Ares Dynamic Credit Allocation Fund, Inc.
Form 40-17G
December 09, 2015

100 Huntington Avenue

Tower 2, Floor 3

Mail Stop CPH0326

Boston, MA 02116

December 9, 2015

VIA EDGAR

Securities and Exchange Commission

100 F Street NE

Washington, DC 20549

Attention: Filing Desk

Re: Ares Dynamic Credit Allocation Fund, Inc. (the Fund)
File No. 811-22535

Dear Sir/Madam:

Pursuant to Rule 17g-1 of the Investment Company Act of 1940, as amended, enclosed please find a copy of: (i) the Fund s fidelity bond in the amount of $5,000,000 for the period November 9, 2015 to November 9, 2016 (the Policy Period) and (ii) a Secretary s Certificate certifying the resolutions adopted by the Board of Directors of the Fund approving the fidelity bond. The fidelity bond s premium has been paid to cover the Policy Period.

If you have any questions, please do not hesitate to contact me at (617) 662-1745.

Very truly yours,

/s/ Michael Hill
Michael Hill

Enclosures

FINANCIAL INSTITUTION BOND

Standard Form No. 14, Revised to October, 1987

Bond No. MNN770431/01/2015

Axis Insurance Company

(Herein called Underwriter)

DECLARATIONS

Item 1. Name of Insured (herein called Insured): Ares Dynamic Credit Allocation Fund, Inc.

Principal Address: 2000 Avenue of the Stars, 12th Floor
Los Angeles, CA 90067

Item 2. Bond Period: from 12:01 a.m. on November 9, 2015 to 12:01 a.m. on November 9, 2016

(MONTH, DAY, YEAR) (MONTH, DAY, YEAR)

standard time.

Item 3. The Aggregate Liability of the Underwriter during the Bond Period shall be $10,000,000

Item 4. Subject to Sections 4 and 11 hereof,

the Single Loss Limit of Liability is $5,000,000

and the Single Loss Deductible is $50,000

Provided, however, that if any amounts are inserted below opposite specified Insuring Agreements or Coverage, those amounts shall be controlling. Any amount set forth below shall be part of and not in addition to amounts set forth above. (If an Insuring Agreement or Coverage is to be deleted, insert Not Covered.)

Amount applicable to:

	Single Loss Limit of Liability		Single Loss Deductible	
Insuring Agreement (A) FIDELITY	$	5,000,000	$	0
Insuring Agreement (B) ON PREMISES	$	5,000,000	$	50,000
Insuring Agreement (C) IN TRANSIT	$	5,000,000	$	50,000
Insuring Agreement (D)-FORGERY OR ALTERATION	$	5,000,000	$	50,000
Insuring Agreement (E)-SECURITIES	$	5,000,000	$	50,000
Insuring Agreement (F)-COUNTERFEIT CURRENCY	$	5,000,000	$	50,000
Optional Insuring Agreements and Coverages:				
Computer Systems Fraud	$	5,000,000	$	50,000
Voice Initiated Transfer Fraud	$	5,000,000	$	50,000
Telefacsimile Transfer Fraud	$	5,000,000	$	50,000
Destruction of Data - Hacker	$	5,000,000	$	50,000
Destruction of Data - Virus	$	5,000,000	$	50,000
Claims Expense	$	100,000	$	50,000
Audit Expense	$	100,000	$	50,000
Partners Coverage	$	Nil	$	Nil

If Not Covered is inserted above opposite any specified Insuring Agreement or Coverage, such Insuring Agreement or Coverage and any other reference thereto in this bond shall be deemed to be deleted therefrom.

Item 5. The liability of the Underwriter is subject to the terms of the following riders attached hereto:

TSB 5062b

Riders:

1. ERISA Compliance Rider (SR6145b 1990);
2. CA Premium Rider (SR5862);
3. Amend Insurance Agreement F to money issued by any country (MANU);
4. Computer Systems Fraud Rider(SR6196 1993);
5. Audit Expense Rider (MANU);
6. Amend Fidelity Insuring Agreement (A) Larceny or Embezzlement (MANU);
7. Amend Change of Control- Notice (Section C) Comply with Investment Company Act of 1940 Rider (MANU);
8. Amend Notice/Proof-Legal Proceedings Rider (MANU);
9. Amend Definition of Employee Rider (MANU);
10. Amend Section -12 Termination or Cancellation ($10,000) Rider-(MANU)
11. Amend Named Insured to include Rider (MANU);
12. Amend Discovery Rider (MANU);
13. Protected Information Exclusion Rider (FI 1026 0814)

Item 6. The Insured by the acceptance of this bond gives notice to the Underwriter terminating or canceling prior bond(s) or policy(ies) No.(s) **MNN770431/01/2014** such termination or cancelation to be effective as of the time this bond becomes effective.

Authorized Representative

December 1, 2015
Date

IN WITNESS WHEREOF, the Company has caused the facsimile signatures of its President and secretary to be affixed hereto, and has caused this policy to be signed on the Declarations Page by an authorized representative of the Company.

AXIS Insurance Company

/s/ Gregory W. Springer	/s/ Andrew Weissert
Gregory W. Springer	**Andrew Weissert**
President	**Secretary**

The Underwriter, in consideration of an agreed premium, and in reliance upon all statements made and information furnished to the Underwriter by the Insured in applying for this bond, and subject to the Declarations, Insuring Agreements, General Agreements, Conditions and Limitations and other terms hereof, agrees to indemnify the Insured for:

INSURING AGREEMENTS

FIDELITY

(A) Loss resulting directly from dishonest or fraudulent acts committed by an Employee acting alone or in collusion with others.

Such dishonest or fraudulent acts must be committed by the Employee with the manifest intent:

(a) to cause the Insured to sustain such loss; and

(b) to obtain financial benefit for the Employee and which, in fact, result in obtaining such benefit.

As used in this Insuring Agreement, financial benefit does not include any employee benefits earned in the normal course of employment, including salaries, commissions, fees, bonuses, promotions, awards, profit sharing or pensions.

ON PREMISES

(B) (1) Loss of Property resulting directly from

(a) robbery, burglary, misplacement, mysterious unexplainable disappearance and damage thereto or destruction thereof, or

(b) theft, false pretenses, common-law or statutory larceny, committed by a person present in an office or on the premises of the Insured,

while the Property is lodged or deposited within offices or premises located anywhere.

(2) Loss of or damage to

(a) furnishings, fixtures, supplies or equipment within an office of the Insured covered under this bond resulting directly from larceny or theft in, or by burglary or robbery of, such office, or attempt thereat, or by vandalism or malicious mischief, or

(b) such office resulting from larceny or theft in, or by burglary or robbery of such office or attempt thereat, or to the interior of such office by vandalism or malicious mischief.

provided that

(i) the Insured is the owner of such furnishings, fixtures, supplies, equipment, or office or is liable for such loss or damage, and

(ii) the loss is not caused by fire.

IN TRANSIT

(C) Loss of Property resulting directly from robbery, common-law or statutory larceny, theft, misplacement, mysterious unexplainable disappearance, being lost or made away with, and damage thereto or destruction thereof, while the Property is in transit anywhere in the custody of

(a) a natural person acting as a messenger of the Insured (or another natural person acting as messenger or custodian during an emergency arising from the incapacity of the original messenger), or

(b) a Transportation Company and being transported in an armored motor vehicle, or

(c) a Transportation Company and being transported in a conveyance other than an armored motor vehicle provided that covered Property transported in such manner is limited to the following:

(i) records, whether recorded in writing or electronically, and

(ii) Certified Securities issued in registered form and not endorsed, or with restrictive endorsements, and

(iii) Negotiable Instruments not payable to bearer, or not endorsed, or with restrictive endorsements.

Coverage under this Insuring Agreement begins immediately upon the receipt of such Property by the natural person or Transportation Company and ends immediately upon delivery to the designated recipient or its agent.

FORGERY OR ALTERATION

(D) Loss resulting directly from

(1) Forgery or alteration of, on or in any Negotiable Instrument (except an Evidence of Debt), Acceptance, Withdrawal Order, receipt for the withdrawal of Property, Certificate of Deposit or Letter of Credit.

(2) transferring, paying or delivering any funds or Property or establishing any credit or giving any value on the faith of any written instructions or advices directed to the Insured and authorizing or acknowledging the transfer, payment, delivery or receipt of funds or Property, which instructions or advices purport to have been signed or endorsed by any customer of the Insured or by any financial institution but which instructions or advices either bear a signature which is a Forgery or have been altered without the knowledge and consent of such customer or financial institution.

A mechanically reproduced facsimile signature is treated the same as a handwritten signature.

SECURITIES

(E) Loss resulting directly from the insured having, in good faith, for its own account or for the account of others

(1) acquired, sold or delivered, or given value, extended credit or assumed liability, on the faith of, any original

(a) Certificated Security,

(b) deed, mortgage or other instrument conveying title to, or creating or discharging a lien upon, real property,

(c) Evidence of Debt,

(d) Instruction to a Federal Reserve Bank of the United States, or

(e) Statement of Uncertificated Security of any Federal Reserve Bank of the United States

which

(i) bears a signature of any maker, drawer, issuer, endorser, assignor, lessee, transfer agent, registrar, acceptor, surety, guarantor, or of any person signing in any other capacity which is a Forgery, or

(ii) is altered, or

(iii) is lost or stolen;

(2) guaranteed in writing or witnessed any signature upon any transfer, assignment, bill of sale, power of attorney, Guarantee, or any items listed in (a) through (c) above.

(3) acquired, sold or delivered, or given value, extended credit or assumed liability, on the faith of any item listed in (a) and (b) above which is a Counterfeit.

A mechanically reproduced facsimile signature is treated the same as a handwritten signature.

COUNTERFEIT CURRENCY

(F) Loss resulting directly from the receipt by the Insured, in good faith, of any Counterfeit Money of the United States of America, Canada or of any other country in which the Insured maintains a branch office.

GENERAL AGREEMENTS

NOMINEES

A. Loss sustained by any nominee organized by the Insured for the purpose of handling certain of its business transactions and composed exclusively of its Employees shall, for all the purposes of this bond and whether or not any partner of such nominee is implicated in such loss, be deemed to be loss sustained by the Insured.

ADDITIONAL OFFICES OR EMPLOYEES CONSOLIDATION, MERGER OR PURCHASE OF ASSETS NOTICE

B. If the Insured shall, while this bond is in force, establish any additional offices, other than by consolidation or merger with, or purchase or acquisition of assets or liabilities of, another institution such offices shall be automatically covered hereunder from the date of such establishment without the requirement of notice to the Underwriter or the payment of additional premium for the remainder of the premium period.

If the Insured shall, while this bond is in force, consolidate or merge with, or purchase or acquire assets or liabilities of, another institution, the Insured shall not have such coverage as is afforded under this bond for loss which

(a) has occurred or will occur in offices or premises, or

(b) has been caused or will be caused by an employee or employees of such institution, or

(c) has arisen or will arise out of the assets or liabilities

acquired by the Insured as a result of such consolidation, merger or purchase or acquisition of assets or liabilities unless the Insured shall

(i) give the Underwriter written notice of the proposed consolidation, merger or purchase or acquisition of assets or liabilities prior to the proposed effective date of such action and

(ii) obtain the written consent of the Underwriter to extend the coverage provided by this bond to such additional offices or premises, Employees and other exposures, and

(iii) upon obtaining such consent, pay to the Underwriter an additional premium.

CHANGE OF CONTROL NOTICE

C. When the Insured learns of a change in control, it shall give written notice to the Underwriter.

As used in this General Agreement, control means the power to determine the management or policy of a controlling holding company or the Insured by virtue of voting stock ownership. A change in ownership of voting stock which results in direct or indirect ownership by a stockholder or an affiliated group of stockholders of ten percent (10%) or more of such stock shall be presumed to result in a change of control for the purpose of the required notice.

Failure to give the required notice shall result in termination of coverage for any loss involving a transferee, to be effective upon the date of the stock transfer.

REPRESENTATION OF INSURED

D. The Insured represents that the information furnished in the application for this bond is complete, true and correct. Such application constitutes part of this bond.

Any misrepresentation, omission, concealment or incorrect statement of a material fact, in the application or otherwise, shall be grounds for the rescission of this bond.

JOINT INSURED

E. If two or more Insureds are covered under this bond, the first named Insured shall act for all Insureds. Payment by the Underwriter to the first named Insured of loss sustained by any Insured shall fully release the Underwriter on account of such loss. If the first named Insured ceases to be covered under this bond, the Insured next named shall thereafter be considered as the first named Insured. Knowledge possessed or discovery made by any Insured shall constitute knowledge or discovery by all Insureds for all purposes of this bond. The liability of the Underwriter for loss or losses sustained by all Insureds shall not exceed the amount for which the Underwriter would have been liable had all such loss or losses been sustained by one Insured.

NOTICE OF LEGAL PROCEEDINGS AGAINST INSURED ELECTION TO DEFEND

F. The Insured shall notify the Underwriter at the earliest practicable moment, not to exceed 30 days after notice thereof, of any legal proceeding brought to determine the Insured s liability for any loss, claim or damage, which, if established, would constitute a collectible loss under this bond. Concurrently, the Insured shall furnish copies of all pleadings and pertinent papers to the Underwriter.

The Underwriter, at its sole option, may elect to conduct the defense of such legal proceeding, in whole or in part. The defense by the Underwriter shall be in the Insured s name through attorneys selected by the Underwriter. The Insured shall provide all reasonable information and assistance required by the Underwriter for such defense.

If the Underwriter elects to defend the Insured, in whole or in part, any judgment against the Insured on those counts or causes of action which the Underwriter defended on behalf of the Insured or any settlement in which the Underwriter participates and all attorneys fees, costs and expenses incurred by the Underwriter in the defense of the litigation shall be a loss covered by this bond.

If the Insured does not give the notices required in subsection (a) of Section 5 of this bond and in the first paragraph of this General Agreement, or if the Underwriter elects not to defend any causes of action, neither a judgment against the Insured, nor a settlement of any legal proceeding by the Insured, shall determine the existence, extent or amount of coverage under this bond for loss sustained by the Insured, and the

Underwriter shall not be liable for any attorneys fees, costs and expenses incurred by the Insured.

With respect to this General Agreement, subsections (b) and (d) of Section 5 of this bond apply upon the entry of such judgment or the occurrence of such settlement instead of upon discovery of loss. In addition, the Insured must notify the Underwriter within 30 days after such judgment is entered against it or after the Insured settles such legal proceeding, and, subject to subsection (e) of Section 5, the Insured may not bring legal proceedings for the recovery of such loss after the expiration of 24 months from the date of such final judgment or settlement.

CONDITIONS AND LIMITATIONS

DEFINITIONS

Section 1. As used in this bond:

(a) Acceptance means a draft which the drawee has, by signature written thereon, engaged to honor as presented.

(b) Certificate of Deposit means an acknowledgment in writing by a financial institution of receipt of Money with an engagement to repay it.

(c) Certificated Security means a share, participation or other interest in property of or an enterprise of the issuer or an obligation of the issuer, which is:

(1) represented by an instrument issued in bearer or registered form;

(2) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(3) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests or obligations.

(d) Counterfeit means an imitation of an actual valid original which is intended to deceive and to be taken as the original.

(e) Employee means

(1) a natural person in the service of the Insured at any of the Insured s offices or premises covered hereunder whom the Insured compensates directly by salary or commissions and whom the Insured has the right to direct and

control while performing services for the Insured;

(2) an attorney retained by the Insured and an employee of such attorney while either is performing legal services for the Insured;

(3) a person provided by an employment contractor to perform employee duties for the Insured under the Insured s supervision at any of the Insured s offices or premises covered hereunder, and a guest student pursuing studies or duties in any of said offices or premises;

(4) an employee of an institution merged or consolidated with the Insured prior to the effective date of this bond;

(5) each natural person, partnership or corporation authorized by the Insured to perform services as data processor of checks or other accounting records of the Insured (not including preparation or modification of computer software or programs), herein called Processor. (Each such Processor, and the partners, officers and employees of such Processor shall, collectively, be deemed to be one Employee for all the purposes of this bond, excepting, however, the second paragraph of Section 12. A Federal Reserve Bank or clearing house shall not be construed to be a processor.); and

(6) a Partner of the Insured, unless not covered as stated in Item 4 of the Declarations.

(f) Evidence of Debt means an instrument, including a Negotiable Instrument, executed by a customer of the Insured and held by the Insured which in the regular course of business is treated as evidencing the customer s debt to the Insured.

(g) Financial Interest in the Insured of the Insured s general partner(s), or limited partner(s), committing dishonest or fraudulent acts covered by this bond or concerned or implicated therein means:

(1) as respects general partner(s) the value of all right, title and interest of such general partner(s), determined as of the close of business on the date of discovery of loss covered by this bond, in the aggregate of:

(a) the net worth of the Insured, which for the purposes of this bond, shall be deemed to be the excess of its total assets over its total liabilities, without adjustment to give effect to loss covered by this bond, (except that credit balances and equities in proprietary accounts of the Insured, which shall include capital accounts of partners, investment and trading accounts of the Insured, participations of the Insured in joint accounts, and accounts of partners which are covered by agreements providing for the inclusion of equities therein as partnership property, shall

not be considered as liabilities) with securities, spot commodities, commodity future contracts in such proprietary accounts and all other assets marked to market or fair value and with adjustment for profits and losses at the market of contractual commitments for such proprietary accounts of the Insured; and

(b) the value of all other Money, securities and property belonging to such general partner(s), or in which such general partner(s) have a pecuniary interest, held by or in the custody of and legally available to the Insured as set off against loss covered by this bond;

provided, however, that if such net worth adjusted to give effect to loss covered by this bond and such value of all other Money, securities and property as set forth in (g)(1)(b) preceding, plus the amount of coverage afforded by this bond on account of such loss, is not sufficient to enable the Insured

to meet its obligations, including its obligations to its partners other than to such general partner(s), then the Financial Interest in the Insured, as above defined, of such general partner(s) shall be reduced in an amount necessary, or eliminated if need be, in order to enable the Insured upon payment of loss under this bond to meet such obligations, to the extent that such payment will enable the Insured to meet such obligations, without any benefit accruing to such general partner(s) from such payment; and

(2) as respects limited partners the value of such limited partner s ( ) investment in the Insured.

(h) Forgery means the signing of the name of another person or organization with intent to deceive; it does not mean a signature which consists in whole or in part of one s own name signed with or without authority, in any capacity, for any purpose.

(i) Guarantee means a written undertaking obligating the signer to pay the debt of another to the Insured or its assignee or to a financial institution from which the Insured has purchased participation in the debt, if the debt is not paid in accordance with its terms.

(j) Instruction means a written order to the issuer of an Uncertificated Security requesting that the transfer, pledge, or release from pledge of the Uncertificated Security specified be registered.

(k) Letter of Credit means an engagement in writing by a bank or other person made at the request of a customer that the bank or other person will honor drafts or other demands for payment upon compliance with the conditions specified in the Letter of Credit.

(l) Money means a medium of exchange in current use authorized or adopted by a domestic or foreign government as a part of its currency.

(m) Negotiable Instrument means any writing

(1) signed by the maker or drawer; and

(2) containing any unconditional promise or order to pay a sum certain in Money and no other promise, order, obligation or power given by the maker or drawer; and

(3) is payable on demand or at a definite time; and

(4) is payable to order or bearer.

(n) Partner means a natural person who

(1) is a general partner of the Insured, or

(2) is a limited partner and an Employee (as defined in Section 1(e)(1) of the bond) of the Insured.

(o) Property means Money, Certificated Securities, Uncertificated Securities of any Federal Reserve Bank of the United States, Negotiable Instruments, Certificates of Deposit, documents of title, Acceptances, Evidences of Debt, security agreements, Withdrawal Orders, certificates of origin or title, Letters of Credit, insurance policies, abstracts of title, deeds and mortgages on real estate, revenue and other stamps, tokens, unsold state lottery tickets, books of account and other records whether recorded in writing or electronically, gems, jewelry, precious metals of all kinds and in any form, and tangible items of personal property which are not herein before enumerated.

(p) Statement of Uncertificated Security means a written statement of the issuer of an Uncertificated Security containing:

(1) a description of the Issue of which the Uncertificated Security is a part;

(2) the number of shares or units:

(a) transferred to the registered owner;

(b) pledged by the registered owner to the registered pledgee;

(c) released from pledge by the registered pledgee;

(d) registered in the name of the registered owner on the date of the statement; or

(e) subject to pledge on the date of the statement;

(3) the name and address of the registered owner and registered pledgee;

(4) a notation of any liens and restrictions of the issuer and any adverse claims to which the Uncertificated Security is or may be subject or a statement that there are none of those liens, restrictions or adverse claims; and

(5) the date:

(a) the transfer of the shares or units to the new registered owner of the shares or units was registered;

(b) the pledge of the registered pledgee was registered, or

(c) of the statement, if it is a periodic or annual statement.

(q) Transportation Company means any organization which provides its own or leased vehicles for transportation or which provides freight forwarding or air express services.

(r) Uncertificated Security means a share, participation or other interest in property of or an enterprise of the issuer or an obligation of the issuer, which is:

(1) not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer;

(2) of a type commonly dealt in on securities exchanges or markets; and

(3) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests or obligations.

(s) Withdrawal Order means a non-negotiable instrument, other than an Instruction, signed by a customer of the Insured authorizing the Insured to debit the customer s account in the amount of funds stated therein.

