CALIFORNIA COASTAL COMMUNITIES INC
Form 10-K
March 15, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 0-17189

CALIFORNIA COASTAL COMMUNITIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**02-0426634**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6 Executive Circle, Suite 250 Irvine, California	**92614**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(949) 250-7700**

Securities registered pursuant to Section 12(b) of the Act: **NONE**

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

Common Stock, par value $.05 per share

(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. YES x NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). YES x NO o

The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 1, 2005 was $158,225,281.

The number of shares of Common Stock outstanding as of March 1, 2005 was 10,160,212.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the 2005 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

PART I

Item 1. Business

General

California Coastal Communities, Inc. and its consolidated subsidiaries (the Company) is a residential land development and homebuilding company with properties located primarily in southern California. The principal activities of the Company include: (i) obtaining zoning and other entitlements for land it owns or controls through purchase options and improving the land for residential development; and (ii) designing, constructing and selling single-family residential homes in southern California. Once the residential land owned by the Company is entitled, the Company may build homes, sell unimproved land to other developers or homebuilders, sell improved land to homebuilders, or participate in joint ventures with other developers, investors or homebuilders to finance and construct infrastructure and homes. During 2005, the Company will focus its immediate efforts to (i) obtain a Coastal Development Permit (CDP) from the California Coastal Commission (Coastal Commission) to build 349 homes on the upper bench of the Bolsa Chica Mesa (Upper Mesa), as further described below and in Note 3 to the Company s Consolidated Financial Statements; and (ii) continue to expand its profitable homebuilding operations. However, the Company may also consider other strategic and joint venture opportunities; and there can be no assurance that the Company will accomplish, in whole or in part, all or any of these strategic goals.

The Company s executive offices are located at 6 Executive Circle, Suite 250, Irvine, California 92614 (telephone: (949) 250-7700).

Principal Properties

The following sections describe the Company s principal properties.

Bolsa Chica. The Bolsa Chica Mesa is the principal property in the Company s portfolio, representing 62% of its assets as of December 31, 2004. The Bolsa Chica Mesa is one of the last large undeveloped coastal properties in southern California, and is located in Orange County, approximately 35 miles south of downtown Los Angeles. Bolsa Chica is bordered on the north and east by residential development in the City of Huntington Beach, to the south by open space and the Bolsa Chica wetlands, and to the west by Pacific Coast Highway, Bolsa Chica State Beach, and the Pacific Ocean. The Company owns approximately 351 acres of the 1,600 acres of undeveloped land at Bolsa Chica. The Company s holdings include 208 acres on the Bolsa Chica Mesa, approximately 100 acres on, or adjacent to, the Huntington Mesa and 43 acres of lowlands.

In February 1997, the Company completed the sale of its approximately 880-acre Bolsa Chica lowlands, which had previously been planned for the development of up to 900 homes and wetlands restoration, to the California State Lands Commission for $25 million. Under an interagency agreement among various state and federal agencies, these agencies have agreed to restore the Bolsa Chica wetlands habitat utilizing escrowed funds from the Ports of Los Angeles and Long Beach. In January 2002, the California Coastal Commission and the State Lands Commission approved an approximately $100 million wetlands restoration plan which is expected to significantly improve the views of many of the homes that the Company plans to develop on the Bolsa Chica Mesa, as discussed below. Wetlands restoration construction is currently scheduled to commence in 2005.

The Company is currently pursuing approval of permits for development of 68 acres of its approximately 105-acre upper bench on the Bolsa Chica Mesa (Upper Mesa). During 2002, the County of Orange approved the Company s site plan and tentative tract map for development of 379 single-family homes on 77 acres of the Upper Mesa. The Company submitted a Coastal Development Permit (CDP) application for the planned community, known as Brightwater , to the Coastal Commission in November 2002. On October 13, 2004, the Coastal Commission held a public hearing on the Company s

CDP application. Following completion of the public hearing, the Company withdrew its CDP application in order to have additional time to work with Commissioners and their staff in an effort to develop changes to the project which would be acceptable to the Commission.

