HOVNANIAN ENTERPRISES INC
Form 10-Q
March 04, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For quarterly period ended JANUARY 31, 2011
OR

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 1-8551

Hovnanian Enterprises, Inc. (Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)

22-1851059 (I.R.S. Employer Identification No.)

110 West Front Street, P.O. Box 500, Red Bank, NJ 07701 (Address of Principal Executive Offices)

732-747-7800 (Registrant's Telephone Number, Including Area Code)

N/A (Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer [ ] Accelerated Filer [X]
Non-Accelerated Filer [ ] (Do not check if smaller reporting company) Smaller Reporting Company [ ]

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 77,962,543 shares of Class A Common Stock and 14,562,064 shares of Class B Common Stock were outstanding as of March 1, 2011.

HOVNANIAN ENTERPRISES, INC.

FORM 10-Q

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands Except Share Amounts)

ASSETS	January 31, 2011 (Unaudited)	October 31, 2010 (1)
Homebuilding:		
Cash and cash equivalents	$311,032	$359,124
Restricted cash	105,579	108,983
Inventories:		
Sold and unsold homes and lots under development	652,742	591,729
Land and land options held for future development or sale	275,686	348,474
Consolidated inventory not owned:		
Specific performance options	15,626	21,065
Variable interest entities	-	32,710
Other options	4,120	7,962
Total consolidated inventory not owned	19,746	61,737
Total inventories	948,174	1,001,940
Investments in and advances to unconsolidated joint ventures	57,818	38,000
Receivables, deposits, and notes	51,224	61,023
Property, plant, and equipment – net	60,938	62,767
Prepaid expenses and other assets	85,333	83,928
Total homebuilding	1,620,098	1,715,765
Financial services:		
Cash and cash equivalents	5,344	8,056
Restricted cash	4,023	4,022
Mortgage loans held for sale	37,643	86,326
Other assets	2,975	3,391
Total financial services	49,985	101,795

Total assets	$1,670,083	$1,817,560

(1) Derived from the audited balance sheet as of October 31, 2010.

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands Except Share Amounts)

LIABILITIES AND EQUITY	January 31, 2011 (Unaudited)	October 31, 2010 (1)
Homebuilding:		
Nonrecourse land mortgages	$20,946	$4,313
Accounts payable and other liabilities	269,377	319,749
Customers' deposits	14,201	9,520
Nonrecourse mortgages secured by operating properties	20,435	20,657
Liabilities from inventory not owned	18,239	53,249
Total homebuilding	343,198	407,488
Financial services:		
Accounts payable and other liabilities	14,314	16,142
Mortgage warehouse line of credit	24,072	73,643
Total financial services	38,386	89,785
Notes payable:		
Senior secured notes	784,978	784,592
Senior notes	711,662	711,585
Senior subordinated notes	120,170	120,170
Accrued interest	32,953	23,968
Total notes payable	1,649,763	1,640,315
Income taxes payable	40,035	17,910
Total liabilities	2,071,382	2,155,498
Equity:		
Hovnanian Enterprises, Inc. stockholders' equity deficit:		
Preferred stock, $.01 par value - authorized 100,000 shares; issued 5,600 shares with a liquidation preference of $140,000 at January 31, 2011 and at October 31, 2010	135,299	135,299
Common stock, Class A, $.01 par value – authorized		

200,000,000 shares; issued 75,189,506 shares at January 31, 2011 and 74,809,683 shares at October 31, 2010 (including 11,694,720 shares at January 31, 2011 and October 31, 2010 held in Treasury)	752	748
Common stock, Class B, $.01 par value (convertible to Class A at time of sale) – authorized 30,000,000 shares; issued 15,255,969 shares at January 31, 2011 and 15,256,543 shares at October 31, 2010 (including 691,748 shares at January 31, 2011 and October 31, 2010 held in Treasury)	153	153
Paid in capital - common stock	464,579	463,908
Accumulated deficit	(887,561)	(823,419)
Treasury stock - at cost	(115,257)	(115,257)
Total Hovnanian Enterprises, Inc. stockholders' equity deficit	(402,035)	(338,568)
Noncontrolling interest in consolidated joint ventures	736	630
Total equity deficit	(401,299)	(337,938)
Total liabilities and equity	$1,670,083	$1,817,560

(1) Derived from the audited balance sheet as of October 31, 2010.