EXCLUSIONS

Section 2. This bond does not cover:

(a) loss resulting directly or indirectly from forgery or alteration, except when covered under Insuring Agreements (A), (D), or (E);

(b) loss due to riot or civil commotion outside the United States of America and Canada; or loss due to military, naval or usurped power, war or insurrection unless such loss occurs in transit in the circumstances recited in Insuring Agreement (C), and unless, when such transit was initiated, there was no knowledge of such riot, civil commotion, military, naval or usurped power, war or insurrection on the part of any person acting for the Insured in initiating such transit;

(c) loss resulting directly or indirectly from the effects of nuclear fission or fusion or radioactivity; provided, however, that this paragraph shall not apply to loss resulting from industrial uses of nuclear energy;

(d) loss resulting from any act or acts of any person who is a member of the Board of Directors of the Insured or a member of any equivalent body by whatsoever name known unless such person is also an Employee or an elected official of the Insured in some other capacity, nor, in any event, loss resulting from the act or acts of any person while acting in the capacity of a member of such Board or equivalent body;

(e) loss resulting directly or indirectly from the complete or partial nonpayment of, or default upon, any loan or transaction involving the Insured as a lender or borrower, or extension of credit, including the purchase, discounting or other acquisition of false or genuine accounts, invoices, notes, agreements or Evidences of Debt, whether such loan, transaction or extension was procured in good faith or through trick, artifice, fraud or false pretenses, except when covered under Insuring Agreements (A), (D) or (E);

(f) loss resulting from any violation by the Insured or by any Employee

(1) of law regulating (i) the issuance, purchase or sale of securities, (ii) securities transactions upon security exchanges or over the counter market, (iii) investment companies, or (iv) investment advisers, or

(2) of any rule or regulation made pursuant to any such law, unless it is established by the Insured that the act or acts which caused the said loss involved fraudulent or dishonest conduct which would have caused a loss to the Insured in a similar amount in the absence of such laws, rules or regulations;

(g) loss resulting directly or indirectly from the failure of a financial or depository institution, or its receiver or liquidator, to pay or deliver, on demand of the Insured, funds or Property of the Insured held by it in any capacity, except when covered under Insuring Agreements (A) or (B)(1)(a);

(h) loss caused by an Employee, except when covered under Insuring Agreement (A) or when covered under Insuring Agreement (B) or (C) and resulting directly from misplacement, mysterious unexplainable disappearance or destruction of or damage to Property;

(i) loss resulting directly or indirectly from transactions in a customer s account, whether authorized or unauthorized, except the unlawful withdrawal and conversion of Money, securities or precious metals, directly from a customer s account by an Employee provided such unlawful withdrawal and conversion is covered under Insuring Agreement (A);

(j) damages resulting from any civil, criminal or other legal proceeding in which the Insured is alleged to have engaged in racketeering activity except when the Insured establishes that the act or acts giving rise to such damages were committed by an Employee under circumstances which result directly in a loss to the Insured covered by Insuring Agreement (A). For the purposes of this exclusion, racketeering activity is defined in 18 United States Code 1961 et seq., as amended;

(k) loss resulting directly or indirectly from the use or purported use of credit, debit, charge, access, convenience, identification, cash management or other cards

(1) in obtaining credit or funds, or

(2) in gaining access to automated mechanical devices which, on behalf of the Insured, disburse Money, accept deposits, cash checks, drafts or similar written instruments or make credit card loans, or

(3) in gaining access to point of sale terminals, customer-bank communication terminals, or similar electronic terminals of electronic funds transfer systems,

whether such cards were issued, or purport to have been issued, by the Insured or by anyone other than the Insured, except when covered under Insuring Agreement (A);

(l) loss involving automated mechanical devices which, on behalf of the Insured, disburse Money, accept deposits, cash checks, drafts or similar written instruments or make credit card loans, except when covered under Insuring Agreement (A);

(m) loss through the surrender of Property away from an office of the Insured as a result of a threat

(1) to do bodily harm to any person, except loss of Property in transit in the custody of any person acting as messenger provided that when such transit was initiated there was no knowledge by the Insured of any such threat, or

(2) to do damage to the premises or property of the Insured, except when covered under Insuring Agreement (A);

(n) loss resulting directly or indirectly from payments made or withdrawals from a depositor s or customer s account involving erroneous credits to such account, unless such payments or withdrawals are physically received by such depositor or customer or representative of such depositor or customer who is within the office of the Insured at the time of such payment or withdrawal, or except when covered under Insuring Agreement (A);

(o) loss involving items of deposit which are not finally paid for any reason, including but not limited to Forgery or any other fraud, except when covered under Insuring Agreement (A);

(p) loss resulting directly or indirectly from counterfeiting, except when covered under Insuring Agreements (A), (E) or (F);

(q) loss of any tangible item of personal property which is not specifically enumerated in the paragraph defining Property if such property is specifically insured by other insurance of any kind and in any amount obtained by the Insured, and in any event, loss of such property occurring more than 60 days after the Insured takes possession of such property, except when covered under Insuring Agreements (A) or (B) (2);

(r) loss of Property while

(1) in the mail, or

(2) in the custody of any Transportation Company, unless covered under Insuring Agreement (C),

except when covered under Insuring Agreement (A);

(s) potential income, including but not limited to interest and dividends, not realized by the Insured or by any customer of the Insured;

(t) damages of any type for which the Insured is legally liable, except compensatory damages, but not multiples thereof, arising directly from a loss covered under this bond;

(u) all fees, costs and expenses incurred by the Insured

(1) in establishing the existence of or amount of loss covered under this bond, or

(2) as a party to any legal proceeding whether or not such legal proceeding exposes the Insured to loss covered by this bond;

(v) indirect or consequential loss of any nature;

(w) loss involving any Uncertificated Security except an Uncertificated Security of any Federal Reserve Bank of the United States or when covered under Insuring Agreement (A);

(x) loss resulting directly or indirectly from any dishonest or fraudulent act or acts committed by any non-Employee who is a securities, commodities, money, mortgage, real estate, loan, insurance, property management, investment banking broker, agent or other representative of the same general character;

(y) loss caused directly or indirectly by a Partner of the Insured unless the amount of such loss exceeds the Financial Interest in the Insured of such Partner and the Deductible Amount applicable to this bond, and then for the excess only;

(z) loss resulting directly or indirectly from any actual or alleged representation, advice, warranty or guarantee as to the performance of any investments;

(aa) loss due to liability imposed upon the Insured as a result of the unlawful disclosure of non-public material information by the Insured or any Employee, or as a result of any Employee acting upon such information, whether authorized or unauthorized.

DISCOVERY

Section 3. This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.

Discovery also occurs when the Insured receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.

LIMIT OF LIABILITY

Section 4.

Aggregate Limit of Liability

The Underwriter s total liability for all losses discovered during the Bond Period shown in Item 2 of the Declarations shall not exceed the Aggregate Limit of Liability shown in Item 3 of the Declarations. The Aggregate Limit of Liability shall be reduced by the amount of any payment made under the terms of this bond.

Upon exhaustion of the Aggregate Limit of Liability by such payments:

(a) The Underwriter shall have no further liability for loss or losses regardless of when discovered and whether or not previously reported to the Underwriter, and

(b) The Underwriter shall have no obligation under General Agreement F to continue the defense of the Insured, and upon notice by the Underwriter to the Insured that the Aggregate Limit of Liability has been exhausted, the Insured shall assume all responsibility for its defense at its own cost.

The Aggregate Limit of Liability shall not be increased or reinstated by any recovery made and applied in accordance with subsections (a), (b) and (c) of Section 7. In the event that a loss of Property is settled by the Underwriter through the use of a lost instrument bond, such loss shall not reduce the Aggregate Limit of Liability.

Single Loss Limit of Liability

Subject to the Aggregate Limit of Liability, the Underwriter s liability for each Single Loss shall not exceed the applicable Single Loss Limit of Liability shown in Item 4 of the Declarations. If a Single Loss is covered under more than one Insuring Agreement or Coverage, the maximum payable shall not exceed the largest applicable Single Loss Limit of Liability.

Single Loss Defined

Single Loss means all covered loss, including court costs and attorneys fees incurred by the Underwriter under General Agreement F, resulting from

(a) any one act or series of related acts of burglary, robbery or attempt thereat, in which no Employee is implicated, or

(b) any one act or series of related unintentional or negligent acts or omissions on the part of any person (whether an Employee or not) resulting in damage to or destruction or misplacement of Property, or

(c) all acts or omissions other than those specified in (a) and (b) preceding, caused by any person (whether an Employee or not) or in which such person is implicated, or

(d) any one casualty or event not specified in (a), (b) or (c) preceding.

NOTICE/PROOF LEGAL PROCEEDINGS
AGAINST UNDERWRITER

Section 5.

(a) At the earliest practicable moment, not to exceed 30 days, after discovery of loss, the Insured shall give the Underwriter notice thereof.

(b) Within 6 months after such discovery, the Insured shall furnish to the Underwriter proof of loss, duly sworn to, with full particulars.

(c) Lost Certificated Securities listed in a proof of loss shall be identified by certificate or bond numbers if such securities were issued therewith.

(d) Legal proceedings for the recovery of any loss hereunder shall not be brought prior to the expiration of 60 days after the original proof of loss is filed with the Underwriter or after the expiration of 24 months from the discovery of such loss.

(e) If any limitation embodied in this bond is prohibited by any law controlling the construction hereof, such limitation shall be deemed to be amended so as to equal the minimum period of limitation provided by such law.

(f) This bond affords coverage only in favor of the Insured. No suit, action or legal proceedings shall be brought hereunder by any one other than the named Insured.

VALUATION

Section 6. Any loss of Money, or loss payable in Money, shall be paid, at the option of the Insured, in the Money of the country in which the loss was sustained or in the United States of America dollar equivalent thereof determined at the rate of exchange at the time of payment of such loss.

Securities

The Underwriter shall settle in kind its liability under this bond on account of a loss of any securities or, at the option of the Insured, shall pay to the Insured the cost of replacing such securities, determined by the market value thereof at the time of such settlement. However, if prior to such settlement the Insured shall be compelled by the demands of a third party or by market rules to purchase equivalent securities, and gives written notification of this to the Underwriter, the cost incurred by the Insured shall be taken as the value of those securities. In case of a loss of subscription, conversion or redemption privileges through the misplacement or loss of securities, the amount of such loss shall be the value of such privileges immediately preceding the expiration thereof. If such securities cannot be replaced or have no quoted market value, or if such privileges have no quoted market value, their value shall be determined by agreement or arbitration.

If the applicable coverage of this bond is subject to a Deductible Amount and/or is not sufficient in amount to indemnify the Insured in full for the loss of securities for which claim is made hereunder, the liability of the Underwriter under this bond is limited to the payment for, or the duplication of, so much of such securities as has a value equal to the amount of such applicable coverage.

Books of Account and Other Records

In case of loss of, or damage to, any books of account or other records used by the Insured in its business, the Underwriter shall be liable under this bond only if such books or records are actually reproduced and then for not more than the cost of the blank books, blank pages or other materials plus the cost of labor for the actual transcription or copying of data which shall have been furnished by the Insured in order to reproduce such books and other records.

Property other than Money, Securities or Records

In case of loss of, or damage to, any Property other than Money, securities, books of account or other records, or damage covered under Insuring Agreement (B)(2), the Underwriter shall not be liable for more than the actual cash value of such Property, or of items covered under Insuring Agreement (B)(2). The Underwriter may, at its election, pay the actual cash value of, replace or repair such property. Disagreement between the Underwriter and the Insured as to the cash value or as to the adequacy of repair or replacement shall be resolved by arbitration.

Set-Off

Any loss covered under this bond shall be reduced by a set-off consisting of any amount owed to the Employee causing the loss if such loss is covered under Insuring Agreement (A)

ASSIGNMENT SUBROGATION RECOVERY COOPERATION

Section 7.

(a) In the event of payment under this bond, the Insured shall deliver, if so requested by the Underwriter, an assignment of such of the Insured s rights, title and interest and causes of action as it has against any person or entity to the extent of the loss payment.

(b) In the event of payment under this bond, the Underwriter shall be subrogated to all of the Insured s rights of recovery therefor against any person or entity to the extent of such payment.

(c) Recoveries, whether effected by the Underwriter or by the Insured, shall be applied net of the expense of such recovery first to the satisfaction of the Insured s loss which would otherwise have been paid but for the fact that it is in excess of either the Single or Aggregate Limit of Liability, secondly, to the Underwriter as reimbursement of amounts

paid in settlement of the Insured s claim, and thirdly, to the Insured in satisfaction of any Deductible Amount. Recovery on account of loss of securities as set forth in the second paragraph of Section 6 or recovery from reinsurance and/or indemnity of the Underwriter shall not be deemed a recovery as used herein.

(d) Upon the Underwriter s request and at reasonable times and places designated by the Underwriter the Insured shall

(1) submit to examination by the Underwriter and subscribe to the same under oath; and

(2) produce for the Underwriter s examination all pertinent records; and

(3) cooperate with the Underwriter in all matters pertaining to the loss.

(e) The Insured shall execute all papers and render assistance to secure to the Underwriter the rights and causes of action provided for herein. The Insured shall do nothing after discovery of loss to prejudice such rights or causes of action.

LIMIT OF LIABILITY UNDER THIS BOND AND PRIOR INSURANCE

Section 8. With respect to any loss set forth in sub-section (c) of Section 4 of this bond which is recoverable or recovered in whole or in part under any other bonds or policies issued by the Underwriter to the Insured or to any predecessor in interest of the Insured and terminated or canceled or allowed to expire and in which the period for discovery has not expired at the time any such loss thereunder is discovered, the total liability of the Underwriter under this bond and under such other bonds or policies shall not exceed, in the aggregate, the amount carried hereunder on such loss or the amount available to the Insured under such other bonds or policies, as limited by the terms and conditions thereof, for any such loss if the latter amount be the larger.

If the coverage of this bond supersedes in whole or in part the coverage of any other bond or policy of insurance issued by an Insurer other than the Underwriter and terminated, canceled or allowed to expire, the Underwriter, with respect to any loss sustained prior to such termination, cancelation or expiration and discovered within the period permitted under such other bond or policy for the discovery of loss thereunder, shall be liable under this bond only for that part of such loss covered by this bond as is in excess of the amount recoverable or recovered on account of such loss under such other bond or policy, anything to the contrary in such other bond or policy notwithstanding.

OTHER INSURANCE OR INDEMNITY

Section 9. Coverage afforded hereunder shall apply only as excess over any valid and collectible insurance or indemnity obtained by the Insured, or by one other than the Insured on Property subject to exclusion (q) or by a Transportation Company, or by another entity on whose premises

the loss occurred or which employed the person causing the loss or the messenger conveying the Property involved.

OWNERSHIP

Section 10. This bond shall apply to loss of Property (1) owned by the Insured, (2) held by the Insured in any capacity, or (3) for which the Insured is legally liable. This bond shall be for the sole use and benefit of the Insured named in the Declarations.

DEDUCTIBLE AMOUNT

Section 11. The Underwriter shall be liable hereunder only for the amount by which any single loss, as defined in Section 4, exceeds the Single Loss Deductible amount for the Insuring Agreement or Coverage applicable to such loss, subject to the Aggregate Limit of Liability and the applicable Single Loss Limit of Liability.

The Insured shall, in the time and in the manner prescribed in this bond, give the Underwriter notice of any loss of the kind covered by the terms of this bond, whether or not the Underwriter is liable therefor, and upon the request of the Underwriter shall file with it a brief statement giving the particulars concerning such loss.

TERMINATION OR CANCELATION

Section 12. This bond terminates as an entirety upon occurrence of any of the following: (a) 60 days after the receipt by the Insured of a written notice from the Underwriter of its desire to cancel this bond, or (b) immediately upon the receipt by the Underwriter of a written notice from the Insured of its desire to cancel this bond, or (c) immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials, or (d) immediately upon the taking over of the Insured by another institution, or (e) immediately upon exhaustion of the Aggregate Limit of Liability, or (f) immediately upon expiration of the Bond Period as set forth in Item 2 of the Declarations.

This bond terminates as to any Employee or any partner, officer or employee of any Processor (a) as soon as any Insured, or any director or officer not in collusion with such person, learns of any dishonest or fraudulent act committed by such person at any time, whether in the employment of the Insured or otherwise, whether or not of the type covered under Insuring Agreement (A), against the Insured or any other person or entity, without prejudice to the loss of any Property then in transit in the custody of such person, or (b) 15 days after the receipt by the Insured of a written notice from the Underwriter of its desire to cancel this bond as to such person.

Termination of the bond as to any Insured terminates liability for any loss sustained by such Insured which is discovered after the effective date of such termination.

In witness whereof, the Underwriter has caused this bond to be executed on the Declarations page.

8

Rider No. 1

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

It is agreed that:

1. Employee as used in the attached bond shall include any natural person who is a director or trustee of the Insured while such director or trustee is engaged in handling funds or other property of any Employee Welfare or Pension Benefit Plan owned, controlled or operated by the Insured or any natural person who is a trustee, manager, officer or employee of any such Plan.

2. If the bond, in accordance with the agreements, limitations and conditions thereof, covers loss sustained by two or more Employee Welfare or Pension Benefit Plans or sustained by any such Plan in addition to loss sustained by an Insured other than such Plan, it is the obligation of the Insured or the Plan Administrator(s) of such Plans under Regulations published by the Secretary of Labor implementing Section 13 of the Welfare and Pension Plans Disclosure Act of 1958 to obtain under one or more bonds issued by one or more Insurers an amount of coverage for each such Plan at least equal to that which would be required if such Plans were bonded separately.

3. In compliance with the foregoing, payment by the Company in accordance with the agreements, limitations and conditions of the bond shall be held by the Insured, or, if more than one, by the Insured first named, for the use and benefit of any Employee Welfare or Pension Benefit Plan sustaining loss so covered and to the extent that such payment is in excess of the amount of coverage required by such Regulations to be carried by said Plan sustaining such loss, such excess shall be held for the use and benefit of any other such Plan also covered in the event that such other Plan discovers that it has sustained loss covered thereunder.

4. If money or other property of two or more Employee Welfare or Pension Benefit Plans covered under the bond is commingled, recovery for loss of such money or other property through fraudulent or dishonest acts of Employees shall be shared by such Plans on a pro rata basis in accordance with the amount for which each such Plan is required to carry bonding coverage in accordance with the applicable provisions of said Regulations.

5. The Deductible Amount of this bond applicable to loss sustained by a Plan through acts committed by an Employee of the Plan shall be waived, but only up to an amount equal to the amount of coverage required to be carried by the Plan because of compliance with the provisions of the Employee Retirement Income Security Act of 1974.

6. Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, conditions, provisions, agreements or limitations of the bond, other than as stated herein.

7. This rider is effective as of 12:01 a.m. on November 9, 2015.

Accepted:

ERISA RIDER

TO COMPLY WITH BONDING REGULATIONS MADE APPLICABLE TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

NOTE: This rider should not be used for any insured exempted from the bonding provisions of the Act.

REVISED TO JUNE, 1990.

All other provisions remain unchanged.

Authorized Representative

December 1, 2015
Date

SR 6145b

1

Rider No. 2

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

CALIFORNIA PREMIUM

It is agreed that:

1. In compliance with the ruling of the Commissioner of Insurance of the State of California and the Opinion of the Attorney-General of that State requiring that the premium for all bonds or policies be endorsed thereon, the basic premium charged for the attached bond for the period

from November 9, 2015
to November 9, 2016

is Twenty-Six Thousand, Nine Hundred and Six. Dollars ($ 26,906).

2. This rider is effective as of noon on November 9, 2015.

CALIFORNIA PREMIUM RIDER

FOR USE WITH ALL FORMS OF STANDARD BONDS, TO COMPLY WITH RULINGS OF THE INSURANCE COMMISSIONER AND THE ATTORNEY-GENERAL.

REVISED TO AUGUST, 168

All other provisions remain unchanged.

Authorized Representative

December 1, 2015
Date

SR 5862

Rider No. 3

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Counterfeit Currency)

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This endorsement modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that Insuring Agreement (F) COUNTERFEIT CURRENCY is replaced with the following:

COUNTERFEIT CURRENCY

(F) Loss resulting directly from the receipt by the Insured, in good faith, of any Counterfeit Money of the United States of America, Canada or any other country.

All other provisions of the bond remain unchanged.

	December 1, 2015
Authorized Representative	Date

Includes copyright material of The Surety Association of America

1

Rider No. 4

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

It is agreed that:

1. The attached bond is amended by adding an Insuring Agreement as follows:

COMPUTER SYSTEMS FRAUD

Loss resulting directly from a fraudulent

(1) entry of Electronic Data or Computer Program into, or

(2) change of Electronic Data or Computer Program within

any Computer System operated by the Insured, whether owned or leased; or any Computer System identified in the application for this bond; or a Computer System first used by the Insured during the Bond Period, as provided by General Agreement B of this bond;

provided that the entry or change causes

(i) Property to be transferred, paid or delivered,

(ii) an account of the Insured, or of its customer to be added, deleted, debited or credited, or

(iii) an unauthorized account or a fictitious account to be debited or credited.

In this Insuring Agreement, fraudulent entry of change shall include such entry or change made by an Employee of the Insured acting in good faith on an instruction from a software contractor who has a written agreement with the Insured to design, implement or service programs for a Computer System covered by this Insuring Agreement.

2. In addition to the Conditions and Limitations in the bond, the following, applicable to the Computer Systems Fraud Insuring Agreement, are added:

DEFINITIONS

(A) Computer Program means a set of related electronic instructions which direct the operations and functions of a computer or devices connected to it which enable the computer or devices to receive, process, store or send Electronic Data;

(B) Computer System means

(1) computers with related peripheral components, including storage components wherever located,

(2) systems and applications software,

(3) terminal devices, and

(4) related communications networks

by which Electronic Data are electronically collected, transmitted, processed, stored and retrieved;

(C) Electronic Data means facts or information converted to a form usable in a Computer System by Computer Programs, and which is stored on magnetic tapes or disks, or optical storage disks or other bulk media.

Accepted:

COMPUTER SYSTEMS FRAUD INSURING AGREEMENT

FOR USE WITH FINANCIAL INSTITUTION BONDS, STANDARD FORMS NOS. 14, 15 AND 25

ADOPTED DECEMBER, 1993

SR 6196

EXCLUSIONS

(A) loss resulting directly or indirectly from the assumption of liability by the Insured by contract unless the liability arises from a loss covered by the Computer Systems Fraud Insuring Agreement and would be imposed on the Insured regardless of the existence of the contract:

(B) loss resulting directly or indirectly from negotiable instruments, securities, documents or other written instruments which bear a forged signature, or are counterfeit, altered or otherwise fraudulent and which are used as source documentation in the preparation of Electronic Data or manually keyed into a data terminal;

(C) loss resulting directly or indirectly from

(1) mechanical failure, faulty construction, error in design, latent defect, fire, wear or tear, gradual deterioration, electrical disturbance or electrical surge which affects a Computer System, or

(2) failure or breakdown of electronic data processing media, or

(3) error omission in programming or processing;

(D) loss resulting directly or indirectly from the input of Electronic Data into a Computer System terminal device either on the premises of a customer of the Insured or under the control of such a customer by a person who had authorized access to the customer s authentication mechanism;

(E) loss resulting directly or indirectly from the theft of confidential information.

SERIES OF LOSSES

All loss or series of losses involving the fraudulent acts of one individual, or involving fraudulent acts in which one individual is implicated, whether or not that individual is specifically identified, shall be treated as a Single Loss and subject to the Single Loss Limit of Liability. A series of losses involving unidentified individuals but arising from the same method of operation shall be deemed to involve the same individual and in that event shall be treated as a Single Loss and subject to the Single Loss Liability.

3. The exclusion below, found in financial institution bonds forms 14, and 25, does not apply to the Computer Systems Fraud Insuring Agreement.

loss involving any Uncertificated Security except an Uncertificated Security of any Federal Reserve Bank of the United States or when covered under Insuring Agreement (A);

4. This rider shall become effective as of 12:01 a.m. on November 9, 2015.

All other provisions remain unchanged.

Authorized Representative

December 1, 2015
Date

Rider No. 5

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Audit Expenses Insuring Agreement)

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This endorsement modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that:

I. The INSURING AGREEMENTS are amended by the addition of the following:

AUDIT EXPENSES

Reasonable expenses incurred by the Insured for that part of the cost of audits or examinations required by any governmental regulatory authority to be conducted either by such authority or by an independent accountant by reason of the discovery of loss under Insuring Agreement (A).

II. The applicable Single Loss Limit of Liability and Single Loss Deductible for Audit Expenses is as set forth in Item 4 of the Declarations. Such limit shall be part of, and not in addition to, the Single Loss Limit of Liability for

Insuring Agreement (A) set forth in Item 4 of the Declarations.

III. Exclusion (u) is replaced with the following:

(u) all fees, costs and expenses incurred by the Insured:

(1) in establishing the existence of or amount of loss covered under this bond, except to the extent covered is afforded under the Audit Expenses Insuring Agreement of this bond; or

(2) as a party to any legal proceeding whether or not such legal proceeding exposes the Insured to loss covered by this bond;

All other provisions of the bond remain unchanged.

Authorized Representative	December 1, 2015 Date

Includes copyright material of The Surety Association of America

Rider No. 6

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Fidelity Insuring Agreement)

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This endorsement modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that:

I. The first paragraph of Insuring Agreement (A) FIDELITY is replaced with the following:

Loss resulting directly from dishonest or fraudulent acts, including Larceny or Embezzlement, committed by an Employee acting alone or in collusion with others.

