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CAPITAL PACIFIC HOLDINGS INC

Form 10-K

May 29, 2001

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SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
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FORM 10-K  
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- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED FEBRUARY 28, 2001

COMMISSION FILE NUMBER: 001-09911

CAPITAL PACIFIC HOLDINGS, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION) 4100 MACARTHUR BLVD., SUITE 200 NEWPORT BEACH, CALIFORNIA (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	95-2956559 (IRS EMPLOYER IDENTIFICATION NUMBER)  92660 (ZIP CODE)
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(949) 622-8400  
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

COMMON STOCK \$.10 PAR VALUE  
(TITLE OF EACH CLASS)

THE AMERICAN STOCK EXCHANGE  
(NAME OF EACH EXCHANGE ON WHICH REGISTERED)

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE

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 and (2) has been subject to such filing  
requirements for the past 90 days. Yes  No

At May 1, 2001, the aggregate market value of the voting stock held by  
persons other than the directors, executive officers and principal shareholders  
filing Schedules 13D of the Registrant was \$6,780,718 as determined by the  
closing price on the American Stock Exchange. The basis of this calculation does  
not constitute a determination by the Registrant that all of its principal

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shareholders, directors and executive officers are affiliates as defined in Rule 405 under the Securities Act of 1933.

At May 1, 2001, there were 13,716,811 shares of Common Stock outstanding.

Part III incorporates certain information by reference to the Registrant's definitive proxy statement to be filed with the Commission no later than June 28, 2001.

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### PART I

#### ITEM 1. BUSINESS

##### GENERAL

Capital Pacific Holdings, Inc., together with its subsidiaries (the "Company"), is a regional builder and developer with operations throughout selected metropolitan areas of Southern California, Nevada, Texas, Arizona and Colorado. The Company's principal business activities are to build and sell single-family homes. The Company's single-family homes are targeted to entry-level, move-up and luxury buyers. Since 1975, the Company has built and sold over 23,000 homes in the markets it serves. During the fiscal year ended February 28, 2001, the Company (including unconsolidated joint ventures) closed 2,199 home and lot sales, including 1,209 homes, at an average home sales price of \$315,000. The Company currently conducts its operations under various names, including the name Capital Pacific Homes in California, Nevada, Arizona and Colorado and Clark Wilson Homes, Inc. ("Clark Wilson") in Texas.

In fiscal year 1998, the Company consummated an equity and restructuring transaction whereby the Company and certain of its subsidiaries transferred to Capital Pacific Holdings, LLC ("CPH LLC") substantially all of their respective assets and CPH LLC assumed all the liabilities of the Company and its subsidiaries. An unaffiliated investment company, California Housing Finance, L.P. ("CHF") then acquired a 32.07% minority interest in CPH LLC as a result of a cash investment in CPH LLC. From fiscal 1998 through fiscal 2001, the Company expanded its operating strategy to encompass the acquisition and development of commercial and mixed-use projects, as well as ownership of existing commercial properties, primarily through non-majority investments in joint ventures, with approximately 99% of the capital for these projects being provided by CHF and its affiliates.

In February 2001, the Company and CHF consummated an interest exchange transaction (the "Exchange Transaction"), whereby the Company exchanged its interests in the majority of the joint ventures capitalized by CHF (the "Divested Joint Ventures") for approximately 75% of CHF's interest in CPH LLC and all of CHF's interests in certain residential joint ventures. At February 28, 2001, the Company had a 93% interest in CPH LLC and CHF held a 7% minority interest. The Company and CHF both have an option to convert CHF's remaining 7% interest in CPH LLC into 1,235,000 shares of non-voting Common Stock of the Company for the period extending from 90 to 180 days following the closing of the Exchange Transaction. The Company expects that this option will be exercised. In addition, Capital Pacific Homes, Inc., a subsidiary of the Company, has entered or expects to enter into construction, management and marketing agreements relating to certain of the Divested Joint Ventures with residential components (the "Managed Projects").

The Exchange Transaction had the effect of lowering the Company's exposure to the risks associated with land development activities and to commercial and

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very high-end projects which were, in the Company's judgement, more vulnerable than the Company's other operations in the event of an economic slowdown. The Exchange Transaction also increased the Company's equity in CPH, LLC by approximately \$28 million and its equity in certain other residential joint ventures. The Company was also released from any potential obligations to make future investments in the Divested Joint Ventures. In addition, through the management fees which will continue to be paid with respect to the Managed Projects, the Company will retain some of the economic benefit of the Divested Joint Ventures.

While the Company has relinquished the potential economic benefits of a substantial increase in the realizable value of the Divested Joint Ventures, the Company made the judgment to enter into the Exchange Transaction in light of the benefits set forth above and the fact that any such increased value in any particular Divested Joint Venture (1) would be potentially offset by the potential loss of the Company's investment in other Divested Joint Ventures, (2) would be subordinate to all bank and other debt financing and would in effect be subordinate to the investment by CHF in such venture, since CHF's investment of 99% of the capital in such venture would receive a 12% annual preferred rate of return before the Company would receive anything more than the same return on its 1% capital, and (3) would be dependent upon a host of factors, including regulatory approvals and economic conditions.

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Assets under management, including assets owned by unconsolidated joint ventures and Managed Projects, totaled \$475 million at February 28, 2001 in 55 residential properties. At February 28, 2001, CPH LLC had \$244 million in assets and a net worth of \$109 million. The Company is the sole managing member of CPH LLC. The Company maintains certain licenses and other assets as is necessary to fulfill its obligations as managing member and under management agreements. The Company and its subsidiaries perform their respective management functions for CPH LLC and the Managed Projects pursuant to management agreements, which include provisions for the reimbursement of Company and subsidiary costs and a management fee. CPH LLC, the Managed Projects and certain other project-specific entities indemnify the Company against liabilities arising from the projects owned by such entities.

References to the Company are, unless the context indicates otherwise, also references to CPH LLC and the project-specific entities in which the Company has an equity ownership interest. At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by the project-specific entities.

### STRATEGY

The Company's long-term strategy includes the following key elements:

(1) Maintaining diversity in its geographic markets. The Company believes that geographic market diversification is a key element in achieving long-term stability and growth. While the Company has no specific plans to expand outside the Southern California, Texas, Arizona, Colorado and Nevada markets, it may consider expansion to other markets in the future.

(2) Diversifying its product. The Company builds homes targeted for all price segments, from entry level buyers to the semi-custom luxury market move-up buyers, so that it is able to deliver well-priced homes to a broad segment of its potential customer base. Within Texas, Arizona, Colorado and Nevada, the Company serves the entry level as well as move-up markets. Within Southern California, the Company has products targeted

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toward second and third time move-up buyers, as well as the million dollar luxury market. This product diversification enables the Company to adapt to changing market conditions.

(3) Enhancing the Company's capital base and sources of financial liquidity. In addition to the equity and restructuring transaction described above, the Company has diversified sources of financing and will continue to pursue new financing alternatives in the future. In fiscal year 1995, the Company accessed the public debt capital markets through the sale of \$100 million of 12 3/4% Senior Notes ("Senior Notes") including 790,000 warrants to purchase common stock (the "Offering"). The Senior Notes are due May 1, 2002. The proceeds from the offering were used to repay certain debt of the Company, acquire certain properties and for general working capital purposes. Effective upon the completion of the October 1, 1997 equity and restructuring transaction, the obligations under the Senior Notes were transferred to CPH LLC. Credit facilities in place at February 28, 2001 totaled \$251 million, of which \$104 million was outstanding. The Company intends to maintain, through CPH LLC and other entities in which it has an equity ownership interest, its traditional lending relationships as a source of liquidity to the extent permitted by the indenture (the "Indenture") to which the Notes are subject. The Company believes this financing strategy allows orderly growth and greater flexibility to react quickly to changing market conditions. The Company also utilizes joint ventures within its operations as a source of financing and risk management. The Company has repurchased approximately \$44.4 million of the Senior Notes and is currently considering alternatives for refinancing the remaining Senior Notes.

(4) Controlling costs and maintaining operational efficiency. The Company has job cost, warranty tracking and construction scheduling systems and other quality control processes to control costs and to reduce the effect of certain risks inherent in the home-building industry. These systems and controls enable the Company to monitor and improve its efficiencies.

(5) Minimizing inventory risk. The Company tries to carefully manage its land and inventory risk in a variety of ways. The Company monitors its supply of owned, optioned and controlled land to maintain

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an adequate pipeline of building lots in each of its markets while avoiding excess land holdings. For its homebuilding projects, the Company generally prefers to purchase entitled land, typically in parcels of 50 to 250 lots, and makes use of options, seller financing and joint ventures, when available, to reduce its capital commitment and exposure to risks. "Entitled" land is generally defined as land that has received all necessary land use approvals for residential development from the appropriate state, county and local governments, including any required tract maps and subdivision approvals. The Company generally tries to limit its speculative building by commencing construction only after some sales have been made and tries to limit the size of each construction phase. The Company generally purchases and holds land in amounts sufficient to support home production and sales over a 24 to 48 month period in California, and in amounts sufficient to support home production and sales over an 18 to 36 month period in Texas, Arizona, Colorado and Nevada. In Nevada, the Company's plans do not include any additional land purchases.

(6) Land Development. In certain project-specific joint ventures, the Company has purchased unentitled land, with the intention of obtaining the required entitlements and then either selling the unimproved land,

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developing lots and selling them to other builders or building homes itself. Due in part to a declining inventory of entitled land in certain of the Company's markets, the Company's land development activities may increase. The completion of the Exchange Transaction, however, has reduced the Company's exposure to the risks arising from land development activities.

### HOMEBUILDING GEOGRAPHIC MARKETS

At February 28, 2001, the Company, either directly or through joint ventures, including 6 Managed Projects in which the Company does not have an equity ownership interest, controlled lots in various stages of development with respect to approximately 55 residential projects, including 18 projects located in the Orange, Los Angeles, Santa Barbara and Riverside Counties of Southern California, 5 projects located in Las Vegas, Nevada, 10 projects located in Austin, Texas, 12 projects located in Phoenix, Arizona and 10 projects in the Denver metropolitan and Colorado Springs areas of Colorado. The Company is currently selling homes in 28 of these projects. The Company's homes for sale currently range in size from 950 to 8,000 square feet in Southern California, from 1,600 to 3,600 square feet in Nevada, from 1,500 to 4,500 square feet in Texas, from 1,000 to 3,300 square feet in Arizona and from 1,200 to 2,500 square feet in Colorado. The Company's homes are currently priced from \$75,000 to \$5,800,000 in Southern California, from \$115,000 to \$385,000 in Nevada, from \$170,000 to \$1,300,000 in Texas, from \$113,000 to \$324,000 in Arizona, and from \$128,000 to \$243,000 in Colorado.

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The following table sets forth the estimated number of homes under construction and lots owned, under option and controlled as of February 28, 2001:

ESTIMATED NUMBER OF HOUSING UNITS THAT COULD BE  
CONSTRUCTED ON LAND CONTROLLED AS OF FEBRUARY 28, 2001(a)

REGION -----	HOMES UNDER CONSTRUCTION(b) -----	LOTS OWNED -----	LOTS UNDER OPTION(c) -----	LOTS CONTROLLED(d) -----
Southern California.....	115	300	57	590
Managed Projects (Southern California).....	34	248	--	--
Nevada.....	69	--	46	--
Texas.....	240	236	263	2,092
Arizona.....	116	350	144	636
Colorado.....	90	838	14	2,102
	---	-----	---	-----
Total.....	664	1,972	524	5,420
	===	=====	===	=====

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(a) Based upon current management estimates, which are subject to change. This table includes housing units in the Managed Projects in which the Company's sole economic interest is through management agreements.

(b) Including completed model homes.

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- (c) Lots under option represent lots under rolling option contracts within existing projects. There can be no assurance that the Company will actually acquire any lots under option.
- (d) Controlled home sites include those properties for which the Company has entered into a variety of contractual relationships including non-binding letters of intent, binding purchase agreements with customary conditions precedent and similar arrangements. There can be no assurance that the Company will actually acquire any such properties.

The table below summarizes the residential developments currently in process in the Company's geographic markets:

PROJECTS AND UNITS CURRENTLY IN PROCESS(a)

REGION -----	NUMBER OF PROJECTS HELD FOR DEVELOPMENT (b) -----	NUMBER OF PROJECTS IN SALES STAGE (c) -----	TOTAL UNITS PLANNED (d) -----	UNITS CLOSED IN FY 2001 -----
Southern California.....	12	7	809	80
Managed Projects (Southern California).....	6	2	335	46
Nevada.....	5	4	671	446
Texas.....	10	5	2,281	894
Arizona.....	12	5	1,056	243
Colorado.....	10	5	1,322	490
	--	--	-----	-----
Total.....	55 ==	28 ==	6,474 =====	2,199 =====

- (a) This table includes the Managed Projects in which the Company's sole economic interest is through management agreements.
- (b) The number of projects held for development includes projects with houses in the planning, development, construction and sales stages.
- (c) The number of projects in the sales stage includes projects where the sales office has opened, reservations are being taken or sales contracts are being executed.
- (d) Includes units under construction, in backlog and lots under option in projects owned by the Company or the Managed Projects.

JOINT VENTURES

The Company conducts its operations as either wholly owned projects or through joint ventures in which the joint venture partner typically provides more than a majority of the capital and/or financing required for the project. The Company has utilized joint ventures in order to increase access to sources of capital, financing and quality sites. The Company expects to continue to utilize joint ventures in the future on a selective basis, taking into account other available sources of financing, project risk and the potential return to the Company. The Company typically is required to fund a small percentage of the

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capital requirements of each joint venture, which amount is included in investments in and advances to unconsolidated joint ventures in the Company's consolidated balance sheets.

### Residential Subsidiaries, Joint Ventures and Managed Projects

At February 28, 2001, the Company's residential subsidiaries (wholly-owned as a result of the Exchange Transaction), joint ventures and Managed Projects, were as follows:

	TOTAL UNITS PLANNED	UNITS CLOSED IN FY 2001	UNITS REMAINING AT 2/28/01
	-----	-----	-----
<b>CONSOLIDATED SUBSIDIARIES (a)</b>			
CPH Newport Coast, LLC -- Orange County.....	97	35	61
CPH Yucaipa I, LLC -- Riverside County.....	100	4	96
	-----	-----	-----
	197	39	157
	-----	-----	-----
<b>UNCONSOLIDATED JOINT VENTURES</b>			
CPH Colorado, LLC -- Boulder County.....	485	--	485
CPH Providence Ranch, LLC -- Riverside County.....	98	--	98
	-----	-----	-----
	583		583
	-----	-----	-----
<b>MANAGED PROJECTS (b)</b>			
Makallon RPV Associates, LLC -- Los Angeles County.....	79	9	70
Makallon Dana Point, LLC -- Orange County.....	44	--	44
Makallon Monarch Beach, LLC -- Orange County.....	65	37	21
Makallon Resorts I, LLC -- Orange County(c).....	92	--	92
Makallon Vista Palisades, LLC -- San Diego County.....	55	--	55
	-----	-----	-----
	335	46	282
	-----	-----	-----
	1,115	85	1,022
	=====	=====	=====

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(a) Previously consolidated joint ventures. Minority interest in these joint ventures was acquired in Exchange Transaction.

(b) Previously unconsolidated joint ventures.

(c) Residential portion of joint venture. Includes two projects.

### LAND ACQUISITION

For typical residential developments, the Company tries to purchase and hold land in California in amounts sufficient to support home production and sales over a 24 to 48 month period. The Company also tries to maintain an additional 18-month supply of entitled land through options and other means. The Company typically purchases or options entitled land in Texas, Arizona and Colorado in amounts sufficient to support home production and sales over an 18 month to 36 month period. In Nevada, the Company's plans do not include any additional land purchases. The Company typically does not acquire and hold land

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for speculative investment.