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands Except Per Share Data)
(Unaudited)

	Three Months Ended January 31,	
	2011	2010
Revenues:		
Homebuilding:		
Sale of homes	$235,885	$309,353
Land sales and other revenues	9,588	2,686
Total homebuilding	245,473	312,039
Financial services	7,094	7,606
Total revenues	252,567	319,645
Expenses:		
Homebuilding:		
Cost of sales, excluding interest	201,430	259,816
Cost of sales interest	15,626	19,848
Inventory impairment loss and land option write-offs	13,525	4,966
Total cost of sales	230,581	284,630
Selling, general and administrative	40,207	43,072
Total homebuilding expenses	270,788	327,702
Financial services	5,470	5,395
Corporate general and administrative	15,008	16,213
Other interest	23,985	25,607
Other operations	887	1,897
Total expenses	316,138	376,814
Gain on extinguishment of debt	-	2,574
Loss from unconsolidated joint ventures	(992)	(373)
Loss before income taxes	(64,563)	(54,968)
State and federal income tax (benefit) provision:		

State	665	171
Federal	(1,086)	(291,328)
Total income taxes	(421)	(291,157)
Net (loss) income	$(64,142)	$236,189
Per share data:		
Basic:		
(Loss) income per common share	$(0.82)	$3.01
Weighted-average number of common shares outstanding	78,598	78,553
Assuming dilution:		
(Loss) income per common share	$(0.82)	$2.97
Weighted-average number of common shares outstanding	78,598	79,536

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF EQUITY
(In Thousands Except Share Amounts)
(Unaudited)

	A Common Stock Shares Issued and Outstanding	A Common Stock Amount	B Common Stock Shares Issued and Outstanding	B Common Stock Amount	Preferred Stock Shares Issued and Outstanding	Preferred Stock Amount	Paid-In Capital	Accumulated Deficit	T
Balance, November 1, 2010	63,114,963	$748	14,564,795	$153	5,600	$135,299	$463,908	$(823,419)	$(
Stock options, amortization and issuances	379,249	4					1,311		
Restricted stock amortization, issuances and forfeitures							(640)		
Conversion of Class B to Class A Common Stock	574		(574)						
Changes in noncontrolling interest in consolidated joint ventures									
Net loss								(64,142)	
Balance, January 31, 2011	63,494,786	$752	14,564,221	$153	5,600	$135,299	$464,579	$(887,561)	$(

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Three Months Ended January 31, 2011	2010
Cash flows from operating activities:		
Net (loss) income	$(64,142)	$236,189
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation	2,319	3,386
Compensation from stock options and awards	1,940	2,364
Amortization of bond discounts and deferred financing costs	1,309	1,227
Gain on sale and retirement of property and assets	(293)	(119)
Loss from unconsolidated joint ventures	992	373
Distributions of earnings from unconsolidated joint ventures	525	1,697
Gain on extinguishment of debt	-	(2,574)
Inventory impairment and land option write-offs	13,525	4,966
Decrease in assets:		
Mortgage loans held for sale	48,683	22,976
Restricted cash, receivables, prepaids, deposits and other assets	11,077	10,881
Inventories	30,095	26,076
(Decrease) increase in liabilities:		
State and Federal income tax liabilities	22,125	(291,334)
Customers' deposits	4,681	(3,955)
Accounts payable, accrued interest and other accrued liabilities	(70,359)	(63,523)
Net cash provided by (used in) operating activities	2,477	(51,370)
Cash flows from investing activities:		
Proceeds from sale of property and assets	360	150
Purchase of property, equipment, and other fixed assets and acquisitions	(267)	(371)
Investments in and advances to unconsolidated joint ventures	(2,379)	(989)
Distributions of capital from unconsolidated joint ventures	698	816
Net cash used in investing activities	(1,588)	(394)
Cash flows from financing activities:		
(Payments) proceeds from mortgages and notes	(2,122)	3,450
Net payments related to mortgage warehouse lines of credit	(49,571)	(22,593)

Deferred financing cost from note issuances	-	(448)
Principal payments and debt repurchases	-	(22,273)
Net cash used in financing activities	(51,693)	(41,864)
Net decrease in cash and cash equivalents	(50,804)	(93,628)
Cash and cash equivalents balance, beginning of period	367,180	426,692
Cash and cash equivalents balance, end of period	$316,376	$333,064

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands - Unaudited)
(Continued)

	Three Months Ended January 31,	
	2011	2010
Supplemental disclosures of cash flow:		
Cash (received) paid during the period for:		
Income taxes	$(22,520)	$177

Supplemental disclosure of noncash financing activities:

In the first quarter of fiscal 2011, our partner in a land development joint venture transferred its interest in the venture to us. The consolidation resulted in increases in inventory and non-recourse land mortgages of $9.5 million and $18.5 million, respectively, and a decrease in other liabilities of $9.0 million.