II. For the purposes of this bond, the terms Larceny and Embezzlement shall have the same meaning ascribed to such terms in Section 37 of The Investment Company Act of 1940.

All other provisions of the bond remain unchanged.

Authorized Representative	December 1, 2015 Date

Includes copyright material of The Surety Association of America

Rider No. 7

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Change of Control)

THIS RIDER CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This rider modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that the first two paragraphs of Section C. CHANGE OF CONTROL   NOTICE of the GENERAL AGREEMENTS are replaced with the following:

When the Insured learns of a change in control, it shall give written notice to the Underwriter as soon as practicable, but in no event later than thirty (30) days, after such change in control has occurred. Such notice shall contain the names of the transferors and the transferees (or the names of the beneficial owners if the voting securities are requested in another name), the total number of voting securities owned by the transferors and the transferees (or the beneficial owners), both immediately before and after the transfer, and the total number of outstanding voting securities.

As used in this General Agreement, control shall have the meaning set forth in Section 2(a)(9) of the Investment Company Act of 1940, and means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company. A change in ownership of voting securities of a company which results in direct or indirect ownership by a securities holder or an affiliated group of securities holders of more than twenty-five percent (25%) of such voting securities shall be presumed to result in a change in control for the purpose of giving the required notice.

All other provisions of the bond remain unchanged.

Authorized Representative	December 1, 2015 Date

Includes copyright material of The Surety Association of America

1

Rider No. 8

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Notice)

THIS RIDER CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This rider modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that Section F. NOTICE OF LEGAL PROCEEDINGS AGAINST INSURED ELECTION TO DEFEND of the GENERAL AGREEMENTS is amended as follows:

A. The first paragraph is replaced with:

The Insured shall notify the Underwriter at the earliest practicable moment, not to exceed sixty (60) days after notice thereof, of any legal proceeding brought to determine the Insured s liability for any loss, claim or damage, which, if established, would constitute a collectible loss under this bond. Concurrently, the Insured shall furnish copies of all pleadings and pertinent papers to the Underwriter.

B. The last paragraph is replaced with:

With respect to this General Agreement, subsections (b) and (d) of Section 5 of this bond apply upon the entry of such judgment or the occurrence of such settlement instead of upon discovery of loss. In addition, the Insured must notify the Underwriter within sixty (60) days after

such judgment is entered against it or after the Insured settles such legal proceeding, and, subject to subsection (e) of Section 5, the Insured may not bring legal proceedings for the recovery of such loss after the expiration of twenty-four (24) months from the date of such final judgment or settlement.

All other provisions of the bond remain unchanged.

Authorized Representative	December 1, 2015 Date

Includes copyright material of The Surety Association of America

Rider No. 9

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Employee)

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This endorsement modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that Definition 1(e) Employee of the CONDITIONS AND LIMITATIONS is amended by the addition of the following:

Employee also means

(i) a natural person consultant while in the service of the Insured whom the Insured has the right to direct and control in such service pursuant to a written contract;

(ii) an employee of Ares Capital Management II, LLC, solely while such employee is performing services for the Insured; and

(iii) a director or trustee of the Insured, whether or not compensated, when performing acts coming within the scope of the usual duties of a natural person in the service of the Insured whom the Insured has the right to direct and control in

the performance of his or her duties, or while acting as a member of any committee duly elected or appointed by resolution of the board of directors or equivalent body to perform specific, as distinguished from general, directorial acts on behalf of the Insured.

All other provisions of the bond remain unchanged.

	December 1, 2015
Authorized Representative	Date

Includes copyright material of The Surety Association of America

Rider No. 10

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Termination)

THIS RIDER CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This rider modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that the second paragraph of Section 12. TERMINATION OR CANCELATION of the CONDITIONS AND LIMITATIONS is replaced with the following:

This bond terminates as to any Employee or any partner, officer or employee of any Processor:

(i) as soon as any Insured, or any director or officer not in collusion with such person, learns of any dishonest or fraudulent act committed by such person involving Money or Property of a value of more than $10,000 and which occurred at any time, whether in the employment of the Insured or otherwise. Termination as to such person is effective whether or not the dishonest or fraudulent act is of the type covered under Insuring Agreement (A), whether committed against the Insured or any other person or entity, and without regard to whether the knowledge was obtained before or after the commencement of this bond; provided this does not apply to loss of any Money or Property already in transit in the custody of such person at the time knowledge of the dishonest or fraudulent act was obtained; or

(ii) fifteen (15) days after the receipt by the Insured of a written notice from the Underwriter of its desire to cancel this bond as to such person.

All other provisions of the bond remain unchanged.

Authorized Representative	December 1, 2015 Date

Includes copyright material of The Surety Association of America

Rider No. 11

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

THIS RIDER CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This rider modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

In consideration of the premium charged, it is agreed that:

1. Item 1 of the Declarations page, Name of Insured (herein called Insured), is amended to include the following:

• Ares Multi-Strategy Credit Fund, Inc.

All other provisions remain unchanged.

Authorized Representative

December 1, 2015
Date

1

Rider No. 12

Effective date of this rider: 12:01 a.m. on November 9, 2015

To be attached to and form part of Policy Number: MNN770431/01/2015

Issued to: Ares Dynamic Credit Allocation Fund, Inc.

By: AXIS Insurance Company

MANUSCRIPT RIDER

(Amend Discovery)

THIS RIDER CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

This rider modifies insurance provided under the following:

FINANCIAL INSTITUTION BOND, Standard Form 14

It is agreed that Section 3. DISCOVERY of the CONDITIONS AND LIMITATIONS is replaced with the following:

This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured s General Counsel s Office, Department of Risk Management, serving in a functionally equivalent position first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.

Discovery also occurs when the Insured s General Counsel s Office, Department of Risk Management, or Human Resource Department serving in a functionally equivalent position receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.

All other provisions of the bond remain unchanged.

Authorized Representative	December 1, 2015 Date

Includes copyright material of The Surety Association of America

1

Rider No.	This rider is effective on the effective date of the bond unless a different date is set forth below.	Bond No.	o Additional o Return Premium
13	12:01 a.m. on November 9, 2015	MNN770431/01/2015	N/A

PROTECTED INFORMATION EXCLUSION RIDER
(Fidelity Carveback)

It is agreed that this bond shall not apply to any loss resulting directly or indirectly from the: (i) theft, disappearance, or destruction of; (ii) unauthorized use or disclosure of; (iii) unauthorized access to; or (iv) failure to protect any:

A. confidential or non-public; or

B. personal or personally identifiable;

information that any person or entity has a duty to protect under any law, rule or regulation, agreement, or industry guideline or standard; provided that this shall not apply to the extent that any unauthorized use or disclosure of a password enables a theft by an Employee of the Insured of tangible Property of the Insured or tangible Property that the Insured is holding for a third party.

Theft of tangible Property does not include the use of confidential or non-public information or personal or personally identifiable information to enable the theft of or disclosure of information.

All other provisions of the bond remain unchanged.

Authorized Representative

December 1, 2015
Date

Includes copyright material of The Surety & Fidelity Association of America

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1

SECRETARY S CERTIFICATE

I, Daniel Hall, Secretary of Ares Dynamic Credit Allocation Fund, Inc. (the Fund), hereby certify that the following resolutions were adopted by the Fund s Board of Directors and separately by a majority of the Directors who are not interested persons of the Fund as such term is defined in the Investment Company Act of 1940, as amended (the 1940 Act) (the Independent Directors), at a meeting duly called and held on November 6, 2015 at which a quorum was present and acting throughout (the Meeting):

RESOLVED, that it is the finding of the Board of Directors of the Fund and separately by a majority of the Independent Directors that the fidelity bond written by Axis Insurance Company in at least the minimum amount required under Rule 17g-1 promulgated by the U.S. Securities and Exchange Commission (the SEC) under Section 17(g) of the 1940 Act (Rule 17g-1) (the Bond), covering, among others, officers and employees of the Fund against larceny and embezzlement and such other types of losses as are included in standard fidelity bonds, in accordance with the requirements of Rule 17g-1, is reasonable in form and amount and is hereby approved, after giving due consideration to, among other things, the amount of the Bond, the estimated amount of the premium for such Bond, the value of the aggregate assets of the Fund to which any person covered under the Bond may have access, the type and terms of the arrangements made for the custody and safekeeping of assets of the Fund, and the nature of the securities in the Fund s portfolio; and it is further

RESOLVED, that the appropriate officers of the Fund be, and each of them hereby is, authorized and empowered to obtain and bind the aforementioned fidelity bond coverage for the Fund; and it is further

RESOLVED, that the Secretary of the Fund shall file, or cause to be filed, the binder to the Bond, if any, and appropriate notices with the SEC in accordance with paragraph (g) of Rule 17g-1 promulgated by the SEC under the 1940 Act; and it is further

RESOLVED, that the appropriate officers of the Fund be, and each of them hereby is, authorized and empowered to make any and all payments and to do any and all other acts, in the name of the Fund, as they, or any of them, may determine to be necessary, desirable or advisable and proper in connection with or in furtherance of the foregoing resolutions.

IN WITNESS WHEREOF, I have hereunto set my hand this 9th day of December 2015.

/s/ Daniel Hall
Daniel Hall
Secretary of the Fund

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2006.

Executive Officers of the Registrant

The executive officers of the Company are elected each year at a meeting of the Board of Directors, which follows the annual meeting of the stockholders, and at other Board of Directors meetings as appropriate.

The names, ages, positions and business experience of our executive officers are listed below (all ages are as of March 1, 2007). There are no understandings between any of our executive officers and any other person pursuant to which any executive officer was selected to his office.

Name	Age	Position
Steven J. Hilton	45	Chairman of the Board and Chief Executive Officer
Larry W. Seay	51	Chief Financial Officer and Executive Vice President
C. Timothy White	46	General Counsel, Executive Vice President and Secretary
Sandra R.A. Karrmann	41	Executive Vice President Chief Human Resources Officer
Steven M. Davis	48	Executive Vice President of National Home Building Operations

Steven J. Hilton co-founded Monterey Homes in 1985, which merged with the Company s predecessor in December 1996. Mr. Hilton served as Co-Chairman and CEO from July 1997 to May 2006 and has been the Chairman and Chief Executive Officer since May 2006.

Larry W. Seay has been Chief Financial Officer since December 1996 and was appointed Executive Vice President in October 2005. Mr. Seay served as Secretary from 1997 to October 2005.

C. Timothy White has been General Counsel, Executive Vice President and Secretary since October 2005 and served on the Meritage Board of Directors from December 1996 until October 2005. Mr. White served as outside counsel to the Company from 1991 through September 2005.

Sandra Karrmann has been Chief Human Resources Officer since December 2005 and was appointed Executive Vice President in September 2006. From April 1993 to December 2005, Ms. Karrmann was employed by Pepsico in various roles with the Frito-Lay North America and Taco Bell divisions, most recently as its Vice President Human Resources Sales at Frito-Lay.

Steven M. Davis has been Executive Vice President of National Home Building Operations since October 2006. From 2000 to September 2006, Mr. Davis was employed by KBHome as a Regional General Manager, with various other management roles at KBHome from 1995 to 2000.

PART II

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

Our common stock is listed on the New York Stock Exchange (NYSE) under the symbol MTH . The high and low sales prices per share of our common stock for the periods indicated, as reported by the NYSE, follow. Prices reflect a 2-for-1 stock split effected in the form of a stock dividend that occurred in January 2005.

Quarter Ended	2006 High	Low	2005 High	Low
March 31	$ 67.91	$ 52.42	$ 76.62	$ 53.42
June 30	$ 68.34	$ 45.35	$ 85.00	$ 58.54
September 30	$ 47.80	$ 34.44	$ 96.50	$ 72.06
December 31	$ 51.11	$ 41.00	$ 78.27	$ 57.29

The following Performance Graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

	2001	2002	2003	2004	2005	2006
Meritage Homes Corp	100	131	259	440	491	372
S&P 500 Index	100	77	97	106	109	124
Peer Group (1)	100	103	211	280	279	205
Dow Jones US Home Construction Index	100	92	180	243	280	222

(1) Peer Group consists of the following companies: Beazer Homes USA, Inc., Dominion Homes, Inc., Hovnanian Enterprises, Inc., MDC Holdings, Inc., Ryland Group, Inc., Toll Brothers, Inc., Standard Pacific Corporation, Technical Olympic USA, Inc., M/I Schottenstein Homes, Inc. and WCI Communities, Inc.

For the year ended December 31, 2006, we analyzed the composition of the Peer Group we have historically used and determined that the Dow Jones U.S. Construction (DJUSHB) Index provides a more comparable industry benchmark

18

than our listed Peer Group noted in (1) above. As such, in future periods, we intend to use the S&P 500 and DJUSHB Indices only. We believe the homebuilders of the DJUSHB are a more representative set of peer companies.

On February 16, 2007, the closing sales price of the common stock as reported by the NYSE was $43.56 per share. At that date, there were approximately 285 owners of record and approximately 5,500 beneficial owners of common stock.

The transfer agent for our common stock is Mellon Investor Services LLC, 85 Challenger Road, Ridgefield Park, NJ 07660 *(www.melloninvestor.com).*

We have not declared cash dividends for the past nine years, nor do we intend to declare cash dividends in the foreseeable future. We plan to retain the Company s earnings to finance the continuing development of the business. Future cash dividends, if any, will depend upon our financial condition, results of operations, capital requirements, compliance with certain restrictive debt covenants, as well as other factors considered relevant by our Board of Directors. Certain of our debt instruments contain restrictions on the payment of cash dividends. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and Note 6 Senior Notes, in the accompanying consolidated financial statements.

Issuer Purchases of Equity Securities:

We did not acquire any of our own securities during the three months ended December 31, 2006.

In November 2004, we announced that the Board of Directors had approved a new stock buyback program, authorizing the expenditure of up to $50 million to repurchase shares of our common stock. The program was completed in February 2006, with the repurchase of 601,000 shares at an average price of $59.21.

On February 21, 2006, we announced that the Board of Directors approved a new stock repurchase program, authorizing the expenditure of up to $100 million to repurchase shares of our common stock. In August 2006, the Board of Directors authorized an additional $100 million under this program. There is no stated expiration date for this program. In the first quarter of 2006, we repurchased 255,000 shares at an average price of $53.77 under this program. In the second quarter of 2006, we repurchased 1,000,000 shares from John R. Landon, our former Co-CEO and Co-Chairman, for $52.19 per share. In August 2006, we repurchased 100,000 shares at an average price of $38.96 per share. As of December 31, 2006, we had approximately $130.2 million available to repurchase shares under this program.

Reference is made to Note 6 of the consolidated financial statements included in this Annual Report on Form 10-K. This note discusses limitations on our ability to pay dividends.

Item 6. Selected Financial Data

The following table presents selected historical consolidated financial and operating data of Meritage Homes Corporation and subsidiaries as of and for each of the last five years ended December 31, 2006. The financial data has been derived from our consolidated financial statements and related notes for the periods presented, audited by our independent registered public accounting firms. This table should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included elsewhere in this Annual Report. These historical results may not be indicative of future results.

The data in the table includes the operations of Hammonds Homes, Perma-Bilt Homes, Citation Homes, Colonial Homes and Greater Homes since their dates of acquisition, July 2002, October 2002, January 2004, February 2005 and September 2005, respectively.

	Historical Consolidated Financial Data Years Ended December 31, ($in thousands, except per share amounts)				
	2006	**2005**	**2004**	**2003**	**2002**
Statement of Earnings Data:					
Total closing revenue	$ 3,461,320	$ 3,001,102	$ 2,040,004	$ 1,471,001	$ 1,119,817
Total cost of closings	(2,748,690)	(2,294,112)	(1,631,534)	(1,178,484)	(904,921)
Gross profit	712,630	706,990	408,470	292,517	214,896
Commissions and other sales costs	(216,341)	(160,114)	(116,527)	(92,904)	(65,291)
General and administrative expenses	(164,477)	(124,979)	(79,257)	(53,929)	(41,496)
Earnings from unconsolidated entities, net	20,364	18,337	2,788	1,743	1,383
Other income, net	11,833	7,468	9,284	4,033	4,052
Loss on extinguishment of debt		(31,477)			
Earnings before income taxes	364,009	416,225	224,758	151,460	113,544
Income taxes	(138,655)	(160,560)	(85,790)	(57,054)	(43,607)
Net earnings	$ 225,354	$ 255,665	$ 138,968	$ 94,406	$ 69,937
Earnings per common share: (1)					
Basic	$ 8.52	$ 9.48	$ 5.33	$ 3.62	$ 2.82
Diluted	$ 8.32	$ 8.88	$ 5.03	$ 3.42	$ 2.66
Balance Sheet Data (December 31):					
Real estate	$ 1,530,602	$ 1,390,803	$ 867,218	$ 678,011	$ 484,970
Total assets	$ 2,170,525	$ 1,971,357	$ 1,265,394	$ 954,539	$ 691,788
Senior notes, loans payable and other borrowings	$ 733,276	$ 592,124	$ 471,415	$ 351,491	$ 264,927
Total liabilities	$ 1,163,693	$ 1,120,352	$ 742,839	$ 542,644	$ 374,480
Stockholders equity	$ 1,006,832	$ 851,005	$ 522,555	$ 411,895	$ 317,308

	Historical Consolidated Financial Data Years Ended December 31, ($ in thousands, except per share amounts)				
	2006	**2005**	**2004**	**2003**	**2002**
Cash Flow Data:					
Cash provided by (used in):					
Operating activities	$ (21,964)	$ 72,243	$ 63,869	$ (50,302)	$ 1,050
Investing activities	(57,720)	(247,427)	(85,502)	(35,812)	(149,691)
Financing activities	70,582	193,120	64,710	84,313	151,858

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(1) 2002-2004 amounts have been adjusted to reflect a 2-for-1 stock split in the form of a stock dividend that occurred in January 2005. There were no cash dividends paid during 2002-2006.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a leading designer and builder of single-family homes in the rapidly growing western and southern United States, based on the number of home closings and revenue. We focus on providing a broad range of first-time, move-up, active adult and luxury homes to our targeted customer base. We believe that the relatively strong population, job and income growth as well as the favorable migration characteristics of our markets will continue to provide significant long-term growth opportunities for us. At December 31, 2006, we were actively selling homes in 213 communities, with base prices ranging from $100,000 to $1,176,000. We operate in the following geographic regions, which are presented as our reportable business segments:

West:	California and Nevada
Central:	Arizona, Texas and Colorado
East:	Florida

We achieved record home closings and revenue in 2006. Home closing revenue increased 15% in 2006 to $3.4 billion; however, net earnings decreased 12% to $225 million due primarily to $78 million of inventory impairments and write-offs of option deposits and pre-acquisition costs. In 2006 we closed 10,487 homes, up 11% from 2005, while new orders received of 7,778 were down 26% from 2005.

During the latter half of 2006, our markets experienced significant declines in orders due to the weakened homebuilding market and high cancellation rates. This decline in net orders contributed to the 42% decrease of units in backlog and 45% decrease of backlog value at December 31, 2006 as compared to the prior year.

At December 31, 2006, we had a backlog of 3,685 homes with a value of approximately $1.2 billion. Our lower backlog reflects the slowdown the homebuilding industry as a whole experienced in 2006.

In 2006, we received 7,778 net new orders valued at $2.5 billion, decreases of 26% and 31%, respectively, compared to 2005, due to a slower sales pace in 2006 from the weakened homebuilding market, coupled with higher cancellation rates. Cancellation rates were 35% of gross unit sales in 2006 as compared to 24% in 2005. During the fourth quarter of 2006, we experienced a continued slowdown in our markets in the pace of new orders compounded by increased cancellations when compared to the abnormally high level of orders in the fourth quarter of 2005, resulting in decreases in the number of homes ordered of 42% and 51% in the value of those orders. It is our expectation that during 2007 cancellation rates will begin to trend toward historical average levels of less than 25%.

During January 2007, demand continued to moderate from the prior year s pace of sales orders. We believe our experiences are consistent with the overall trends in the homebuilding market. In addition, we are offering our customers increased incentives and discounts to remain competitive in the currently weak market.

Our Strategy and Other Recent Developments

In general, we focus on minimizing land risk by purchasing property only after full entitlements have been obtained and typically begin development or construction immediately after close. We acquire land primarily through rolling option contracts, allowing us to purchase individual lots as our building needs dictate. These arrangements allow us to control lot inventory typically on a non-recourse basis without incurring the risks of land ownership. At December 31, 2006, we owned or had options to acquire approximately 44,075 housing lots, of which approximately 83% were under option and land purchase contracts. We believe that the lots we own or have the right to acquire represent an approximate four- to five-year supply, and that we are well positioned for future growth.

On February 23, 2007, we completed the sale of an aggregate principal amount of $150 million of 7.73% senior subordinated notes due 2017 in a private placement. The notes were issued at par and resulted in net proceeds to the Company of $147.2 million, after deduction of fees, commmissions and expenses. We used the proceeds from the sale of these senior subordinated notes to paydown our revolving credit facility.

This discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America.

Critical Accounting Policies

We have established various accounting policies that govern the application of United States generally accepted accounting principles (GAAP) in the preparation and presentation of our consolidated financial statements. Our significant accounting policies are described in Note 1 of the consolidated financial statements. Certain of these policies involve significant judgments, assumptions and estimates by management that may have a material impact on the carrying value of certain assets and liabilities, and revenue and costs. We are subject to uncertainties such as the impact of future events, economic, environmental and political factors and changes in our business environment; therefore, actual results could differ from these estimates. Accordingly, the accounting estimates used in the preparation of our financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. Changes in estimates are made when circumstances warrant. Such changes in estimates and refinements in estimation methodologies are reflected in our reported results of operations and, if material, the effects of changes in estimates are disclosed in the notes to the consolidated financial statements. The judgments, assumptions and estimates we use and believe to be critical to our business are based on historical experience, knowledge of the accounts and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we have made, actual results may differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of our operations. Our inability to accurately estimate stock-based compensation, expenses, accruals, or an impairment of real estate or goodwill could result in charges, or income, in future periods, which relate to activities or transactions in a preceding period. The estimates and assumptions we make relating to our application of FIN 46R, if not accurate, could result in us incorrectly including, or excluding, certain contractual land acquisition arrangements or investments in unconsolidated entities as variable interest entities in, or from, respectively, our consolidated financial statements.

The accounting policies that we deem most critical to us, and involve the most difficult, subjective or complex judgments, include:

Revenue Recognition

In accordance with SFAS No. 66, *Accounting for Sales of Real Estate*, we recognize revenue from home sales when title passes to the homeowner, the homeowner s initial and continuing investment is adequate to demonstrate a commitment to pay for the home, the receivable from the homeowner is not subject to future subordination and we do not have a substantial continuing involvement with the sold home. These conditions are typically achieved when a home closes.

Revenue from land sales is recognized when a significant down payment is received, the earnings process is relatively complete, title passes and collectibility of the receivable is reasonably assured.