The Company typically considers numerous factors when analyzing the suitability of land for acquisition and development including, but not limited to, proximity to existing developed areas; population growth

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patterns; availability of existing community services (i.e., utilities, schools and transportation); employment growth rates; anticipated absorption rates for new housing; and the estimated cost of development.

The Company tries to avoid speculative building by constraining project phase sizes, and entitlement risks by acquiring entitled land when practicable and acquiring lots through the use of options, development agreements and joint ventures with lot owners, when appropriate. Additionally, by forming strategic alliances with partners, the Company has been able to obtain access to additional capital and construction financing to spread project risk, which allows the Company to minimize the risk of holding property and to preserve its capital. To date, the Company's alliances have been conducted through joint ventures.

During fiscal years 2000 and 2001, the Company expanded its land development presence in the Southern California market. The Company has reduced its exposure to the risks associated with land development through completion of the Exchange Transaction. Due in part to a declining inventory of entitled land in certain of the Company's markets, the Company's land development activities may increase.

### PRODUCT DESIGN

The Company has received numerous industry design awards for its homes and developments. One of the Company's Managed Projects has been featured in several nationally known periodicals, on network television and in various international publications. The Company's homes are noted for their innovative design, attention to detail and quality construction. By emphasizing the right product designs, the Company has also been able to build brand loyalty while attempting to reduce warranty costs. In many markets, resales of the Company's homes include the Company's name as a sign of quality construction and design.

The Company contracts with a number of outside architects, designers, engineers, consultants and subcontractors. While some of the Company's employees are involved in various stages of the design process, the Company believes that the use of third parties for the production of the final design, engineering and construction reduces its costs, increases design innovation and quality, and reduces the risks of liability associated with the design and construction process. The Company monitors the work of outside architects, designers and engineers through consultants and employees of the Company. The Company believes it is critical to coordinate the design process with the construction and sales and marketing efforts of the Company to ensure an appropriate balance between market responsiveness, design innovation, construction effectiveness and quality.

The Company creates architectural variety within its projects by offering numerous models, floor plans, and exterior styles in an effort to enhance home values by creating diversified neighborhood looks within its projects. Generally, the Company selects the exterior finishes of its homes. The Company offers homebuyers the opportunity to engage interior design consultants to personalize the interior of their homes. Such services are offered at an additional cost to buyers in California through the Company's wholly owned subsidiary, Newport Design Center ("Newport Design"), or the services may be



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provided through the homebuyer's own consultants.

### DEVELOPMENT AND CONSTRUCTION

The Company acts as the general contractor for the construction of its projects and the Managed Projects. Virtually all construction work for the Company is performed by subcontractors. The Company's consultants and employees coordinate the construction of each project and the activities of subcontractors and suppliers, and subject their work to quality and cost controls and compliance with zoning and building codes. Subcontractors typically are retained on a phase-by-phase basis to complete construction at a fixed price. Agreements with the Company's subcontractors are generally entered into after competitive bidding on a project by project basis. The Company has established relationships with a large number of subcontractors and is not dependent to any material degree upon the services of any one subcontractor and believes that, if necessary, it can generally retain sufficient qualified subcontractors for each aspect of construction. The Company believes that conducting its operations in this manner enables it not only to readily and efficiently adapt to changes in housing demand, but also to avoid fixed costs associated with retaining construction personnel.

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The Company typically develops its residential projects in several phases generally averaging approximately 10 to 15 homes per phase. From market studies, the Company determines the number of homes to be built in the first phase, the appropriate price range for the market and other factors. The first phase of home construction is typically small to reduce risk while the Company measures consumer demand. Construction generally does not begin until some sales have occurred, except for construction of model homes. Subsequent phases are generally not started until 50% to 75% of the homes in the previous phase have been sold. Sales prices in the second phase are then adjusted to reflect market demand as evidenced by sales experience in the first phase. With each subsequent phase, the Company continues to accumulate market data which, along with information such as time of year, the local labor situation and the availability of materials and supplies, enables the Company to determine the pricing, timing and size of subsequent phases. Although the time required to complete a phase varies from development to development depending on the above factors, the Company typically completes construction of a phase within one of its California developments in approximately six to ten months for larger homes and four to five months for smaller homes and within its Texas, Arizona, Colorado and Nevada developments within three to five months.

### SALES AND MARKETING

The Company typically builds, furnishes and landscapes model homes for each residential project and maintains on-site sales offices, which are usually open seven days a week. Management believes that model homes play a particularly important role in the Company's marketing efforts. Consequently, the Company expends a significant effort in creating an attractive atmosphere at its model homes. Interior decorations vary among the Company's models and are carefully selected based upon the lifestyles of targeted buyers. Structural changes in design from the model homes generally are not permitted, but homebuyers may select various optional construction and design amenities.

The Company normally sells all of its homes through Company sales representatives who typically work from the sales offices located either at the model homes or at sales centers used in each subdivision. When appropriate, the Company also uses cooperative brokers to sell its homes. Company sales representatives are available to assist prospective buyers by providing them with floor plans, price information and tours of model homes, and to assist them with the selection of options and upgrades. Sales representatives attend

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periodic meetings at which they are provided with information regarding other products in the area, the variety of financing programs available, construction schedules and marketing and advertising plans.

The Company generally opens an on-site sales office before the construction of the model homes is completed. This on-site sales office is utilized as a temporary sales center to commence the sales process to potential customers. Potential homebuyers may reserve a home by submitting a refundable deposit (a reservation deposit) usually ranging from \$500 to \$20,000 and executing a reservation document. The Company then conducts preliminary research concerning the credit status of the potential homebuyer in order to "pre-qualify" the homebuyer. Once the prospective homebuyer has been "pre-qualified" and there is a strong indication that the homebuyer will qualify for a mortgage (although final loan approval is still pending), the homebuyer must then convert the reservation deposit to an "earnest money deposit" and complete a purchase contract for the purchase of their home. The Company attempts to keep its contract cancellation rate low by attempting to pre-qualify prospective homebuyers and by allowing homebuyers to customize their homes at an early point in the purchase process. When home purchase contracts are canceled, damages are usually limited to a percentage of the purchase price of the home and may be less pursuant to applicable law or to the terms of the purchase contract. The Company generally determines whether to seek to obtain such damages on a case-by-case basis. When home purchase contracts are canceled, the Company is usually able to identify alternate homebuyers.

The Company makes extensive use of advertising and promotional resources, including newspaper and magazine advertisements, brochures, direct mail and the placement of strategically located signboards in the immediate areas of its projects, and occasionally places radio and television advertisements. Because the Company usually offers multiple projects within a market area, it is able to utilize regional advertising that highlights all of the Company's projects within that same market area. The Company's wholly-owned

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subsidiary, Creative Design & Media, designs most advertising materials and brochures for the Company's California operations.

The Company has established a highly sophisticated website on the Internet, [www.cph-inc.com](http://www.cph-inc.com). In addition, Clark Wilson Homes' website can be found at [www.clarkwilsonhomes.com](http://www.clarkwilsonhomes.com). The Company utilizes the Internet through its website address to augment its advertising and promotional activities. The Company intends to continue to pursue B2C and B2B opportunities with the intention of increasing communication and operating efficiencies.

The Company provides flooring and other amenities and upgrades to its homebuyers in California through Newport Design and through its design center in Texas.

### OPERATING DATA

The following table shows new home and lot deliveries, net new orders and average sales prices for each of the last three fiscal years for each of the Company's residential operations, including unconsolidated joint ventures:

YEAR ENDED		
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FEBRUARY 28, 1999	FEBRUARY 29, 2000	FEBRUARY 28, 2001

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New homes delivered:			
California.....	119	58	68
Texas.....	438	471	426
Nevada.....	217	339	231
Arizona.....	70	358	240
Colorado.....	--	42	198
	-----	-----	-----
Subtotal.....	844	1,268	1,163
Unconsolidated Joint Ventures (California).....	88	28	46
	-----	-----	-----
Total homes delivered.....	932	1,296	1,209
	-----	-----	-----
Lots delivered.....	50	710	990
	-----	-----	-----
Total homes and lots delivered.....	982	2,006	2,199
	=====	=====	=====
Net new orders.....	1,053	1,397	1,155
	=====	=====	=====
Average sales price for homes delivered:			
California (excluding unconsolidated joint ventures).....	\$566,000	\$898,000	\$1,518,000
California (including unconsolidated joint ventures).....	698,000	935,000	1,458,000
Texas.....	164,000	189,000	203,000
Nevada.....	190,000	206,000	211,000
Arizona.....	148,000	144,000	159,000
Colorado.....	--	193,000	212,000
Combined (excluding unconsolidated joint ventures).....	224,000	216,000	274,000
Combined (including unconsolidated joint ventures).....	287,000	233,000	315,000

BACKLOG AND INVENTORY

The Company typically pre-sells homes prior to and during construction through home purchase contracts requiring earnest money deposits or through reservation documents requiring reservation deposits. Generally, reservation deposits are refundable, but home purchase contracts are not cancelable unless the customer is unable to sell their existing home, qualify for financing or under certain other circumstances. A home sale is placed in backlog status upon execution of such a contract or reservation and receipt of an earnest money deposit or reservation deposit and is removed when such contracts or reservations are canceled as described above or the home purchase escrow is closed.

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The following table shows backlog in units and dollars at the end of each of the last three fiscal years for each of the Company's residential operations, including unconsolidated joint ventures. Backlog data does not include Managed Projects at February 28, 2001.

ENDING BACKLOG		
-----	-----	-----
FEBRUARY 28, 1999	FEBRUARY 29, 2000	FEBRUARY 28, 2001
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	UNITS	(\$000S)	UNITS	(\$000S)	UNITS	(\$000S)
	-----	-----	-----	-----	-----	-----
California.....	51	\$ 45,700	52	\$ 62,000	71	\$ 69,900
Texas.....	252	47,600	272	54,700	265	68,800
Nevada.....	57	12,200	97	20,200	45	11,400
Arizona.....	137	18,500	71	11,100	56	8,500
Colorado.....	--	--	106	18,400	75	15,000
	---	-----	---	-----	---	-----
Total.....	497	\$124,000	598	\$166,400	512	\$173,600
	===	=====	===	=====	===	=====

The following table shows net new orders (sales made less cancellations and credit rejections), homes closed and ending backlog relating to sales of the Company's homes and homes under contract or reservation for each quarter since the beginning of fiscal year 2000, including unconsolidated joint ventures, and excluding Managed Projects as of February 28, 2001. The Company's backlog at any given time is typically a good indicator of the number of units that will be closed in the four to six months following such date:

	NET NEW ORDERS	HOMES CLOSED	ENDING BACKLOG UNITS	ENDING BACKLOG (\$000S)
	-----	-----	-----	-----
FISCAL YEAR 2000				
1st Quarter.....	349	303	543	\$124,900
2nd Quarter.....	364	308	599	138,000
3rd Quarter.....	380	291	688	176,800
4th Quarter.....	304	394	598	166,400
	----	----		
Total Fiscal Year 2000.....	1,397	1,296		
	=====	=====		
FISCAL YEAR 2001				
1st Quarter.....	375	326	647	\$235,300
2nd Quarter.....	302	319	630	247,800
3rd Quarter.....	290	260	660	249,400
4th Quarter.....	188	304	512	173,600
	----	----		
Total Fiscal Year 2001.....	1,155	1,209		
	=====	=====		

MORTGAGE COMPANY

The Company offers mortgage broker services to certain of its homebuyers through its wholly owned subsidiary Capital Pacific Mortgage, Inc., formed during fiscal year 1996. The Company also offers mortgage broker services to certain of its Texas homebuyers through its subsidiary, Fairway Financial Company (Fairway), established in fiscal year 1995. In addition, the Company has established certain relationships, including joint venture investments, with local mortgage broker operations in other operating regions.

HOMEOWNER WARRANTY

The Company provides homeowners with a limited warranty on the terms of which the Company will correct, for a limited period, deficiencies listed in the homeowner warranty manual. The warranty does not, however, include items that are covered by manufacturer's warranties (such as appliances and air

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conditioning) or items that are not installed by employees or contractors of the Company (such as flooring installed by an outside contractor employed by the homeowner). The Company also provides certain homebuyers with policies issued by third-parties that extend protection beyond the Company's warranty period. Statutory requirements in the states in which the Company does business may grant to homebuyers rights in addition to those provided by the Company.

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### COMPETITION

The homebuilding industry is highly competitive. In each of the markets in which it operates, the Company competes in terms of location, design, quality and price with numerous other residential builders, including large national and regional firms, some of which have greater financial resources than the Company. As the Company enters and until it develops a reputation in a new market area, the Company can expect to face even more significant competitive pressures. In certain markets, the Company may from time to time engage in redesigns of product and/or make changes in existing model homes to make the Company's product more competitive. Such redesigns and/or changes may cause the Company to incur additional expenses and/or to write-off previous investments in such design or model homes.

### REGULATION

The housing and land development industries are subject to increasing environmental, building, zoning and real estate sales regulations by various federal, state and local authorities. Such regulations affect home building by specifying, among other things, the type and quality of building materials that must be used, certain aspects of land use and building design, as well as the manner in which the Company conducts sales activities and otherwise deals with customers. Such regulations affect development activities by directly affecting the viability and timing of projects.

The Company must increasingly obtain the approval of numerous government authorities which regulate such matters as land use and level of density, the installation of utility services, such as water and waste disposal, and the dedication of acreage for open space, parks, schools and other community purposes. If such authorities determine that existing utility services will not adequately support proposed development, especially in light of the electrical power shortages in California, building moratoriums may be imposed. As a result, the Company devotes an increasing amount of time to evaluating the impact of governmental restrictions imposed upon a new residential development. Furthermore, as local circumstances or applicable laws change, the Company may be required to obtain additional approvals or modifications of approvals previously obtained. Such increasing regulation has resulted in a significant increase in time between the Company's initial acquisition of land and the commencement and completion of its developments, particularly in California. In addition, the extent to which the Company participates in land development activities subjects it to greater exposure to regulatory risks. The Company has decreased its land development activities through completion of the Exchange Transaction, but such activities may increase in the future.

### EMPLOYEES

As of April 30, 2001, the Company employed 297 persons full-time, compared to 335 persons at April 30, 2000. Of these, 20 were in executive positions, 41 were engaged in sales activities, 132 in project management activities and 104 in administrative and clerical activities. None of the Company's employees is represented by a union and the Company considers its employee relationships to be good.

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## RAW MATERIALS

All of the raw materials and most of the components used in the Company's business are readily available in the United States. Most are standard items carried by major suppliers. However, a rapid increase in the number of homes started could cause shortages in the availability of such materials, thereby leading to delays in the delivery of homes under construction. In addition, increases in the price of lumber and other materials have a negative impact on margins. In order to maintain its quality standards while providing a product at good value, the Company has used and will under appropriate market circumstances consider the further use of alternative materials, such as metal studs and framing in some of its projects.

## ITEM 2. PROPERTIES

The Company leases several facilities in California, Texas, Arizona, Colorado and Nevada.

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## ITEM 3. LEGAL PROCEEDINGS

The Company is involved in routine claims and litigation arising in the ordinary course of its business. The legal responsibility and financial impact with respect to pending litigation cannot be presently ascertained.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the American Stock Exchange (AMEX) under the Symbol "CPH." The following table sets forth the quarterly high and low sales prices for the Common Stock for the periods indicated.