See notes to Condensed Consolidated Financial Statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

Hovnanian Enterprises, Inc. and Subsidiaries (the "Company", "we", "us" or "our") has reportable segments consisting of six Homebuilding segments (Northeast, Mid-Atlantic, Midwest, Southeast, Southwest and West) and the Financial Services segment (see Note 15).

The accompanying unaudited Condensed Consolidated Financial Statements include our accounts and those of all wholly-owned subsidiaries after elimination of all significant intercompany balances and transactions. Certain immaterial prior year amounts have been reclassified to conform to the current year presentation.

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K/A for the year ended October 31, 2010. In the opinion of management, all adjustments for interim periods presented have been made, which include normal recurring accruals and deferrals necessary for a fair presentation of our consolidated financial position, results of operations, and cash flows. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and these differences could have a significant impact on the financial statements. Results for interim periods are not necessarily indicative of the results which might be expected for a full year. The balance sheet at October 31, 2010 has been derived from the audited Consolidated Financial Statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

2. For the three months ended January 31, 2011 and 2010, the Company's total stock-based compensation expense was $1.9 million and $2.4 million, respectively. Included in this total stock-based compensation expense was the vesting of stock options of $1.3 million for both the three months ended January 31, 2011 and 2010.

3. Interest costs incurred, expensed and capitalized were:

	Three Months Ended January 31,	
(In thousands)	2011	2010
Interest capitalized at beginning of period	$136,288	$164,340
Plus interest incurred(1)	37,827	40,141
Less cost of sales interest expensed	(15,626)	(19,848)
Less other interest expensed(2)(3)(4)	(23,985)	(25,607)
Interest capitalized at end of period(5)	$134,504	$159,026

(1) Data does not include interest incurred by our mortgage and finance subsidiaries.
(2) Our assets that qualify for interest capitalization (inventory under development) do not exceed our debt, and therefore, the portion of interest not covered by qualifying assets is expensed.
(3) Interest on completed homes and land in planning, which does not qualify for capitalization is expensed.

(4) Cash paid for interest, net of capitalized interest, is the sum of other interest expensed, as defined above, and interest paid by our mortgage and finance subsidiaries adjusted for the change in accrued interest, which is calculated as follows:

	Three Months Ended January 31,	
(In thousands)	2011	2010
Other interest expensed	$23,985	$25,607
Interest paid by our mortgage and finance subsidiaries	582	323
Increase in accrued interest	(8,985)	(6,757)
Cash paid for interest, net of capitalized interest	$15,582	$19,173

(5) We have incurred significant inventory impairments in recent years, which are determined based on total inventory including capitalized interest. However, the capitalized interest amounts above are shown gross before allocating any portion of the impairments to capitalized interest.

4. Accumulated depreciation at January 31, 2011 and October 31, 2010 amounted to $74.7 million and $73.0 million, respectively, for our homebuilding property, plant and equipment.

5. We record impairment losses on inventories related to communities under development and held for future development when events and circumstances indicate that they may be impaired and the undiscounted cash flows estimated to be generated by those assets are less than their related carrying amounts. If the expected undiscounted cash flows are less than the carrying amount, then the community is written down to its fair value. We estimate the fair value of each impaired community by determining the present value of the estimated future cash flows at a discount rate commensurate with the risk of the respective community. For the three months ended January 31, 2011, our discount rates used for the impairments recorded ranged from 18.0% to 19.8%. Should the estimates or expectations used in determining cash flows or fair value decrease or differ from current estimates in the future, we may need to recognize additional impairments. We recorded impairment losses, which are included in the Condensed Consolidated Statement of Operations line entitled "Homebuilding – inventory impairment loss and land option write-offs", and deducted from inventory, of $6.8 million and $3.3 million for the three months ended January 31, 2011 and 2010, respectively.