Real Estate

Real estate is stated at cost and includes the costs of land acquisition, land development and home construction, capitalized interest, real estate taxes and direct overhead costs incurred during development and home construction that benefit the entire community. Land and development costs are typically allocated to individual lots on a relative value basis. The costs of these lots are transferred to homes under construction when construction begins. Home construction costs are accumulated on a per-home basis. Cost of home closings includes the specific construction costs of the home and all related land acquisition, land development and other common costs (both incurred and estimated to be incurred) based upon the total number of homes expected to be closed in each community. Any changes to the estimated total development costs of a community are allocated on a relative value basis to the remaining homes in the community. When a home is closed, we may have not yet paid all costs incurred to complete it. At the time of close, we record a liability and as a charge to cost of sales the amount we determine will ultimately be paid to complete the home.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets*, land inventory and related communities under development are reviewed for potential write-downs when impairment indicators are present. SFAS No. 144 requires that in the event the undiscounted cash flows projected for those assets are less than their carrying amounts, impairment charges are to be recorded if the fair value of such assets is less than their carrying amounts. Our determination of fair value is based on projections and estimates, including future sales prices, construction costs and absorption rates. Changes in these expectations may lead to a change in the outcome of our impairment analysis. Our analysis is completed at community level; therefore, changes in local conditions may effect one of several of our communities. For those assets deemed to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

During 2006, we recorded $23.7 million of such impairment charges related to our real estate inventories. Additionally, we wrote off $54.6 million of deposits and pre-acquisition costs relating to projects that were no longer feasible. The impairment charges were based on our fair value calculations, which are affected by current market conditions, assumptions and expectations, all of which are highly subjective and may differ significantly from actual results if market conditions change.

22

Goodwill

We test goodwill for impairment annually or more frequently if an event occurs or circumstances change that more likely than not reduce the value of a reporting unit below its carrying value. For purposes of goodwill impairment testing, we compare the fair value of each reporting unit with its carrying amount, including goodwill. Our operations in each state are considered a reporting unit. The fair value of reporting units is determined using various valuation methodologies, including discounted future cash flow models and enterprise value computations. If the carrying amount of a reporting unit exceeds its fair value, goodwill is considered impaired. If goodwill is considered impaired, the impairment loss to be recognized is measured by the amount by which the carrying amount of the goodwill exceeds implied fair value of that goodwill.

Inherent in our fair value determinations are certain judgements and estimates, including projections of future cash flows, the discount rate reflecting the risk inherent in future cash flows, the interpretation of current economic indicators and market valuations and our strategic plans with regard to our operations. A change in these underlying assumptions may cause a change in the results of our analysis, which could cause the fair value of one or more reporting units to be less than their respective carrying amounts. In addition, to the extent that there are significant changes in market conditions or overall economic conditions or our strategic plans change, it is possible that our conclusion regarding goodwill impairment could change, which could have a material adverse effect on our financial position and results of operations.

Our goodwill has been assigned to reporting units in different geographic locations. Therefore, potential goodwill impairment charges resulting from changes in local market and/or local economic conditions or changes in our strategic plans may be isolated to one or a few of our reporting units. However, a widespread decline in the homebuilding industry or a significant deterioration of general economic conditions could have a negative impact on the estimated fair value of several or all of our reporting units.

While we believe that no goodwill impairment existed as of December 31, 2006, future economic or financial developments, including general interest rate increases or poor performance in either the national economy or individual local economies, could lead to impairment of goodwill in future periods.

Warranty Reserves

We use subcontractors for nearly all aspects of home construction. Although our contracts generally require subcontractors to repair and replace any product or labor defects, we are generally responsible for such repairs. As such, warranty reserves are recorded to cover potential costs for materials and labor as they relate to warranty-type claims expected to be incurred subsequent to the delivery of a home to the homeowner. Reserves are determined based upon the Company s and industry-wide historical data and trends with respect to product types and geographical areas.

At December 31, 2006, our warranty reserve was $28.4 million. While we believe that the warranty reserve is sufficient to cover our projected costs, there can be no assurances that historical data and trends will accurately predict our actual warranty costs. Furthermore, there can be no assurances that future economic or financial developments might not lead to a significant change in the reserve.

Off-Balance Sheet Arrangements

We invest in entities that acquire and develop land for sale to us in connection with our homebuilding operations or for sale to third parties. Our partners generally are unrelated homebuilders, land sellers and financial or other strategic partners.

Most of the unconsolidated entities through which we acquire and develop land are accounted for by the equity method of accounting because the criteria for consolidation set forth in FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R) have not been met. We record our investments in these entities in our consolidated balance sheets as Investments in unconsolidated entities and our pro rata share of the entities earnings or losses in our consolidated statements of earnings as Earnings from unconsolidated entities, net.

We use our business judgement to determine if we are the primary beneficiary of, or have a controlling interest in, an unconsolidated entity. Factors considered in our determination include the profit/loss sharing terms of the entity, experience and financial condition of the other partners, voting rights, involvement in day-to-day capital and operating decisions and continuing involvement.

As of December 31, 2006, we believe that the equity method of accounting is appropriate for our investments in unconsolidated entities where we are not the primary beneficiary, we do not have a controlling interest, and our ownership interest exceeds 20%. At December 31, 2006, the unconsolidated entitites in which we had equity investments had total

assets of $763.9 million and total liabilities of $497.8 million. See Note 4 in the accompanying financial statements for additional information related to our investments in unconsolidated entities.

We also enter into option or purchase agreements to acquire land or lots from entities, for which we generally pay non-refundable deposits. We analyze these agreements under FIN 46R to determine whether we are the primary beneficiary of the VIE (as defined) created as result of these agreements using a model developed by management. If we are deemed to be the primary beneficiary of the VIE because we are obligated to absorb the majority of the expected losses, receive the majority of the residual returns, or both, we will consolidate the VIE in our consolidated financial statements. See Note 3 in the accompanying financial statements for additional information related to our off-balance sheet arrangements.

Valuation of Deferred Tax Assets

We account for income taxes using the asset and liability method, which requires that deferred tax assets and liabilities be recognized based on future tax consequences of both temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the changes are enacted.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, we assess our ability to realize deferred tax assets primarily based on earnings history, future earnings potential, the reversal of taxable temporary differences and available tax planning strategies. At December 31, 2006, our net deferred tax asset was $28.1 million. Based on our assessment, it appears more likely than not that the net deferred tax asset will be fully realized and does not require a valuation allowance.

Share-Based Payments

We have stock options and restricted common stock (nonvested shares) outstanding under two stock compensation plans. Per the terms of these plans, the exercise price of our stock options may not be less than the closing market value of our common stock on the date of the grant. No options granted under the plans may be exercised within one year from the date of the grant. Thereafter, exercises are permitted in pre-determined installments based upon a vesting schedule established at the time of grant. Each stock option expires on a date determined at the time of the grant, but not to exceed seven years from the date of the grant.

Prior to January 1, 2006, we accounted for stock option awards granted under our compensation plans in accordance with the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*. Share-based employee compensation expense was not recognized in our consolidated statements of earnings prior to January 1, 2006, as our stock options had an exercise price equal to or greater than the market value of our common stock on the date of the grant and therefore, no intrinsic value. On January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment,* (SFAS No. 123R) using the modified-prospective-transition method. Under this transition method, our compensation expense recorded in 2006 includes both charges related to the vesting of options and restricted stock granted since the adoption of SFAS No. 123R as well as compensation cost related to the unvested portions of options granted prior to January 1, 2006. For all compensation cost recorded, fair value of the options was determined using the provisions of SFAS No. 123R. In accordance with the modified-prospective-transition method, results for prior periods have not been restated.

The calculation of employee compensation expense involves estimates that require management judgements. These estimates include determining the value of each of our stock options on the date of grant using a Black-Scholes option-pricing model discussed in Note 9. The fair value of our stock options, which typically vest ratably over a five-year period, is expensed on a straight-line basis over the vesting life of the options. Expected volatility is based on a composite of (1) historical volatility of our stock and (2) implied volatility from our traded options. The risk-free rate for periods within the contractual life of the stock option award is based on the rate of a zero-coupon Treasury bond on the date the stock option is granted with a maturity equal to the expected term of the stock option. We use historical data to estimate stock option exercises and forfeitures within our valuation model. The expected life of our stock option awards is derived from historical experience under our share-based payment plans and represents the period of time that we expect our stock options to be outstanding.

Home Closing Revenue, Home Orders and Order Backlog   Segment Analysis

The tables provided below show operating and financial data regarding our homebuilding activities (dollars in thousands).

	Years Ended December 31,		
	2006	**2005**	**2004**
Home Closing Revenue			
Total			
Dollars	$ 3,444,286	$ 2,996,946	$ 2,015,742
Homes closed	10,487	9,406	7,254
Average sales price	$ 328.4	$ 318.6	$ 277.9
West Region			
California			
Dollars	$ 820,583	$ 947,228	$ 628,324
Homes closed	1,471	1,627	1,367
Average sales price	$ 557.8	$ 582.2	$ 459.6
Nevada			
Dollars	$ 244,343	$ 201,907	$ 120,576
Homes closed	620	541	404
Average sales price	$ 394.1	$ 373.2	$ 298.5
West Region Totals			
Dollars	$ 1,064,926	$ 1,149,135	$ 748,900
Homes closed	2,091	2,168	1,771
Average sales price	$ 509.3	$ 530.0	$ 422.9
Central Region			
Arizona			
Dollars	$ 1,102,662	$ 873,137	$ 585,743
Homes closed	3,355	3,122	2,331
Average sales price	$ 328.7	$ 279.7	$ 251.3
Texas			
Dollars	$ 996,739	$ 787,204	$ 681,099
Homes closed	4,263	3,576	3,152
Average sales price	$ 233.8	$ 220.1	$ 216.1
Colorado			
Dollars	$ 40,875	$ 2,809	N/A
Homes closed	112	8	N/A
Average sales price	$ 365.0	$ 351.1	N/A
Central Region Totals			
Dollars	$ 2,140,276	$ 1,663,150	$ 1,266,842
Homes closed	7,730	6,706	5,483
Average sales price	$ 276.9	$ 248.0	$ 231.0
East Region			
Florida			
Dollars	$ 239,084	$ 184,661	N/A
Homes closed	666	532	N/A
Average sales price	$ 359.0	$ 347.1	N/A

25

	Years Ended December 31,		
	2006	2005	2004
Home Orders			
Total			
Dollars	$ 2,462,747	$ 3,580,855	$ 2,604,948
Homes ordered	7,778	10,571	9,007
Average sales price	$ 316.6	$ 338.7	$ 289.2
West Region			
California			
Dollars	$ 529,435	$ 976,921	$ 821,266
Homes ordered	983	1,646	1,582
Average sales price	$ 538.6	$ 593.5	$ 519.1
Nevada			
Dollars	$ 139,668	$ 249,104	$ 146,141
Homes ordered	328	653	417
Average sales price	$ 425.8	$ 381.5	$ 350.5
West Region Totals			
Dollars	$ 669,103	$ 1,226,025	$ 967,407
Homes ordered	1,311	2,299	1,999
Average sales price	$ 510.4	$ 533.3	$ 483.9
Central Region			
Arizona			
Dollars	$ 611,266	$ 1,174,452	$ 884,771
Homes ordered	1,833	3,558	3,490
Average sales price	$ 333.5	$ 330.1	$ 253.5
Texas			
Dollars	$ 1,069,437	$ 983,579	$ 752,770
Homes ordered	4,299	4,264	3,518
Average sales price	$ 248.8	$ 230.7	$ 214.0
Colorado			
Dollars	$ 47,836	$ 14,631	N/A
Homes ordered	125	40	N/A
Average sales price	$ 382.7	$ 365.8	N/A
Central Region Totals			
Dollars	$ 1,728,539	$ 2,172,662	$ 1,637,541
Homes ordered	6,257	7,862	7,008
Average sales price	$ 276.3	$ 276.3	$ 233.7
East Region			
Florida			
Dollars	$ 65,105	$ 182,168	N/A
Homes ordered	210	410	N/A
Average sales price	$ 310.0	$ 444.3	N/A

	At December 31, 2006	2005	2004
Order Backlog			
Total			
Dollars	$ 1,200,061	$ 2,181,600	$ 1,320,951
Homes in backlog	3,685	6,394	4,408
Average sales price	$ 325.7	$ 341.2	$ 299.7
West Region			
California			
Dollars	$ 129,816	$ 420,964	$ 391,271
Homes in backlog	226	714	695
Average sales price	$ 574.4	$ 589.6	$ 563.0
Nevada			
Dollars	$ 21,725	$ 126,400	$ 79,203
Homes in backlog	57	349	237
Average sales price	$ 381.1	$ 362.2	$ 334.2
West Region Totals			
Dollars	$ 151,541	$ 547,364	$ 470,474
Homes in backlog	283	1,063	932
Average sales price	$ 535.5	$ 514.9	$ 504.8
Central Region			
Arizona			
Dollars	$ 347,306	$ 838,702	$ 537,387
Homes in backlog	905	2,427	1,991
Average sales price	$ 383.8	$ 345.6	$ 269.9
Texas			
Dollars	$ 582,163	$ 509,465	$ 313,090
Homes in backlog	2,209	2,173	1,485
Average sales price	$ 263.5	$ 234.5	$ 210.8
Colorado			
Dollars	$ 18,783	$ 11,822	N/A
Homes in backlog	45	32	N/A
Average sales price	$ 417.4	$ 369.4	N/A
Central Region Totals			
Dollars	$ 948,252	$ 1,359,989	$ 850,477
Homes in backlog	3,159	4,632	3,476
Average sales price	$ 300.2	$ 293.6	$ 244.7
East Region			
Florida			
Dollars	$ 100,268	$ 274,247	N/A
Homes in backlog	243	699	N/A
Average sales price	$ 412.6	$ 392.3	N/A

Home Closing Revenue. *Companywide*. Home closing revenue increased 15% to a Company record of $3.4 billion in 2006 from $3.0 billion in 2005. The factor primarily leading to this increase was the strong demand and pricing power relating to 2005 sales orders, which were realized in the 2006 closings. Average selling prices on homes closed rose 3% from 2005 to 2006 and we benefited from an 11% increase in the number of homes closed in 2006 to 10,487 from 9,406 in 2005.

Home closing revenue increased 49% to a Company record of $3.0 billion in 2005 from $2.0 billion in 2004. The factors primarily leading to this increase were continued strong demand and our ability to raise prices throughout many of our markets. Average selling prices on homes closed rose 15% from 2004 to 2005 and we benefited from a 30% increase in the number of homes closed in 2005 to 9,406 from 7,254 in 2004. Additionally, our two acquisitions in Florida, though only included in our 2005 results for less than one year, accounted for approximately 18% of our increase in home closing revenues in 2005.

West. In 2006, the West Region experienced a 7% revenue decline. As some markets in the western United States were first to feel the impacts of the downturn in the housing markets, closings in 2006 in both dollars and volume reflect our reduced pricing power and high cancellations, particularly in California. The 13% decrease in California home closing revenue to $820.6 million in 2006 compared to $947.2 million in 2005 reflects a 10% decrease in the number of homes closed and a 4% decrease in the average selling price of homes closed. In Nevada, strong sales performance in early 2006 resulted in the number of homes closed increasing 15% in 2006, producing home closing revenue of $244.3 million, an increase of 21% compared to 2005.

In 2005, the West Region experienced 53% revenue growth to $1.1 billion as compared to $748.9 million in 2004. The strong performance of the West Region in 2005 was primarily attributed to exceptionally high demand and pricing power as reflected in the number of closings and increased average sales price. The 51% increase in California home closing revenue to $947.2 million in 2005 compared to $628.3 million in 2004 reflected a 19% increase in the number of homes closed and a 27% increase in the average selling price of homes closed. In Nevada, the number of homes closed increased 34% in 2005, producing home closing revenue of $201.9 million, an increase of 67% compared to 2004.

Central. In 2006, sales mix and strong 2005 orders were the primary drivers behind the overall increased results in the Central Region. Home closing revenue increased $477.1 to $2.1 billion as compared to $1.7 billion in 2005. Both Arizona and Texas had a year of record closings, with 3,355 and 4,263 homes closed, respectively, increases of 7% and 19% over 2005. Additionally, average sales price increases of 18% and 6%, respectively, in Arizona and Texas in 2006 as compared to 2005 further contributed to the year s strong performance.

In 2005, healthy demand and pricing power resulted in strong results in the Central Region. Home closing revenue increased $396.3 to $1.7 billion as compared to $1.3 billion in 2004. In Arizona, home closing revenue increased $287.4 million, due to increases of 34% and 11% in the number of homes closed and average sales price, respectively. These strong results reflected the pricing power and limited homes inventory availability in this local market during 2005. In a very competitive Texas market, where we expanded our entry-level and semi-custom luxury offerings in addition to our primary focus on move-up homes, we closed 3,576 homes in 2005 for $787.2 million in revenue, increases of 13% and 16%, respectively.

East. During 2006, we closed 666 homes, generating revenue of $239.1 million. The 29% increase in revenue is due to both increased volume and the higher average sales price of $359,000 as compared to $347,100 in 2005.

In 2005, as a result of our two acquisitions and the commencement of closings in our Orlando start-up division, we produced home closing revenue of $184.7 million on 532 home closings.

Home Orders. *Companywide.* Home orders for any period represent the aggregate sales price of all homes ordered by customers, net of cancellations. We do not include orders contingent upon the sale of a customer s existing home as a sales contract until the contingency is removed. Historically, we have experienced a cancellation rate of less than 25% of gross sales, although our rate in 2006 was 35%. In 2006, we took home orders for 7,778 homes, a decrease of 26% compared to the 10,571 home orders in 2005 primarily due to the decline in demand in many of our homebuilding markets, partially offset by home sales at new communities, which increased by 16% to 213 actively selling communities at December 31, 2006.

28

In 2005, we took home orders for 10,571 homes, an increase of 17% compared to the 9,007 home orders in 2004 primarily due to strong demand for homes in most of our markets and a 32% increase in the number of actively selling communities to 184 at December 31, 2005.

West. Our West Region posted significantly weaker order volume in 2006, decreasing 45% in the value of home orders, with our fourth quarter order value for this region also falling 45%, reflecting the continued slowing from the unusually robust sales pace seen in previous years in these markets. We expect home order rates to return to more normal and sustainable levels in late 2007 or early 2008 as market conditions adjust and cancellation rates stabilize to more typical levels.

Our West Region posted strong order growth in 2005, increasing 27% in the value of home orders and 15% in the number of homes ordered. However, our fourth quarter 2005 order value for this region fell 41% year over year, reflecting the start of the slowing trend in the homebuilding market as a whole and this Region in particular.

Central. In 2006, a weaker housing market in the Arizona Region contributed to a 48% decrease in the value of home orders in Arizona. While average sales price per home held steady due to changes in sales mix offsetting price decreases, the number of home orders declined 1,605 to 6,257 for the Region, reflecting the deterioration in the local market from the strong demand a year earlier. In Texas, despite a very competitive market, we experienced solid demand in all of our markets and received orders for 4,299 homes valued at $1.1 billion in 2006, increases of 1% and 9%, respectively, compared to 4,264 home orders with a value of $983.6 million in 2005. Additionally, the Central Region increased its number of actively-selling communities to 169 as of December 31, 2006, as compared to 146 a year ago, also offsetting slower sales and high cancellations.

In 2005, the Central Region experienced a 33% increase in the value of home orders as compared to 2004. The increase was primarily due to particularly strong results in Arizona. The value of home orders in Arizona rose 33% in 2005 due, in part, to a 35% increase in the number of actively-selling communities and the diversification of our product offerings. We were able to take advantage of emerging demographic trends such as maturing baby boomers in the form of Active Adult communities.

East. In 2006, the number of home sales in Florida decreased by 200 orders to 210 units worth $65.1 million, a 49% and 64% decrease over 2005. This decrease is due to the extremely difficult market conditions in Ft. Myers/Naples, where demand and pricing power have declined at a faster pace than the rest of the nation. We expect these conditions to continue in 2007.

Order Backlog. *Companywide.* Our backlog represents net sales contracts that have not closed. Our backlog was $1.2 billion at December 31, 2006, a decrease of 45% compared to $2.2 billion at December 31, 2005 and was comprised of 3,685 homes, a 42% decrease compared to December 31, 2005. Our homes in backlog at December 31, 2006 reflect an average sales price of $325,700, a decrease of 5% compared to $341,200 at the same time a year ago. These decreases are primarily the result of declining housing markets in many of our markets, as reflected by decreased pricing power and higher cancellation rates, coupled with record closings in 2006.

Our backlog was $2.2 billion at December 31, 2005, an increase of 65% compared to $1.3 billion at December 31, 2004 and was comprised of 6,394 homes, a 45% increase compared to the year ended December 31, 2004. Our homes in backlog at December 31, 2005 reflected an average sales price of $341,200, an increase of 14% compared to $299,700 at the same time a year ago. These increases were primarily due to healthy housing markets in many of our markets.

West. In 2006, the West Region experienced a 72% decrease in dollar backlog as compared to 2005. In California, we had a decrease in the dollar value of backlog of 69%, reflecting weaker demand in the fourth quarter, while Nevada s 57 backlog units represent an 84% decrease over the prior year. As previously noted, record high cancellation rates were a primary factor causing the reduced backlog.

In 2005, the West Region experienced a 16% increase in dollar backlog as compared to 2004. In California, we had a modest increase in the dollar value of backlog of 8%, reflecting moderating demand in the fourth quarter, while Nevada s 349 homes represented a 47% increase over the prior year.

Central. As of December 31, 2006, the Central Region had 3,159 homes in backlog, a decrease of 32% over 2005. In Arizona, the number of homes in backlog decreased 63% and the value of those homes decreased 59%. These results were partially offset by Texas, where homes in backlog increased 2% to 2,209 from 2,173 at December 31, 2005 with an increase of 14% in value to $582.2 million.

As of December 31, 2005, the Central Region had 4,632 homes in backlog, an increase of 33% over 2004. In Arizona, the number of homes in backlog increased 22% and the value of those homes increased 56%, while in Texas, homes in backlog increased 46% to 2,173 from 1,485 at December 31, 2004 with an increase of 63% in value to $509.5 million.

East. We ended 2006 with 243 homes in backlog in Florida with a value of $100.3 million, decreases of 65% and 63%, respectively, from 2005. The poor homebuilding market conditions and high cancellation rates, particularly in Ft. Myers/Naples, were the main cause for these declines.

Other Operating Information

	Years Ended December 31, ($ in thousands) 2006	2005	2004
Home Closing Gross Profit			
West			
Home closing gross profit	$ 198,890	$ 319,759	$ 173,481
Percent of home closing revenue	18.7 %	27.8 %	23.2 %
Central			
Home closing gross profit	$ 486,780	$ 348,998	$ 226,806
Percent of home closing revenue	22.7 %	21.0 %	17.9 %
East			
Home closing gross profit	$ 26,318	$ 37,696	
Percent of home closing revenue	11.0 %	20.4 %	
Total			
Home closing gross profit	$ 711,988	$ 706,453	$ 400,287
Percent of home closing revenue	20.7 %	23.6 %	19.9 %

Home Closing Gross Profit. *Companywide.* Home closing gross profit represents home closing revenue less cost of home closings. Cost of home closings include land and lot development costs, direct home construction costs, an allocation of common community costs (such as model complex costs and architectural, legal and zoning costs), interest, sales tax, impact fees, warranty, construction overhead and closing costs.

Our companywide gross profit of 20.7% is 290 basis points below our 2005 gross profit of 23.6%. Our 2006 gross profit included real estate inventory impairments and write-offs of option deposits and pre-acquisition costs of $78.3 million, which is 2.3% of total home closing revenue. Excluding such charges, our 2006 and 2005 margins are relatively comparable as many of the 2006 closings reflect the favorable pricing conditions of 2005, when many of these homes were sold.