	HIGH	LOW
	-----	-----
FISCAL 2000		
Fourth Quarter.....	\$2.88	\$2.44
Third Quarter.....	2.69	1.88
Second Quarter.....	3.88	2.88
First Quarter.....	3.50	2.44
FISCAL 2001		
Fourth Quarter.....	\$3.63	\$2.38
Third Quarter.....	3.69	2.38
Second Quarter.....	2.69	2.38
First Quarter.....	3.00	2.75

Payment of dividends is within the discretion of the Company's Board of

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Directors and holders of shares of Common Stock are entitled to receive dividends when and if declared by the Board of Directors out of funds legally available therefore. The Company has not paid dividends for over ten years, and has historically retained its earnings. The covenants in the Indenture and in the Company's bank loan documents have restrictions on permissible dividend payments to the Company from Capital Pacific Holdings, LLC. There can be no assurance that such limits may not become more restrictive.

On May 1, 2001, the Company had approximately 1,000 beneficial holders of its Common Stock.

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### ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial information of the Company is presented as of and for the fiscal years ended February 28, 1997, February 28, 1998, February 28, 1999, February 29, 2000 and February 28, 2001. The selected financial information and other data should be read in conjunction with the Company's audited Consolidated Financial Statements and the notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are included elsewhere in this report. Certain reclassifications have been made to the prior years' balances to conform to the current year presentation.

	LAST DAY OF FEBRUARY			
	1997	1998	1999	2000
	(AMOUNTS IN THOUSANDS, EXCEPT SHARE AMOUNTS AND OPERATING EXPENSES)			
<b>INCOME STATEMENT DATA:</b>				
Sales of homes and land.....	\$216,549	\$191,098	\$192,422	\$200,000
Cost of sales.....	164,814	148,702	156,493	160,000
Impairment loss on real estate assets.....	--	8,000	--	--
Gross margin.....	51,735	34,396	35,929	40,000
Income (loss) from unconsolidated joint ventures.....	259	764	7,949	(1,000)
Selling, general and administrative expenses.....	(30,282)	(24,744)	(21,186)	(25,000)
Interest expense(1).....	(18,743)	(14,264)	(17,842)	(15,000)
Interest and other income, net.....	900	1,391	1,381	1,000
Income (loss) from operations.....	3,869	(2,457)	6,231	(1,000)
Minority interest(2).....	192	(469)	(1,850)	(1,000)
Income (loss) before income taxes and extraordinary item.....	4,061	(2,926)	4,381	(2,000)
Income tax provision (benefit).....	539	(735)	1,095	(1,000)
Income (loss) before extraordinary item.....	3,522	(2,191)	3,286	(3,000)
Extraordinary gain on debt retired at less than face value, net of minority interest and taxes.....	--	--	--	--
Net income (loss).....	\$ 3,522	\$ (2,191)	\$ 3,286	\$ (3,000)
Income (loss) per common share before extraordinary item -- basic and diluted.....	\$ .23	\$ (.15)	\$ .23	\$ (.23)

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Extraordinary item.....	--	--	--	--
	-----	-----	-----	-----
Net income (loss) per share -- basic and diluted.....	\$ .23	\$ (.15)	\$ .23	\$ .23
	=====	=====	=====	=====
Weighted average share -- basic.....	14,995	14,795	14,237	14,237
	=====	=====	=====	=====
Weighted average shares -- diluted(3).....	14,995	14,795	14,271	14,271
	=====	=====	=====	=====
Pro forma revenues (including unconsolidated joint ventures).....	\$227,750	\$214,093	\$271,372	\$271,372
	=====	=====	=====	=====
<b>BALANCE SHEET DATA:</b>				
Real estate projects.....	\$233,562	\$192,347	\$261,333	\$261,333
Total assets.....	271,918	251,655	324,763	324,763
Notes payable.....	73,474	36,714	91,489	91,489
Senior Unsecured Notes Payable.....	100,000	100,000 (4)	100,000 (4)	100,000 (4)
Minority interest.....	360	30,061 (4)	30,032 (4)	30,032 (4)
Stockholders' equity.....	66,868	63,050 (4)	65,354 (4)	65,354 (4)
<b>OPERATING DATA (IN UNITS):</b>				
Homes delivered.....	1,113	909	932	932
Total homes and lots delivered.....	1,140	969	982	982
Net new orders.....	1,039	919	1,053	1,053
Homes in backlog.....	366	376	497	497

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- (1) Represents interest costs initially capitalized which are recognized as homes and land are sold.
  - (2) Includes the minority interest share of earnings of CPH LLC since the financial restructuring in fiscal year 1998.
  - (3) Reflects dilution due to outstanding warrants and stock options. See Note 1 to the Consolidated Financial Statements.
  - (4) At February 28, 1998 and 1999, February 29, 2000 and February 28, 2001, respectively, minority interest includes \$29.8 million, \$29.9 million, \$32.6 and \$7.7 million of capital in CPH LLC attributable to CHF. At February 28, 1998 and 1999, February 29, 2000 and February 28, 2001, respectively, CPH LLC had total capital accounts of \$91.4 million, \$92.5 million, \$100.1 and \$109.5 million and was the sole obligor for the balance of the Senior Unsecured Notes Payable.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORWARD-LOOKING INFORMATION IS SUBJECT TO RISK AND UNCERTAINTY

Certain statements in the financial discussion and analysis by management contain "forward-looking" information (as defined in the Private Securities Litigation Reform Act of 1995 and within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended) that involves risk and uncertainty, including projections and assumptions regarding the business environment in which the Company operates. Actual future results and trends may differ materially depending on a variety of factors, including the Company's successful execution of internal performance strategies; changes in general national and regional economic conditions, such as levels of employment, consumer confidence and income, availability to homebuilders of financing for acquisitions, development and construction,



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availability to homebuyers of permanent mortgages, interest rate levels and the demand for housing; supply levels of land, labor and materials; difficulties in obtaining permits or approvals from governmental authorities; difficulties in marketing homes; regulatory changes and weather and other environmental uncertainties; competitive influences; and the outcome of pending and future legal claims and proceedings.

### RESULTS OF OPERATIONS -- GENERAL

The following table illustrates the actual and pro forma results of the Company's operations for the past three fiscal years. The pro forma results have been adjusted to reflect the inclusion of the operating results of the Company's unconsolidated joint ventures, including the portion attributable to the Company's joint venture partners, and are used throughout this discussion for comparative purposes wherever the phrase "pro forma" is utilized.

### RESULTS OF OPERATIONS

	YEAR ENDED					
	FEBRUARY 28, 1999		FEBRUARY 29, 2000		FEBRUARY 28, 2001	
	ACTUAL	PRO FORMA (INCLUDING JOINT VENTURES)	ACTUAL	PRO FORMA (INCLUDING JOINT VENTURES)	ACTUAL	PRO FORMA (INCLUDING JOINT VENTURES)
	(AMOUNTS IN THOUSANDS)					
Sales of homes and land.....	\$192,422	\$271,372	\$290,791	\$319,064	\$363,743	\$363,743
Cost of sales.....	156,493	217,059	231,273	254,666	272,332	272,332
Gross margin.....	\$ 35,929	\$ 54,313	\$ 59,518	\$ 64,398	\$ 91,411	\$ 91,411

As is noted in footnote 1 to the financial statements presented herein, the Company is reporting its results on a consolidated basis with the results of CPH LLC. References to the Company in this Item 7 are, unless the context indicates otherwise, also references to CPH LLC. At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by project-specific entities.

The Company has migrated to structuring certain California projects and one project in Colorado through joint ventures, most of which are not consolidated. Non-California operations are conducted primarily through wholly-owned, consolidated subsidiaries. The Company has increased its activities in Arizona and Colorado, markets which have not provided significant revenues in prior years. Activity has also increased in Texas and decreased in Nevada.

The unconsolidated California projects from which significant equity in earnings was derived through early fiscal 2000 are substantially completed. The Company does not expect to derive substantial equity in earnings from its current unconsolidated joint ventures until future years due to (1) the stage of development of the current projects, and/or (2) the preferred returns to be initially paid to capital partners, as discussed in Note 4 to the consolidated financial statements.

FISCAL 2001 (YEAR ENDED FEBRUARY 28, 2001) COMPARED TO FISCAL 2000 (YEAR ENDED FEBRUARY 29, 2000):

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The Company reported income from operations of \$18.1 million in fiscal 2001, as compared to income from operations of \$9.8 million in fiscal 2000. The Company reported net income of \$12.2 million, or \$0.88 per

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share, in fiscal 2001, as compared to net income of \$6.2 million, or \$0.44 per share, in fiscal 2000. Net income for fiscal 2001 included an extraordinary gain of \$1.5 million, or \$0.11 per share, as compared to \$1.0 million, or \$0.07 per share, in fiscal 2000, as a result of the retirement of debt at less than face value.

Sales of homes and land including unconsolidated joint ventures were \$426.4 million for fiscal 2001 compared to \$319.1 million for fiscal 2000. The increase was due to an increase in total unit closings from 2,006 for fiscal 2000 to 2,199 in fiscal 2001 and an increase in average sales price. Home closings declined slightly from 1,296 in fiscal 2000 to 1,209 in fiscal 2001, including 28 and 46 homes, respectively, closed in unconsolidated joint ventures. The average home sales price increased from \$233,000 in fiscal 2000 to \$315,000 in fiscal 2001.

The increase in total unit closings was due primarily to increased activity in the Company's Colorado market and to a few significant lot sales. The increase in average sales price is due to the closing of a higher number of units in the higher-priced California market in fiscal 2001. The Company's actual gross margin increased from 20.5% in fiscal 2000 to 25.1% in fiscal 2001, due to a change in the mix of closings to certain higher-margin projects. The pro forma gross margin increased from 20.2% in fiscal 2000 to 25.0% in fiscal 2001.

As a percentage of revenue, selling, general and administrative expense remained stable at 10.6% in both fiscal 2000 and fiscal 2001. Selling, general and administrative expense of \$38.6 million for fiscal 2001 increased \$7.8 million or 25.3% as compared to fiscal 2000 due to a higher level of sales activity.

Income from unconsolidated joint ventures decreased from \$1.7 million fiscal 2000 to a loss of \$874,000 in fiscal 2001, due to the establishment of certain reserves in connection with the wind down of some of the older joint ventures, as well as the fact that the profits from the newer joint ventures were being allocated primarily to cover preferred return on partner's capital during fiscal 2001.

Interest and other income increased from \$1.5 million in fiscal 2000 to \$1.9 million in fiscal 2001 and consists primarily of the results of operations of the Company's mortgage broker operations, as well as certain financing and other transactions.

Minority interest of \$2.8 million in fiscal 2000 and \$5.6 million in fiscal 2001 primarily represents the share of income from CPH LLC and CPH Newport Coast, LLC attributable to CHF.

Interest incurred was \$25.7 million in fiscal 2001, as compared to \$24.5 million in fiscal 2000, while interest expensed was \$35.7 million in fiscal 2001 as compared to \$22.1 million in fiscal 2000. Substantially all interest costs are initially capitalized and are recognized as homes and land are sold. As presented in the consolidated statements of operations, income from unconsolidated joint ventures for fiscal 2000 excludes the recognition of approximately \$519,000 in interest previously capitalized to the lots contributed to MPE. Such interest costs are included in interest expense.

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The Company recorded a provision for income taxes of \$1.8 million in fiscal 2001, as compared to \$1.7 million in fiscal 2000. The effective tax rate in both years was reduced from the statutory rate by the use of available loss carryforwards. Such loss carryforwards have now been substantially fully utilized.

FISCAL 2000 (YEAR ENDED FEBRUARY 29, 2000) COMPARED TO FISCAL 1999 (YEAR ENDED FEBRUARY 28, 1999):

The Company reported income from operations of \$9.8 million in fiscal 2000, as compared to income from operations of \$6.2 million in fiscal 1999. The Company reported net income of \$6.2 million, or \$0.44 per share, in fiscal 2000, as compared to net income of \$3.3 million, or \$0.23 per share, in fiscal 1999. Net income for fiscal 2000 included an extraordinary gain of \$1.0 million, or \$0.07 per share, as a result of the retirement of debt at less than face value.

Sales of homes and land including unconsolidated joint ventures were \$319.1 million for fiscal 2000 compared to \$271.4 million for fiscal 1999. The increase was due to an increase in total home closings from 932 in fiscal 1999 to 1,296 in fiscal 2000, including 88 and 28 homes, respectively, closed in unconsolidated joint ventures, offset by a decrease in average sales price from \$287,000 in fiscal 1999 to \$233,000 in fiscal

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2000. Total unit closings increased from 982 in fiscal 1999 to 2,006 in fiscal 2000, reflecting an increase in lot sales.

The increase in closings was due primarily to stronger demand in the Company's Nevada and Texas markets and the addition of several projects in Arizona and Colorado, offset by reduction in closings attributable to the buildout of certain California projects. The decrease in average sales price is due to the shift in relative unit closings from the higher-priced California market to the Company's other markets. The Company's actual gross margin increased from 18.7% in fiscal 1999 to 20.5% in fiscal 2000, due to the close out of certain lower-margin projects in fiscal 1999 and a gradual shift to certain higher-margin projects. The pro forma gross margin increased marginally from 20.0% in fiscal 1999 to 20.2% in fiscal 2000.

Selling, general and administrative expense of \$30.8 million for fiscal 2000 increased \$9.6 million or 45.4% as compared to fiscal 1999 due to a higher level of activity. As a percentage of revenue, selling, general and administrative expense decreased from 11.0% in fiscal 1999 to 10.6% in fiscal 2000.

Income from unconsolidated joint ventures decreased from \$7.9 million fiscal 1999 to \$1.7 million in fiscal 2000, due to lower unit closings in the existing joint ventures, principally Grand Coto Estates, L.P. and M.P.E. Partners, L.P. (MPE).

Interest and other income increased slightly from \$1.4 million in fiscal 1999 to \$1.5 million in fiscal 2000 and consists primarily of the results of operations of the Company's mortgage broker operations, as well as certain financing and other transactions.

Minority interest of \$1.9 million in fiscal 1999 and \$2.8 million in fiscal 2000 primarily represents the share of CPH LLC's income attributable to CHF.

Interest incurred was \$24.5 million in fiscal 2000, as compared to \$22.3 million in fiscal 1999, while interest expensed was \$22.1 million in fiscal 2000

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as compared to \$17.8 million in fiscal 1999. Substantially all interest costs are initially capitalized and are recognized as homes and land are sold. As presented in the consolidated statements of operations, income from unconsolidated joint ventures for fiscal 2000 and 1999 excludes the recognition of approximately \$519,000 and \$2.1 million, respectively, in interest previously capitalized to the lots contributed to MPE. Such interest costs are included in interest expense.

The Company recorded a provision for income taxes of \$1.7 million in fiscal 2000, as compared to \$1.1 million in fiscal 1999. The effective tax rate in both years was reduced from the statutory rate by the use of available loss carryforwards.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's principal cash requirements are for the acquisition, development, construction, marketing and overhead of its projects. The need to stage the acquisition and use of raw materials such as land and finished lots and the need, on certain projects, to construct community facilities ahead of the start of home construction requires homebuilders such as the Company to commit working capital for longer periods than many traditional manufacturing companies. When building inventory, the Company uses substantial amounts of cash that are generally obtained from borrowings, available cash flow from operations and partners' contributions to joint ventures.

At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by certain project specific entities. As of February 28, 2001, the Company has in place several credit facilities with contingent availabilities totaling \$251 million (the "Facilities") with various bank lenders (the "Banks"), of which \$104 million was outstanding. The Facilities are secured by liens on various completed or under construction homes and lots held by CPH LLC and CPH Newport Coast, LLC and CPH Yucaipa I, LLC, which are consolidated subsidiaries. Pursuant to the Facilities, CPH LLC and the consolidated subsidiaries are subject to certain covenants, which require, among other things, the maintenance of a consolidated liabilities to net worth ratio, minimum liquidity, minimum net worth and loss limitations, all as defined in the documents that evidence the Facilities. At February 28, 2001, CPH LLC was in compliance with these covenants. The Facilities also define certain events that constitute events of default. As of

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February 28, 2001, no such event had occurred. Commitment fees are payable annually on some of the Facilities.

