Lender’s intention to accelerate payment of any amounts due under the Loan.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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| **Exhibit No.** | | |  | | | **Description** | | |  | | | **Form** | | |  | | | **Exhibit** | | |  | | | **Filing Date** | | |  | | | **Filed Herewith** | | |
|  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |  | | |
| 31.1 | | |  | | | [Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](hcdi-093022exhibit311.htm) | | |  | | |  | | |  | | | 31.1 | | |  | | |  | | |  | | | X | | |
| 31.2 | | |  | | | [Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](hcdi-093022exhibit312.htm) | | |  | | |  | | |  | | | 31.2 | | |  | | |  | | |  | | | X | | |
| 32 | | |  | | | [Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](hcdi-093022exhibit32.htm) | | |  | | |  | | |  | | | 32 | | |  | | |  | | |  | | | X | | |
| 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**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused

this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

|  |  |  |  |  |  |  |  |  |
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|  | | | **HARBOR CUSTOM DEVELOPMENT, INC.** | | | | | |
|  | | |  | | |  | | |
| Date: November 14, 2022 | | | By | | | */s/ Sterling Griffin* | | |
|  | | |  | | | Sterling Griffin Chief Executive Officer and President (Principal Executive Officer) | | |
|  | | |  | | |  | | |
| Date: November 14, 2022 | | | By | | | */s/ Lance Brown* | | |
|  | | |  | | | Lance Brown Chief Financial Officer (Principal Financial and Accounting Officer) | | |

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