In January 2005, the Company filed a new application with the Coastal Commission for a CDP consisting of 347 homes (subsequently amended to add two additional lots for a total of 349 homes) to be built on 68 acres of the Upper Mesa. This new application reflects elimination of development in environmentally sensitive habitat areas and increased buffers between the habitat areas and the proposed development. The Company made these substantial changes to its proposed development plan in response to issues raised with respect to the prior CDP application at the Coastal Commission s October 13, 2004 hearing. These modifications resulted in a nine-acre decrease in the proposed development area and a corresponding decrease of 30 homes in the plan. The Company expects that the Coastal Commission staff will issue their recommendation to the Coastal Commission in late March or early April 2005 and the Company currently expects that the Commission will hold a public hearing on the new CDP application in mid-April 2005. However, there can be no assurance that further delays will not be encountered.

As a result of the modifications made to the development plans for the Upper Mesa and submitted to the Coastal Commission, further approval will be required by the County of Orange. In addition, the Company expects that following any Coastal Commission approval of a development plan, there will be numerous specific conditions for planning items to be completed prior to the issuance of a CDP. The Company currently expects that a CDP could be issued by the end of 2005, subject to satisfying the permit conditions. Ultimately, the Company does not believe that the Coastal Commission process will permanently prevent it from developing a planned community at Bolsa Chica; however, there can be no assurance in that regard, or as to (i) when development could commence, (ii) the number of acres or homes the Company will be permitted to develop, or (iii) the absence of further litigation or administrative delay.

The Brightwater planned community is currently expected to offer a broad mix of home choices, averaging 2,740 square feet and ranging in size from 1,560 square feet to 4,000 square feet. The plan also includes 37 acres of open space and conservation area on the 105-acre Upper Mesa. With only 349 homes on 68 acres of the Upper Mesa, the resulting low-density plan equates to approximately 5 homes per acre, consistent and compatible with the neighboring Huntington Beach communities. In addition, the Company will offer to dedicate 51 acres of land on the Huntington Mesa to the County of Orange to complete the Harriett M. Wieder Linear Park, a 105-acre planned regional park. The 1,200-acre Bolsa Chica Wetlands are fully preserved and protected in accordance with previous agreements with the State of California and are not included in the Brightwater plan.

On August 12, 2004, an agreement to sell a 103-acre parcel of the Bolsa Chica Mesa known as the Lower Bench to the State s Wildlife Conservation Board (WCB) for $65 million was approved by the WCB. The sale remains subject to shareholder approval and the terms of the agreement include an outside closing date of June 30, 2005. If the proposed sale is completed, WCB s purchase of the property will be funded with bond proceeds authorized by voter-approved Proposition 50, which was passed in November 2002. The Company has indicated that it will require Coastal Commission approval of the Brightwater development plan for the Upper Mesa prior to seeking shareholder approval and issuance of the CDP prior to closing the sale. Therefore, the Company has initiated discussions with the WCB to extend the outside closing date to December 31, 2005. However, there can be no assurances that the WCB agreement will be extended or that a sale transaction will ever be completed.

If the Coastal Commission approves a CDP for the Upper Mesa, the Company would then re-evaluate its projected profitability as it relates to recorded deferred tax asset valuation allowance on net operating losses (NOLs) as required by SFAS No. 109. Such re-evaluation may result in management concluding that it is more likely than not that the Company will realize its deferred tax assets, which would result in a reversal of all or a portion of the related valuation allowance.

The Company s valuation allowance on federal NOLs and other tax assets as of December 31, 2004 is approximately $43.2 million. Recognition of tax benefits from reductions in valuation allowances attributable to any utilization or future potential utilization of pre-Reorganization NOLs would be excluded from results of operations and credited to capital in excess of par value. The portion of the valuation allowance attributable to federal pre-Reorganization NOLs is approximately $38.1 million as of December 31, 2004. Therefore, the Company would expect to reflect a tax benefit of $5.1 million in its statement of operations for reversal of valuation allowance on post-Reorganization NOLs and other tax assets and credit capital in excess of par value in the amount of $38.1 million for reversal of valuation allowance on pre-Reorganization NOLs if it concludes that it is more likely than not that all the NOLs will ultimately be utilized to offset operating income generated from the disposition of the Bolsa Chica property. Preservation of the Company s NOLs is dependent upon the enforcement of certain transfer restrictions on the Company s common stock. These restrictions are set forth in the Company s charter documents and stock transfers are monitored for compliance purposes.

Upon completion of the Company s recapitalization (the Recapitalization) in September 1997 as discussed in Note 1 to the Consolidated Financial Statements included in this Annual Report, the Company applied the accounting principles required by Fresh-Start Reporting and the carrying value of land held for development (Bolsa Chica) was adjusted to fair value as of September 2, 1997. The fair value was determined in 1997 using discounted estimated cash flows expected from the asset s operations and eventual disposition. The Company updated its analysis at each year-end since 1997, and has noted no indicators of impairment since that date.