Homebuilding activity is being financed out of CPH LLC cash, bank financing, and the existing joint ventures, including joint ventures with institutional investors, including CHF, the investor in CPH LLC. In addition, development work undertaken in certain of the Company's joint ventures is financed through various non-recourse lending arrangements. The Company anticipates that it will continue to utilize both third party financing and joint ventures to cover financing needs in excess of internally generated cash flow.

In May, 1994 the Company completed the sale of \$100 million of 12 3/4% Senior Notes including 790,000 warrants to purchase common stock. The proceeds from the offering were used to repay certain debt of the Company, acquire certain properties and for general working capital and construction purposes. The obligations associated with the Senior Notes have been transferred from the Company to CPH LLC. The Senior Notes are due May 1, 2002. During fiscal 2000 and 2001, the Company repurchased \$11.6 million and \$32.8 million (face value),

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respectively, of the Senior Notes.

The Indenture to which the Senior Notes are subject contains restrictions on CPH LLC on the incurring of indebtedness, which affect the availability of the Facilities based on various measures of the financial performance of CPH LLC. Subject to such restrictions, the Facilities are available to augment cash flow from operations and joint venture financing to fund CPH LLC's operations.

Management expects that cash flow generated from operations and from additional financing permitted by the terms of the Indenture will be sufficient to cover the debt service and to fund CPH LLC's current development and homebuilding activities for the reasonably foreseeable future, and expects that capital commitments from its joint venture partners and other bank facilities will provide sufficient financing for the operation of its joint ventures.

### INTEREST RATES AND INFLATION

The long-term impact of inflation on the Company is manifested in increased land prices, land development, construction and overhead costs balanced by increased sales prices.

The Company generally contracts for land significantly before development and sales efforts begin and, accordingly, to the extent land acquisition costs are fixed, increases or decreases in the sales prices of homes, land and other real estate properties may affect the Company's profits. Since the sales prices of homes are fixed at the time of sale and the Company generally sells its homes prior to commencement of construction, any inflation of construction costs in excess of those anticipated may result in lower gross margins. The Company generally attempts to minimize that effect by entering into fixed-price contracts with its subcontractors and material suppliers for specified periods of time, which generally do not exceed one year.

Housing demand, in general, is adversely affected by increases in interest costs, as well as materials and other costs. Interest rates, the length of time that land remains in inventory and the proportion of inventory that is financed affect the Company's interest costs. If the Company is unable to duplicate its past ability to raise sales prices enough to compensate for higher costs, or if mortgage interest rates increase significantly, affecting prospective buyers' ability to adequately finance a home purchase, the Company's homebuilding revenues, gross margins and net income would be adversely affected. Increases in sales prices, whether the result of inflation or demand, may affect the ability of prospective buyers to afford a new home.

### NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). Under the provisions of SFAS 133, companies are required to recognize all derivatives as either assets or liabilities in the statements of financial position and measure those instruments at fair value. The Company is required to adopt SFAS 133, as amended by SFAS No. 137 and 138, effective March 1, 2001. Currently, the Company does not have any instruments that would qualify as derivatives under SFAS 133. Accordingly, the Company

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does not believe SFAS 133 would have a material impact on the Company's financial position, results of operations, or liquidity at the current time.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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The Company is exposed to market risks related to fluctuations in interest rates on its debt. Currently, the Company does not utilize interest rate swaps, forward or option contracts on foreign currencies or commodities, or other types of derivative financial instruments. The purpose of the following analysis is to provide a framework to understand the Company's sensitivity to hypothetical changes in interest rates as of February 28, 2001. Many of the statements contained in this section are forward looking and should be read in conjunction with the Company's disclosures under the heading "Forward-Looking Statements."

The Company uses debt financing primarily for the purpose of acquiring and developing land and constructing and selling homes. Historically, the Company has made short-term borrowings under its revolving credit facilities to fund these expenditures. In addition, the Company has previously issued \$100 million in fixed rate debt to provide longer-term financing. At February 28, 2001, \$55.6 million of the Senior Notes remain outstanding.

For fixed rate debt, changes in interest rates generally affect the fair market value of the debt instrument, but not the Company's earnings or cash flows. Conversely, for variable rate debt, changes in interest rates generally do not impact fair market value of the debt instrument, but do affect the Company's future earnings and cash flows. The Company does not have an obligation to prepay fixed rate debt prior to maturity, and as a result, interest rate risk and changes in fair market value should not have a significant impact on such debt until the Company would be required to refinance such debt. Based on the amount of variable rate debt outstanding at February 28, 2001, and holding the variable rate debt balance constant, each one-percentage point increase in interest rates would result in an increase in interest incurred for the coming year of approximately \$1.0 million.

The table below details the principal amount and the average interest rates for debt for each category based upon the expected maturity dates. The carrying value of the Company's variable rate debt approximates fair value due to the frequency of repricing of this debt. The Company's fixed rate debt consists of the Senior Notes payable. The Senior Notes payable are publicly traded debt instruments and their fair values are based on their quoted market prices as of February 28, 2001.

	EXPECTED MATURITY DATE			FAIR VALUE
	YEAR ENDING FEBRUARY 28,			
	2002	2003	TOTAL	
	(DOLLARS IN THOUSANDS)			
<b>LIABILITIES:</b>				
Fixed rate debt.....	\$ --	\$55,592	\$ 55,592	\$ 51,97
Average interest rate.....	--	12.75%	12.75%	
Variable rate debt.....	\$48,411	\$61,812	\$110,223	\$110,22
Average interest rate.....	9.31%	7.75%	8.40%	

The Company does not believe that the future market rate risks related to the above securities will have a material adverse impact on the Company's financial position, results of operations or liquidity.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders  
of Capital Pacific Holdings, Inc.:

We have audited the accompanying consolidated balance sheets of Capital Pacific Holdings, Inc. (a Delaware corporation) and subsidiaries as of February 29, 2000 and February 28, 2001, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended February 28, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain Joint Ventures as of February 29, 2000 and for the two years then ended (Notes 1 and 4), the investments in which are reflected in the accompanying financial statements using the equity method of accounting. The investments in these Joint Ventures represent less than one percent of the Company's total assets at February 29, 2000, and the equity in the net income of

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these Joint Ventures was \$5,819,000, and \$1,197,000 for the years ended February 28, 1999 and February 29, 2000, respectively. Those financial statements were audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Capital Pacific Holdings, Inc. and subsidiaries as of February 29, 2000 and February 28, 2001, and the results of their operations and their cash flows for each of the three years in the period ended February 28, 2001, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Orange County, California  
May 16, 2001

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

	FEBRUARY 29, 2000	FEBRUARY 28, 2001
	-----	-----
Cash and cash equivalents.....	\$ 19,389	\$ 7,552
Restricted cash.....	1,373	781
Accounts and notes receivable.....	22,862	25,082
Real estate projects.....	282,497	259,873
Property and equipment.....	8,536	--
Investment in and advances to unconsolidated joint ventures.....	15,379	5,273
Prepaid expenses and other assets.....	8,245	10,851
	-----	-----
Total assets.....	\$ 358,281	\$ 309,412
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Accounts payable and accrued liabilities.....	\$ 39,600	\$ 43,150
Notes payable.....	125,809	110,223
Senior unsecured notes payable.....	88,392	55,592
	-----	-----



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Total liabilities.....	253,801	208,965
Negative goodwill.....	--	9,924
Minority interest.....	33,594	7,743
Stockholders' equity:		
Common stock, par value \$.10 per share; 30,000,000 shares authorized; 14,995,000 shares issued; 13,815,911 and 13,767,311 shares outstanding, respectively.....	1,500	1,500
Additional paid-in capital.....	211,888	211,888
Accumulated deficit.....	(139,243)	(127,054)
Treasury stock.....	(3,259)	(3,554)
Total stockholders' equity.....	70,886	82,780
Total liabilities and stockholders' equity.....	\$ 358,281	\$ 309,412

See accompanying notes to financial statements.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	FOR THE YEARS ENDED		
	FEBRUARY 28, 1999	FEBRUARY 29, 2000	FEBRUAR 200
Sales of homes and land.....	\$192,422	\$290,791	\$363,
Cost of sales.....	156,493	231,273	272,
Gross margin.....	35,929	59,518	91,
Income (loss) from unconsolidated joint ventures.....	7,949	1,730	(
Selling, general and administrative expenses.....	(21,186)	(30,813)	(38,
Interest expense.....	(17,842)	(22,141)	(35,
Interest and other income, net.....	1,381	1,513	1,
Income from operations.....	6,231	9,807	18,
Minority interest.....	(1,850)	(2,835)	(5,
Income before income taxes.....	4,381	6,972	12,
Provision for income taxes.....	1,095	1,745	1,
Income before extraordinary item.....	3,286	5,227	10,
Extraordinary gain on debt retired at less than face value, net of minority interest and taxes.....	--	955	1,
Net income.....	\$ 3,286	\$ 6,182	\$ 12,
Net income per share -- basic and diluted:			
Income per share before extraordinary item.....	\$ 0.23	\$ 0.37	\$ 0
Extraordinary gain on debt retired at less than face			

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value, net of minority interest and taxes.....	--	0.07	0
Net income per common share.....	\$ 0.23	\$ 0.44	\$ 0
Weighted average number of common shares -- basic.....	14,237	13,923	13,
Weighted average number of common shares -- diluted...	14,271	14,014	13,

See accompanying notes to financial statements.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE THREE YEARS ENDED FEBRUARY 28, 2001  
(IN THOUSANDS, EXCEPT SHARES)

	COMMON STOCK		ADDITIONAL	ACCUMULATED	TREASURY
	SHARES	AMOUNT	PAID-IN CAPITAL	DEFICIT	STOCK
BALANCE, FEBRUARY 28, 1998.....	14,305,511	\$1,500	\$211,888	\$ (148,711)	\$ (1,627)
Repurchase of common stock.....	(277,600)	--	--	--	(982)
Net income.....	--	--	--	3,286	--
BALANCE, FEBRUARY 28, 1999.....	14,027,911	1,500	211,888	(145,425)	(2,609)
Repurchase of common stock.....	(212,000)	--	--	--	(650)
Net income.....	--	--	--	6,182	--
BALANCE, FEBRUARY 29, 2000.....	13,815,911	1,500	211,888	(139,243)	(3,259)
Repurchase of common stock and warrants.....	(48,600)	--	--	--	(295)
Net income.....	--	--	--	12,189	--
BALANCE, FEBRUARY 28, 2001.....	13,767,311	\$1,500	\$211,888	\$ (127,054)	\$ (3,554)

See accompanying notes to financial statements.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

FOR THE YEARS ENDED

FEBRUARY 28, 1999	FEBRUARY 29, 2000	FEBRUAR 200
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OPERATING ACTIVITIES:

Net income.....	\$ 3,286	\$ 6,182	\$ 12,
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Gain on retirement of senior unsecured notes payable.....	--	(955)	(1,
Gain on sale of building.....	--	--	(1,
Depreciation and amortization.....	1,768	1,897	1,
Changes in Assets and Liabilities:			
(Increase) decrease in accounts and notes receivable.....	13,658	(10,329)	(2,
(Increase) decrease in real estate projects.....	(68,986)	(21,164)	18,
(Increase) decrease in prepaid expenses and other assets.....	610	2,020	(2,
Increase (decrease) in accounts payable and accrued liabilities.....	16,058	1,394	(1,
(Income) loss from unconsolidated joint ventures, including interest expense.....	(5,822)	(1,211)	
Minority interest.....	1,850	3,424	5,
	-----	-----	-----
Net cash provided by (used in) operating activities.....	(37,578)	(18,742)	29,

INVESTING ACTIVITIES:

Proceeds from sale of building.....	--	--	3,
Purchases of property and equipment.....	(2,164)	(1,039)	(1,
Cash distributed with Divested Joint Ventures.....	--	--	(3,
Decrease (increase) in investments in and advances to unconsolidated joint ventures.....	(10,718)	9,133	5,
	-----	-----	-----
Net cash provided by (used in) investing activities.....	(12,882)	8,094	3,

FINANCING ACTIVITIES:

Proceeds from notes payable.....	208,383	306,169	417,
Principal payments of notes payable.....	(153,608)	(271,849)	(431,
Capital contributions (distributions) to minority interest, net.....	(1,879)	106	(
Retirement of senior unsecured notes payable.....	--	(9,521)	(29,
Repurchase of common stock and warrants.....	(982)	(650)	(
	-----	-----	-----
Net cash provided by (used in) financing activities.....	51,914	24,255	(44,

Net increase (decrease) in cash and cash equivalents....	1,454	13,607	(11,
Cash and cash equivalents, beginning of year.....	4,328	5,782	19,
	-----	-----	-----
Cash and cash equivalents, end of year.....	\$ 5,782	\$ 19,389	\$ 7,
	=====	=====	=====

SUPPLEMENTAL DISCLOSURE OF CASH AND NON-CASH ACTIVITIES:

Cash paid during the year for interest, all capitalized to real estate projects.....	\$ 22,289	\$ 25,450	\$ 27,
	=====	=====	=====
Cash paid during the year for income taxes.....	\$ --	\$ --	\$ 1,
	=====	=====	=====

NON-CASH ACTIVITIES:

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During fiscal 2001, the Company consummated an Exchange Transaction with CHF (see Note 1) which was an entirely non-cash transaction, other than the distribution of cash balances held by the Divested Joint Ventures. The transaction resulted in the elimination of a substantial portion of the Company's minority interest and certain other accounts as summarized below:

Assets and liabilities held by Divested Joint Ventures	
exchanged by the Company:	
Cash.....	\$ (3,983)
Accounts receivable.....	(81)
Real estate projects.....	(3,929)
Property and equipment.....	(3,038)
Prepaid expenses and other assets.....	(213)
Accounts payable and accrued liabilities.....	103
Notes payable.....	1,249
	-----
	\$ (9,892)
	=====
Summary of amounts recorded as a result of the Exchange	
Transaction:	
Minority interest acquired.....	\$31,685
Assets exchanged:	
Divested Joint Ventures.....	(9,892)
Investment in unconsolidated joint ventures.....	(4,070)
	-----
	17,723
Deferred income taxes and accrued expenses recorded.....	(4,805)
Adjustment of remaining property and equipment to zero....	(2,994)
Negative goodwill recorded.....	(9,924)
	-----
	\$ --
	=====

See accompanying notes to financial statements.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. COMPANY ORGANIZATION, OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company Organization and Operations

Capital Pacific Holdings, Inc., together with its subsidiaries, (the "Company") conducts business under various names, including the name Capital Pacific Homes in California, Arizona, Colorado and Nevada and Clark Wilson Homes in Texas.

In fiscal year 1998, the Company consummated an equity and restructuring transaction whereby the Company and certain of its subsidiaries transferred to Capital Pacific Holdings, LLC ("CPH LLC") substantially all of their respective assets and CPH LLC assumed all the liabilities of the Company and its subsidiaries. An unaffiliated investment company, California Housing Finance, L.P. ("CHF") then acquired a 32.07% minority interest in CPH LLC as a result of a cash investment in CPH LLC. From fiscal 1998 through fiscal 2001, the Company

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expanded its operating strategy to encompass the acquisition and development of commercial and mixed-use projects, as well as ownership of existing commercial properties, primarily through non-majority investments in limited liability companies, with approximately 99% of the capital for these projects being provided by CHF.