The following table represents inventory impairments by homebuilding segment for the three months ended January 31, 2011 and 2010:

(Dollars in millions)	Three Months Ended January 31, 2011			Three Months Ended January 31, 2010		
	Number of Communities	Dollar Amount of Impairment	Pre-Impairment Value(1)	Number of Communities	Dollar Amount of Impairment	Pre-Impairment Value(1)
Northeast	2	$5.4	$17.9	1	$2.6	$4.7
Mid-Atlantic	1	0.3	1.4	1	0.3	0.6
Midwest	-	-	-	-	-	-
Southeast	-	-	-	5	0.4	1.0
Southwest	-	-	-	-	-	-
West	1	1.1	5.5	-	-	-

Total	4	$6.8	$24.8	7	$3.3	$6.3

(1) Represents carrying value, net of prior period impairments, if any, at the time of recording the applicable period's impairments.

We also record losses for the write-offs of options, and approval, engineering and capitalized interest costs when we redesign communities and/or abandon certain engineering costs or we do not exercise options because the communities' pro forma profitability is not projected to produce adequate returns on investment commensurate with the risk. Total aggregate write-offs were $6.7 million and $1.7 million for the three months ended January 31, 2011 and 2010, respectively. Occasionally, these write-offs are offset by recovered deposits (sometimes through legal action) that had been written off in a prior period as walk-away costs. These recoveries have not been significant in comparison to the total cost written off.

The following table represents write-offs of such costs (after giving effect to any recovered deposits in the applicable period) and the number of lots walked away from by homebuilding segment for the three months ended January 31, 2011 and 2010:

	Three Months Ended January 31,			
	2011		2010	
(Dollars in millions)	Number of Walk-Away Lots	Dollar Amount of Write-Offs	Number of Walk-Away Lots	Dollar Amount of Write-Offs
Northeast	989	$3.1	259	$1.6
Mid-Atlantic	252	0.4	11	-
Midwest	132	-	-	(0.1)
Southeast	983	0.2	-	0.1
Southwest	68	-	-	0.1
West	143	3.0	-	-
Total	2,567	$6.7	270	$1.7

We have decided to mothball (or stop development on) certain communities where we have determined the current market conditions do not justify further investment at this time. When we decide to mothball a community, the inventory is reclassified from "Sold and unsold homes and lots under development" to "Land and land options held for future development or sale". During the first quarter of fiscal 2011, we did not mothball any communities but re-activated three previously mothballed communities and sold two previously mothballed communities. As of January 31, 2011, the net book value associated with our 53 total mothballed communities was $167.1 million, net of impairment charges of $542.8 million.

6. We establish a warranty accrual for repair costs under $5,000 per occurrence to homes, community amenities, and land development infrastructure. We accrue for warranty costs as part of cost of sales at the time each home is closed and title and possession have been transferred to the homebuyer. In addition, we accrue for warranty costs over $5,000 per occurrence as part of our general liability insurance deductible, which is expensed as selling, general, and administrative costs. For homes delivered in fiscal 2011 and 2010, our deductible under our general liability insurance is $20 million per occurrence for construction defect and warranty claims. For bodily injury claims, our deductible per occurrence in 2011 and 2010 is $0.1 million up to a $5 million limit. Our aggregate retention in 2011 is $21 million for construction defect, warranty and bodily injury claims. Our aggregate retention in 2010 was $21 million for construction defect and warranty claims, and $20 million for bodily injury claims. Additions and charges in the warranty reserve and general liability reserve for the three months ended January 31, 2011 and 2010 are as follows:

	Three Months Ended January 31,	
(In thousands)	2011	2010
Balance, beginning of period	$125,268	$127,869
Additions	7,488	9,902
Charges incurred	(9,567)	(7,227)
Balance, end of period	$123,189	$130,544

Warranty accruals are based upon historical experience. We engage a third-party actuary that uses our historical warranty data and other industry data to assist us to estimate our reserves for unpaid claims, claim adjustment expenses and incurred but not reported claims reserves for the risks that we are assuming under the general liability and workers compensation programs. The estimates include provisions for inflation, claims handling, and legal fees.

Insurance claims paid by our insurance carriers were $11.4 million and $5.3 million for the three months ended January 31, 2011 and 2010, respectively, for prior year deliveries.