In evaluating the recoverability of the carrying value of Bolsa Chica, the Company considered the current status of development planning for the Upper Mesa, including the likelihood of obtaining Coastal Commission approval for its CDP application, and the pending sale of the Lower Bench in its probability-weighted approach to evaluating the recoverability of the carrying value of this asset under SFAS No. 144.

The Company s application for a CDP from the Coastal Commission relates only to the Upper Mesa, where the Coastal Commission has previously approved residential development in four previous public hearings (1986, 1996, 1997 and 2000). Since the Coastal Commission, in its 2000 public hearing on Bolsa Chica, indicated that it would allow substantial development on the Upper Mesa and reiterated that some development was likely at its October 13, 2004 public hearing, it appears likely that the Commission would allow reasonable development on the Upper Mesa in the future. A tentative tract map and site plan for the Upper Mesa have been approved by the County of Orange. Changes made to the plan since the County s approval are anticipated to be acceptable to the County. Therefore, the Company believes that it will eventually be permitted to reasonably develop the Upper Mesa; however there can be no assurance in that regard. Given that the Company has no debt which is secured by any of the Bolsa Chica property, and its current homebuilding operations are providing cash flow, the Company expects to be able to continue pursuing reasonable development as long as necessary until it succeeds in obtaining permits for development on the Upper Mesa. Alternatively, if the Company s CDP is not approved, the Company expects to vigorously oppose any challenges to reasonable development of the Upper Mesa. Future costs incurred for capitalizable development activities for the Bolsa Chica project will increase the basis of the land. An estimate for these costs has been included in the Company s estimated undiscounted cash flow forecast used in its impairment analyses.

The following facts and assumptions were utilized by the Company in evaluating the potential value which could be derived from development of the Bolsa Chica Upper Mesa:

- The Upper Mesa CDP application encompasses 349 homes aggregating approximately 950,000 square feet.

- Following Coastal Commission approval, the Company expects it may take approximately six to nine months to satisfy the Commission s permit conditions which would be a pre-requisite to issuance of a CDP.

- Following receipt of a CDP, the Upper Mesa development is projected to take approximately six months for infrastructure and two to three years for home construction.

- New home prices approximate $525 per square foot, including view and other premiums, in the local residential market (coastal Huntington Beach).

- The finished lot component of home prices ranges from 60% to 65%.

- Costs to improve the lots from their raw condition to finished lots approximate $120,000 per lot.

- Home prices in the coastal Huntington Beach area (as well as other Orange County coastal areas) appreciated approximately 20% during 2004. While demand continues to exceed the supply of housing, pressure for continued appreciation of home prices may be reduced by any significant increases in interest rates.

- Generally, homebuilders expect to earn a gross profit of 8% of the sales price of homes.

Given the facts and assumptions described above, the Company believes that the eventual development of the Upper Mesa will result in realization of an amount that is substantially in excess of the $156.4 million book value presently reflected in the Company s consolidated financial statements. From time to time, the Company has received outside appraisals on an as developed basis which have supported the Company s beliefs, although there can be no assurance that those beliefs will be validated.

In accordance with the Company s policy described in Note 2 to the Consolidated Financial Statements Impairment of Long-Lived Assets, since the estimated undiscounted future cash flows from the proposed Upper Mesa development plan for 349 single-family homes and the proceeds which would be received if the pending sale of the Lower Bench to WCB is completed are expected to exceed its December 31, 2004 carrying value, the Company believes there has been no impairment.

The estimation process involved in the determination of value is inherently uncertain because it requires estimates as to future events and market conditions. Such estimation process assumes the Company s ability to complete development and disposition of its real estate properties in the ordinary course of business based on management s present plans and intentions. Economic, market, environmental and political conditions may affect management s development and marketing plans. In addition, the implementation of such development and marketing plans could be affected by the availability of future financing for development and construction activities. The development of the Company s Upper Mesa project is dependent upon various governmental approvals and economic factors. Accordingly, the amount ultimately realized from such project may differ materially from current estimates and the project s carrying value.