Effective February 23, 2001, the Company and CHF consummated an interest exchange transaction (the "Exchange Transaction"), whereby the Company exchanged its interests in the majority of the joint ventures capitalized by CHF, including certain entities which were previously consolidated, (the "Divested Joint Ventures") for approximately 75% of CHF's interest in CPH LLC and all of CHF's interests in certain residential joint ventures. At February 28, 2001, the Company had a 93% interest in CPH LLC and CHF held a 7% minority interest. The Company and CHF both have an option to convert CHF's remaining 7% interest in CPH LLC into 1,235,000 shares of non-voting Common Stock of the Company for the period extending from 90 to 180 days following the closing of the Exchange Transaction. The Company expects that this option will be exercised. In addition, Capital Pacific Homes, Inc., a subsidiary of the Company, has entered or expects to enter into construction, management and marketing agreements relating to certain of the Divested Joint Ventures with residential components, (the "Managed Projects"), whereby the Company will be compensated for performing such services through a management fee arrangement.

The Exchange Transaction has been accounted for as the simultaneous acquisition of the majority of CHF's minority interest in CPH LLC and certain other residential joint ventures and the disposition of the Company's interest in the Divested Joint Ventures. As a result, no gain has been recognized, the remaining balance of the Company's property and equipment was adjusted to zero at February 28, 2001, and the balance of the transaction was recorded as negative goodwill.

Assets under management, including assets owned by unconsolidated joint ventures and Managed Projects, totaled \$475 million at February 28, 2001 in 55 residential properties. At February 28, 2001, CPH LLC had \$244 million in assets and a net worth of \$109 million. The Company is the sole managing member of CPH LLC. The Company maintains certain licenses and other assets as is necessary to fulfill its obligations as managing member and under management agreements. The Company and its subsidiaries perform their respective management functions for CPH LLC and the Managed Projects, pursuant to management agreements, which include provisions for the reimbursement of Company and subsidiary costs and a management fee. CPH LLC, the Managed Projects and certain other project-specific entities indemnify the Company against liabilities arising from the projects owned by such entities.

References to the Company are, unless the context indicates otherwise, also references to CPH LLC and the project-specific entities in which the Company has an equity ownership interest. At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by the project-specific entities.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company is a regional builder and developer with operations throughout selected metropolitan areas of Southern California, Nevada, Texas, Arizona and Colorado. The Company's principal business activities are to build and sell single-family homes. The Company's single-family homes are targeted to entry-level, move-up and luxury buyers.

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Approximately 42, 12, 24, 9 and 13 percent of the Company's total revenues (including the unconsolidated joint ventures) were in California, Nevada, Texas, Arizona and Colorado, respectively, for the year ended February 28, 2001.

The Company's business, and the markets which it serves in California, Nevada, Texas, Arizona and Colorado are affected by local, national and world economic conditions and events, in particular by the level of mortgage interest rates, consumer confidence and real estate prices. The Company cannot predict whether mortgage interest rates will be at levels attractive to prospective homebuyers. If interest rates increase, in particular mortgage interest rates, the Company's operating results could be adversely impacted.

### Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Significant estimates include projected revenues and costs of projects, which impact the allocation of costs to homes sold. Actual results could differ from estimated amounts.

### Principles of Consolidation and Minority Interest in Joint Ventures

The consolidated financial statements include the accounts of the Company and wholly owned subsidiaries and certain majority-owned joint ventures, as well as the accounts of CPH LLC, including the capital accounts of CPH LLC totaling \$109.5 million at February 28, 2001, \$7.7 million of which is required to be presented as minority interest in the accompanying consolidated balance sheets. All other investments (See Note 4) are accounted for under the equity method. All significant intercompany balances and transactions have been eliminated in consolidation.

### Long-Lived Assets

The Company follows Statement of Financial Accounting Standards ("SFAS") No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 121 requires that long-lived assets and certain identified intangibles to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable based on the estimated future cash flows (undiscounted and without interest charges). SFAS No. 121 also requires that long-lived assets and certain identifiable intangibles to be disposed of be reported at the lower of carrying amount or fair value less costs to sell.

### Property and Equipment

Property and equipment are recorded at cost and are depreciated over their estimated useful lives of three to thirty years using the straight-line method. Total property and equipment was \$8,536,000 (net of accumulated depreciation of \$6,608,000) as of February 29, 2000. During fiscal 2001, a building with a book value of \$2,460,000 was sold, resulting in a gain of \$1,040,000. In addition, a building with a book value of \$3,038,000 was exchanged as part of the Exchange Transaction. As a result of the Exchange Transaction, the remaining balance of \$2,994,000 in property and equipment was adjusted to zero at February 28, 2001.

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### Real Estate Projects

All direct and indirect land costs, offsite and onsite improvements and applicable interest and carrying charges are capitalized to real estate projects under development. Capitalized costs are expensed as real estate is sold; direct marketing costs are expensed in the period incurred. Land and land development costs are accumulated by project and are allocated to individual phases using the relative sales value method.

SFAS No. 121 requires long-lived assets that are expected to be held and used in operations are to be carried at the lower of cost or, if impaired, the fair value of the asset, rather than the net realizable value. Long-lived assets to be disposed of should be reported at the lower of carrying amount or fair value less cost to sell. For purposes of applying SFAS No. 121, real estate under development is considered to be held for use whereas finished units are considered assets to be disposed of. In evaluating long-lived assets held for use, a review for impairment loss is triggered if the sum of the expected future cash flows (undiscounted and without interest charge) is less than the carrying amount of the asset. Various assumptions and estimates are used to determine fair value in determining the amount of any impairment loss including, among others, estimated costs of construction, development and direct marketing, sales absorption rates, anticipated sales prices and carrying costs. The estimates used to determine any impairment adjustment can change in the near term as the economy in the Company's key areas changes.

### Negative Goodwill

Negative goodwill recorded as a result of the Exchange Transaction is being accreted over five years. No accretion was recorded during fiscal 2001.

### Revenue Recognition

The Company's revenue recognition policy follows the provisions of SFAS No. 66 "Accounting for Sales of Real Estate," which specify minimum down payment requirements, financing terms and certain other requirements for sales of real estate.

Income from sales is recognized when title has passed, the buyer has met minimum down payment requirements and the terms of any notes received by the Company satisfy continuing investment requirements. At the time of sale, accumulated costs are relieved from real estate projects and charged to cost of sales on a relative sales value basis.

### Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, which requires the liability method of accounting for income taxes.

### Statements of Cash Flows

For purposes of the consolidated statements of cash flows, short-term investments which have a maturity of 90 days or less from the date of purchase are considered cash equivalents.

### Stock Options

The Company accounts for equity-based compensation under SFAS No. 123 "Accounting for Stock-Based Compensation." Under SFAS No. 123, companies have the option to implement a fair value-based accounting method or continue to account for employee stock options and stock purchase plans using the intrinsic value based method of accounting as prescribed by Accounting Principles Board

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(APB) Opinion No. 25 "Accounting for Stock Issued to Employees." Entities electing to remain under APB Opinion No. 25 must make pro forma disclosures of net income or loss and earnings per share as if the fair value based method

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### CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

of accounting defined in SFAS No. 123 had been applied. The Company has adopted the disclosure requirements of SFAS No. 123 and will continue accounting for stock options under APB Opinion No. 25.

#### Net Income Per Common Share

Effective February 28, 1998, the Company adopted SFAS No. 128. This statement requires the presentation of both basic and diluted net income per share for financial statement purposes. Basic net income per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding. Diluted net income per share includes the effect of the potential shares outstanding, including dilutive securities using the treasury stock method. The table below reconciles the components of the basic net income per share calculation to diluted net income per share (in thousands, except per share data):

	YEAR ENDED FEBRUARY 28, 1999			YEAR ENDED FEBRUARY 29, 2000		
	INCOME	SHARES	EPS	INCOME	SHARES	EPS
Basic Net Income Per Share:						
Income available to common stockholders						
before extraordinary item.....	\$3,286	14,237	\$0.23	\$5,227	13,923	\$0.3
Effect of Dilutive Securities:						
Warrants.....	--	32	--	--	--	--
Stock options.....	--	2	--	--	91	--
	-----	-----	-----	-----	-----	-----
Diluted Net Income Per Share before						
extraordinary item.....	\$3,286	14,271	\$0.23	\$5,227	14,014	\$0.3
	=====	=====	=====	=====	=====	=====

#### Comprehensive Income

During the year ended February 28, 1999, the Company adopted SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and the display of comprehensive income and its components in a full set of general-purpose financial statements. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. For each of the three years ended February 28, 2001 comprehensive income equaled net income; therefore, a separate statement of comprehensive income is not included in the accompanying financial statements.

#### Segment Reporting



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Effective February 28, 1999, the Company adopted SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information." Under the provisions of SFAS No. 131, the Company's operations are conducted primarily under one segment, homebuilding, at this time.

### New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Under the provisions of SFAS 133, companies are required to recognize all derivatives as either assets or liabilities in the statements of financial position and measure those instruments at fair value. The Company is required to adopt SFAS 133, as amended by SFAS No. 137 and 138, effective March 1, 2001. Currently, the Company does not have any instruments that would qualify as derivatives under SFAS 133. Accordingly, the Company does not believe SFAS 133 would have a material impact on the Company's financial position, results of operations, or liquidity at the current time.

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### CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### Reclassifications

Certain reclassifications have been made to certain prior year balances in order to conform with the current year presentation.

#### 2. RESTRICTED CASH

The Company has restricted cash totaling \$1,373,000 and \$781,000 as of February 29, 2000 and February 28, 2001, respectively. Restricted cash primarily consists of deposits to various municipalities, banks, and utilities to guarantee future performance of development obligations.

#### 3. REAL ESTATE PROJECTS

Real estate projects consist of the following at February 29, 2000 and February 28, 2001 (in thousands):

	2000	2001
	-----	-----
Land and improvements under construction.....	\$254,206	\$229,207
Completed residential homes.....	11,592	12,678
Completed model homes.....	16,699	17,988
	-----	-----
	\$282,497	\$259,873
	=====	=====

Total interest costs incurred during the years ended February 28, 1999, February 29, 2000 and February 28, 2001 were \$22,346,000, \$24,465,000 and \$25,696,000 respectively, all of which was initially capitalized.

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### CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 4. INVESTMENTS IN AND ADVANCES TO UNCONSOLIDATED ENTITIES

The Company is a general partner or member and has a 50 percent or less ownership in 6 unconsolidated entities at February 28, 2001. In addition, the Company had certain advances outstanding to the Divested Joint Ventures at February 28, 2001, which were repaid subsequent to year end. The Company's net investments in and advances to unconsolidated entities are as follows at February 29, 2000 and February 28, 2001 (in thousands):

	2000	2001
	-----	-----
UNCONSOLIDATED JOINT VENTURES:		
JMP Canyon Estates, L.P.....	\$ 159	\$ 162
JMP Harbor View, L.P.....	621	609
Grand Coto Estates, L.P.....	(633)	231
M.P.E. Partners, L.P.....	1,710	983
LB/L -- CPH Providence, LLC.....	--	715
LB/L -- CPH Longmont, LLC.....	--	1,087
	-----	-----
	1,857	3,787
	-----	-----
DIVESTED JOINT VENTURES (1):		
RPV Associates, LLC.....	2,759	76
CPH Dana Point, LLC.....	266	(79)
CPH Monarch Beach, LLC.....	445	260
CPH Resorts I, LLC.....	4,700	689
CPH Vista Palisades, LLC.....	435	376
Atlanta Huntington Beach, LLC.....	1,259	25
CPH Dos Pueblos, LLC.....	3,595	139
CPH Airport Office Building, LLC.....	7	--
CPH Redhill Office Building, LLC.....	56	--
	-----	-----
	13,522	1,486
	-----	-----
	\$15,379	\$5,273
	=====	=====

-----  
 (1) These entities were unconsolidated joint ventures at February 29, 2000 and until February 23, 2001, the closing of the Exchange Transaction. The names of these entities were changed subsequent to the Exchange Transaction.

The Company's ownership interests in the unconsolidated joint ventures vary. Generally, the Company receives a portion of earnings although a preferred return on invested capital is provided. Typically, the majority of capital is provided by capital partners. The Company is typically a general partner or managing member in each of the above entities and is the managing entity pursuant to terms in each venture's agreement. In the case of Divested Joint Ventures which are also Managed Projects, the Company or its subsidiary manages the development of the project under a management contract. The Company's carrying amount in each of the unconsolidated joint ventures (and the Divested Joint Ventures prior to the Exchange Transaction) equals the underlying equity in the joint venture, and there are generally no significant amounts of undistributed earnings. The Company provides for income taxes currently on its share of distributed and undistributed earnings and losses from the investments.

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The Company uses the equity method of accounting for its investments in the unconsolidated 50 or less percent-owned entities. The accounting policies of the entities are substantially the same as those of the Company.

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### CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Following is summarized, combined financial information for the unconsolidated entities at February 29, 2000 and February 28, 2001 (in thousands). The balance sheet information at February 28, 2001 does not include the Divested Joint Ventures, but the income statement information does reflect the results of the Divested Joint Ventures because the Company held an ownership interest in those entities for substantially all of fiscal 2001:

	2000	2001
	-----	-----
<b>ASSETS</b>		
Cash.....	\$ 11,225	\$ 512
Real estate projects.....	281,402	14,620
Commercial buildings.....	21,071	--
Other assets.....	31,281	611
	-----	-----
	\$344,979	\$15,743
	=====	=====

	2000	2001
	-----	-----
<b>LIABILITIES AND EQUITY</b>		
Accounts payable and other liabilities.....	\$ 15,136	\$ 1,962
Due to the Company.....	10,588	2,205
Notes payable.....	37,722	1,878
	-----	-----
	63,446	6,045
	-----	-----
<b>Equity</b>		
The Company.....	4,791	1,278
Others.....	276,742	8,420
	-----	-----
	281,533	9,698
	-----	-----
	\$344,979	\$15,743
	=====	=====

	1999	2000	2001
	-----	-----	-----
<b>INCOME STATEMENT</b>			
Sales of homes and land.....	\$78,950	\$28,274	\$62,704
Interest and other income, net.....	7,151	16,296	16,214

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	-----	-----	-----
	86,101	44,570	78,918
Costs and expenses.....	72,416	33,428	63,505
	-----	-----	-----
Net income.....	\$13,685	\$11,142	\$15,413
	=====	=====	=====

The fiscal years of Grand Coto Estates, L.P. (Grand Coto) and M.P.E. Partners, L.P. (MPE) end on December 31, pursuant to which the last year audited by other auditors was the year ended December 31, 1999.

Equity in earnings (losses) from unconsolidated joint ventures consisted of the following for the years ended February 28, 1999, February 29, 2000 and February 28, 2001.

	1999	2000	2001
	-----	-----	-----
MPE.....	\$3,994	\$ 932	\$ (476)
Grand Coto.....	3,939	785	(395)
Others.....	16	13	(3)
	-----	-----	-----
	\$7,949	\$1,730	\$ (874)
	=====	=====	=====

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

As presented in the consolidated statements of operations, income from unconsolidated joint ventures for fiscal 1999 and fiscal 2000 excludes the recognition of approximately \$2.1 million and \$519,000, respectively, of interest previously capitalized to the lots contributed to MPE. Such interest costs are included in interest expense.

As of February 28, 2001, there were no remaining homes to be sold by MPE or Grand Coto. Several other unconsolidated joint ventures were disposed of in the Exchange Transaction. The Company has recently commenced development and/or sales activity at certain new projects that are owned by unconsolidated joint ventures.

5. NOTES PAYABLE

Notes payable consist of the following at February 29, 2000 and February 28, 2001 (in thousands):

	2000	2001
	-----	-----
Notes payable to banks, including interest varying from LIBOR plus two to prime plus two percent maturing between July 31, 2001 and February 3, 2003 secured by certain real estate projects on a non-recourse basis.....	\$105,951	\$ 88,272
Notes payable to bank, including interest at prime with the		

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term of the commitment reducing commencing August 1, 2002 secured by certain real estate projects on a recourse basis.....	19,281	16,158
Other.....	577	5,793
	-----	-----
	\$125,809	\$110,223
	=====	=====

At February 29, 2000 and February 28, 2001, the aggregate carrying value of assets collateralizing the above notes was \$249,581,000 and \$252,534,000, respectively.