West. For 2006, home closing gross profit decreased 910 basis points over 2005 to 18.7%. The 2006 margins reflect our declining pricing power and increased use of incentives in 2006, coupled with home construction costs holding steady when compared to the robust homebuilding environment of 2005. Margins in 2006 were further impacted by inventory impairments and write-downs of options and pre-acquisition costs. The West Region recorded $36.9 million of impairment and write-downs, reducing the gross profit margin by 3.5%.

As we expected, our 2005 homebuilding margins were not sustainable, and we believe our margins will continue to decline to more historical average levels. We believe that further margin compression could result from a continued slowing in home sale price increases (or decreases in home sale prices), increasing costs of land and building materials and the offering of increased incentives to homebuyers if the homebuilding market slows and interest rates increase.

Home closing gross profit increased 460 basis points in 2005 over 2004 to 27.8%. The 2005 margins reflected an overall robust homebuilding environment and were above our target range. This increase was primarily due to strong demand in 2005 and our ability to increase prices in many of our markets at that time, while cost-containment efforts of our land and construction costs further contributed to the increase.

Central. The Central Region experienced a 170 basis point increase in gross profit percentage in 2006 to 22.7% as compared to 2005. This increase is due primarily to the mix of homes sold in Arizona, with higher margin communities

30

contributing a larger percentage of the sales. The Central Region also recorded $13.7 million of impairments and write-downs as discussed above.

The Central Region experienced a 310 basis point increase in gross profit percentage in 2005 to 21.0% as compared to 2004 due to the strong homebuilding environment and cost management efforts of our land and construction costs.

East. The East Region had home closing profit of 11.0% during 2006. The 940 basis point decline is due to both the inventory impairments recorded during 2006, as well as the weakened homebuilding market, particularly in Ft. Myers/Naples, where significant price concessions and sales incentives were utilized in order to remain competitive in the local market. Total impairments and write-downs aggregated to $27.7 million during 2006, 11.6% of the Region s home closing revenue for the year.

	Years Ended December 31, ($ in thousands) 2006	2005	2004
Commissions and Other Sales Costs			
Dollars	$ 216,341	$ 160,114	$ 116,527
Percent of home closing revenue	6.3 %	5.3 %	5.8 %
General and Administrative Expenses			
Dollars	$ 164,477	$ 124,979	$ 79,257
Percent of total closing revenue	4.8 %	4.2 %	3.9 %
Provision for Income Taxes			
Dollars	$ 138,655	$ 160,560	$ 85,790
Percent of earnings before provision for income taxes	38.1 %	38.6 %	38.2 %

Commissions and Other Sales Costs. Commissions and other sales costs, such as advertising and sales office expenses, increased as a percent of home closing revenue to 6.3% in 2006 from 5.3% in 2005. This increase was primarily due to the weakened housing markets, which resulted in the increased involvement of external real estate agents who are paid a higher commission than our internal sales force, and additional sales and marketing efforts targeted at improving our competitiveness in this challenging market.

Commissions and other sales costs as a percent of home closing revenue were 5.3% in 2005, down from 5.8% in 2004. This decrease was primarily the result of our ability to leverage our fixed and semi-fixed sales and marketing costs with our 49% increase in home closing revenue.

General and Administrative Expenses. General and administrative expenses represent corporate and divisional overhead expenses such as salaries and bonuses, occupancy, insurance and travel expenses. General and administrative expenses increased to 4.8% of total revenue in 2006 from 4.2% in 2005. The increase is primarily attributed to $24.9 million (pre-tax) of charges related to severance costs and stock-based compensation due to the adoption of SFAS No. 123R, which contributed an additional 72 basis points.

During 2005 we completed two acquisitions in Florida. These acquisitions, along with our growth in our existing markets, necessitated an expansion of our corporate infrastructure capabilities, such as accounting, internal audit, human resources, legal and information technology to prudently manage the growth of the Company. This expansion resulted in an increase in 2005 general and administrative cost to 4.2% of total revenue compared to 3.9% for 2004.

Loss on Extinguishment of Debt. In 2005, we incurred a $31.5 million loss on extinguishment of debt relating to our 2005 bond refinancing, the proceeds of which were used to repurchase pursuant to a tender offer and consent solicitation approximately $276.8 million of our outstanding 9.75% senior notes due 2011.

Income Taxes. Income taxes decreased to $138.7 million in 2006 from $160.6 million in 2005. As a percent of pre-tax earnings, taxes were 38.1% in 2006, down from 38.6% in 2005. The slight decrease in 2006 is primarily attributed to an increase in the deduction related to qualified production activities provided by the American Jobs Creation Act of

2004, a reduction in the amount of non-deductible executive incentive compensation, and the impact of incentive stock options under SFAS No. 123R, which was implemented at the beginning of 2006.

Income taxes increased to $160.6 million in 2005 from $85.8 million in 2004. As a percent of pre-tax earnings, taxes were 38.6% in 2005, up from 38.2% in 2004. This increase was mainly due to the 2005 increase in pre-tax earnings in Arizona and California, which have higher state tax rates than Nevada and Texas. The tax benefit associated with the exercise of employee stock options reduced taxes payable for 2004 by approximately $3.0 million, which was credited to additional paid-in-capital.

Liquidity and Capital Resources

Our principal uses of capital for the year ended December 31, 2006 were for operating expenses, land purchases, investments in joint ventures, lot development, home construction, the repurchase of common stock, income taxes and interest. We used a combination of borrowings under our revolving credit facility and funds generated by operations to meet our short-term working capital requirements.

Cash flows for each of our communities depend on the status of the development cycle and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, plat and other approvals, and construction of model homes, roads, utilities, general landscaping and other amenities. Because these costs are capitalized, income reported for financial statement purposes during those early stages may significantly exceed cash flow. Cash flows during the later stages of a community may significantly exceed earnings reported for financial statement purposes, as cost of closings includes charges for substantial amounts of previously expended costs.

We enter into various option and purchase contracts for land in the normal course of business. Except for a minor number of our specific performance options, none of these agreements require us to purchase lots. Generally, our options to purchase lots remain effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the respective agreement. Although the pre-established number is typically structured to approximate our expected rate of home construction starts, during a weakened homebuilding market, as we are currently experiencing, we may be required to purchase lots at an absorption level that exceeds our sales pace in order to maintain the pre-established purchase rate. At December 31, 2006, we had entered into option purchase contracts with an aggregate purchase price of approximately $2.1 billion, on which we had made deposits of approximately $168.1 million in cash along with approximately $64.3 million in letters of credit. Additional information regarding our purchase agreements and related deposits is presented in Note 3 Variable Interest Entities and Consolidated Real Estate Not Owned in the accompanying consolidated financial statements.

Unsecured Revolving Credit Facility

On May 16, 2006, we amended and restated our senior unsecured revolving credit facility (Amended Credit Agreement). Under the Amended Credit Agreement, our credit facility was increased from $600 million to $800 million, and the term was extended from May 2009 to May 2010. On June 30, 2006, we amended our Credit Agreement to increase our borrowing capacity under the Credit Agreement by $50 million and to make certain other minor changes. The total borrowing capacity of the credit facility is now $850 million. The increase in capacity was made pursuant to an accordion feature contained in the Credit Agreement. This accordion feature allows us to request from time to time an aggregate increase of up to $250 million in the maximum borrowing commitment. Each member of the lending group may elect to participate or not participate in any request we make. In addition, any increase in the borrowing capacity pursuant to this accordion feature is subject to certain terms and conditions, including the absence of an event of default. At December 31, 2006, $200 million was available under the accordion feature.

At December 31, 2006, $226.5 million was outstanding under our Amended Credit Agreement and approximately $102.6 million was outstanding in letters of credit that collateralize our obligations under various land purchase and other contracts. After considering our most restrictive bank covenants, our borrowing availability under the Amended Credit Agreement was approximately $449 million at December 31, 2006, as determined by borrowing base limitations defined by our agreement with the lending banks.

On February 23, 2007, we completed the sale of an aggregate principal amount of $150 million of 7.73% senior subordinated notes due 2017 in a private placement. The notes were issued at par and resulted in net proceeds to the Company of $147.2 million, after deduction of fees, commmissions and expenses. We used the proceeds from the sale of these senior subordinated notes to paydown our revolving credit facility.

This credit facility contains certain financial and other covenants, including covenants:

- requiring us to maintain tangible net worth of at least $500 million plus 50% of net income earned since January 1, 2005 plus 50% of the aggregate net increase in tangible net worth resulting from the sale of capital stock and other equity interests (as defined);

- prohibiting our ratio of indebtedness (including accrued expenses) to tangible net worth from being greater than 2.25 to 1;

- requiring us to maintain a ratio of EBITDA (including interest amortized to cost of sales) to interest incurred (as defined) of at least 2.0 to 1;

- prohibiting the net book value of our land and lots where construction of a home has not commenced to exceed 100% of tangible net worth and prohibiting the net book value of our raw land where grading or infrastructure improvements have not begun to exceed 20% of tangible net worth;

- limiting the number of unsold housing units and model units that we may have in our inventory at the end of any fiscal quarter as follows:

(1) unsold homes cannot exceed 25% of the number of home closings within the four fiscal quarters ending on such date; and

(2) model homes cannot exceed 10% of the number of home closings within the four fiscal quarters ending on such date; and

- prohibiting us from entering into any sale and leaseback transaction, excluding the sale and leaseback of model homes.

7.0% Senior Notes

In April 2004, we issued $130.0 million in principal amount of 7.0% senior notes due 2014. The indenture for our 7.0% senior notes requires us to comply with a number of covenants that restrict certain transactions, including covenants:

- limiting the amount of additional indebtedness we can incur unless after giving effect to such additional indebtedness, either (i) our fixed charge coverage ratio would be at least 2.0 to 1.0 or (ii) our ratio of consolidated debt to consolidated tangible net worth would be less than 3.0 to 1.0, provided, however, this limitation does not generally apply to indebtedness under our senior unsecured credit facility, most types of inter-company indebtedness, purchase money indebtedness up to $15 million, other indebtedness up to $15 million and non-recourse indebtedness;

- generally limiting the amount of dividends, redemptions of equity interests and certain investments we can make to $10 million plus (i) 50% of our net income since June 1, 2001 plus (ii) 100% of the net cash proceeds from the sale of qualified equity interests, plus other items and subject to other exceptions;

- requiring us to maintain tangible net worth of at least $60 million;

- limiting our ability to incur or create certain liens; and

- placing limitations on the sale of assets, mergers and consolidations and transactions with affiliates.

6.25% Senior Notes

In March 2005, we completed the private placement of $350 million in aggregate principal amount of 6.25% senior notes due 2015 which resulted in net proceeds to us of approximately $344 million. The indenture which governs the 6.25% senior notes contains covenants that are substantially similar to the covenants in the indenture that governs our existing 7.0% senior notes, except that, among other things, the new indenture:

- does not require us to maintain a certain level of minimum tangible net worth;

- provides that the exceptions to the limitation of the amount of additional indebtedness we may acquire with respect to purchase money indebtedness is unlimited, and with respect to other indebtedness is $25 million;

- provides that the amount of dividends, redemptions of equity interests and certain investments we can make is

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limited to $25 million plus (i) 50% of net income since June 1, 2001 plus (ii) 100% of the net cash proceeds from the sale of qualified equity interests, plus other items and subject to other exceptions;

- increases the amount of investments we can make in joint ventures in a permitted business with unaffiliated third parties to 30% of our consolidated tangible net worth (as defined in the new indenture); and

- provides for a suspension of certain covenants if the new 6.25% senior notes have investment grade ratings, as defined in the indenture, including covenants relating to change of control, limitations on additional indebtedness, limitations on the amount of dividends, redemptions of equity interest and certain limitations on investments and asset sales.

As of and for the year ended December 31, 2006, we were in compliance with the credit facility and senior note covenants.

Although we believe that our current borrowing capacity, cash on hand and anticipated net cash flows from operations are and will be sufficient to meet liquidity needs for the foreseeable future, certain events may occur, particularly in light of the current slowdown of the homebuilding market, which may require additional cash outlays beyond our historical levels. Such events include the acquisition of land from our lots under option at a rate faster than our sales pace and the build-up of unsold inventory due to high cancellation rates. We believe our future cash needs will include funds for the completion of projects that are underway, the acquisition of land and property for new projects, repurchases of common stock. the maintenance of our day-to-day operations, and the acquisition or start-up of additional homebuilding operations, should the opportunities arise. There is no assurance, however, that future cash flows will be sufficient to meet future capital needs. The amount and types of indebtedness that we incur may be limited by the terms of the indenture governing our senior notes and by the terms of the credit agreement governing our senior unsecured credit facility.

See Part II, Item 5 for additional discussions regarding our share repurchase program.

Off-Balance Sheet Arrangements

We often acquire finished building lots at market prices from various development entities under fixed price purchase agreements. This lot acquisition strategy reduces the financial requirements and risks associated with direct land ownership and land development. Under these purchase agreements, we are usually required to make deposits in the form of cash or a letter of credit, which may be forfeited if we fail to perform under the agreement. At December 31, 2006, we had entered into purchase agreements with an aggregate purchase price of approximately $2.1 billion and had made deposits of approximately $168.1 million in the form of cash and approximately $64.3 million in letters of credit.

We also enter into land acquisition and development joint ventures. We believe our participation in such joint ventures provides us a means of accessing larger parcels and lot positions and helps us expand our market opportunities and manage our risk profile. Our participation in joint ventures is an increasingly important part of our business model and we expect it to continue to be in the future. We and/or our joint venture partners occasionally provide limited repayment guarantees on a pro rata basis on debt of certain unconsolidated land acquisition and development joint ventures. At December 31, 2006, we had limited repayment guarantees of $38.6 million.

In addition, we and/or our joint venture partners occasionally provide guarantees that are only applicable if and when the joint venture directly, or indirectly through agreement with its joint venture partners or other third parties, causes the joint venture to voluntarily file a bankruptcy or similar liquidation or reorganization action (commonly referred to as bad boy guarantees). These types of guarantees typically are on a pro rata basis and are designed to protect the secured lender from the joint venture filing voluntary bankruptcy to impede the lender s remedies with respect to its mortgage or other secured lien on the joint venture s underlying property. To date, no such guarantees have been invoked and we believe it is unlikely that such a guarantee would be invoked in the future as it would generally require us to voluntarily take actions that would generally be disadvantageous to the joint venture and to us. At December 31, 2006, we had outstanding guarantees of this type totaling approximately $82.3 million. By definition, guarantees of this type, unless invoked as described above, are not considered guarantees or indebtedness under our revolving credit facility or senior note indentures.

We and our joint venture partners are also typically obligated to the project lenders to complete land development improvements if the joint venture does not perform the required development. Provided we and the other joint venture partners are in compliance with these completion obligations, the project lenders generally would be obligated to fund these improvements through any financing commitments available under the applicable joint venture development and construction

loans. In addition, we and our joint venture partners have from time to time provided unsecured environmental indemnities to joint venture project lenders. In some instances, these indemnities are subject to caps. These indemnities generally obligate us to reimburse the project lenders only for claims related to environmental matters for which such lenders are held responsible. As part of our project acquisition due diligence process to determine potential environmental risks, we, or the joint venture entity, generally obtain an independent environmental review from outside consultants.

Additionally, we and our joint venture partners have agreed to indemnify third party surety providers with respect to performance bonds issued on behalf of certain of our joint ventures. If a joint venture does not perform its obligations, the surety bond could be called. If these surety bonds are called and the joint venture fails to reimburse the surety, we and our joint venture partners would be obligated to indemnify the surety. These surety indemnity arrangements are generally joint and several obligations with our other joint venture partners. As of December 31, 2006, we were subject to approximately $45.4 million of these types of surety bond indemnity arrangements. None of these bonds have been called to date and we believe it is unlikely that any of these bonds will be called.

We also obtain letters of credit and performance, maintenance, and other bonds in support of our related obligations with respect to the development of our projects. The amount of these obligations outstanding at any time varies depending on the stage and level of our development activities. In the event the letters of credit or bonds are drawn upon, we would be obligated to reimburse the issuer of the letter of credit or bond. At December 31, 2006, we had approximately $38.3 million in outstanding letters of credit and $272.5 million in performance bonds for such purposes. We believe it is unlikely that any of these letters of credit or performance bonds will be drawn upon.

Contractual Obligations

The following is a summary of our contractual obligations at December 31, 2006, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

	Payments Due by Period				
	Total	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**More Than 5 Years**
Principal, senior notes	$ 480,000	$	$	$	$ 480,000
Interest, senior notes	245,452	30,975	61,950	61,950	90,577
Unsecured revolving credit facility	226,500			226,500	
Other borrowing obligations (1)(2)	28,140	27,964	176		
Interest, other borrowing obligations (1)(2)	917	916	1		
Operating lease obligations (1)	58,090	18,462	23,088	10,084	6,456
Specific performance option obligations	4,269	2,468	1,801		
Total	$ 1,043,368	$ 80,785	$ 87,016	$ 298,534	$ 577,033

(1) As a part of our model home construction activities, we enter into lease transactions with third parties, the monthly payments for which are typically calculated by applying a LIBOR-based rate to the agreed upon basis of the leased asset. As discussed in Note 5, at December 31, 2006 and 2005, approximately $26.8 and $39.3 million of these transactions were included in our balance sheet as model home inventory with a corresponding debt balance, which is included in the other borrowings category above. Other payments relating to the model home leases and other operating leases are included in the Operating lease obligations category. See Notes 3 and 14 to our consolidated financial statements included in this report for additional information regarding our contractual obligations.

(2) Includes $1.3 million in principal related to an acquisition and development loan with interest payments totaling approximately $40,000.

We do not engage in commodity trading or other similar activities. We had no derivative financial instruments at December 31, 2006 or 2005.

Seasonality

We typically experience seasonal variations in our quarterly operating results and capital requirement. Historically, we sell more homes in the first half of the fiscal year than in the second half, which results in more working capital requirements and home closings in the third and fourth quarters. We expect this seasonal pattern to continue, although it may vary as our operations continue to expand.

Recent Accounting Standards

See Note 1 for discussion of recently-issued accounting standards. Reference is also made to Note 9 regarding our adoption of SFAS No. 123R, *Share-based Payment.*

35

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk primarily related to potential adverse changes in interest rates on our existing revolving credit facility. The interest rate relative to this borrowing fluctuates with the Prime and LIBOR lending rates. At December 31, 2006, we had $226.5 million drawn under our revolving credit facility that would be subject to changes in interest rates. We do not enter into, or intend to enter into, derivative financial instruments for trading or speculative purposes.

Our fixed rate debt is made up primarily of $350.0 million in principal of our 6.25% senior notes and $130.0 million in principal of our 7.0% senior notes. Except in limited circumstances, we do not have an obligation to prepay our fixed-rate debt prior to maturity and, as a result, interest rate risk and changes in fair value should not have a significant impact on our fixed rate borrowings until we would be required to repay such debt.

The following table presents our long-term debt obligations, principal cash flows by maturity, weighted average interest rates and estimated fair market value. Information regarding interest rate sensitivity principal (notional) amount by expected maturity and average interest rates for the year ended December 31, 2006 follows:

	December 31, 2006 For the Years Ended December 31,							Fair Value at December 31,
	2007 (dollars in millions)	2008	2009	2010	2011	Thereafter	Total	2006
Fixed rate	$					$ 480.0	$ 480.0	$ 460.6 (a)
Average interest rate						6.45 %	6.45 %	n/a
Variable rate	$ 28.0 (b)(c)	0.1 (b)		226.5 (d)			$ 254.6	$ 254.6
Average interest rate								n/a

(a) Fair value of our fixed rate debt at December 31, 2006, is based on quoted market prices by independent dealers.

(b) $26.7 and $0.1 million relates to our model home lease program in 2007 and 2008. Although we have no legal obligation to repay this amount, generally accepted accounting principles require we include this liability and a related asset in our consolidated financial statements. The lease payments required under this program are based on the outstanding principal amount at approximately 7.85% of such amount per annum.

(c) $1.3 million relates to an acquisition and development loan which carries a variable interest rate of the 30 day LIBOR plus 3.5% per annum.

(d) $226.5 million relates to our revolving credit facility which carries a variable interest rate of LIBOR plus 1.25% per annum or Prime.

Our operations are interest rate sensitive. As overall housing demand is adversely affected by increases in interest rates, a significant increase in mortgage interest rates may negatively affect the ability of homebuyers to secure adequate financing. Higher interest rates could adversely affect our revenues, gross margins and net income and would also increase our variable rate borrowing costs.