7. We are involved in litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on our financial position or results of operations, and we are subject to extensive and complex regulations that affect the development and home building, sales and customer financing processes, including zoning, density, building standards and mortgage financing. These regulations often provide broad discretion to the administering governmental authorities. This can delay or increase the cost of development or homebuilding.

We also are subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment. The particular environmental laws that apply to any given community vary greatly according to the community site, the site's environmental conditions and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation and/or other costs, and can prohibit or severely restrict development and homebuilding activity.

We have been notified by the New York State Department of Environmental Conservation that it is seeking a civil penalty from us in connection with notices of violation for allegedly failing to comply with a storm water permit at an incomplete project in the state of New York; and the New Jersey Department of Environmental Protection has contacted us regarding violations it asserts occurred when one of our contractors demolished a structure in New Jersey prior to obtaining a storm water permit. Although we do not know the final outcomes, we believe any penalties and any other impacts of these two matters will not have a material adverse effect on us.

We anticipate that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot predict the effect of these requirements, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules, and regulations and their interpretations and application.

The Company is also involved in the following litigation:

A subsidiary of the Company has been named as a defendant in a purported class action suit filed on May 30, 2007 in the United States District Court for the Middle District of Florida, Randolph Sewell, et al., v. D'Allesandro & Woodyard, et al., alleging violations of the federal securities acts, among other allegations, in connection with the sale of some of the subsidiary's homes in Fort Myers, Florida. Plaintiffs filed an amended complaint on October 19, 2007. Plaintiffs sought to represent a class of certain home purchasers in southwestern Florida and sought damages, rescission of certain purchase agreements, restitution of out-of-pocket expenses, and attorneys' fees and costs. The Company's subsidiary filed a motion to dismiss the amended complaint on December 14, 2007. Following oral argument on the motion in September 2008, the court dismissed the amended complaint with leave for plaintiffs to amend. Plaintiffs filed a second amended complaint on October 31, 2008. The Company's subsidiary filed a motion to dismiss this second amended complaint. The Court dismissed portions of the second amended complaint. The Court dismissed additional portions of the second amended complaint on April 28, 2010. We have had negotiations with the plaintiffs recently to settle this case. Based on these negotiations we have accrued an immaterial amount for the potential settlement based on our assessment of the outcome. However, our assessment of the potential outcome may differ from the ultimate resolution of this matter.

8. Cash and cash equivalents include cash deposited in checking accounts, overnight repurchase agreements, certificates of deposit, Treasury Bills and government money market funds with maturities of 90 days or less when purchased. Our cash balances are held at a few financial institutions and may, at times, exceed insurable amounts. We believe we help to mitigate this risk by depositing our cash in major financial institutions. At January 31, 2011, $287.7 million of the total cash and cash equivalents was in cash equivalents, the book value of which approximates fair value.

9. In connection with the issuance of our senior secured first lien notes in the fourth quarter of fiscal 2009, we terminated our revolving credit facility and refinanced the borrowing capacity thereunder. Also in connection with the refinancing, we entered into certain stand alone cash collateralized letter of credit agreements and facilities under which there were a total of $86.3 million and $89.5 million of letters of credit outstanding as of January 31, 2011 and October 31, 2010, respectively. These agreements and facilities require us to maintain specified amounts of cash as collateral in segregated accounts to support the letters of credit issued thereunder, which will affect the amount of cash we have available for other uses. As of January 31, 2011 and October 31, 2010, the amount of cash collateral in these segregated accounts was $88.3 million and $92.3 million, respectively, which is reflected in "Restricted cash" on the Condensed Consolidated Balance Sheets.

Our wholly owned mortgage banking subsidiary, K. Hovnanian American Mortgage, LLC ("K. Hovnanian Mortgage"), originates mortgage loans primarily from the sale of our homes. Such mortgage loans and related servicing rights are sold in the secondary mortgage market within a short period of time. Our secured Master Repurchase Agreement with Citibank, N.A. ("Citibank Master Repurchase Agreement") is a short-term borrowing facility that provides up to $50 million through April 5, 2011. The loan is secured by the mortgages held for sale and is repaid when we sell the underlying mortgage loans to permanent investors. Interest is payable upon the sale of each mortgage loan to a permanent investor at LIBOR plus 4.00%. We believe that we will be able to extend the Citibank Master Repurchase Agreement beyond its expiration date, but there can be no assurance of such extension. As of January 31, 2011, the aggregate principal amount of all borrowings under the Citibank Master Repurchase Agreement was $18.8 million.