At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by certain project specific entities. As of February 28, 2001, CPH LLC has in place several credit facilities with contingent availabilities totaling \$251 million (the "Facilities") with various bank lenders (the "Banks"), of which \$104 million was outstanding. The Facilities are secured by liens on various completed or under construction homes and lots held by CPH LLC and CPH Newport Coast, LLC and CPH Yucaipa I, LLC, which are consolidated subsidiaries. Pursuant to the Facilities, CPH LLC and the consolidated subsidiaries are subject to certain covenants, which require, among other things, the maintenance of a consolidated liabilities to net worth ratio, minimum liquidity, minimum net worth and loss limitations, all as defined in the documents that evidence the Facilities. At February 28, 2001, CPH LLC was in compliance with these covenants. The Facilities also define certain events that constitute events of default. As of February 28, 2001, no such event had occurred. Commitment fees are payable annually on some of the Facilities.

Homebuilding activity is being financed out of CPH LLC cash, bank financing, and the existing joint ventures, including joint ventures with institutional investors, including CHF, the investor in CPH LLC. In addition, development work undertaken in certain of the Company's joint ventures is financed through various non-recourse lending arrangements. The Company anticipates that it will continue to utilize both third party financing and joint ventures to cover financing needs in excess of internally generated cash flow.

During the years ended February 28, 1999, February 29, 2000 and February 28, 2001, the highest month-end balance on notes payable was \$101,943,000, \$125,809,000 and \$204,983,000, respectively, and the weighted average outstanding balance was \$70,073,000, \$110,830,000 and \$124,059,000, respectively. The weighted average interest rates on notes payable during the years ended February 28, 1999, February 29, 2000 and February 28, 2001, were 8.7 percent, 9.0 percent and 10.0 percent, respectively. The weighted average

CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

interest rates on notes payable at February 28, 1999, February 29, 2000 and February 28, 2001, were 8.6 percent, 9.7 percent and 8.4 percent, respectively.

The aggregate scheduled principal maturities of notes payable are as follows (in thousands):

AS OF  
FEBRUARY 28,

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FISCAL YEARS ENDING:	2001
2002.....	\$ 48,411
2003.....	61,812
Total.....	\$110,223
	=====

### 6. SENIOR UNSECURED NOTES PAYABLE; WARRANTS

In May, 1994, the Company issued \$100 million principal amount of its 12 3/4 percent Senior Notes due May 1, 2002 (the "Notes"). In connection with the issuance of the Notes, the Company issued 790,000 warrants to purchase the Company's common stock at a price of \$3.30 per share, all of which are fully exercisable until 2002. Interest is due and payable on May 1 and November 1 of each year. Effective May 1, 2000, the Notes became redeemable at the option of CPH LLC at 103.1875% of their principal amount, declining to par on and after May 1, 2001, plus accrued interest.

The obligations associated with the Notes have been transferred to CPH LLC. CPH LLC will be obligated to make an offer to purchase 10% of the outstanding principal balance of the Notes at a purchase price equal to 100% of the principal amount, plus accrued interest, in the event there are two consecutive fiscal quarters that the CPH LLC's Consolidated Tangible Net Worth (as defined) is less than \$37 million. The Notes also contain certain restrictive covenants, which, among other things, limit the incurrence of additional indebtedness, the payment of dividends, the ability to create liens, make restricted payments (as defined) and the ability to enter into certain transactions with affiliates. As of February 28, 2001 CPH LLC was in compliance with these covenants and was not required to make any such offer.

During fiscal 2000 and 2001, the Company repurchased \$11.6 and \$32.8 million of the Notes (face value), respectively, resulting in an extraordinary gain of \$955,000 and \$1,461,000, respectively.

At February 28, 2001, unamortized bond issuance cost was \$650,000, net of accumulated amortization of \$5.2 million, which is being amortized over the term of the Notes utilizing the effective interest rate method. Unamortized bond issuance cost is included in prepaid expenses and other assets in the accompanying consolidated balance sheets.

### 7. INCOME TAXES

The provision for income taxes consists of the following for the years ended February 28, 1999, February 29, 2000 and February 28, 2001 (in thousands):

	1999	2000	2001
Current			
Federal.....	\$ 75	\$ 745	\$ 2,996
State.....	220	700	865
	295	1,445	3,861
Deferred.....	800	300	(2,075)
Provision for income taxes.....	\$1,095	\$1,745	\$ 1,786

=====

CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The deferred income tax provision (benefit) at February 28, 1999, February 29, 2000 and February 28, 2001 results from the following temporary differences between financial and tax reporting (in thousands):

	1999	2000	2001
	-----	----	-----
Accrued expenses.....	\$ 524	\$ 22	\$ (921)
Construction period expenses.....	46	197	569
Depreciation.....	(30)	(40)	(78)
Built-in losses.....	1,213	722	1,159
Net operating loss carryforward.....	664	(823)	1,950
Other.....	--	--	135
Increase (decrease) in valuation allowance.....	(1,617)	222	(4,889)
	-----	----	-----
	\$ 800	\$300	\$(2,075)
	=====	====	=====

The components of the Company's deferred income tax asset as of February 29, 2000 and February 28, 2001 are as follows:

	2000	2001
	-----	-----
Accrued expenses.....	\$ 49	\$ 975
Construction period expenses.....	1,529	1,878
Depreciation.....	(40)	14
Built-in losses.....	2,204	2,367
Real estate projects.....	--	(5,701)
Property and equipment.....	--	1,197
Net operating loss carryforward.....	1,147	--
Other.....	--	(41)
Valuation allowance.....	(4,889)	--
	-----	-----
	\$ --	\$ 689
	=====	=====

A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

A reconciliation of the income tax provision computed at the federal statutory rate and the income tax provision for financial reporting purposes for the years ended February 28, 1999, February 29, 2000 and February 28, 2001, are as follows:

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	1999	2000	2001
	----	----	----
Income taxes at statutory rate.....	34%	34%	34%
State income taxes, net of federal tax benefit.....	3	3	6
Franchise tax liability.....	2	2	3
Income tax accrued on Exchange Transaction.....	--	--	10
Reversal of valuation allowance.....	--	--	(39)
Utilization of loss carryforwards.....	(14)	(14)	--
	----	----	----
	25%	25%	14%
	====	====	====

8. REPURCHASE OF COMMON STOCK

During the third quarter of fiscal 1998, CPH LLC repurchased 1,015,000 shares of the Company's common stock which were issued to Roger Nix, the previous owner of Durable Homes, Inc. ("Durable"), a wholly owned subsidiary of the Company operating in Nevada, in connection with the Company's acquisition

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

of Durable in 1993, and distributed such shares to the Company and CHF in proportion to their respective ownership percentages in CPH LLC. Accordingly, 689,489 shares were distributed to the Company and are being held as treasury stock. As a result, the number of outstanding shares of the Company was reduced from 14,995,000 to 14,305,511.

In addition, in fiscal 1998, the Company announced a stock repurchase program whereby up to 1,000,000 additional shares of the Company's outstanding common stock may be repurchased by CPH LLC. As of February 28, 2001, 538,200 shares had been repurchased and held by CPH LLC under this program. In addition, the Company has repurchased 220,268 of the warrants originally issued in connection with the issuance of the Senior Notes.

9. STOCK OPTION PLAN

Effective February 28, 1995, the Board of Directors of the Company approved the 1995 Stock Incentive Plan (the "1995 Plan"). The 1995 Plan permits a committee designated by the Board of Directors to make awards to key employees and directors of the Company and its subsidiaries. Subject to various restrictions, awards could be in the form of stock options, restricted or unrestricted stock, stock appreciation rights or a combination of the above. The maximum number of shares or share equivalents that may be awarded under the 1995 Plan is 1,500,000.

Options are granted to purchase shares at prices equal to the fair market value of the shares at the date of grant. The options are typically intended to vest over a one to five year period and are generally intended to be exercisable at various dates over one to 10 year periods. When the options are exercised, the proceeds will be credited to equity along with the related income tax benefits, if any.

The following is a summary of the transactions relating to the Company's stock option plan for the years ended February 28, 1999, February 29, 2000 and February 28, 2001:



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	FISCAL 1999		FISCAL 2000		FISCAL 2001
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS
Options outstanding, beginning of year.....	--	\$ --	256,000	\$2.75	463,000
Granted.....	256,000	2.75	250,000	1.88	250,000
Exercised.....	--	--	--	--	--
Canceled.....	--	--	(43,000)	2.75	(112,500)
Options outstanding, end of year.....	256,000	\$2.75	463,000	\$2.28	600,500
Options exercisable at end of year...	--		71,000		171,499
Options available for future grant...	1,244,000		1,037,000		899,500

The following information is provided pursuant to the requirements of SFAS No. 123. The fair value of each option granted during the years ended February 28, 1999, February 29, 2000 and February 28, 2001, is estimated using the Black-Scholes option-pricing model on the date of grant using the following weighted average assumptions:

	FISCAL 1999	FISCAL 2000	FISCAL 2001
Dividend yield.....	0%	0%	0%
Expected volatility.....	35.5%	56.5%	25.8%
Risk-free interest rate.....	4.67%	6.12%	5.88%
Expected life.....	5 years	5 years	5 years

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The 164,000, 186,500 and 250,000 options granted in fiscal 1999, 2000 and 2001, respectively, which remain outstanding as of February 28, 2001 have exercise prices of \$2.75, \$1.875 and \$2.50, respectively, and a remaining contractual life of 7.92 and 8.58 and 9.59 years, respectively. As of February 28, 2001, 171,499 of these options are exercisable. The per share fair value of all options granted during fiscal 1999, 2000 and 2001 was \$1.07, \$1.03 and \$0.87, respectively.

During the years ended February 28, 1999, February 29, 2000 and February 28, 2001, no compensation expense was recognized related to the stock options granted, however, had compensation expense been determined consistent with SFAS No. 123 for the Company's stock option grants for its stock-based compensation plan, the Company's net income and diluted net income per share for the years ended February 28, 1999, February 29, 2000 and February 28, 2001 would approximate the pro forma amounts below (Dollars in thousands, except per share

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amounts):

	FISCAL 1999		FISCAL 2000		FISCAL 2001	
	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA
Income before extraordinary item.....	\$3,286	\$3,281	\$5,227	\$5,144	\$10,728	\$10,728
Diluted income per common share before extraordinary item.....	\$ 0.23	\$ 0.23	\$ 0.37	\$ 0.37	\$ 0.77	\$ 0.77

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

10. RELATED PARTY TRANSACTIONS

In fiscal 1999, the Company contributed cash totaling \$3,176,000 to unconsolidated joint ventures. In fiscal 2000, the Company contributed cash totaling \$3,278,000 to unconsolidated joint ventures. In fiscal 2001, the Company contributed cash totaling \$1,244,000 to unconsolidated joint ventures.

The Company has made reimbursable advances to unconsolidated joint ventures (including the Divested Joint Ventures) for construction and other expenditures. The balance of advances at February 29, 2000 and February 28, 2001 was \$10,588,000 and \$3,725,000, respectively. These amounts are included in investment in and advances to unconsolidated joint ventures in the accompanying consolidated balance sheets. During fiscal 2000 and fiscal 2001, the Company charged interest totaling \$1,422,000 and \$338,163, respectively, to the joint ventures based on these advances.

During fiscal 1999, 2000 and 2001, the Company recognized \$10,452,000, \$12,446,000 and \$12,092,000, respectively, in construction overhead reimbursements from unconsolidated joint ventures (including the Divested Joint Ventures). Amounts are received pursuant to terms of the joint venture agreements, which generally specify a fixed payment per month over the anticipated period of development. Such amounts are included in selling, general and administrative expenses in the accompanying statements of operations. As a result of the Exchange Transaction, the amount of overhead incurred, as well as the corresponding reimbursements, will decrease in the future years with respect to the Divested Joint Ventures.

During fiscal 1999, the Company acquired four parcels of land for total consideration of approximately \$3,283,000 from a partnership in which an officer of one of the Company's subsidiaries held an ownership interest. The terms of this transaction had been agreed upon prior to the time that this officer became an employee of the Company. This officer is no longer an employee.

Included in accounts receivable at February 29, 2000 and February 28, 2001 is \$1,633,000 and \$1,805,000, respectively, of amounts owed from the Company's various unconsolidated joint ventures to the Company's wholly-owned subsidiary, Newport Design Center, Inc. for goods and services rendered.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Under the Exchange Transaction, the Company transferred its interests in the Divested Joint Ventures to Makallon, LLC ("Makallon"), which is beneficially owned by CHF and a former director and officer of the Company, who is a relative of the Chairman of the Board of the Company. In connection with the Exchange Transaction, Capital Pacific Homes, Inc., a subsidiary of the Company, has entered or expects to enter into construction, management and marketing agreements with Makallon relating to the Managed Projects whereby the Company will be compensated for performing such services through a management fee arrangement. In addition, the Company has entered into lease agreements with Makallon for office space in two buildings owned by certain joint ventures controlled by Makallon.

During fiscal 1999 and 2000, approximately \$207,000, \$193,000, respectively, was paid to a company owned by a relative of the Chairman of the Board for services rendered in connection with website design and maintenance and the development of virtual reality home tour models. In addition, this company paid approximately \$15,000 in rent for office space leased from the Company during fiscal 1999.

An officer of the Company purchased a home from one of the Company's joint ventures in fiscal 1999 for \$780,000.

An officer of the Company purchased a home from one of the Company's joint ventures in fiscal 2001 for \$1,450,000.

### 11. COMMITMENTS AND CONTINGENCIES

#### General

Approximately \$38,480,000 and \$47,352,000 of performance bonds which have been issued on behalf of both CPH LLC and certain joint ventures, and for which the Company has been indemnified, were outstanding at February 29, 2000 and February 28, 2001, respectively. The estimated cost to complete the development work related to the performance bonds is \$24,026,000 and \$33,147,000 at February 29, 2000 and February 28, 2001, respectively. The beneficiaries of these bonds are certain municipalities.

CPH LLC has entered into agreements to lease certain office equipment and facilities under operating leases which expire at various dates through fiscal year 2005. The facility leases generally provide that CPH LLC shall pay property taxes, insurance and other items. Minimum payments under noncancelable leases at February 28, 2001, are as follows (in thousands):

#### FISCAL YEARS ENDING:

	-----
2002.....	\$1,259
2003.....	1,113
2004.....	841
2005.....	282
	-----
Total.....	\$3,495
	=====

Total rent expense was \$442,000, \$769,000 and \$1,153,000 for the years ended February 28, 1999, February 29, 2000 and February 28, 2001, respectively.

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As discussed in Notes 1 and 4, CPH LLC is a general partner in certain joint venture partnerships. As a general partner, CPH LLC is liable for all debts of the partnerships without limitation to the respective partnership interest.

### Dividends

No dividends were declared or paid for the years ended February 28, 1999, February 29, 2000 and February 28, 2001.

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### CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### Legal Proceedings

The Company is involved in routine claims and litigation arising in the ordinary course of its business. Although the legal responsibility and financial impact with respect to pending claims and litigation cannot be presently ascertained, the Company does not believe that these matters will result in the payment by the Company, giving consideration to any applicable insurance proceeds or contributions by other parties, that, in the aggregate, would be material in relation to the financial position of the Company. It is reasonably possible that the estimate of reserves provided for by the Company with respect to such claims and litigation could change in the near term and such change could be material.

### 12. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate:

Cash and Equivalents -- The carrying amount is a reasonable estimate of fair value. These assets primarily consist of short-term investments and demand deposits.