Land Development Unconsolidated Joint Venture

Oxnard. In February 2003, the Company entered into two option contracts to acquire land adjacent to the City of Oxnard in Ventura County, California aggregating approximately 168 acres. The Company is in the process of developing a land plan for the area, which also includes an additional 149 acres owned by other landowners, with the intention of entitling the property for residential development and annexing it to the City of Oxnard. The Company currently expects that the residential development plan will include approximately 880 single-family detached lots and approximately 375 attached family residential units; however, these numbers are subject to change during the course of the entitlement process. Approximately 650 of the single-family lots and 250 of the attached units would be developed on the 168 acres of optioned land expected to be purchased by the Company. The option contracts allow for two years, plus up to three

additional years through the exercise of extensions, for the Company to complete these entitlement activities in advance of consummating the purchase transactions. The entitlement process is expected to be completed during the first quarter of 2006; however, delays could be encountered. During January 2005, the first six-month option extensions were exercised. The option-holder has the right in its sole discretion to terminate the obligations under these option agreements by forfeiting the cash deposits with no further financial responsibility.

During October 2003, the Company entered into a Limited Liability Company (Oxnard LLC) joint venture agreement with a major financial partner to pursue the Oxnard development opportunity. The Company assigned the land purchase option contracts to the Oxnard LLC. Hearthside Homes, Inc. (the Company s homebuilding subsidiary) is the managing member of the Oxnard LLC, and has contributed $500,000 to the venture. The non-managing member also made an initial contribution of $500,000 to the venture. Capital contributions of up to an additional $4 million are to be made by the non-managing member. As of December 31, 2004, the non-managing member had made an aggregate of approximately $2.6 million of additional contributions. Under the Oxnard LLC operating agreement, if contributions in excess of $5 million are required and approved by the members, the next $1 million would be contributed equally by the members. Total contributions of the non-managing member are generally limited to $5 million. After payment of a 10% preferred return on invested capital to each member, first tier profits are generally allocated 75% to the non-managing member and 25% to the managing member and second tier profits and losses over $5 million are generally allocated 50% to each member. The first $5 million of losses are generally allocated 80% to the non-managing member and 20% to the managing member. While the Company exerts a large degree of influence over the venture, the non-managing member does have various participating rights such as approval rights with regard to major business decisions. In addition, the Company is not the primary beneficiary of the entity, therefore, the venture is not consolidated.

Homebuilding

The Company s homebuilding operations have increased lot inventory during 2004, completing acquisitions of 265 single-family residential lots during the year, expanding into northern Los Angeles County and returning to the San Diego County market. The Company has also entered into agreements to acquire an additional 357 lots in 2005. Although home prices in Southern California have increased 20% to 30% annually over the last few years, the Company does not expect appreciation to continue at that rate, but rather expects modest increases of less than 10% over the next year. While the 135 home deliveries for 2004 are less than the 154 homes delivered in 2003, homebuilding revenues and margins for 2004 exceeded 2003 results significantly. The Company s active homebuilding projects are described below.

Riverside. During 2003 and 2004, the Company acquired 67 lots for a project known as Jasper Ranch near the city of Riverside, in Riverside County, in the master-planned community known as Victoria Grove . This well-established community is planned for a total of 855 homes. The Company began construction of homes averaging 3,673 square feet during the third quarter of 2003. The Company opened for sales on these homes during June 2003. The Company delivered the first phase of five homes during the fourth quarter of 2003 at an average price of approximately $468,000, and an additional 38 homes during 2004, at an average price of approximately $612,000. The Company delivered six additional homes during January and February 2005 and as of March 6, 2004, nine homes are in escrow, four homes are available for sale and the remaining five homes are currently scheduled to be released for sale during the first half of 2005.

Chino. In May 2003, through a consolidated joint venture, the Company acquired 77 finished lots in Chino, California in San Bernardino County. This infill site is part of a new community known as The Reserve , encompassing 244 homes. Construction of homes averaging approximately 3,320 square feet began during the fourth quarter of 2003. The Company opened for home sales in February 2004, and delivered 65 homes at an average price of $593,000 during 2004. As of March 6, 2005, three additional homes have been delivered, one home is in escrow and the remaining eight homes are currently scheduled to be released for sale during the first half of 2005.

During January 2004, the Company acquired 17 additional finished lots in the City of Chino which are near, but not a part of The Reserve, and are not a part of the joint venture described above. The Company began construction of homes averaging 2,990 square feet during the fourth quarter of 2004. The Company opened for sales at this project during January 2005 and 13 of the 17 homes are in escrow as of March 6, 2005.