In addition to the Citibank Master Repurchase Agreement discussed above, K. Hovnanian Mortgage has a secured Master Repurchase Agreement with JPMorgan Chase Bank, N.A. ("Chase Master Repurchase Agreement") which is a short-term borrowing facility that provides up to $25 million through July 18, 2011. The loan is secured by the mortgages held for sale and is repaid when we sell the underlying mortgage loans to permanent investors. Interest is payable monthly on outstanding advances at LIBOR floor of 2.00% plus applicable margin ranging from 2.50% to 3.00% based on the takeout investor and type of loan. We believe that we will be able to extend the Chase Master Repurchase Agreement beyond its expiration date, but there can be no assurance of such extension. As of January 31, 2011, the aggregate principal amount of all borrowings under the Chase Master Repurchase Agreement was $5.3 million.

Both the Citibank Master Repurchase Agreement and the Chase Master Repurchase Agreement require K. Hovnanian Mortgage to satisfy and maintain specified financial ratios and other financial condition tests. Because of the extremely short period of time mortgages are held by K. Hovnanian Mortgage before the mortgages are sold to investors (generally a period of a few weeks), the immateriality to us on a consolidated basis of the size of the facilities, the levels required by these financial covenants, our ability based on our immediately available resources to contribute sufficient capital to cure any default, were such conditions to occur, and our right to cure any conditions of default based on the terms of the two agreements, we do not consider any of these covenants to be substantive or material. As of January 31, 2011, we believe we were in compliance with the covenants of the Citibank Master Repurchase Agreement and the Chase Master Repurchase Agreement.

10. At January 31, 2011, we had $797.2 million ($785.0 million net of discount) of outstanding senior secured notes, comprised of $0.5 million 11 1/2% Senior Secured Notes due 2013, $785.0 million 10 5/8% Senior Secured Notes due 2016 and $11.7 million 18% Senior Secured Notes due 2017. At January 31, 2011, we also had $713.2 million of outstanding senior notes ($711.7 million net of discount), comprised of $35.5 million 8% Senior Notes due 2012, $54.4 million 6 1/2% Senior Notes due 2014, $29.2 million 6 3/8% Senior Notes due 2014, $52.7 million 6 1/4% Senior Notes due 2015, $173.2 million 6 1/4% Senior Notes due 2016, $172.3 million 7 1/2% Senior Notes due 2016 and $195.9 million 8 5/8% Senior Notes due 2017. In addition, we had $120.2 million of outstanding senior subordinated notes, comprised of $66.7 million 8 7/8% Senior Subordinated Notes due 2012, and $53.5 million 7 3/4% Senior Subordinated Notes due 2013. During February 2011, we issued new senior notes and tangible equity units as well as repurchased certain senior and senior subordinated notes in tender offers for such notes. We also called for redemption all of such notes not tendered in the tender offers. See Note 21 for more detail on these transactions.

We and each of our subsidiaries are guarantors of the senior secured, senior and senior subordinated notes, except for K. Hovnanian Enterprises, Inc. ("K. Hovnanian"), the issuer of the notes, our home mortgage subsidiaries, joint ventures and subsidiaries holding interests in our joint ventures, certain of our title insurance subsidiaries and our foreign subsidiary (see Note 20). The indentures governing the senior secured, senior and senior subordinated notes do not contain any financial maintenance covenants, but do contain restrictive covenants that limit, among other things, the Company's ability and that of certain of its subsidiaries, including K. Hovnanian, the issuer of the senior secured, senior and senior subordinated notes, to incur additional indebtedness (other than certain permitted indebtedness, refinancing indebtedness and non-recourse indebtedness), pay dividends and make distributions on common and preferred stock, repurchase senior and senior subordinated notes (with respect to the senior secured first-lien notes indenture), make other restricted payments, make investments, sell certain assets, incur liens, consolidate, merge, sell or otherwise dispose of all or substantially all assets and enter into certain transactions with affiliates. The indentures also contain events of default which would permit the holders of the senior secured, senior, and senior subordinated notes to declare those notes to be immediately due and payable if not cured within applicable grace periods, including the failure to make timely payments on the notes or other material indebtedness, the failure to comply with agreements and covenants and specified events of bankruptcy, and insolvency and, with respect to the indentures governing the senior secured notes, the failure of the documents granting security for the senior secured notes to be in full force and effect and the failure of the liens on any material portion of the collateral securing the senior secured notes to be valid and perfected. As of January 31, 2011, we believe we were in compliance with the covenants of the indentures governing our outstanding notes.