Notes Payable to Banks -- These notes payable mature in two to three years. The rates of interest paid on the notes approximate the current rates available for secured real estate financing with similar terms and maturities.

Senior Unsecured Notes Payable Due 2002 -- This issue is not publicly traded on a major exchange. Consequently, the fair value of this issue is based on the repurchase closest to the year ended February 28, 2001.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	AT FEBRUARY 29, 2000		AT FEBRUARY 28, 2001	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial Assets:				
Cash and equivalents.....	\$ 19,389	\$ 19,389	\$ 7,552	\$ 7,552
Financial Liabilities:				

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Notes payable.....	125,809	125,809	110,223	110,223
Senior unsecured notes payable.....	88,392	74,028	55,592	51,978

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

13. UNAUDITED QUARTERLY FINANCIAL DATA

Summarized quarterly financial data for the years ended February 29, 2000 and February 28, 2001 is as follows (in thousands except for per share data):

	QUARTER				TOTAL
	FIRST	SECOND	THIRD	FOURTH	
2000:					
Sales of homes and land.....	\$61,974	\$67,383	\$63,430	\$ 98,004	\$290,79
Gross margin.....	11,304	12,493	14,137	21,584	59,51
Net income.....	\$ 820	\$ 1,100	\$ 812	\$ 3,450	\$ 6,18
	=====	=====	=====	=====	=====
Net income per common share -- basic and diluted.....	\$ 0.06	\$ 0.08	\$ 0.06	\$ 0.24	\$ 0.4
	=====	=====	=====	=====	=====
2001:					
Sales of homes and land.....	\$65,034	\$96,215	\$84,583	\$117,911	\$363,74
Gross margin.....	14,388	22,893	21,438	32,692	91,41
Net income.....	\$ 2,289	\$ 2,544	\$ 1,830	\$ 5,526	\$ 12,18
	=====	=====	=====	=====	=====
Net income per common share -- basic and diluted.....	\$ 0.17	\$ 0.18	\$ 0.13	\$ 0.40	\$ 0.8
	=====	=====	=====	=====	=====

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Partners  
Grand Coto Estates, L.P.

We have audited the accompanying balance sheet of Grand Coto Estates, L.P., a California limited partnership (the "Partnership"), as of December 31, 1999, and the related statements of operations, partners' capital (deficit) and cash flows for the years ended December 31, 1999 and 1998. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial

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statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Grand Coto Estates, L.P. at December 31, 1999, and the results of its operations and its cash flows for the years ended December 31, 1999 and 1998, in conformity with accounting principles generally accepted in the United States.

ERNST & YOUNG LLP

Irvine, California  
January 28, 2000

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GRAND COTO ESTATES, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

BALANCE SHEETS  
DECEMBER 31, 2000 AND 1999

ASSETS

	2000	1999
	-----	-----
	(UNAUDITED)	
Cash.....	\$ 51,213	\$ 236,795
Other assets.....	48,445	106,880
	-----	-----
	\$ 99,658	\$ 343,675
	=====	=====
LIABILITIES AND PARTNERS' CAPITAL (DEFICIT)		
Accounts payable and accrued liabilities (Note 2).....	\$ 55,160	\$ 1,297,177
Due to general partner (Note 4).....	836,207	176,493
	-----	-----
	891,367	1,473,670
Commitments and contingencies (Note 5)		
Partners' capital (deficit).....	(791,709)	(1,129,995)
	-----	-----
	\$ 99,658	\$ 343,675
	=====	=====

See accompanying notes to financial statements.

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GRAND COTO ESTATES, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

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	2000 ----- (UNAUDITED)	1999 -----	1998 -----
Sales.....	\$ 2,991	\$37,557,500	\$23,172,946
Cost of sales.....	(259,449)	28,116,357	16,659,863
Gross profit.....	262,440	9,441,143	6,513,083
Other expenses (income)			
Selling and marketing.....	4,800	2,650,480	1,572,850
Other income.....	--	(18,032)	(35,473)
Net income.....	\$ 257,640 =====	\$ 6,808,695 =====	\$ 4,975,706 =====

See accompanying notes to financial statements.

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GRAND COTO ESTATES, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

STATEMENTS OF PARTNERS' CAPITAL (DEFICIT)  
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	IHP INVESTMENT FUND I, L.P. -----	CAPITAL PACIFIC HOLDINGS, LLC -----	TOTAL -----
BALANCE -- DECEMBER 31, 1997.....	\$ 14,760,274	\$ 814,964	\$ 15,575,238
Contributions from partner.....	18,395,326	--	18,395,326
Distributions to partners.....	(20,832,471)	(1,307,681)	(22,140,152)
Net income.....	3,027,853	1,947,853	4,975,706
BALANCE -- DECEMBER 31, 1998.....	15,350,982	1,455,136	16,806,118
Contributions from partners.....	7,688,262	2,801,787	10,490,049
Distributions to partners.....	(27,318,352)	(7,916,505)	(35,234,857)
Net income.....	3,686,647	3,122,048	6,808,695
BALANCE -- DECEMBER 31, 1999.....	(592,461)	(537,534)	(1,129,995)
Contributions from partners.....	67,602	67,602	135,204
Distributions to partners.....	--	(54,558)	(54,558)
Net income.....	128,820	128,820	257,640
BALANCE -- DECEMBER 31, 2000 (UNAUDITED).....	\$ (396,039) =====	\$ (395,670) =====	\$ (791,709) =====

See accompanying notes to financial statements.

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GRAND COTO ESTATES, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

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	2000	1999	1998
	-----	-----	-----
	(UNAUDITED)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income.....	\$ 257,640	\$ 6,808,695	\$ 4,975,706
Adjustments to reconcile net income to net cash provided by (used in) operating activities			
Cost of sales.....	--	28,116,357	16,659,863
Changes in operating assets and liabilities			
Additions to real estate inventories.....	--	(7,951,363)	(19,413,753)
Due from general partner.....	--	56,467	(56,467)
Other assets.....	58,435	(33,386)	42,504
Accounts payable and accrued liabilities.....	(1,242,017)	(2,651,401)	2,759,099
Due to general partner.....	659,714	176,493	(214,166)
	-----	-----	-----
Net cash provided by (used in) operating activities.....	(266,228)	24,521,862	4,752,786
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES			
Principal payments on notes payable.....	--	--	(575,206)
Capital contributions from partner.....	135,204	10,490,049	18,395,326
Capital distributions to partners.....	(54,558)	(35,234,857)	(22,140,152)
	-----	-----	-----
Net cash (used in) provided by financing activities.....	80,646	(24,744,808)	(4,320,032)
	-----	-----	-----
Net (decrease) increase in cash.....	(185,582)	(222,946)	432,754
Cash -- beginning of year.....	236,795	459,741	26,987
	-----	-----	-----
Cash -- end of year.....	\$ 51,213	\$ 236,795	\$ 459,741
	=====	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid for interest during the year.....	\$ --	\$ --	\$ 28,875
	=====	=====	=====

See accompanying notes to financial statements.

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GRAND COTO ESTATES, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 1999 AND 1998

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Grand Coto Estates, L.P., a California limited partnership (the "Partnership"), was formed on October 30, 1996 in accordance with the provisions of the laws of the State of California for the purpose of developing and selling 93 single-family homes in Coto de Caza, California (the "Project"). The general partner, Peters Ranchland Company, Inc. ("Peters"), and the limited partner, IHP Investment Fund I, L.P. ("IHP"), each owned a 50% interest in the Partnership at inception. On October 1, 1997, Peters transferred its interest in the Partnership to Capital Pacific Holdings, LLC ("CPH").



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The Partnership Agreement provides that cash flows, as defined, are distributed to the partners first, in the amount of the adjusted GAAP profit component (as defined) from the sale of each home, in accordance with their percentage interests; second, in satisfaction of unpaid preferred returns; third, for payment of partners' capital contributions; fourth, in accordance with their percentage interests.

Net income is allocated to the partners in the following order of priority: first, to recover any net losses allocated previously; second, to the extent of and in proportion to the amount by which cash flow distributed in satisfaction of preferred returns and the adjusted GAAP profit component (as defined in the partnership agreement) exceeds previously allocated net income; thereafter, in accordance with their percentage interests. Net losses are allocated first, to the general partner up to \$2,076,921 plus all previously allocated net income; second, to the limited partner until the limited partner's capital account is reduced to zero; any remaining losses are allocated to the general partner.

Certain distributions reflected in the statement of partners' capital were not in accordance with the provisions of the partnership agreement and it is management's and the partners' intent to cumulatively adjust future contributions and distributions of the Partnership to reflect the provisions of the partnership agreement.

The partnership agreement provides, among other things, that the partners shall be entitled to receive a preferred return on contributed capital computed using an interest rate equal to prime plus 2%. As of December 31, 1999 and 1998, the Partnership has unpaid preferred returns of \$0 and \$394,827, respectively, on IHP's capital contributions, and \$0 and \$8,178, respectively, on CPH's capital contributions.

### Use of Estimates

The preparation of the Partnership's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of December 31, 1999 and 1998, and revenues and expenses for each of the years in the period ended December 31, 1999. Actual results could materially differ from those estimates in the near term.

### Real Estate Inventories

Real estate inventories include direct and indirect land costs, offsite costs and on-site improvement costs, project commitment fees and builder overhead fees which are capitalized to the real estate project. Selling and marketing costs are expensed as incurred.

The Partnership complies with the provisions of Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of ("SFAS No. 121"). SFAS No. 121 requires the Partnership to review the Project whenever events or changes in circumstances indicate that the cost basis of such assets may not be recoverable. If the cost basis of the Project is greater than the projected future net cash flows from the Project, an impairment loss is recognized. Impairment losses are calculated as the difference between the Project's cost basis and its estimated fair value,

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## NOTES TO FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 1999 AND 1998

net of disposal costs on completed units, if any. No impairment losses were recorded in December 31, 1999 and 1998, Accordingly, the Project was carried at its historical cost basis. The Partnership sold all of its remaining homes in 1999, therefore, there is no inventory balance as of December 31, 1999.

### Sales and Profit Recognition

Sales are recorded and profit is recognized when title has passed to a buyer who has met down payment and continuing investment criteria and substantially all of the risks and rewards of ownership have been transferred to the buyer. At the time of sale, accumulated costs are relieved from real estate inventories by a method that approximates relative sales value and are charged to cost of sales.

### Income Taxes

The Partnership is not a taxable entity and the results of its operations are included in the tax returns of the partners. Accordingly, no provision for income taxes is reflected in the accompanying financial statements.

## 2. REAL ESTATE INVENTORIES

During 1999, the Project's remaining 45 homes were sold. At December 31, 1999, included in accounts payable and accrued liabilities is \$1,155,219 of estimated costs to complete the development of the Project and \$141,958 of warranty cost reserves.

## 3. NOTE PAYABLE

The Partnership had a noninterest-bearing note payable issued to the seller in connection with the acquisition of the land on which the Project is being developed. The note payable was secured by real estate inventories and was paid off in May 1998. Imputed interest of \$19,252 was capitalized to real estate inventories during the year ended December 31, 1998.

## 4. RELATED PARTY TRANSACTIONS

The partnership agreement provides that a total of \$1,579,199 be paid to the general partner in monthly installments for builder overhead fees. If, after all of the homes in the Project are sold, actual sales prices (as defined) are less than budgeted sales prices, the general partner shall be liable to the Partnership for all overhead fees received in excess of 3% of actual gross sales prices (as defined). If actual sales prices are greater than budgeted sales prices, the general partner shall be entitled to receive from the Partnership an amount equal to 3% of actual gross sales prices less overhead fees already received. An additional \$394,154 of builder overhead fees was incurred by the Partnership as actual sale prices were greater than budget.

The following fees were paid to the partners and capitalized to the Project during the years ended December 31, 1999 and 1998:

	1999	1998
	-----	-----
Commitment fees paid to IHP.....	\$     --	\$131,600
Builder overhead fees paid to CPH.....	218,920	717,540
	-----	-----

\$218,920      \$849,140  
=====      =====

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GRAND COTO ESTATES, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 1999 AND 1998

5. COMMITMENTS AND CONTINGENCIES

The Partnership's commitments and contingencies include the usual obligations incurred by real estate developers in the normal course of business. In the opinion of management, these matters will not have a material effect on the Partnership's financial position.

In the jurisdiction in which the Partnership develops and constructs the Project, community facilities district bonds are issued by government instrumentalities to finance major infrastructure and other improvements. As a land owner benefited by these improvements, the Partnership is responsible for the assessments on its land until the property is sold to buyers. When homes within the Project are sold, the buyers assume the responsibility for the related assessment.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Partners  
M.P.E. Partners, L.P.

We have audited the accompanying balance sheet of M.P.E. Partners, L.P., a California limited partnership (the "Partnership"), as of December 31, 1999, and the related statements of operations, partners' capital (deficit) and cash flows for the years ended December 31, 1999 and 1998. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of M.P.E. Partners, L.P. at December 31, 1999, and the results of its operations and its cash flows for the years ended December 31, 1999 and 1998, in conformity with accounting principles generally accepted in the United States.

ERNST & YOUNG LLP

Irvine, California  
January 28, 2000

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

BALANCE SHEETS  
DECEMBER 31, 2000 AND 1999

ASSETS

	2000	1999
	-----	-----
	(UNAUDITED)	
Cash.....	\$ 323,102	\$ 529,158
Receivables and other assets.....	--	2,846
	-----	-----
	\$ 323,102	\$ 532,004
	=====	=====
LIABILITIES AND PARTNERS' CAPITAL (DEFICIT)		
Accounts payable and accrued liabilities.....	\$ 542,621	\$ 823,388
Due to partners (Note 3).....	471,683	455,935
	-----	-----
	1,014,304	1,279,323
Commitments and contingencies (Note 4)		
Partners' capital (deficit).....	(691,202)	(747,319)
	-----	-----
	\$ 323,102	\$ 532,004
	=====	=====

See accompanying notes to financial statements.

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	2000	1999	1998
	-----	-----	-----
	(UNAUDITED)		
Sales.....	\$ --	\$24,345,000	\$32,056,400
Cost of sales.....	--	19,039,542	25,739,557
	-----	-----	-----
Gross profit.....	--	5,305,458	6,316,843
Other expenses			
Selling and marketing (Note 3).....	1,600	2,701,810	2,100,750
Other expense.....	--	17,045	6,170
	-----	-----	-----
Net income (loss).....	\$(1,600)	\$ 2,586,603	\$ 4,209,923

See accompanying notes to financial statements.

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

STATEMENTS OF PARTNERS' CAPITAL (DEFICIT)  
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	IHP INVESTMENT FUND I, L.P.	CAPITAL PACIFIC HOLDINGS, LLC	TOTAL
BALANCE -- DECEMBER 31, 1997.....	\$ 20,405,433	\$ 2,506,554	\$ 22,911,987
Contributions from partner.....	18,799,859	--	18,799,859
Distributions to partners.....	(29,918,842)	(2,176,899)	(32,095,741)
Net income.....	2,621,826	1,588,097	4,209,923
BALANCE -- DECEMBER 31, 1998.....	11,908,276	1,917,752	13,826,028
Contributions from partner.....	6,149,660	--	6,149,660
Distributions to partners.....	(21,609,165)	(1,700,445)	(23,309,610)
Net income.....	1,677,956	908,647	2,586,603
BALANCE -- DECEMBER 31, 1999.....	(1,873,273)	1,125,954	(747,319)
Contributions from partner.....	57,717	--	57,717
Distributions to partners.....	--	--	--
Net income.....	(1,494)	(106)	(1,600)
BALANCE -- DECEMBER 31, 2000 (UNAUDITED).....	\$ (1,817,050)	\$ 1,125,848	\$ (691,202)

See accompanying notes to financial statements.