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements as of December 31, 2006 and 2005 and for each of the years in the three-year period ended December 31, 2006, together with related notes and the report of Deloitte & Touche LLP, independent registered public accounting firm, are on the following pages. Other required financial information is more fully described in Item 15.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
Meritage Homes Corporation

We have audited the accompanying consolidated balance sheets of Meritage Homes Corporation and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of earnings, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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, such consolidated financial statements present fairly, in all material respects, the financial position of Meritage Homes Corporation and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 9 to the consolidated financial statements, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123(R), *Share-Based Payment*, using the modified prospective method.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2007 expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Phoenix, Arizona

February 26, 2007

MERITAGE HOMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2006	2005
	(In thousands, except share data)	
Assets		
Cash and cash equivalents	$ 56,710	$ 65,812
Receivables	68,725	60,745
Real estate	1,530,602	1,390,803
Real estate not owned	5,269	1,464
Deposits on real estate under option or contract	167,132	167,040
Investments in unconsolidated entities	114,250	88,714
Property and equipment, net	40,712	36,239
Deferred tax asset, net	28,119	
Goodwill	129,659	130,222
Intangibles, net	9,492	14,029
Prepaid expenses and other assets	19,855	16,289
Total assets	$ 2,170,525	$ 1,971,357
Liabilities		
Accounts payable	$ 117,443	$ 140,789
Accrued liabilities	266,683	289,307
Home sale deposits	42,022	76,299
Liabilities related to real estate not owned	4,269	968
Deferred tax liability, net		20,865
Loans payable and other borrowings	254,640	112,398
Senior notes	478,636	479,726
Total liabilities	1,163,693	1,120,352
Stockholders Equity		
Common stock, par value $0.01. Authorized 50,000,000 shares; issued 34,035,084 and 33,112,358 shares at December 31, 2006 and 2005, respectively	340	331
Additional paid-in capital	332,652	296,804
Retained earnings	862,602	637,248
Treasury stock at cost, 7,891,068 and 5,935,068 shares at December 31, 2006 and 2005, respectively	(188,762)	(83,378)
Total stockholders equity	1,006,832	851,005
Total liabilities and stockholders equity	$ 2,170,525	$ 1,971,357

See accompanying notes to consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

	Years Ended December 31, 2006	2005	2004
	(In thousands, except per share data)		
Home closing revenue	$ 3,444,286	$ 2,996,946	$ 2,015,742
Land closing revenue	17,034	4,156	24,262
Total closing revenue	3,461,320	3,001,102	2,040,004
Cost of home closings	(2,732,298)	(2,290,493)	(1,615,455)
Cost of land closings	(16,392)	(3,619)	(16,079)
Total cost of closings	(2,748,690)	(2,294,112)	(1,631,534)
Home closing gross profit	711,988	706,453	400,287
Land closing gross profit	642	537	8,183
Total closing gross profit	712,630	706,990	408,470
Commissions and other sales costs	(216,341)	(160,114)	(116,527)
General and administrative expenses	(164,477)	(124,979)	(79,257)
Earnings from unconsolidated entities, net	20,364	18,337	2,788
Other income, net	11,833	7,468	9,284
Loss on extinguishment of debt		(31,477)	
Earnings before provision for income taxes	364,009	416,225	224,758
Provision for income taxes	(138,655)	(160,560)	(85,790)
Net earnings	$ 225,354	$ 255,665	$ 138,968
Earnings per share*:			
Basic	$ 8.52	$ 9.48	$ 5.33
Diluted	$ 8.32	$ 8.88	$ 5.03
Weighted average number of shares*:			
Basic	26,448	26,977	26,066
Diluted	27,102	28,787	27,610

**2004 share amounts reflect a 2-for-1 stock split in the form of a stock dividend that occurred in January 2005.*

See accompanying notes to consolidated financial statements

39

MERITAGE HOMES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Years Ended December 31, 2006, 2005 and 2004
(In thousands)

	Number of Shares*	Common Stock*	Additional Paid-In Capital*	Retained Earnings	Treasury Stock	Total
Balance at January 1, 2004	30,958	310	202,523	242,615	(33,553)	411,895
Net earnings				138,968		138,968
Income tax benefit from stock option exercises			2,972			2,972
Exercise of stock options	502	5	4,114			4,119
Purchase of treasury stock					(35,420)	(35,420)
Stock option expense			21			21
Balance at December 31, 2004	31,460	315	209,630	381,583	(68,973)	522,555
Net earnings				255,665		255,665
Income tax benefit from stock option exercises			10,465			10,465
Exercise of stock options	617	6	6,985			6,991
Purchase of treasury stock					(14,405)	(14,405)
Stock option expense			25			25
Issuance of common stock	1,035	10	69,699			69,709
Balance at December 31, 2005	33,112	331	296,804	637,248	(83,378)	851,005
Net earnings				225,354		225,354
Income tax benefit from stock option exercises			10,777			10,777
Exercise of stock options	923	9	13,526			13,535
Purchase of treasury stock					(105,384)	(105,384)
Stock option expense			11,545			11,545
Balance at December 31, 2006	34,035	$ 340	$ 332,652	$ 862,602	$ (188,762)	$ 1,006,832

**2004 amounts reflect a 2-for-1 stock split in the form of a stock dividend that occurred in January 2005.*

See accompanying notes to consolidated financial statements

40

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2006	2005	2004
	(In thousands)		
Cash flows from operating activities:			
Net earnings	$ 225,354	$ 255,665	$ 138,968
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:			
Depreciation and amortization	23,729	17,207	13,233
Write-off of senior note issuance cost		4,977	
Inventory impairments and land option deposit and land pre-acquisition cost write-offs	78,268		
Increase (decrease) in deferred taxes	(48,984)	(5,965)	609
Stock-based compensation	11,545		
Income tax benefit from stock option exercises		10,465	2,972
Excess income tax benefit from stock-based awards	(8,938)		
Equity in earnings of unconsolidated entities	(20,364)	(18,337)	(2,788)
Distributions of earnings from unconsolidated entities	17,126	16,140	3,698
Changes in assets and liabilities, net of effect of acquisitions:			
Increase in real estate	(182,391)	(364,571)	(136,967)
Increase in deposits on real estate under option or contract	(19,785)	(33,455)	(23,776)
Increase in receivables and prepaid expenses and other assets	(7,569)	(40,805)	(11,347)
Increase (decrease) in accounts payable and accrued liabilities	(55,678)	208,968	63,169
Increase (decrease) in home sale deposits	(34,277)	21,954	16,098
Net cash provided by (used in) operating activities	(21,964)	72,243	63,869
Cash flows from investing activities:			
Investments in unconsolidated entities	(51,909)	(89,085)	(45,567)
Distributions of capital from unconsolidated entities	18,959	20,799	951
Cash paid for acquisitions		(152,425)	(24,165)
Cash paid for earn-out agreements		(1,929)	(1,780)
Purchases of property and equipment	(25,850)	(25,279)	(15,113)
Proceeds from sales of property and equipment	1,080	492	172
Net cash used in investing activities	(57,720)	(247,427)	(85,502)
Cash flows from financing activities:			
Net borrowings (payments) under line of credit agreement	153,900	72,000	(34,077)
Proceeds from loans payable and other borrowings	847	462	
Proceeds from issuance of senior notes, net		343,835	130,088
Proceeds from sale of common stock, net		69,709	
Purchase of treasury stock	(105,384)	(14,405)	(35,420)
Payments for repurchase of senior notes	(1,254)	(285,472)	
Excess income tax benefit from stock-based awards	8,938		
Proceeds from stock option exercises	13,535	6,991	4,119
Net cash provided by financing activities	70,582	193,120	64,710
Net increase (decrease) in cash and cash equivalents	(9,102)	17,936	43,077
Cash and cash equivalents, beginning of year	65,812	47,876	4,799
Cash and cash equivalents, end of year	$ 56,710	$ 65,812	$ 47,876

See Supplemental Disclosure of Cash Flow Information at Note 11.

See accompanying notes to consolidated financial statements

41

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization. Meritage Homes is a leading designer and builder of single-family attached and detached homes in the fast-growing southern and western United States, based on the number of home closings. We offer a variety of homes that are designed to appeal to a wide range of homebuyers, including first-time, move-up, luxury and active adult buyers. We have operations in three regions: West, Central and East, which are comprised of 14 metropolitan areas in Arizona, Texas, California, Nevada, Colorado and Florida. Through our successors, we commenced our homebuilding operations in 1985. Meritage Homes Corporation was incorporated in 1988 in the State of Maryland.

Our homebuilding and marketing activities are conducted under the name of Meritage Homes in each of our markets, except for certain communities in Arizona, where we operate under the name of Monterey Homes, and in Texas, where we operate in certain communities as Legacy Homes, Meritage Homes and Monterey Homes. At December 31, 2006, we were actively selling homes in 213 communities, with base prices ranging from approximately $100,000 to $1,176,000.

Basis of Presentation. The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles and include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, the Company). Intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents**.** Liquid investments with an initial maturity of three months or less are classified as cash equivalents. Amounts in transit from title companies for home closings of approximately $51.6 million and $62.7 million are included in cash and cash equivalents at December 31, 2006 and 2005, respectively.

Real Estate. Real estate consists of finished home sites and home sites under development, completed homes and homes under construction, and land held for development. Capitalized costs include direct construction costs for homes, development period interest and certain common costs that benefit the entire community. Common costs are incurred on a community-by-community basis and allocated to residential lots based on the number of lots to be built in the project, which approximates the relative sales value method. Common costs incurred prior to construction are allocated to the land parcel benefited, based on the relative fair value of the parcel prior to construction.

An impairment loss is recorded when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable from the cash flows generated by future disposition. Real estate is reviewed quarterly to determine whether recorded costs are recoverable. In such cases, amounts are carried at the lower of cost or estimated fair value less disposal costs. During 2006, we recorded a $23.7 million impairment charge related to real estate inventories. Additionally, we wrote off $54.6 million of deposits and pre-acquisition costs relating to projects that were no longer feasible. These changes are included in cost of home closings.

Deposits. Deposits paid related to land options and contracts to purchase land are capitalized when incurred and classified as deposits on real estate under option or contract until the related land is purchased. The deposits are then transferred to real estate at the time the lots are acquired. To the extent they are non-refundable, deposits are charged to expense if the land acquisition is terminated or no longer considered probable.

Property and Equipment, net. Property and equipment, net, at December 31, 2006 and 2005 consists of approximately $20.4 million and $17.9 million, respectively, of computer and office equipment and approximately $20.3 million and $18.3 million, respectively, of model home furnishings, and is stated at cost less accumulated depreciation. Accumulated depreciation related to these assets amounted to approximately $33.6 million and $24.4 million at December 31, 2006 and 2005, respectively. Depreciation is generally calculated using the straight-line method over

the estimated useful lives of the assets, which range from three to seven years. Maintenance and repair costs are expensed as incurred.

Deferred Costs. At December 31, 2006 and 2005, deferred costs representing financing fees totaled approximately $7.1 million, net of accumulated amortization of approximately $3.8 million and $2.4 million, respectively, and are included

on our consolidated balance sheets within prepaid expenses and other assets. The costs are primarily amortized using the straight line method which approximates the effective interest method. Additionally, in 2005, we wrote off approximately $5.0 million of deferred costs related to our 9.75% senior notes of which $278.8 million in aggregate principal amount was repurchased during 2005.

***Investments in Unconsolidated Entities*.** We use the equity method of accounting for investments in unconsolidated entities over which we exercise significant influence but do not have a controlling interest. Under the equity method, our share of the unconsolidated entities earnings or loss is included in earnings from unconsolidated entities, net. We use the cost method of accounting for investments in unconsolidated entities over which we do not have significant influence. See Note 4 for further discussion.

Intangibles, net. Intangible assets consist primarily of non-compete agreements, tradenames and floor plan designs acquired in connection with our February 2005 acquisition of Colonial Homes and our September 2005 acquisition of Greater Homes. These intangible assets were valued at the acquisition dates utilizing accepted valuation procedures. The non-compete agreements, tradenames and floorplan designs are being amortized over their estimated useful lives. The acquired cost and accumulated amortization of our intangible assets was $8.5 million and $4.6 million, respectively, at December 31, 2006. During 2006, we wrote off $3.0 million of trade names that we no longer expect to use. The amortization expense in 2006 was $2.7 million and is expected to be approximately $1.2 million in 2007 and $1.1, $1.1 and $0.5 million per year in 2008, 2009 and 2010, respectively.

We have capitalized software costs at December 31, 2006 and 2005, in accordance with AICPA Statement of Position (SOP) 98-1 Accounting for Costs of Computer Software Development or Obtained for Internal Use with a cost basis of $9.8 and $6.9 million, respectively, net of accumulated amortization of $5.4 and $2.5 million, respectively. In 2006, amortization expense was approximately $2.9 million related to the capitalized software costs and is expected to be approximately $1.8, $0.7, $0.7, $0.7 and $0.5 million in 2007, 2008, 2009, 2010 and 2011, respectively. Additionally, we have $1.2 million of capitalized software costs that have not begun to amortize.

***Accrued Liabilities*.** Accrued liabilities at December 31, 2006 and 2005 consisted of the following (in thousands):

	At December 31, 2006	2005
Accruals related to real estate development and construction activities	$ 120,604	$ 135,953
Payroll and other benefits	54,893	51,382
Accrued taxes	9,112	48,941
Warranty reserves	28,437	25,168
Other accruals	53,637	27,863
Total	$ 266,683	$ 289,307

Revenue Recognition. Revenue from closings of residential real estate is recognized when closings have occurred, the buyer has made the required minimum down payment, obtained necessary financing, the risks and rewards of ownership are transferred to the buyer, and we have no continuing involvement with the property, which is generally the close of escrow.

***Cost of Home Closings*.** Cost of home closings includes direct home construction costs, closing costs, land acquisition and development costs, development period interest and common costs. Direct construction costs are accumulated during the period of construction and charged to cost of closings under specific identification methods, as are closing costs.

Estimated future warranty costs are charged to cost of home closings in the period when the revenues from the related home closings are recognized. Costs are accrued based upon historical experience and generally range from 0.42% to 0.83% of the home s sales price (see Note 14).

Income Taxes. We account for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in future years and are subsequently adjusted for changes in the rates. The effect on deferred tax assets and liabilities of a change in tax rates

is a charge or credit to deferred tax expense in the period of enactment. See Note 10 for further discussion.

43

Advertising Costs. The Company expenses advertising costs as they are incurred. Advertising expense was approximately $35.6 million, $21.7 million and $14.4 million in fiscal 2006, 2005 and 2004, respectively.

Stock Splits. In April 2002 and in January 2005, we completed two-for-one splits of our common stock in the form of stock dividends. All share and per share amounts have been restated to reflect the stock splits.

Earnings Per Share. We compute basic earnings per share by dividing net earnings available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share gives effect to the potential dilution that could occur if securities or contracts to issue common stock that are dilutive were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings.

Stock-Based Compensation. In the first quarter of 2006, we adopted Statement SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R), which revises SFAS No. 123, *Accounting for Stock-Based Compensation*. Prior to 2006, we accounted for stock awards granted to employees under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees, and Related Interpretations*. As a result, in periods prior to fiscal year 2006, no compensation expense was recognized for stock options granted to employees because we did not grant stock options with exercise prices below the market price of the underlying stock on the date of the grant.

SFAS No. 123R applies to new awards and to awards modified, repurchased or cancelled after the required effective date, as well as to the unvested portion of awards outstanding as of the required effective date. We use the Black-Scholes model to value new stock option grants under SFAS No. 123R. We have applied the modified prospective method for existing grants, which requires us to value stock options prior to our adoption of SFAS No. 123R under the fair value method and expense the unvested portion over the remaining vesting period. SFAS No. 123R also requires us to estimate forfeitures in calculating the expense related to stock-based compensation and to reflect the benefits of tax deductions in excess of recognized compensation expense as both a financing inflow and an operating cash outflow upon adoption.

Goodwill. Upon our January 1, 2002 adoption of SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is no longer subject to amortization, though it is subject to at least an annual assessment for impairment by applying a fair value-based test. If the carrying amount of the net assets of an identified reporting unit exceeds the fair value of that reporting unit, goodwill is considered to be impaired. Our operations in each state are considered a reporting unit. We continually evaluate whether events and circumstances have occurred that indicate the remaining balance of goodwill of each reporting unit may not be recoverable. In determining fair value, we use various valuation methodologies, including discounted cash flow models and enterprise value computations.

Inherent in our fair value determinations are certain judgements and estimates, including projections of future cash flows, the discount rate reflecting the risk inherent in future cash flows, the interpretation of current economic indicators and market valuations and our strategic plans with regard to our operations. A change in these underlying assumptions may cause a change in the results of our analysis, which could result in the fair value of one or more reporting units to be less than their respective carrying amounts. In addition, to the extent that there are significant changes in market conditions or overall economic conditions or our strategic plans change, it is possible that our conclusion regarding goodwill impairment could change, which could have a material adverse effect on our financial position and results of operations.

Fair Value of Financial Instruments. We determine fair value of financial instruments as required by SFAS No. 107, Disclosures About Fair Value of Financial Instruments.

The estimated fair value of our 7.0% senior notes at December 31, 2006 and 2005 was $128.1 and $123.5 million, respectively, based on quoted market prices by independent dealers. The aggregate principal amount of these notes at December 31, 2006 and 2005 was $130.0 million.

The estimated fair value of our 6.25% senior notes at December 31, 2006 and 2005 was $332.5 million and $320.3 million, respectively, based on quoted market prices by independent dealers. The aggregate principal amount of these notes at December 31, 2006 and 2005 was $350.0 million.

Our revolving credit facility and liabilities related to our model lease program carry interest rates that are variable and/or comparable to current market rates based on the nature of the obligations, their terms and remaining maturity, and therefore, the cost basis approximates fair value.

Due to the short-term nature of other financial assets and liabilities, we consider the carrying amounts of our short-term financial instruments to approximate fair value.

Recently Issued Accounting Pronouncements. In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (SAB No. 108). Due to diversity in practice among registrants, SAB No. 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB No. 108 did not have a material impact on our consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently reviewing the effect of SFAS No. 157, if any, on our consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Upon adoption, FIN 48 requires an adjustment to retained earnings for the initial cumulative effect of the interpretation. We are continuing to review and evaluate the impact of FIN 48 on our retained earnings.

Reference is made to Note 9 regarding our adoption of SFAS No. 123R, *Share-based Payment.*

NOTE 2 - REAL ESTATE AND CAPITALIZED INTEREST

Real estate at December 31 consists of the following (in thousands):

	2006	**2005**
Homes under contract under construction	$ 589,241	$ 815,925
Finished home sites and home sites under development	592,949	370,921
Unsold homes, completed and under construction	271,559	116,088
Model homes	39,131	45,060
Model home lease program	26,831	39,336
Land held for development	10,891	3,473
	$ 1,530,602	$ 1,390,803

Subject to sufficient qualifying assets, we capitalize all development period interest costs incurred in connection with the development and construction of real estate. Capitalized interest is allocated to real estate when incurred and charged to cost of closings when the related property is delivered. Certain information regarding interest follows (in thousands):

	Years Ended December 31,	
	2006	**2005**
Capitalized interest, beginning of year	$ 23,939	$ 19,701
Interest incurred and capitalized	52,063	43,034
Amortization to cost of home and land closings	(42,986)	(38,796)
Capitalized interest, end of year	$ 33,016	$ 23,939

NOTE 3 VARIABLE INTEREST ENTITIES AND CONSOLIDATED REAL ESTATE NOT OWNED

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R) requires the consolidation of entities in which an enterprise absorbs a majority of the entity s expected losses, receives a majority of the entity s expected residual returns, or

both, as a result of ownership, contractual or other financial interests in the entity. Prior to the issuance of FIN 46R, entities were generally consolidated by an enterprise when it had a controlling

45

financial interest through ownership of a majority voting interest in the entity.

Under FIN 46R, a variable interest entity, or VIE, is created when any of the following factors are present: (i) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, (ii) equity holders either (a) lack direct or indirect ability to make decisions about the entity, (b) are not obligated to absorb expected losses of the entity, or (c) do not have the right to receive expected residual returns of the entity or (iii) the equity investors as a group are considered to lack the direct or indirect ability to make decisions about the entity if (x) the voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity, their rights to receive the expected residual returns of the entity, or both, and (y) substantially all of the entity s activities either involve or are conducted on behalf of an investor that has disproportionately fewer voting rights.

Based on the provisions of FIN 46R, we have concluded that when we enter into option or purchase agreements to acquire land or lots from an entity and pay a non-refundable deposit, a VIE is created because we are deemed to have provided subordinated financial support, which refers to variable interests that will absorb some or all of an entity s expected losses if they occur. For each VIE created, we compute expected losses and residual returns based on the probability of future cash flows as outlined in FIN 46R. If we are deemed to be the primary beneficiary of the VIE, because we are obligated to absorb the majority of the expected losses, receive the majority of the residual returns, or both, we will consolidate the VIE in our consolidated financial statements. Not all of our purchase or option agreements are determined to be VIEs.

We have applied FIN 46R by developing a methodology to determine whether or not we are the primary beneficiary of the VIE. Part of this methodology requires the use of estimates in assigning probabilities to various future cash flow possibilities relative to changes in the fair value and changes in the development costs associated with the property. Although we believe that our accounting policy properly identifies our primary beneficiary status with these VIEs, changes in the probability estimates could produce different conclusions regarding our primary beneficiary status.

We generally do not have any ownership interest in the VIEs that hold the lots and land under option or contract, and accordingly, we generally do not have legal or other access to the VIEs books or records. Therefore, it is not possible for us to compel the VIEs to provide financial or other data to us in performing our primary beneficiary evaluation. Accordingly, this lack of information from the VIEs may result in our evaluation being conducted primarily based on management s judgments and estimates.

In most cases, creditors, if any, of the entities with which we have option agreements have no recourse against us and the maximum exposure to loss in our option agreements is limited to our option deposit. Often, we are at risk for items over budget related to land development on property we have under option. In these cases, we have contracted to complete development at a fixed cost on behalf of the land owner. Some of our option deposits may be refundable if certain contractual conditions are not performed by the party selling the lots.

The table below presents a summary of our lots under option at December 31, 2006 (dollars in thousands):

	Number of Lots	Fair Value	Purchase Price	Option/Earnest Money Deposits Cash	Letters of Credit
Options recorded on balance sheet as real estate not owned (1) (3)	170	$ 5,269	$	$ 1,000	$
Option contracts not recorded on balance sheet non-refundable deposits (1)	29,072	N/A	$ 1,673,046	$ 133,393	$ 63,501
Purchase contracts not recorded on balance sheet non-refundable deposits (1)	7,279	N/A	261,962	32,939	803
Purchase contracts not recorded on balance sheet refundable deposits (2)	3,720	N/A	126,515	800	
Total options not recorded on balance sheet	40,071	N/A	2,061,523	167,132	64,304
Total lots under option or contract	40,241	$ 5,269	$ 2,061,523	$ 168,132	$ 64,304

(1) Deposits are non-refundable except if certain contractual conditions are not performed by the selling party.

(2) Deposits are refundable at our sole discretion. We have not completed our acquisition evaluation process on these lots and we have not internally committed to purchase them.

(3) The purpose and nature of these consolidated lot option contracts (VIEs) is to provide the Company with the option to purchase the lots in anticipation of building homes on the lots in the future.

Note: Our option to purchase lots remains effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the agreement. The pre-established number of lots typically is structured to approximate our expected rate of home orders at the inception of the option.

Generally, our options to purchase lots remain effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the respective agreement. Although the pre-established number is typically structured to approximate our expected rate of home construction starts, during a weakened homebuilding market, as we are currently experiencing, we may purchase lots at an absorption level that exceeds our sales pace.

NOTE 4 INVESTMENTS IN UNCONSOLIDATED ENTITIES

We participate in homebuilding and land development joint ventures from time to time as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base. Based on the structure of these joint ventures, they may or may not be consolidated into our results. Our joint venture partners generally are other homebuilders, land sellers or real estate investors. We also enter into mortgage and title business joint ventures from time to time. These unconsolidated entities follow accounting principles generally accepted in the United States of America and we generally share in their profits and losses in accordance with our ownership interests.

For land development joint ventures, we, and in some cases our joint venture partners, usually receive an option or other similar arrangement to purchase portions of the land held by the joint venture. Option prices are generally negotiated prices that approximate market value when we enter into the option contract. For homebuilding and land development joint ventures, our share of the joint venture earnings relating to lots we purchase from the joint ventures is deferred until homes are delivered by us and title passes to a homebuyer. At such time, we allocate our joint venture earnings to the land acquired by us as a reduction in the basis of the property.

We and/or our joint venture partners occasionally provide limited repayment guarantees on a pro rata basis on the debt of certain unconsolidated land acquisition and development joint ventures. At December 31, 2006, our share of these limited pro rata repayment guarantees was approximately $38.6 million.

In addition, we and/or our joint venture partners occasionally provide guarantees that are only applicable if and when the joint venture directly, or indirectly through agreement with its joint venture partners or other third parties, causes the joint venture to voluntarily file a bankruptcy or similar liquidation or reorganization action or take other actions that are fraudulent or improper (commonly referred to as bad boy guarantees). These types of guarantees typically are on a pro rata basis and are designed to protect the respective secured lender s remedies with respect to its mortgage or other secured lien on the joint venture s underlying property. To date, no such guarantees have been invoked and we believe it is unlikely that such a guarantee would be invoked in the future as it would require us to voluntarily take actions that would generally be disadvantageous to the joint venture and to us. At December 31, 2006, we had outstanding guarantees of this type totaling approximately $82.3 million. By definition, these guarantees, unless invoked as described above, are not considered guarantees or indebtedness under our revolving credit facility or senior note indentures.

We believe that the equity method of accounting is appropriate for our invements in unconsolidated entities where we are not the primary beneficiary, we do not have a controlling interest, and our ownership interest exceeds 20%. Summarized condensed financial information related to unconsolidated joint ventures that are accounted for using the equity method was as follows:

	At December 31,	
	2006	**2005**
	(in thousands)	
Assets:		
Cash	$ 14,392	$ 10,337
Real estate	723,753	524,775
Other assets	25,722	22,373
Total assets	$ 763,867	$ 557,485
Liabilities and equity:		
Accounts payable and other liabilities	$ 26,639	$ 32,244
Notes and mortgages payable	471,197	299,498
Equity of:		
Meritage	93,792	72,362
Other	172,239	153,381
Total liabilities and equity	$ 763,867	$ 557,485

	Years Ended December 31,		
	2006	**2005**	**2004**
	(in thousands)		
Revenue	$ 100,322	$ 145,580	$ 29,130
Costs and expenses	(51,717)	(91,289)	(21,917)
Net earnings of unconsolidated entities	$ 48,605	$ 54,291	$ 7,213
Meritage s share of pre-tax earnings *	$ 21,170	$ 19,420	$ 2,788

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* Our share of net earnings is recorded in Earnings from unconsolidated entities, net on our consolidated statements of earnings. Our share of net earnings excludes joint venture earnings related to lots we purchased from the joint ventures. Those earnings are deferred until homes are delivered by us and title passes to a homebuyer.