Under the terms of the indentures, we have the right to make certain redemptions and, depending on market conditions and covenant restrictions, may do so from time to time. We also continue to evaluate our capital structure and may also continue to make debt purchases and/or exchanges from time to time through tender offers, open market purchases, private transactions, or otherwise or seek to raise additional debt or equity capital, depending on market conditions and covenant restrictions.

If our consolidated fixed charge coverage ratio, as defined in the indentures governing our senior secured, senior, and senior subordinated notes, is less than 2.0 to 1.0, we are restricted from making certain payments, including dividends, and from incurring indebtedness other than certain permitted indebtedness, refinancing indebtedness, and non-recourse indebtedness. As a result of this restriction, we are currently restricted from paying dividends, which are not cumulative, on our 7.625% Series A Preferred Stock. If current market trends continue or worsen, we will continue to be restricted from paying dividends for the foreseeable future. Our inability to pay dividends is in accordance with covenant restrictions and will not result in a default under our bond indentures or otherwise affect compliance with any of the covenants contained in the bond indentures.

The 10 5/8% Senior Secured Notes due 2016 are secured by a first-priority lien, the 11 1/2% Senior Secured Notes due 2013 are secured by a second-priority lien and the 18% Senior Secured Notes due 2017 are secured by a third-priority lien, in each case, subject to permitted liens and other exceptions, on substantially all the assets owned by us, K. Hovnanian (the issuer of the senior secured notes) and the guarantors, in the case of the 11 1/2% Senior Secured Notes due 2013 and the 18% Senior Secured Notes due 2017, to the extent such assets secure obligations under the 10 5/8% Senior Secured Notes due 2016. At January 31, 2011, the aggregate book value of the real property collateral securing these notes was approximately $757.5 million, which does not include the impact of inventory investments, home deliveries, or impairments thereafter and which may differ from the appraised value. In addition, cash collateral securing these notes was $273.3 million as of January 31, 2011, which includes $88.3 million of restricted cash also collateralizing certain letters of credit. Subsequent to such date, cash uses include general business operations and real estate and other investments.

11. Each share of Class A Common Stock entitles its holder to one vote per share and each share of Class B Common Stock entitles its holder to ten votes per share. The amount of any regular cash dividend payable on a share of Class A Common Stock will be an amount equal to 110% of the corresponding regular cash dividend payable on a share of Class B Common Stock. If a shareholder desires to sell shares of Class B Common Stock, such stock must be converted into shares of Class A Common Stock.

Basic earnings per share is computed by dividing net income or (loss) (the “numerator”) by the weighted-average number of common shares, adjusted for non-vested shares of restricted stock (the “denominator”) for the period. Computing diluted earnings per share is similar to computing basic earnings per share, except that the denominator is increased to include the dilutive effects of options and non-vested shares of restricted stock. Any options that have an exercise price greater than the average market price are considered to be anti-dilutive and are excluded from the diluted earnings per share calculation. For the three months ended January 31, 2011, 0.6 million incremental shares attributed to non-vested stock and outstanding options to purchase common stock were excluded from the computation of diluted EPS because we had a net loss for the period, and any incremental shares would not be dilutive. In addition, shares related to out-of-the money stock options that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS were 4.6 million for the three months ended January 31, 2011, because to do so would have been anti-dilutive for the period presented. For the three months ended January 31, 2010, diluted earnings per common share was computed using the weighted average number of shares outstanding adjusted for the 0.6 million incremental shares attributed to non-vested stock and outstanding options to purchase common stock, but excluded 3.5 million shares related to out-of-the money stock options that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS.

On July 3, 2001, our Board of Directors authorized a stock repurchase program to purchase up to 4 million shares of Class A Common Stock. There have been no purchases during the three months ended January 31, 2011. As of January 31, 2011, 3.4 million shares of Class A Common Stock have been purchased under this program.

During February 2011, we issued an aggregate of 13,512,500 shares of Class A Common Stock. See Note 21 for more detail on this transaction.