Rancho Santa Fe. In October 2003, the Company entered into an agreement to acquire 32 lots in a luxury golf community known as Crosby Estates in the Rancho Santa Fe area of California in San Diego County. The Company acquired eight of the lots during the fourth quarter of 2003, 18 additional lots during 2004 and expects to acquire the final six lots during March 2005. Two model homes are under construction for homes averaging approximately 3,370 square feet. The first phase of six homes was released for sale during February 2005 and as of March 6, 2005, five homes are in escrow.

Lancaster. The Company acquired 104 lots in the city of Lancaster in northern Los Angeles County during May 2004. The Company began construction of model homes averaging approximately 2,800 square feet during the third quarter of 2004. The Company opened for sales of the first phase in January 2005, and 10 homes are in escrow as of March 6, 2005. In 2004, the Company also purchased an option to acquire an additional 70 lots in Lancaster, which is expected to occur during the second quarter of 2005.

Corona. The Company acquired 83 lots in North Corona in May 2004. The Company expects to begin construction of homes averaging 3,250 square feet during the first quarter of 2005.

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 land. 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 use of joint ventures may vary in the future in order to enable the Company to control an adequate supply of lots while minimizing capital commitments. The Company typically is required to fund a small percentage of the capital requirements of each joint venture, which amount is included in other assets in the Company s consolidated balance sheets.

Land Acquisition. 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 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 available on favorable terms. Additionally, by forming joint ventures with various sources of capital, the Company has been able to obtain access to additional capital and construction financing to expand the number of lots the Company controls and to spread project risk.

Product Design. The Company contracts with a number of outside architects, designers, engineers, consultants and subcontractors. 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 risks. The Company has a number of plans which it has used in various projects which can be re-used in new projects with appropriate modifications as necessary. The Company offers options and upgrades to provide its homebuyers with opportunities to customize their home to fit their lifestyle, the

extent of which varies depending upon the project. However, structural and other changes which impact the build time of the home are typically limited.

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 appearances within its projects. Generally, the Company selects the exterior finishes of its homes subject to necessary architectural approvals. 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 through third parties contracted with by the Company, or the services may be provided through the homebuyer s own consultants.

Construction and Development. The Company acts as the general contractor for the construction of its projects. All construction work for the Company is performed by subcontractors. The Company s 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. Decreasing availability of insurance coverage for subcontractors as well as the effects of increased worker s compensation insurance rates may have an adverse effect on the availability of qualified subcontractors.

The Company develops its residential projects in several phases generally averaging approximately 6 to 15 homes per phase. The Company determines the number of homes to be built in the first phase and the appropriate price range. The first phase of home construction is typically relatively 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 and in some cases the first few additional homes. Subsequent phases are generally not started until 90% to 100% 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 data which enables the Company to make decisions on the pricing, timing and size of subsequent phases. Although the time required to complete a phase varies from development to development depending on the factors above and the build time which in turn varies generally with the size and complexity of the home, the Company typically completes construction of a phase within one of its developments in approximately five to eight months. The Company is continuously developing and refining its production practices in order to reduce cycle time within the construction process.

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 once a project fully opens. The Company generally sells all of its homes through Company sales representatives working from the sales offices located at the model homes used in each subdivision. When appropriate, the Company also uses cooperative brokers to sell its homes. The Company conducts preliminary research concerning the credit status of each 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 submit an earnest money deposit usually ranging from $4,000 to $5,000 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, the Company seeks 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 signs. Because the Company s projects are often within a multi-builder community, it is able to participate in community-wide advertising that highlights all of the projects within the same community. The Company provides flooring and other amenities and upgrades to its homebuyers through various vendors contracted by the Company.

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 and receipt of an earnest money deposit and is removed when such contracts are canceled as described above, or the home purchase escrow is closed.

Competition. The home building industry is highly competitive and fragmented. The Company does not have a significant market presence in any of the geographic areas where it is currently building homes or where it expects to build homes in the future. Most of the Company s competitors have substantially greater financial resources than those of the Company, and they have much larger staffs and marketing organizations. However, the Company believes that it competes effectively in its existing markets as a result of its product design, development expertise, and its reputation as a producer of quality homes. The Company has seen the financial resources of its competitors increase as a result of the industry consolidation experienced in the past few years. 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.

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 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 (including possibly in ongoing projects), building moratoria 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 or even stop all work. Such increasing regulation may result in a significant increase in time (and related carrying costs) between the Company s initial acquisition of land and the commencement and completion of its developments. In addition, the extent to which the Company participates in land development activities subjects it to greater exposure to regulatory risks.