At December 31, 2006 and December 31, 2005, our investments in unconsolidated entities includes $2.8 million and $1.5 million, respectively, related to the difference between the amounts at which our investments are carried and the amount of underlying equity in net assets. These amounts are amortized to earnings of unconsolidated entities as the assets of the respective joint ventures are sold. We amortized approximately $0.8 million and $1.1 million to our equity of the joint venture earnings in 2006 and 2005, respectively. There was no such amortization in 2004.

In addition to joint ventures accounted for under the equity method summarized in the above table, at December 31,

48

2006, our investments in unconsolidated entities included joint ventures recorded under the cost method. These joint ventures were formed to obtain large parcels of land, to perform off-site development work and to sell lots to the joint venture members. As of December 31, 2006 and 2005, our investments in unconsolidated entities recorded under the cost method were $17.7 and $14.9 million, respectively. For the years ended December 31, 2006, 2005 and 2004, we have not recorded any income or distributions from these joint ventures.

As of December 31, 2006, our total investment in unconsolidated joint ventures of $114.3 million was primarily comprised of $35.2 million in our West Region and $74.7 million in our Central Region. As of December 31, 2005, our total investment in unconsolidated joint ventures of $88.7 million was primarily comprised of $28.5 million in our West Region and $59.4 million in our Central Region.

NOTE 5 LOANS PAYABLE AND OTHER BORROWINGS

Loans payable at December 31 consist of the following (in thousands):

	2006	**2005**
$850 million unsecured revolving credit facility maturing May 2010 with extension provisions, with interest payable monthly approximating LIBOR (approximately 5.32% at December 31, 2006) plus 1.25% or Prime (8.25% at December 31, 2006).	$ 226,500	$ 72,600
Model home lease program, with interest in the form of lease payments payable monthly approximating 7.85% at December 31, 2006	26,831	39,336
Other borrowings, acquisition and development financing	1,309	462
Total loans payable and other borrowings	$ 254,640	$ 112,398

We have determined that the construction costs and related debt associated with certain model homes which are owned and leased to us by others and that we use to market our communities are required to be included on our balance sheet. We do not legally own the model homes, but we are reimbursed by the owner for our construction costs and we have the right, but not the obligation, to purchase these homes. Although we have no legal obligation to repay any amounts received from the third-party owner, such amounts are recorded as debt and are typically deemed repaid when we simultaneously exercise our option to purchase the model home and sell such model home to a third-party home buyer. Should we elect not to exercise our rights to purchase these model homes, the model home costs and related debt under the model lease program will be eliminated upon the termination of the lease, which is generally between one and three years from the origination of the lease. During 2006, $12.5 million of such leases were exercised or terminated.

On May 16, 2006, we amended and restated our senior unsecured revolving credit facility (New Credit Agreement). Under the New Credit Agreement, our credit facility was increased from $600 million to $800 million, and the term was extended from May 2009 to May 2010. On June 30, 2006, we amended our New Credit Agreement to increase our borrowing capacity under the Credit Agreement by $50 million and to make certain other minor changes. The total borrowing capacity of the credit facility is now $850 million. The increase in capacity was made pursuant to an accordion feature contained in the Credit Agreement. Under this accordion feature, we may request from time to time an aggregate increase of up to $250 million in the maximum borrowing commitment, of which $200 million remained available at December 31, 2006. Each member of the lending group may elect to participate or not participate in any request we make. In addition, any increase in the borrowing capacity pursuant to this accordion feature is subject to certain terms and conditions, including the absence of an event of default.

NOTE 6 SENIOR NOTES

Senior notes at December 31 consist of the following (in thousands):

	2006	2005
6.25% senior notes due 2015. At December 31, 2006 and 2005, there was approximately $1.4 and $1.6 million in unamortized discount, respectively	$ 348,571	$ 348,396
7.0% senior notes due 2014. At December 31, 2006 and 2005, there was approximately $0.1 million in unamortized premium.	130,065	130,074
9.75% senior notes due 2011		1,256
	$ 478,636	$ 479,726

In March 2005, we used a portion of the proceeds from the $350 million sale of our 6.25% senior notes to repurchase pursuant to a tender offer and consent solicitation approximately $276.8 million of our outstanding 9.75% senior notes due 2011. In connection with this tender offer and repurchase, we reported a one-time pre-tax charge of approximately $31.5 million for premiums, commissions and expenses associated with the tender offer and the write-off of existing offering costs associated with the 9.75% senior notes, net of the accretion of existing note premiums on the 9.75% senior notes. In 2006, we repurchased the remaining $1.3 million of our outstanding 9.75% senior notes.

The bank facility and indentures for the 7% senior notes due 2014 and the 6.25% senior notes due 2015 contain covenants which require maintenance of certain levels of tangible net worth and compliance with certain minimum financial ratios, place limitations on the payment of dividends and redemptions of equity, and limit the incurrence of additional indebtedness, asset dispositions, mergers, certain investments and creations of liens, among other items. As of and for the year ended December 31, 2006, we were in compliance with these covenants. After considering our most restrictive bank covenants, our borrowing availability under the bank credit facility was approximately $449 million at December 31, 2006 as determined by borrowing base limitations defined by our agreement with the lending banks. The senior notes restrict our ability to pay dividends, and at December 31, 2006, our maximum permitted amount available to pay dividends was $344.1 million.

Obligations to pay principal and interest on the bank credit facility and senior notes are guaranteed by all of our subsidiaries (collectively, the Guarantor Subsidiaries), each of which is directly or indirectly 100% owned by Meritage Homes Corporation. Such guarantees are full and unconditional, and joint and several. Separate financial statements of the Guarantor Subsidiaries are not provided because Meritage (the parent company) has no independent assets or operations, the guarantees are full and unconditional and joint and several. There are no significant restrictions on the ability of the parent company or any guarantor to obtain funds from its subsidiaries by dividend or loan.

Scheduled principal maturities of loans payable and other borrowings and senior notes as of December 31, 2006 follow (in thousands):

Year Ended December 31,	
2007	$ 27,964
2008	176
2009	
2010	226,500
2011	
Thereafter	480,000
	$ 734,640

NOTE 7 ACQUISITIONS AND GOODWILL

Greater Homes. In September 2005 we purchased all of the outstanding stock of Greater Homes, Inc. (Greater Homes), a builder of single-family homes in Orlando, Florida. The purchase price was approximately $86.2 million in cash, including the repayment of existing debt of approximately $27.7 million. The results of Greater Homes operations have been included in our financial statements since September 1, 2005, the effective date of the acquisition.

Colonial Homes. In February 2005, we purchased the homebuilding and related assets of Colonial Homes of Florida (Colonial Homes), which operates primarily in the Ft. Myers/Naples area. The purchase price was approximately $66.2

50

million in cash. The results of Colonial Homes operations have been included in our consolidated financial statements as of the effective date of acquisition, February 1, 2005.

Goodwill. Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the assets acquired. The acquisitions of Colonial Homes and Greater Homes were recorded using the purchase method of accounting. The purchase prices were allocated based on estimated fair value of the assets and liabilities assumed at the date of the acquisition. The excess purchase price over the fair value of the net assets, of $27.9 million and $10.1 million for Colonial Homes and Greater Homes, respectively, were recorded as goodwill, which is included on our consolidated balance sheets. We expect that substantially all of the goodwill recorded for the Colonial Homes acquisition will be deductible for tax purposes.

The changes in the carrying amount of goodwill for the years ended December 31, 2006 and 2005 were as follows (in thousands):

	Corporate	West	Central	East	Total
Balance at January 1, 2005	$ 1,323	$ 36,036	$ 54,116	$	$ 91,475
Goodwill acquired during the year				37,802	37,802
Increase due to earn-out agreements		1,476			1,476
Amortization of excess tax basis		(117)	(73)	(341)	(531)
Balance at December 31, 2005	1,323	37,395	54,043	37,461	130,222
Amortization of excess tax basis		(118)	(73)	(372)	(563)
Balance at December 31, 2006	$ 1,323	$ 37,277	$ 53,970	$ 37,089	$ 129,659

From time to time, we may acquire companies that are determined to have a tax basis goodwill in excess of book basis goodwill. Current tax law provides for the amortization of purchased goodwill. Under this circumstance, SFAS No. 109 requires that the goodwill be separated into two components. The first component is equivalent to book goodwill and future tax amortization of this component is treated as a temporary difference, for which a deferred tax liability is established. The second component is the excess tax goodwill over the book goodwill, for which no deferred taxes are recognized. The tax benefit from the recognition on the tax return of the amortization of the second component is treated as a reduction in the book basis of goodwill.

Under the guidelines contained in SFAS No. 142, *Goodwill and Other Intangible Assets*, management selected January 1 as the date of our annual goodwill impairment test. During 2006 and 2005, management performed an analysis of potential impairment of goodwill carried and determined that no impairment existed. We completed our analysis of potential impairment of goodwill carried on our balance sheet at December 31, 2006, and determined that no impairment existed.

See Note 11 for a summary of the allocation of the purchase price to acquired assets and liabilities.

NOTE 8 EARNINGS PER SHARE

Basic and diluted earnings per share for the years ended December 31, were calculated as follows (in thousands, except per share amounts):

	2006	2005	2004
Basic average number of shares outstanding	26,448	26,977	26,066
Effect of dilutive securities:			
Options to acquire common stock	654	1,810	1,544
Diluted average shares outstanding	27,102	28,787	27,610
Net earnings	$ 225,354	$ 255,665	$ 138,968
Basic earnings per share	$ 8.52	$ 9.48	$ 5.33
Diluted earnings per share	$ 8.32	$ 8.88	$ 5.03
Antidilutive stock options not included in the calculation of diluted earnings per share	657	52	

NOTE 9 INCENTIVE AWARDS AND RETIREMENT PLAN

Stock Based Compensation

In the first quarter of 2006, we adopted Statement SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R), which revised SFAS No. 123, *Accounting for Stock-Based Compensation*. Prior to 2006, we accounted for stock awards granted to employees under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees, and Related Interpretations*. As a result, in periods prior to fiscal year 2006, no compensation expense was recognized for stock options granted to employees because we did not grant stock options with exercise prices below the market price of the underlying stock on the date of the grant.

SFAS No. 123R applies to new awards and to awards modified, repurchased or cancelled after the required effective date, as well as to the unvested portion of awards outstanding as of the required effective date. We use the Black-Scholes model to value new stock option grants under SFAS No. 123R. We have applied the modified prospective method for existing grants, which requires us to value stock options prior to our adoption of SFAS No. 123R under the fair value method and expense the unvested portion over the remaining vesting period. SFAS No. 123R also requires us to estimate forfeitures in calculating the expense related to stock-based compensation and to reflect the benefits of tax deductions in excess of recognized compensation expense as both a financing inflow and an operating cash outflow upon adoption.

We have two stock compensation plans, the Meritage Stock Option Plan, which was adopted in 1997 and has been amended from time to time (the 1997 Plan), and the Stock Incentive Plan (the 2006 Plan and together with the 1997 Plan, the Plans). The Plans, which were approved by our stockholders, are administered by our Board of Directors. The provisions of the Plans are generally consistent with the exception that the 2006 Plan allows for the grant of stock appreciation rights, restricted stock awards, performance share awards and performance-based awards in addition to the non-qualified and incentive stock options allowed under the 1997 Plan. The Plans authorize awards to officers, key employees, non-employee directors and consultants for up to 6,600,000 shares of common stock, of which 1,042,701 shares remain available for grant at December 31, 2006. We believe that such awards provide a means of performance-based compensation to attract and retain qualified employees and better align the interests of our employees with those of our stockholders. Option awards are granted with an exercise price equal to the market price of Meritage stock at the date of grant, and generally have a five-year ratable vesting period and a seven-year contractual term.

The fair values of option awards are estimated using a Black-Scholes option pricing model that uses the assumptions noted in the following table. Beginning January 1, 2006, expected volatilities are based on a combination of implied volatilities from traded options on our stock and historical volatility of our stock. Expected term, which represents the period of time that options granted are expected to be outstanding, is estimated using historical data. Groups of employees that have

similar historical exercise behavior are considered separately for valuation purposes. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve.

	2006		2005		2004	
Expected dividend yield	0	%	0	%	0	%
Risk-free interest rate	5.01	%	4.41	%	4.39	%
Expected volatility	46.26	%	52.10	%	55.50	%
Expected life (in years)	5		7		7	
Weighted average fair value of options	$ 24.28		$ 35.13		$ 19.37	

The following table illustrates the effect on net income and earnings per share for the years ended December 31, 2005 and 2004, respectively, as if our stock-based compensation had been determined based on the fair value at the grant dates for awards made prior to 2006, under the Plans and consistent with SFAS No. 123R (in thousands, except per share amounts):

	Years Ended December 31, (in thousands, except per share amounts) 2005			2004		
Net earnings						
As reported	$	255,665		$	138,968	
Deduct*	(7,501		)	(4,357		)
Pro forma	$	248,164		$	134,611	
Basic earnings per share						
As reported	$	9.48		$	5.33	
Pro forma	$	9.20		$	5.16	
Diluted earnings per share						
As reported	$	8.88		$	5.03	
Pro forma	$	8.62		$	4.88	

* Deduct: Total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects.

Summary of stock option activity:

	Years Ended December 31, 2006			
	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (In thousands)
Options outstanding at beginning of year:	2,799,282	$ 27.90		
Granted	662,000	$ 52.70		
Exercised	(922,726)	$ 14.67		
Cancelled	(615,502)	$ 41.26		
Outstanding at end of year	1,923,054	$ 38.51	4.6	$ 74,048
Vested and expected to vest at end of year	1,682,017	$ 36.99	4.3	$ 23,961
Exercisable at end of year	676,854	$ 25.07	3.1	$ 16,970
Price range of options exercised	$ 1.41 - $55.92			
Price range of options outstanding	$ 3.59 - $81.96			
Total shares reserved for existing or future grants at end of year	2,965,755			

	Years Ended December 31, 2005		2004	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options outstanding at beginning of year:	2,901,030	$ 17.73	2,693,024	$ 11.37
Granted	588,750	$ 60.40	880,500	$ 31.86
Exercised	(617,298)	$ 11.33	(500,974)	$ 8.22
Cancelled	(73,200)	$ 26.03	(171,520)	$ 18.21
Outstanding at end of year	2,799,282	$ 27.90	2,901,030	$ 17.73
Exercisable at end of year	961,130		855,708	
Price range of options exercised	$ 1.41 - $36.91		$ 2.50 - $26.24	
Price range of options outstanding	$ 1.41 - $81.96		$ 1.41 - 44.29	
Total shares reserved for existing or future grants at end of year	3,289,872		3,907,170	

Summary of Nonvested Shares Activity:

Nonvested Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2006		

Granted	93,886	$	48.54
Vested			
Cancelled	(20,443)	$	54.87
Nonvested at December 31, 2006	73,443	$	46.78

Stock options outstanding at December 31, 2006, were:

	Stock Options Outstanding			**Stock Options Exercisable**	
Range of Exercise Prices	**Number Outstanding**	**Weighted Average Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable**	**Weighted Average Exercise Price**
$ 0.00 - $16.39	359,904	2.4	$ 12.44	252,384	$ 10.92
$16.40 - $32.78	588,000	3.6	$ 27.23	307,720	$ 25.01
$32.79 - $49.17	117,500	5.9	$ 40.46	24,000	$ 37.09
$49.18 - $65.56	801,650	5.9	$ 55.81	79,550	$ 58.54
$65.57 - $81.96	56,000	5.5	$ 72.61	13,200	$ 73.58
	1,923,054	4.5	$ 38.51	676,854	$ 25.07

The total intrinsic value of options exercises for the years ended December 31, 2006, 2005 and 2004 was $35.2, $36.3 and $14.0, respectively. The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the stock option.

As of December 31, 2006, we had $27.5 million of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the Plans that will be recognized on a straight-line basis over the remaining vesting periods. That cost is expected to be recognized over a weighted-average period of 3.42 years. For the year ended December 31, 2006, our total stock-based compensation expense was $11.5 million ($8.5 million net of tax). Stock compensation expense net of tax for the year ended December 31, 2006, was $0.32 and $0.31 per basic and diluted share, respectively.

Cash received from option exercises under the Plans for the years ended December 31, 2006, 2005 and 2004 was $13.5 million, $7.0 million and $4.1 million, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled $10.8 million, $10.5 million and $3.0 million for the years ended December 31, 2006, 2005 and 2004, respectively.

401(k) Retirement Plan

We have a 401(k) plan for all full-time Meritage employees who have been with the Company for a period of six months or more. We match portions of employees voluntary contributions, and contributed to the plan approximately $2.0 million, $1.4 million and $1.2 million for the years ended 2006, 2005 and 2004, respectively.

NOTE 10 INCOME TAXES

Components of income tax expense (benefit) follow (in thousands):

	Years Ended December 31,		
	2006	**2005**	**2004**
Current taxes:			
Federal	$ 165,274	$ 144,287	$ 74,819
State	22,365	22,238	10,362
	187,639	166,525	85,181
Deferred taxes:			
Federal	(44,870)	(5,170)	524
State	(4,114)	(795)	85
	(48,984)	(5,965)	609
Total	$ 138,655	$ 160,560	$ 85,790

Income taxes differ for the years ended December 31, 2006, 2005 and 2004, from the amounts computed using the expected federal statutory income tax rate of 35% as a result of the following (in thousands):

	Years Ended December 31,		
	2006	**2005**	**2004**
Expected taxes at current federal statutory income tax rate	$ 127,403	$ 145,679	$ 78,665
State income taxes, net of federal tax benefit	11,863	13,938	6,791
Non-deductible costs and other	(611)	943	334
Income tax expense	$ 138,655	$ 160,560	$ 85,790

Deferred tax assets and liabilities have been recognized in the consolidated balance sheets due to the following temporary differences at December 31 (in thousands):

	2006	2005
Deferred tax assets:		
Real estate	$ 13,904	$
Warranty reserve	11,678	7,859
Wages payable	6,599	1,828
Reserves and allowances	3,856	1,685
Deferred revenue	3,182	
Equity-based compensation	2,530	
Accrued expenses	1,115	1,770
Other	1,086	450
Total deferred tax assets	43,950	13,592
Deferred tax liabilities:		
Goodwill	12,024	8,607
Intangibles	1,471	3,681
Prepaids	1,353	1,959
Fixed assets	924	1,882
Other	59	565
Real estate		17,763
Total deferred tax liabilities	15,831	34,457
Net deferred tax asset (liability)	$ 28,119	$ (20,865)

On an annual basis, we review our deferred tax assets based on open tax years, the status of refund claims filed and other factors. As a result of our acquisitions of Colonial Homes and Greater Homes, we recorded deferred tax liabilities of approximately $25.3 million in 2005 with a corresponding increase to goodwill.

NOTE 11 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The 2005 acquisitions of Greater Homes and Colonial Homes (East Region) and the 2004 acquisition of Citation Homes (West Region) resulted in the following changes in assets and liabilities (in thousands):

	2005	2004
Increase in real estate	$ (140,538)	$ (12,036)
Increase in deposits on real estate under option or contract	(5,170)	(1,870)
Increase in receivables and other assets	(7,640)	(747)
Increase in goodwill	(37,802)	(11,214)
Increase in intangibles	(11,493)	
Increase in property and equipment	(826)	(89)
Increase in accounts payable and accrued liabilities	12,172	1,704
Increase in home sale deposits	12,809	87
Increase in deferred tax liability	26,063	
Net cash paid for acquisitions	$ (152,425)	$ (24,165)

There were no acquisitions in 2006.

	2006	2005	2004
Cash paid during the year for:			
Interest	$ 48,802	$ 35,820	$ 36,728
Income taxes	$ 216,818	$ 125,026	$ 70,916
Non-cash lot distributions from unconsolidated entities	$ 8,946	$ 33,007	$ 16,291

NOTE 12 RELATED PARTY TRANSACTIONS

We have transacted business with related or affiliated companies and with certain officers and directors of the Company. We believe that the terms and fees negotiated for all transactions listed below are no less favorable than those that could be negotiated in arm s length transactions.

Since 1997, we have leased office space in Plano, Texas from Home Financial Services, a Texas partnership owned by John Landon, our former co-chief executive officer, and his wife. During 2006, this lease was renewed for a three-year period. Rents paid to the partnership were approximately $225,836, $268,000 and $255,000 in 2006, 2005 and 2004, respectively. The office rent is included within general and administrative expenses on our consolidated statements of earnings.

We paid legal fees of approximately $1,643,000 and $783,000 to law firms in 2005 and 2004, respectively, of which C. Timothy White was a partner. Mr. White served on our board of directors until October 1, 2005, at which time he joined the Company as our General Counsel. Of these fees, approximately $1,136,000 and $722,000 were real estate project related and capitalized to real estate on our balance sheet in 2005 and 2004, respectively. The remaining amounts are recorded within general and administrative expenses on our consolidated statements of earnings.

During 2004, we contracted with a landbanker to acquire property in the Tucson, Arizona area for $4.6 million. Robert Sarver, one of our directors, has a 3.8% ownership interest in the entity that sold this property to the landbanker. During 2006 and 2005, we had purchases totaling approximately $1.5 million and $1.2 million from the landbanker related to this property. In addition, during 2006 and 2005, we made purchases of approximately $1.3 million and $64,800 directly from the entity in which Mr. Sarver has the ownership interest. We expect to complete the full acquisition of this property during fiscal 2007.

During 2004 the Company entered into an advertising/sponsorship agreement with the National Basketball Association s Phoenix Suns organization. One of our directors, Robert Sarver is the Controlling Owner and Vice Chairman of the Phoenix Suns, and our CEO, Steven Hilton, is a minority owner of the team. In 2006 and 2005 we paid approximately $714,000 and $392,000 in advertising/sponsorship costs related to the agreement. These amounts are recorded as general and administrative expenses on our consolidated statement of earnings.