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

	2000 ----- (UNAUDITED)	1999 -----	1998 -----
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss).....	\$ (1,600)	\$ 2,586,603	\$ 4,209,923
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities			
Cost of sales.....	--	19,039,542	25,739,557
Changes in operating assets and liabilities			

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Receivables and other assets.....	2,846	275,698	1,604,686
Additions to real estate inventories.....	--	(2,937,194)	(19,091,151)
Accounts payable and accrued liabilities.....	(280,767)	(2,042,853)	2,349,522
Due to partners.....	15,748	346,797	(1,118,257)
	-----	-----	-----
Net cash provided by (used in) operating activities.....	(263,773)	17,268,593	13,694,280
	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES			
Capital contributions from partners.....	57,717	6,149,660	18,799,859
Capital distributions to partners.....	--	(23,309,610)	(32,095,741)
	-----	-----	-----
Net cash (used in) provided by financing activities.....	57,717	(17,159,950)	(13,295,882)
	-----	-----	-----
Net increase (decrease) in cash.....	(206,056)	108,643	398,398
Cash -- beginning of period.....	529,158	420,515	22,117
	-----	-----	-----
Cash -- end of period.....	\$ 323,102	\$ 529,158	\$ 420,515
	=====	=====	=====

See accompanying notes to financial statements.

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 1999 AND 1998

#### 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### Organization

M.P.E. Partners, L.P., a California limited partnership (the "Partnership"), was formed on March 14, 1997 (inception) in accordance with the provisions of the laws of the State of California for the purpose of developing and selling 51 single-family homes in Tarzana, California (the "Project"). The general partner, Peters Ranchland Company, Inc. ("Peters"), and the limited partner, IHP Investment Fund I, L.P. ("IHP"), each owned a 50% interest in the Partnership at inception. On October 1, 1997, Peters transferred its interest in the Partnership to Capital Pacific Holdings, LLC ("CPH").

The partnership agreement provides that cash flows, as defined, are distributed to the partners first, in the amount of the adjusted GAAP profit component (as defined) from the sale of each home, in accordance with their percentage interests; second, in satisfaction of unpaid preferred returns; third, for payment of partners' capital contributions in accordance with their percentage interests; any remaining cash flows are distributed to the partners in accordance with their percentage interests.

Net income is allocated to the partners in the following order of priority: first, to recover any net losses allocated previously; second, to the extent of and in proportion to the amount by which cash flow distributed in satisfaction of preferred returns and the adjusted GAAP profit component (as defined in the partnership agreement) distributed from the sale of each home exceeds previously allocated profits; third, to the extent other cash flows distributed, as defined, exceed previously allocated net income; thereafter, in accordance with their percentage interests. Net losses are allocated first, to the general partner up to \$4,063,045 plus all previously allocated net income; second, to

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the limited partner until the limited partner's capital account is reduced to zero; any remaining losses are allocated to the general partner.

Certain distributions reflected in the statement of partners' capital were not in accordance with the provisions of the partnership agreement and it is management's and the partners' intent to cumulatively adjust future contributions and distributions of the Partnership to reflect the provisions of the partnership agreement.

The partnership agreement provides, among other things, that the partners shall be entitled to receive a preferred return on contributed capital computed at the rate of prime plus 1%. As of December 31, 1999 and 1998, the Partnership has unpaid preferred returns of \$0 and \$6,391, respectively, on IHP's capital contributions, and \$307,434 and \$245,829, respectively, on CPH's capital contributions.

### Use of Estimates

The preparation of the Partnership's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of December 31, 1999 and 1998, and revenues and expenses for the years ended December 31, 1999 and 1998. Actual results could materially differ from those estimates in the near term.

### Real Estate Inventories

Real estate inventories include direct and indirect land costs, offsite costs and onsite improvement costs, project commitment fees and builder overhead fees which are capitalized to the Project. Selling and marketing costs are expensed as incurred.

The Partnership complies with the provisions of Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of ("SFAS No. 121"). SFAS No. 121 requires the Partnership to review the Project whenever events or changes in circumstances indicate that the cost basis of the Project may not be recoverable. If the cost basis of the Project

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 1999 AND 1998

is greater than the projected future net cash flows from the Project, an impairment loss is recognized. Impairment losses are calculated as the difference between the Project's cost basis and its estimated fair value, net of disposal costs on completed units, if any. No impairment losses were recorded in 1999 and 1998. Accordingly, the Project was carried at its historical cost basis. The Partnership sold all of its remaining homes in 1999, therefore, there is no inventory balance at December 31, 1999.

### Sales and Profit Recognition

Sales are recorded and profit is recognized when title has passed to a buyer who has met down payment and continuing investment criteria, and substantially all of the risks and rewards of ownership have been transferred to the buyer. At the time of sale, accumulated costs are relieved from real estate inventories by a method that approximates relative sales value and are charged

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to cost of sales.

### Income Taxes

The Partnership is not a taxable entity and the results of its operations are included in the tax returns of the partners. Accordingly, no provision for income taxes is reflected in the accompanying financial statements.

### 2. REAL ESTATE INVENTORIES

During 1999, the Project's remaining 20 homes were sold. At December 31, 1999, included in accounts payable and accrued liabilities is \$552,475 of estimated costs to complete the development of the Project and \$270,913 of warranty cost reserves.

### 3. RELATED PARTY TRANSACTIONS

The Partnership acquired the Project on April 11, 1997 from a related party, Capital Pacific Holdings, Inc. and two other affiliates (collectively, "CPH, Inc."), for \$12,392,547, utilizing IHP's initial cash contribution.

CPH, Inc. incurred certain costs in connection with the development of the Partnership's models and sales office. In accordance with the Partnership Agreement, \$2,710,000 was credited to CPH's capital account relating to these development costs.

The Partnership entered into a cost sharing agreement with CPH, Inc. which requires the Partnership to reimburse CPH, Inc. for certain costs related to advertising and the operation and maintenance of the models and sales office. Total shared costs allocated to the Partnership during the years ended December 31, 1999 and 1998 and the period ended December 31, 1997 were \$0, \$1,520,811 and \$471,646, respectively, and are included in selling and marketing costs in the Partnership's statements of operations.

The partnership agreement provides that a total of \$1,623,655 be paid to the general partner in monthly installments for builder overhead fees. If, after all of the homes in the Project are sold, actual sales prices (as defined) are less than budgeted sales prices, the general partner shall be liable to the Partnership for all overhead fees received in excess of 3% of actual gross sales prices (as defined). If actual sales prices are greater than budgeted sales prices, the general partner shall be entitled to receive from the Partnership an amount equal to 3% of actual gross sales prices less overhead fees already received. An additional \$126,725 of builder overhead fees was incurred by the Partnership as actual sale prices were greater than budget.

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M.P.E. PARTNERS, L.P.  
(A CALIFORNIA LIMITED PARTNERSHIP)

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 1999 AND 1998

The following fees were paid to the partners and capitalized to the Project during the years ended December 31, 1999 and 1998:

	1999	1998
	-----	-----
Commitment fees paid to IHP.....	\$ --	\$ 270,609



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Builder overhead fees paid to CPH.....	267,913	847,128
	-----	-----
	\$267,913	\$1,117,737
	=====	=====

The amounts due to the partners as of December 31, 1999 and 1998 consist of amounts due to CPH for the payment of builder overhead fees and development fees.

4. COMMITMENTS AND CONTINGENCIES

The Partnership's commitments and contingencies include the usual obligations incurred by real estate developers in the normal course of business. In the opinion of management, these matters will not have a material effect on the Partnership's financial position.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 is incorporated by reference to the Company's definitive proxy statement to be filed with the Commission no later than June 28, 2001 (the "Proxy Statement").

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference to the Company's definitive Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated by reference to the Company's definitive Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 is incorporated by reference to the Company's definitive Proxy Statement.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report:

1. FINANCIAL STATEMENTS. The following Financial Statements, together with the Notes thereto and Reports of Independent Public Accountants thereon, are included in Part II, Item 8 of this report.

CAPITAL PACIFIC HOLDINGS, INC.

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Report of Independent Public Accountants  
Consolidated Balance Sheets as of February 29, 2000 and February 28, 2001  
Consolidated Statements of Income for the years ended February 28, 1999,  
February 29, 2000 and  
February 28, 2001  
Consolidated Statements of Stockholders' Equity for the years ended  
February 28, 1999, February 29,  
2000 and February 28, 2001  
Consolidated Statements of Cash Flows for the years ended February 28,  
1999, February 29, 2000 and  
February 28, 2001  
Notes to Consolidated Financial Statements

GRAND COTO ESTATES, L.P.  
Report of Independent Public Accountants  
Balance Sheets as of December 31, 2000 and 1999  
Statements of Operations for the years ended December 31, 2000, 1999 and  
1998  
Statements of Partners' Capital (Deficit) for the years ended December 31,  
2000, 1999 and 1998  
Statements of Cash Flows for the years ended December 31, 2000, 1999 and  
1998  
Notes to Financial Statements

M.P.E. PARTNERS, L.P.  
Report of Independent Public Accountants  
Balance Sheets as of December 31, 2000 and 1999  
Statements of Operations for the years ended December 31, 2000, 1999, and  
1998  
Statements of Partners' Capital (Deficit) for the years ended December 31,  
2000, 1999 and 1998  
Statements of Cash Flows for the years ended December 31, 2000, 1999 and  
1998  
Notes to Financial Statements

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### 2. EXHIBITS

EXHIBIT NUMBER -----	DESCRIPTION -----
3.1	Second Restated Certificate of Incorporation of the Registrant, as Amended. (Incorporated by reference to Exhibit 3.3 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).
3.2	Second Amended and Restated Bylaws of the Registrant. (Incorporated by reference to Exhibit 3.4 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).
4.1	See the Articles of Incorporation and Bylaws of the Registrant (Exhibits 3.1 - 3.2) and the Indenture and related agreements (Exhibits 10.1 - 10.6).
10.1	Indenture agreement by and between Capital Pacific Holdings, Inc., as Issuer; Durable Homes, Inc., J.M. Peters Nevada, Inc., and Peters Ranchland, Inc., as Guarantors, and United States Trust Company of New York, as Trustee, dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.1 of

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- the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).
- 10.2 Warrant Agreement by and between Capital Pacific Holdings, Inc., and United States Trust Company of New York, Warrant Agent, dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.2 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).
- 10.3 Warrant Registration Rights Agreement by and between Capital Pacific Holdings, Inc., and Morgan Stanley & Co. Incorporated dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.3 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).
- 10.4 Notes Registration Rights Agreement by and between Capital Pacific Holdings, Inc., and Morgan Stanley & Co. Incorporated dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.4 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).
- 10.5 Second Supplemental Indenture dated as of September 10, 1997 to the Indenture agreement dated as of May 13, 1998. (Incorporated by reference to Exhibit 10.5 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).
- 10.6 Third Supplemental Indenture, dated as of October 1, 1997 to the Indenture agreement dated as of May 13, 1994, as amended. (Incorporated by reference to Exhibit 10.6 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).
- 10.7 Capital Pacific Holdings, Inc. Stock Incentive Agreement (Non-Qualified). (Incorporated by reference to Exhibit 10.7 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1999).
- 21.1 Subsidiaries of the Registrant. (Incorporated by reference to Exhibit 21.1 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1999).
- 23.1 Consent of Ernst & Young LLP.
- 23.2 Consent of Arthur Andersen LLP.
- 99.1 Amended and Restated Limited Liability Company Agreement (Incorporated by reference to Exhibit 99.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended August 31, 1997).
- 99.2 Registration Rights Agreement (Incorporated by reference to Exhibit 99.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended August 31, 1997).
- 99.3 Interest Exchange Agreement dated as of February 15, 2001.

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### (b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of the year ended February 29, 2000. A report on Form 8-K was filed on March 9, 2001, regarding the Interest Exchange Agreement between the Registrant and California Housing Finance, L.P.

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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, in the City of Newport Beach, State of California, on May 29, 2001.

CAPITAL PACIFIC HOLDINGS, INC.

By            /s/ HADI MAKARECHIAN

-----  
Hadi Makarechian  
Chairman of the Board,  
Chief Executive Officer and  
President

Date: May 29, 2001

KNOW ALL MEN BY THESE PRESENTS that each person whose signature appears below constitutes and appoints Hadi Makarechian and Steven O. Spelman, Jr., and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for each person and in such person's name, place and stead, in any and all capacities, to sign any and all amendments to this report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully and to all intents and purposes as such person might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or their substitute or substitutes, may lawfully do or cause to be done by virtue of the powers herein granted.

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

SIGNATURE -----	TITLE -----	DATE ---
/s/ HADI MAKARECHIAN ----- Hadi Makarechian	Chairman of the Board, Chief Executive Officer and President	May 29,
/s/ STEVEN O. SPELMAN, JR. ----- Steven O. Spelman, Jr.	Chief Financial Officer and Corporate Secretary	May 29,
/s/ KARLHEINZ M. KAISER ----- Karlheinz M. Kaiser	Director	May 29,
/s/ ALLAN L. ACREE ----- Allan L. Acree	Director	May 29,
/s/ WILLIAM J. HADAWAY ----- William J. Hadaway	Director	May 29,

EXHIBIT INDEX

EXHIBIT NUMBER -----	DESCRIPTION -----	SEQUENTIAL PAGE NUMBER -----
3.1	Second Restated Certificate of Incorporation of the Registrant, as Amended. (Incorporated by reference to Exhibit 3.3 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).....	
3.2	Second Amended and Restated Bylaws of the Registrant. (Incorporated by reference to Exhibit 3.4 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).....	
4.1	See the Articles of Incorporation and Bylaws of the Registrant (Exhibits 3.1 - 3.2) and the Indenture and related agreements (Exhibits 10.1 - 10.6).....	
10.1	Indenture agreement by and between Capital Pacific Holdings, Inc., as Issuer; Durable Homes, Inc., J.M. Peters Nevada, Inc., and Peters Ranchland, Inc., as Guarantors, and United States Trust Company of New York, as Trustee, dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.1 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).....	
10.2	Warrant Agreement by and between Capital Pacific Holdings, Inc., and United States Trust Company of New York, Warrant Agent, dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.2 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).....	
10.3	Warrant Registration Rights Agreement by and between Capital Pacific Holdings, Inc., and Morgan Stanley & Co. Incorporated dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.3 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).....	
10.4	Notes Registration Rights Agreement by and between Capital Pacific Holdings, Inc., and Morgan Stanley & Co. Incorporated dated as of May 13, 1994. (Incorporated by reference to Exhibit 10.4 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1994 filed on May 27, 1994, SEC File No. 001-09911).....	
10.5	Second Supplemental Indenture dated as of September 10, 1997 to the Indenture agreement dated as of May 13, 1998. (Incorporated by reference to Exhibit 10.5 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).....	
10.6	Third Supplemental Indenture, dated as of October 1, 1997 to the Indenture agreement dated as of May 13, 1994, as amended. (Incorporated by reference to Exhibit 10.6 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1998).....	
10.7	Capital Pacific Holdings, Inc. Stock Incentive Agreement (Non-Qualified). (Incorporated by reference to Exhibit 10.7	

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of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1999).....

21.1 Subsidiaries of the Registrant. (Incorporated by reference to Exhibit 21.1 of the Registrant's Annual Report on Form 10-K for the fiscal year ended February 28, 1999).....

23.1 Consent of Ernst & Young LLP.....

23.2 Consent of Arthur Andersen LLP.....

99.1 Amended and Restated Limited Liability Company Agreement (Incorporated by reference to Exhibit 99.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended August 31, 1997).....

EXHIBIT NUMBER -----	DESCRIPTION -----	SEQUENTIAL PAGE NUMBER -----
99.2	Registration Rights Agreement (Incorporated by reference to Exhibit 99.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended August 31, 1997).....	
99.3	Interest Exchange Agreement dated as of February 15, 2001.....	