Raw Materials. Typically all 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 or in the price of services, 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 the last six months, the Company has experienced some delays, shortages and price increases for many raw materials components. Notably, lumber, concrete, insulation, and drywall products have been significantly affected in both price and availability. The Company has minimized the delays based on its long-term relationships with subcontractors and suppliers.

Homeowner Warranty and Mortgage Company Services. The Company provides homeowners with a limited warranty on the terms of which the Company will warrant, for a limited period, items 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 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). Statutory requirements in California may grant to homebuyers rights in addition to those provided by the Company. The Company also offers mortgage broker services to certain of its California homebuyers through its unconsolidated joint venture with an affiliate of Wells Fargo Home Mortgage.

Environmental and Regulatory Matters

Before the Company can develop a property, it must obtain a variety of discretionary approvals from local and state governments, as well as the federal government in certain circumstances, with respect to such matters as zoning, subdivision, grading, architecture and environmental matters. The entitlement approval process is often a lengthy and complex procedure requiring, among other things, the submission of development plans and reports and presentations at public hearings. Because of the provisional nature of these approvals and the concerns of various environmental and public interest groups, the approval process can be delayed by withdrawals or modifications of preliminary approvals and by litigation and appeals challenging development rights. Accordingly, the ability of the Company to develop properties and realize income from such projects could be delayed or prevented due to litigation challenging previously obtained governmental approvals. The Company may also be subject to periodic delays or may be precluded entirely from developing in certain communities due to building moratoriums or slow-growth or no-growth initiatives that could be implemented in the future.

The Company is currently seeking a Coastal Development Permit from the Coastal Commission to build 349 homes on the Upper Mesa. The Company currently expects that the Coastal Commission will hold a public hearing on the Company s permit application in mid-April 2005. Therefore, the regulatory approval process for the Bolsa Chica Mesa property remains subject to further Coastal Commission approval, and there can be no assurance that further delays will not result.

The Company has expended and will continue to expend significant financial and managerial resources to comply with environmental regulations and local permitting requirements. Although the Company believes that its operations are in general compliance with applicable environmental regulations, certain risks of unknown costs and liabilities are inherent in developing and owning real estate. The Company does not believe that such costs will have a material adverse effect on its business, financial condition or results of operations, including the potential remediation expenditures proposed in connection with certain indemnity obligations discussed below in Corporate Indemnification Matters and in Item 3. Legal Proceedings. However, the currently identifiable risks and uncertainties regarding the 43-acre lowlands property and other matters with recorded reserves are discussed in Item 3. Legal Proceedings and Note 6 to the Consolidated Financial Statements included in this Annual Report.

Corporate Indemnification Matters

The Company and its former affiliates have, through a variety of transactions effected since 1986, disposed of several assets and businesses, many of which are unrelated to the Company s current operations. By operation of law or contractual indemnity provisions, the Company may have retained liabilities relating to certain of these assets and businesses. There is generally no maximum obligation or amount of indemnity provided for such liabilities. A portion of such liabilities is supported by insurance or by indemnities from certain of the Company s previously affiliated companies. The Company believes its balance sheet reflects adequate reserves for these matters. (See Item 3. Legal Proceedings and Note 6 to the Consolidated Financial Statements regarding contingent indemnity and environmental obligations.)

Employees

As of March 1, 2005 the Company and its subsidiaries had 48 employees.

Safe Harbor, Statement Under the Private Securities Litigation Reform Act of 1995

Certain of the foregoing information and the information following this Item 1 contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, that relate to future events or the Company s future financial performance. In addition, other statements the Company may make from time to time, such as press releases, oral statements made by Company officials and other reports the Company files with the Securities and Exchange Commission, may also contain such forward-looking statements. Undue reliance should not be placed on these statements, which involve known and unknown risks, uncertainties and other factors which may cause the Company s actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may , will , should , expects , plans , anticipates , believes , estimates , predicts , potential , continue , or the negative of such terms or other comparable terminology.