NOTE 13 OPERATING AND REPORTING SEGMENTS

As required by SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information , we have analyzed our operating segments to determine if they may be further aggregated into reporting segments. Our operating segments that are aggregating into each reporting segment have been determined to have similar economic characteristics such as: historical and projected future operating results, employment trends, land acquisition and land constraints, municipality behavior as well as meeting the other qualitative aggregation criteria. The reportable homebuilding segments are aggregated as follows:

West:	California and Nevada
Central:	Texas, Arizona and Colorado
East:	Florida

Management s evaluation of segment performance is based on segment operating income, which we define as homebuilding and land revenues less cost of home construction, commissions and other sales costs, land development and other land sales costs and other costs incurred by or allocated to each segment. Each reportable segment follows the same accounting policies described in Note 1, Business and Summary of Significant Accounting Policies. Operating results for each segment may not be indicative of the results for such segment had it been an independent, stand-alone entity for the periods presented. The following segment information is in thousands:

	Year Ended December 31,		
	2006	**2005**	**2004**
Revenue (a):			
West	$ 1,076,401	$ 1,149,135	$ 769,085
Central	2,145,835	1,667,305	1,270,919
East	239,084	184,662	
Consolidated total	3,461,320	3,001,102	2,040,004
Operating income (loss)(b):			
West	114,162	247,809	127,407
Central	290,530	203,642	115,045
East	(6,717)	24,606	(100)
Segment operating income	397,975	476,057	242,352
Corporate and unallocated costs (c)	(66,163)	(54,160)	(29,666)
Earnings from unconsolidated entities, net	20,364	18,337	2,788
Other income, net	11,833	7,468	9,284
Loss on extinguishment of debt		(31,477)	
Earnings before provision for income tax	$ 364,009	$ 416,225	$ 224,758

	At December 31,	
	2006	**2005**
Assets:		
West	$ 602,039	$ 587,236
Central	1,183,533	1,003,839
East	168,010	207,692
Corporate and unallocated (d)	216,943	172,590
Consolidated total	$ 2,170,525	$ 1,971,357

(a) Revenue includes the following land closing revenue, by segment (in thousands): 2006 $11,475 in West Region and $5,559 in Central Region; 2005 - $4,156 in Central Region; 2004 - $20,185 in West Region and $4,077 in Central Region.

(b) Balances include the following inventory impairments and write-offs of options and pre-acquisition charges during 2006: $36,876 in West Region, $13,681 in Central Region and $27,711 in East Region. There were no such charges in 2005 or 2004.

(c) Balance consists primarily of corporate costs and numerous shared service functions such as finance, legal and treasury that are not allocated to the operating segments.

(d) Balance consists primarily of goodwill and intangibles and other corporate assets not allocated to the segments.

See additional segment discussions in Notes 4, 7, and 11 to these consolidated financial statements.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

We are involved in various routine legal proceedings incidental to our business, some of which are covered by insurance. With respect to the majority of pending litigation matters, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to those matters are not considered probable. We have reserved approximately $2.4 million for losses related to litigation and asserted claims where our ultimate exposure is considered probable and the potential loss can be reasonably estimated, which is classified within accrued liabilities on our December 31, 2006 balance sheet. Most of the matters relate to the correction of home construction defects, foundation issues and general customer claims. We believe that none of these matters will have a material adverse impact upon our consolidated financial condition, results of operations or cash flows.

From time to time, the United States Environmental Protection Agency and Maricopa County (Arizona) Air Quality Department have assessed fines against us for violating dust control regulations. While we strive to maintain practices that comply with such regulations, dust control violations are common to the residential homebuilding industry in desert regions such as Arizona. We do not believe that such fines will have a material adverse effect on our business, financial position or results of operations.

In the normal course of business, we provide standby letters of credit and performance bonds issued to third parties to secure performance under various contracts. At December 31, 2006, we had outstanding letters of credit of $102.6 million and performance bonds of $317.9 million. We do not believe it is probable that these letters of credit or bonds will be drawn upon.

We also enter into land acquisition and development joint ventures. We believe our participation in such joint ventures provides us a means of accessing larger parcels and lot positions and helps us expand our market opportunities and manage our risk profile. Our participation in joint ventures is an important part of our business model and we expect to continue to use joint ventures in the future. We and/or our joint venture partners occasionally provide limited repayment guarantees on a pro rata basis on debt of certain unconsolidated land acquisition and development joint ventures. At December 31, 2006, we had limited repayment guarantees of $38.6 million.

In addition, we and/or our joint venture partners occasionally provide guarantees that are only applicable if and when the joint venture directly, or indirectly through agreement with its joint venture partners or other third parties, causes the joint venture to voluntarily file a bankruptcy or similar liquidation or reorganization action (commonly referred to as bad boy guarantees). These types of guarantees typically are on a pro rata basis and are designed to protect the secured lender from the joint venture filing voluntary bankruptcy to impede the lender s remedies with respect to its mortgage or other secured lien on the joint venture s underlying property. To date, no such guarantees have been invoked and we believe it is unlikely that such a guarantee would be invoked in the future as it would generally require us to voluntarily take actions that would generally be disadvantageous to the joint venture and to us. At December 31, 2006, we had outstanding guarantees of this type totaling approximately $82.3 million. By definition, guarantees of this type, unless invoked as described above, are not considered guarantees or indebtedness under our revolving credit facility or senior note indentures.

We lease office facilities, model homes and equipment under various operating lease agreements. Approximate future minimum lease payments for non-cancelable operating leases as of December 31, 2006, are as follows (in thousands):

Years Ended December 31,	
2007	$ 18,462
2008	12,986
2009	10,102
2010	6,717
2011	3,367
Thereafter	6,456
	$ 58,090

Rent expense approximated $14.0 million, $11.7 million and $8.7 million in 2006, 2005 and 2004, respectively, and is included within general and administrative expense or in commissions and other sales costs on our consolidated statements of earnings.

We have certain obligations related to post-construction warranties and defects related to homes closed. We have estimated these reserves based on historical data and trends with respect to similar product types and geographical areas. A summary of changes in our warranty reserve follows (in thousands):

	Years Ended December 31,	
	2006	**2005**
Warranty reserve, beginning of year	$ 25,168	$ 14,967
Additions to reserve	23,949	21,681
Warranty claims	(20,680)	(11,480)
Warranty reserve, end of year	$ 28,437	$ 25,168

Warranty reserves are included in accrued liabilities within the accompanying consolidated balance sheets. Additions to warranty reserves are included in cost of sales within the accompanying consolidated statements of earnings.

NOTE 15 OTHER EVENTS

On May 17, 2006, John R. Landon, the Company s Co-CEO, resigned. In connection with Mr. Landon s departure, both his employment and change of control agreement terminated (other than certain provisions in the Employment Agreement that survive termination). Under the terms of the Employment Agreement, subject to his compliance with certain restrictive covenants and other requirements therein, Mr. Landon is entitled to a payment of $10,000,000, payable in equal monthly installments over the course of 24 months, and acceleration of all outstanding stock options that were granted to him after the effective date of the employment agreement, which was July 1, 2003. During the quarter ended June 30, 2006, the Company expensed approximately $10.0 million related to the obligations owed to Mr. Landon pursuant to the terms of his employment agreement and also recorded stock-based compensation expense of approximately $2.3 million related to the accelerated vesting of certain of his outstanding stock options. On June 12, 2006, the Company entered into a Stock Purchase Agreement with Mr. Landon, pursuant to which the Company acquired 1,000,000 shares of the Company s common stock from Mr. Landon at a price of $52.19 per share, or an aggregate purchase price of $52.2 million.

NOTE 16 - SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly results for the years ended December 31, 2006 and 2005 follow (in thousands, except per share amounts):

	First		**Second**		**Third**		**Fourth**	
2006								
Revenue	$	847,271	$	914,660	$	878,196	$	821,193
Gross profit	$	214,041	$	220,618	$	178,008	$	99,963
Earnings before provision for income taxes	$	130,791	$	125,150	$	94,447	$	13,621
Net earnings	$	79,736	$	77,055	$	59,539	$	9,024
Per Share Data:								
Basic earnings per share	$	2.96	$	2.90	$	2.28	$	0.35
Diluted earnings per share	$	2.86	$	2.82	$	2.25	$	0.34
2005								
Revenue	$	551,168	$	653,571	$	755,450	$	1,040,913
Gross profit	$	119,334	$	153,165	$	178,068	$	256,423
Earnings before provision for income taxes	$	38,721	$	94,796	$	112,502	$	170,206
Net earnings	$	24,196	$	59,239	$	70,253	$	101,977
Per Share Data:								
Basic earnings per share	$	0.92	$	2.19	$	2.57	$	3.74
Diluted earnings per share	$	0.86	$	2.05	$	2.40	$	3.53

We typically experience seasonal variability in our quarterly oprating results and capital requirements. Historically, we sell more homes in the first half of the year, which results in more working capital requirements and home closings in the third and fourth quarters. However, in 2006, due to the softening market conditions in many of our markets, the fourth quarter had the lowest revenue and net income for the fiscal year.

In accordance with SFAS No. 144 and as further discussed in Note 1, in the fourth quarter of 2006 we recorded $15.6 million of inventory impairments and an additional $47.1 million of option deposit and pre-acquisition cost write-offs. These charges reduced gross profit and net income by $62.7 million and $41.5 million, respectively, during the fourth quarter of 2006. We had no such charges during 2005.

NOTE 17 SUBSEQUENT EVENT

On February 23, 2007, we completed the sale of an aggregate principal amount of $150 million of 7.73% senior subordinated notes due 2017 in a private placement. The notes were issued at par and resulted in net proceeds to us of $147.2 million, after deduction of fees, commmissions and expenses. We used the proceeds from the sale of these senior subordinated notes to paydown our revolving credit facility.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

As of the end of the period covered by this report, management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon, and as of the date of that evaluation, our CEO and CFO concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required. Further, our CEO and CFO concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in reports filed by us under the Exchange Act as amended, is accumulated and communicated to management, including the CEO and CFO, in a manner to allow timely decisions regarding the required disclosure.

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the foregoing evaluation that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2006. Our management s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by Deloitte & Touche LLP, the independent registered public accounting firm that audited the financial statements included in this report, as stated in their attestation report, which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Meritage Homes Corporation

We have audited management s assessment, included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting, that Meritage Homes Corporation and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2006 of the Company and our report dated February 26, 2007 expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph regarding the adoption of Financial Accounting Standard No. 123(R), *Share-Based Payments,* using the modified prospective method.

/s/ DELOITTE & TOUCHE LLP

Phoenix, Arizona

February 26, 2007

62

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Except as set forth herein, the information required by this item regarding our directors and compliance with Section 16 of the Exchange Act is incorporated by reference from the information contained in our 2007 Proxy Statement (which will be filed with the Securities and Exchange Commission no later than 120 days following the Company s fiscal year end). The information required by Item 10 regarding our executive officers appears under Item 4 of Part I of this Annual Report as permitted by General Instruction G(3).

The Company has adopted a code of ethics that applies to all directors, officers and employees of the Company, including our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer. A copy of our Code of Ethics has been filed as an exhibit hereto and is also available on our website at *www.meritagehomes.com*.

Item 11. Executive Compensation

Information required in response to this item is incorporated by reference to our definitive proxy statement, which will be filed with the SEC within 120 days following the Company s fiscal year end.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required in response to this item is incorporated by reference from our definitive proxy statement, which will be filed with the SEC within 120 days following the Company s fiscal year end.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information required in response to this item is incorporated by reference from our definitive proxy statement, which will be filed with the SEC within 120 days following the Company s fiscal year end.

Item 14. Principal Accountant Fees and Services

Information required in response to this item is incorporated by reference from our definitive proxy statement, which will be filed with the SEC within 120 days following the Company s fiscal year end.

Each year, the audit committee approves the annual audit engagement in advance. The committee has also established procedures to pre-approve all non-audit services provided by the principal independent accountants. All 2006 and 2005 non-audit services listed above were pre-approved.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Financial Statements and Schedules

(i) Financial Statements:

(1)	Report of Deloitte & Touche LLP
(3)	Consolidated Financial Statements and Notes to Consolidated Financial Statements of the Company, including Consolidated Balance Sheets as of December 31, 2006 and 2005 and related Consolidated Statements of Earnings, Stockholders Equity and Cash Flows for each of the years in the three-year period ended December 31, 2006

(ii) Financial Statement Schedules:

Schedules have been omitted because of the absence of conditions under which they are required or because the required information is included in the Consolidated Financial Statements or Notes thereto.

(b) Exhibits

Exhibit Number	Description	Page or Method of Filing
2.1	Agreement and Plan of Reorganization, dated as of September 13, 1996, by and among Homeplex, the Monterey Merging Companies and the Monterey Stockholders	Incorporated by reference to Appendix A of Form S-4 Registration Statement No. 333-15937.
3.1	Restated Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3 of Form 8-K dated June 20, 2002.
3.1.1	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.1 of Form 8-K dated September 15, 2004.
3.2	Amended and Restated Bylaws of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.3 of Form S-3 Registration Statement No. 333-58793.
4.1	Form of Specimen of Common Stock Certificate	Incorporated by reference to Exhibit 4.2 of Form S-3 Registration Statement No. 333-87398.
4.2	Indenture, dated May 30, 2001 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.1 of Form 8-K dated June 6, 2001.
4.2.1	First Supplemental Indenture, dated September 20, 2001 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.3.1 of Form 10-K for the year ended December 31, 2002.
4.2.2	Second Supplemental Indenture, dated July 12, 2002 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.3.2 of Form 10-K for the year ended December 31, 2002.
4.2.3	Third Supplemental Indenture, dated October 21, 2002 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.3.3 of Form 10-K for the year ended December 31, 2002.
4.2.4	Fourth Supplemental Indenture, dated February 19, 2003 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.3.4 of Form 10-K for the year ended December 31, 2002.
4.2.5	Fifth Supplemental Indenture, dated August 22, 2003 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.2.5 of Form S-4 Registration Statement No. 333-109933.

4.2.6	Sixth Supplemental Indenture, dated May 14, 2004 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.2.6 of Form S-4 Registration Statement 333-115610.
4.2.7	Seventh Supplemental Indenture, dated December 20, 2004 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.2.7 of Form 10-K for the year ended December 31, 2004.
4.2.8	Eighth Supplemental Indenture, dated March 10, 2005 (re 9¾% Senior Notes due 2011)	Incorporated by reference to Exhibit 4.2.8 of Form 10-K for the year ended December 31, 2004.
4.3	Indenture, dated April 21, 2004 (re 7% Senior Notes due 2014)	Incorporated by reference to Exhibit 4.1 of Form 10-Q for the quarterly period ended March 31, 2004.
4.3.1	First Supplemental Indenture, dated May 14, 2004 (re 7% Senior Notes due 2014)	Incorporated by reference to Exhibit 4.3.1 of Form S-4 Registration Statement No. 333-115610.
4.3.2	Second Supplemental Indenture, dated December 20, 2004 (re 7% Senior Notes due 2014)	Incorporated by reference to Exhibit 4.3.2 of Form 10-K for the year ended December 31, 2004.
4.3.3	Third Supplemental Indenture, dated April 18, 2005 (re 7% Senior Notes due 2014)	Incorporated by reference to Exhibit 4.3.3 of Form S-4 Registration Statement No. 333-123661.
4.3.4	Fourth Supplemental Indenture, dated September 22, 2005 (re 7% Senior Notes due 2014)	Incorporated by reference to Exhibit 4.1 of Form 10-Q for the quarterly period ended September 30, 2005.
4.4	Indenture dated March 10, 2005 (re 6¼% Senior Notes due 2015) and form of 6¼% Senior Notes due 2015	Incorporated by reference to Exhibit 4.4 of Form 10-K for the year ended December 31, 2004.
4.4.1	First Supplemental Indenture, dated April 18, 2005 (re 6¼% Senior Notes due 2015)	Incorporated by reference to Exhibit 4.1.1 of Form S-4 Registration Statement No. 333-123661.
4.4.2	Second Supplemental Indenture, dated September 22, 2005 (re 6¼% Senior Notes due 2015)	Incorporated by reference to Exhibit 4.2 of Form 10-Q for the quarterly period ended September 30, 2005.
10.1	Master Transaction Agreement, dated February 9, 2005, by and among the Company, Meritage Homes of Florida, Inc., Colonial Homes, Inc., Colonial Shores, LLC and The Colonial Company **	Incorporated by reference to Exhibit 10.1 of Form 8-K/A dated February 9, 2005.
10.2	Stock Purchase Agreement, dated August 24, 2005, by and among Meritage Homes of Florida, Inc. and the stockholders of Greater Homes, Inc. **	Incorporated by reference to Exhibit 10.3 of Form 10-Q for the quarterly period ended September 30, 2005.
10.2.1	First Amendment to Stock Purchase Agreement dated September 1, 2005, by and among Meritage Homes of Florida, Inc. and the stockholders of Greater Homes, Inc.	Incorporated by reference to Exhibit 10.4 of Form 10-Q for the quarterly period ended September 30, 2005.
10.3	Credit Agreement, dated May 16, 2006	Incorporated by reference to Exhibit 10.1 of Form 8-K dated May 16, 2006.
10.3.1	First Amendment and Commitment Increase Agreement, dated June 30, 2006	Incorporated by reference to Exhibit 10.1 of Form 8-K dated June 30, 2006.

10.4	2001 Annual Incentive Plan*	Incorporated by reference to Exhibit B of the Proxy Statement for the 2001 Annual Meeting of Stockholders.
10.5	2006 Annual Incentive Plan*	Incorporated by reference to Exhibit C of the Proxy Statement for the 2006 Annual Meeting of Stockholders
10.6	Amended 1997 Meritage Stock Option Plan *	Incorporated by reference to Exhibit 10.3 of Form 10-K for the year ended December 31, 2004.
10.6.1	Representative Form of Meritage Qualified Stock Option Agreement (1997 Plan) *	Incorporated by reference to Exhibit 10.2 of Form 10-Q for the quarter ended September 30, 2004.
10.6.2	Representative Form of Meritage Non-Qualified Stock Option Agreement (1997 Plan) *	Incorporated by reference to Exhibit 10.3 of Form 10-Q for the quarter ended September 30, 2004.
10.7	Meritage Homes Corporation 2006 Stock Incentive Plan*	Incorporated by reference to Exhibit 4.1 of Form S-8 Registration Statement No. 333-134637
10.7.1	Amendment to Meritage Homes Corporation 2006 Stock Incentive Plan*	Incorporated by reference to Exhibit 10.1 of Form 10-Q for the quarter ended September 30, 2006
10.7.2	Representative Form of Restricted Stock Agreement (2006 Plan)*	Incorporated by reference to Exhibit 4.2 of Form S-8 Registration Statement No. 333-134637
10.7.3	Representative Form of Non-Qualified Stock Option Agreement (2006 Plan)*	Incorporated by reference to Exhibit 4.3 of Form S-8 Registration Statement No. 333-134637
10.7.4	Representative Form of Incentive Stock Option Agreement (2006 Plan)*	Incorporated by reference to Exhibit 4.4 of Form S-8 Registration Statement No. 333-134637
10.7.5	Representative Form of Stock Appreciation Rights Agreement (2006 Plan)*	Incorporated by reference to Exhibit 4.5 of Form S-8 Registration Statement No. 333-134637
10.8	Representative Form of Employment Agreement between the Company and John R. Landon *	Incorporated by reference to Exhibit 10.1 of Form 8-K dated July 8, 2003.
10.8.1	Stock Purchase Agreement between the Company and John R. Landon, dated June 12, 2006*	Incorporated by reference to Exhibit 10.1 of Form 8-K dated June 12, 2006
10.8.2	Settlement Agreement between the Company and John R. Landon, dated June 12, 2006*	Incorporated by reference to Exhibit 10.2 of Form 8-K dated June 12, 2006
10.8.3	Cooperation Agreement between the Company and John R. Landon, dated June 12, 2006*	Incorporated by reference to Exhibit 10.3 of Form 8-K dated June 12, 2006
10.9	Second Amended and Restated Employment Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.1 of Form 8-K dated January 10, 2007
10.9.1	Second Amended and Restated Change of Control Agreement between the Company and Steven J. Hilton*	Incorporated by reference to Exhibit 10.3 of Form 8-K dated January 10, 2007
10.10	Second Amended and Restated Employment Agreement between Larry W. Seay*	Incorporated by reference to Exhibit 10.2 of Form 8-K dated January 10, 2007

10.10.1	Second Amended and Restated Change of Control Agreement between the Company and Larry W. Seay*	Incorporated by reference to Exhibit 10.4 of Form 8-K dated January 10, 2007
10.11	Employment Agreement between the Company and Sandra R.A. Karrmann*	Incorporated by reference to Exhibit 10.1 of Form 8-K dated September 26, 2006
10.11.1	Change of Control Agreement between the Company and Sandra R.A. Karrmann*	Incorporated by reference to Exhibit 10.2 of Form 8-K dated September 26, 2006
10.12	Employment Agreement between the Company and Steven Davis*	Incorporated by reference to Exhibit 10.1 of Form 8-K dated October 16, 2006
10.12.1	Change of Control Agreement between the Company and Steven Davis*	Incorporated by reference to Exhibit 10.2 of Form 8-K dated October 16, 2006
10.13	Employment Agreement between the Company and C. Timothy White *	Incorporated by reference to Exhibit 10.1 of Form 10-Q for the quarterly period ended September 30, 2005.
10.13.1	Change of Control Agreement between the Company and C. Timothy White *	Incorporated by reference to Exhibit 10.2 of Form 10-Q for the quarterly period ended September 30, 2005.
10.14	Deferred Bonus Agreement 2003 Award Year between the Company and Larry W. Seay *	Incorporated by reference to Exhibit 10.2 of Form 10-Q for the quarterly period dated March 31, 2004.
10.15	Deferred Bonus Agreement 2004 Award Year between the Company and Larry W. Seay *	Incorporated by reference to Exhibit 10.3 of Form 10-Q for the quarterly period ended March 31, 2005.
14	Code of Ethics	Incorporated by reference to Exhibit 14 of Form 10-K for the year ended December 31, 2005
21	List of Subsidiaries	Filed herewith.
23.1	Consent of Deloitte & Touche LLP	Filed herewith.
24	Powers of Attorney	See Signature Page.
31.1	Rule 13a-14(a)/15d-14(a) Certificate of Steven J. Hilton, Chief Executive Officer	Filed herewith.
31.2	Rule 13a-14(a)/15d-14(a) Certificate of Larry W. Seay, Chief Financial Officer	Filed herewith.
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer	Filed herewith.

* Indicates a management contract or compensation plan.

** Certain Confidential Information in this Exhibit was omitted by means of redacting a portion of the text and replacing it with an asterisk. This Exhibit has been filed separately with the Secretary of the Securities and Exchange Commission without the redaction pursuant to Confidential Treatment Request under Rule 24b-2 of the Securities Exchange Act of 1934.

67

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 on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, this 22nd day of February 2007.

MERITAGE HOMES CORPORATION,
a Maryland Corporation

By /s/ STEVEN J. HILTON
Steven J. Hilton
Chairman and Chief Executive Officer

By /s/ LARRY W. SEAY
Larry W. Seay
Executive Vice President and Chief Financial Officer

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steve J. Hilton and Larry W. Seay, and each of them, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Form 10-K Annual Report, and to file the same, with all exhibits thereto and other documents in connection therewith the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully and to all intents and purposes as he might or could do in person hereby ratifying and confirming all that said attorneys-in-fact and agents, or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to these requirements of the Securites Exhange Act of 1934, the following persons on behalf of the registrant and in the capacities and on the dates indicated have signed this report on Form 10-K below:

Signature	Title	Date
/s/ STEVEN J. HILTON Steven J. Hilton	Chairman and Chief Executive Officer	February 22, 2007
/s/ LARRY W. SEAY Larry W. Seay	Chief Financial Officer Executive Vice President (Principal Financial Officer)	February 22, 2007
/s/ VICKI L. BIGGS Vicki L. Biggs	Controller and Chief Accounting Officer (Principal Accounting Officer)	February 22, 2007
/s/ PETER L. AX Peter L. Ax	Director	February 22, 2007
/s/ RAYMOND OPPEL Raymond Oppel	Director	February 22, 2007
/s/ ROBERT G. SARVER Robert G. Sarver	Director	February 22, 2007
/s/ RICHARD T. BURKE, SR. Richard T. Burke, Sr.	Director	February 22, 2007
/s/ GERALD W. HADDOCK Gerald W. Haddock	Director	February 22, 2007