These forward-looking statements include, but are not limited to, (1) statements about the Company s strategies, plans, objectives, goals, expectations and intentions; (2) the number and types of homes and number of acres of land that the Company may develop and sell; (3) the timing and outcomes of litigation, regulatory approval processes or administrative proceedings, which may result in delays in the land entitlement, development, construction, or the opening of new home communities (including, but not limited to ongoing administrative proceedings related to the Company s principal asset, the Bolsa Chica Mesa); (4) the Company s ability to realize the value of its net operating loss carry forwards; (5) the completion of the pending $65 million sale of the lower bench of the Bolsa Chica Mesa to the State of California Wildlife Conservation Board; (6) the Company s ability to continue relationships with current or future partners; (7) the Company s ability to expend resources to comply with environmental regulations and local permitting requirements; (8) the effect of certain costs, contractual obligations and tax liabilities, both known and unknown, on the Company s business, results of operations and financial condition; (9) the condition and adequacy of the Company s properties; (10) the Company s ability to estimate cash flow projections due to uncertainties in valuing real property; (11) the Company s ability to acquire residential lots in order to continue homebuilding operations; (12) the adequacy of capital, financing and cash flow required to continue the Company s operations and land development activities; (13) the future condition of the real estate market in Southern California; (14) the ability to react to increases or decreases in demand for housing and to rapidly take advantage of local market opportunities as they arise; (15) local and general economic and market conditions, including consumer confidence, employment rates, interest rates, the cost and availability of mortgage financing and stock market, home and land valuations; (16) competition; (17) the availability and cost of raw materials used by the Company in its homebuilding operations; (18) home building litigation and warranty claims; (19) shortages and the cost of labor; (20) adverse weather and natural disaster related slowdowns; (21) slow growth and no growth initiatives or moratoria; (22) governmental regulation, including the interpretation of tax, labor and environmental laws; (23) accounting changes including the expected impact of new accounting pronouncements; (24) the effectiveness and adequacy of the Company s disclosure and internal controls; (25) the impact on economic conditions of terrorist attacks or the outbreak or escalation of armed conflict involving the United States; (26) other factors over which the Company has little or no control; and (27) other statements contained in this Form 10-K that are not historical facts.

The Company assumes no, and hereby disclaims any, obligation to update any of the foregoing or any other forward-looking statements. The Company nonetheless reserves the right to make such updates from time to time by press release, periodic report or other method of public disclosure without the need for specific reference in this Form 10-K or the 2004 Annual Report to Stockholders. No such update shall be deemed to indicate that other statements not addressed by such update remain correct or create an obligation to provide any other updates.

Item 2. Properties

The Company s principal executive offices are located in Irvine, California. The Company and each of its subsidiaries believe that their properties are generally well maintained, in good condition and adequate for their present and proposed uses. The inability to renew any short-term real property lease would not be expected to have a material adverse effect on the Company s results of operations.

The principal properties of the Company and its subsidiaries, which are owned in fee unless otherwise indicated, are as follows:

Property	Location	Acres	Present or Planned Use
Bolsa Chica Upper Mesa	Orange County, CA	105	Ocean view residential community
Bolsa Chica Lower Mesa	Orange County, CA	103	Pending sale to WCB
Bolsa Chica-Huntington Mesa and lowland	Orange County, CA	143	Raw land
Subtotal Bolsa Chica		351	
Victoria Grove	Riverside County, CA	5	Residential community
The Reserve	Chino, CA	1	Residential community
Crosby Estates	Rancho Santa Fe, CA	14	Residential golf community
Providence Ranch	Lancaster, CA	23	Residential community
Chandler Ranch	Corona, CA	15	Residential community
Irvine*	Irvine, CA		Headquarters

* Leased

Item 3. Legal Proceedings

In September 1997, the Company acquired 43 acres in the Bolsa Chica lowlands with the intent of selling it to the State of California in connection with their planned restoration of 1,000 acres of adjacent wetlands. While the State is negotiating to acquire this property from the Company, no such agreement has been reached to date and there can be no assurances that any agreement will ever be reached. However, in anticipation of entering into a purchase agreement, the State performed limited soils sampling on this property and notified the Company in 1999 that it had discovered contamination from a group of chemicals called PCBs. The source of the contamination is presently unknown; however, the Company has never conducted any development, business or operations on this property. In January 2002, the State s Department of Toxic Substances Control (DTSC) became the regulatory agency responsible for overseeing the Company s efforts to remediate the contamination on this property. In July 2002, a subsidiary of the Company entered into a consent order with DTSC regarding remediation. The Company s subsidiary prepared a Remedial Investigation (RI) Workplan, which was approved by DTSC in August 2003. During September and December 2003, the subsidiary performed soil sampling at the site according to the RI Workplan to determine the nature and extent of contamination, and submitted an RI report to DTSC in February 2004. As of December 31, 2004, the subsidiary has accrued approximately $800,000 for environmental testing and remediation of this property. While the accrual reflects the estimate for the minimum costs which are probable and estimable, such accrual may not be adequate to satisfy the full amount of remediation that may be required by the DTSC. A Remedial Action Workplan was approved by DTSC in December 2004.

In May 2004, the Company s subsidiary received an invoice from DTSC seeking reimbursement for $793,000 of oversight and remediation costs incurred by DTSC with respect to PCBs found on neighboring residential properties. Since receiving the original invoice, the Company s subsidiary has received three similar invoices for an aggregate additional $78,000, including accrued interest. However, the Company s subsidiary contends, based upon advice of counsel, that it is not responsible for such costs because the Company did not develop or build the neighboring residential properties, the Company did not generate the contamination, the contamination did not emanate from the Company s property and the 43-acre site should not be part of the same site as the residential properties. Furthermore, the Company s subsidiary has also disputed such charges due to the fact that DTSC did not bill the Company s subsidiary in accordance with the requirements of the applicable law. The Company s subsidiary intends to vigorously defend itself in this matter. Therefore, the Company has not accrued for any of DTSC s $871,000 of claims related to these residential properties.

The Company s consolidated balance sheet includes reserves for contingent indemnity obligations for certain businesses disposed of by former affiliates and unrelated to the Company s current operations. In May 2002, Dresser Industries, Inc. (Dresser) filed litigation, captioned Dresser Industries, Inc. vs. California Coastal Communities, Inc. and RESCO Holdings, Inc. (RESCO , a former affiliate), in the 58th Judicial District Court of Jefferson County, Texas. Dresser seeks a declaratory judgment regarding the rights and obligations of the parties under a January 1988 purchase agreement. Under the agreement, Dresser acquired an engineering and construction business from The M.W. Kellogg Company (Kellogg), a corporation formerly affiliated with the Company. Kellogg and its parent company, Wheelabrator Technologies, Inc. (Wheelabrator), agreed to indemnify Dresser against certain pre-closing claims. In a subsequent transaction, Wheelabrator assigned certain assets and liabilities relating to the January 1988 purchase agreement to the Company. Dresser also seeks unspecified damages for breach of the 1988 purchase agreement, along with attorney s fees and costs. Dresser s indemnity claims relate to several hundred lawsuits encompassing approximately 5,900 contested asbestos claims made by third parties in connection with work in facilities in which the Dresser-acquired engineering and construction business was allegedly connected.

The Company denied Dresser s allegations and vigorously defended itself in this case and related matters. The Company was not formed until September 1988 and, upon being spun off from Wheelabrator in December 1988, the Company agreed to indemnify Wheelabrator for its potential liabilities under the January 1988 purchase agreement with Dresser, to the extent that any such liabilities are not covered by insurance. However, the Company and RESCO contend that under the terms of the January 1988 purchase agreement, any contractual duty to indemnify Dresser for any third-party asbestos claims expired in March 1991.

In September 2004, RESCO and the Company reached an agreement in principle with Dresser to settle this litigation, subject to negotiation of a definitive settlement agreement. The Company is continuing to negotiate with Dresser, RESCO and RESCO s insurer in an effort to finalize the settlement agreement. The Company s share of the settlement is $1.33 million and is the amount of the Company s litigation accrual as of December 31, 2004. The Company and RESCO are not admitting fault or liability with respect to Dresser s claims, but are negotiating to settle the matter in order to avoid the continued cost and uncertainty of litigation. However, in the event that final settlement is not accomplished and the Company is required to provide indemnification to Dresser, defense costs and damage awards in asbestos cases can involve amounts that would have a material adverse effect on the Company s business, operations and financial condition.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The following tables set forth information with respect to bid quotations for the Common Stock of the Company for the periods indicated as reported on the Nasdaq National Market. These quotations are interdealer prices without retail markup, markdown or commission and may not necessarily represent actual transactions.

	High	Low
2004		
First Quarter	$ 18.70	$ 10.50
Second Quarter	$ 20.55	$ 14.00
Third Quarter	$ 22.85	$ 17.50
Fourth Quarter	$ 24.50	$ 18.01
2003		
First Quarter	$ 6.50	$ 5.26
Second Quarter	$ 6.69	$ 5.82
Third Quarter	$	