12. On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of $25,000. Dividends on the Series A Preferred Stock are not cumulative and are payable at an annual rate of 7.625%. The Series A Preferred Stock is not convertible into the Company’s common stock and is redeemable in whole or in part at our option at the liquidation preference of the shares beginning on the fifth anniversary of their issuance. The Series A Preferred Stock is traded as depositary shares, with each depositary share representing 1/1000th of a share of Series A Preferred Stock. The depositary shares are listed on the NASDAQ Global Market under the symbol “HOVNP”. During the three months ended January 31, 2011 and 2010, we did not make any dividend

payments on the Series A Preferred Stock as a result of covenant restrictions in the indentures governing our senior secured, senior and senior subordinated notes discussed above. We anticipate we will be restricted from paying dividends for the foreseeable future.

13. On August 4, 2008, we announced that our Board of Directors adopted a shareholder rights plan (the "Rights Plan") designed to preserve shareholder value and the value of certain income tax assets primarily associated with net operating loss carryforwards ("NOL") and built-in losses under Section 382 of the Internal Revenue Code. Our ability to use NOLs and built-in losses would be limited if there was an "ownership change" under Section 382. This would occur if shareholders owning (or deemed under Section 382 to own) 5% or more of our stock increase their collective ownership of the aggregate amount of our outstanding shares by more than 50 percentage points over a defined period of time. The Rights Plan was adopted to reduce the likelihood of an "ownership change" occurring as defined by Section 382. Under the Rights Plan, one right was distributed for each share of Class A Common Stock and Class B Common Stock outstanding as of the close of business on August 15, 2008. Effective August 15, 2008, if any person or group acquires 4.9% or more of the outstanding shares of Class A Common Stock without the approval of the Board of Directors, there would be a triggering event causing significant dilution in the voting power of such person or group. However, existing stockholders who owned, at the time of the Rights Plan's adoption, 4.9% or more of the outstanding shares of Class A Common Stock will trigger a dilutive event only if they acquire additional shares. The approval of the Board of Directors' decision to adopt the Rights Plan may be terminated by the Board at any time, prior to the Rights being triggered. The Rights Plan will continue in effect until August 15, 2018, unless it expires earlier in accordance with its terms. The approval of the Board of Directors' decision to adopt the Rights Plan was submitted to a stockholder vote and approved at a Special Meeting of stockholders held on December 5, 2008. Also at the Special Meeting on December 5, 2008, our stockholders approved an amendment to our Certificate of Incorporation to restrict certain transfers of our stock in order to preserve the tax treatment of our net operating loss carryforwards and built-in losses under Section 382 of the Internal Revenue Code. Subject to certain exceptions pertaining to pre-existing 5% stockholders and Class B stockholders, the transfer restrictions in the amended Certificate of Incorporation generally restrict any direct or indirect transfer (such as transfers of our stock that result from the transfer of interests in other entities that own our stock) if the effect would be to: (i) increase the direct or indirect ownership of our stock by any person (or public group) from less than 5% to 5% or more of our stock; (ii) increase the percentage of our stock owned directly or indirectly by a person (or public group) owning or deemed to own 5% or more of our common stock; or (iii) create a new "public group" (as defined in the applicable Treasury Regulations).

14. On November 6, 2009, President Obama signed the Worker, Homeownership, and Business Assistance Act of 2009, under which the Company was able to carryback its 2009 net operating loss to previously profitable years that were not available for carryback prior to the new tax legislation. We recorded the impact of the carryback of $291.3 million in the three months ended January 31, 2010. We received $274.1 million in the second quarter of fiscal 2010 and the remaining $17.2 million in the three months ended January 31, 2011.

Deferred federal and state income tax assets primarily represent the deferred tax benefits arising from temporary differences between book and tax income which will be recognized in future years as an offset against future taxable income. If the combination of future years' income (or loss) and the reversal of the timing differences results in a loss, such losses can be carried forward to future years to recover the deferred tax assets. In accordance with ASC 740, we evaluate our deferred tax assets quarterly to determine if valuation allowances are required. ASC 740 requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence using a "more likely than not" standard. Given the continued downturn in the homebuilding industry during 2009, 2010 and the first quarter of 2011, resulting in additional inventory and intangible impairments, we are in a three-year cumulative loss position as of January 31, 2011. According to ASC 740, a three-year cumulative loss is significant negative evidence in considering whether deferred tax assets are realizable. Our valuation allowance for current and deferred taxes amounted to $833.0 million and $811.0 million at January 31, 2011 and October 31, 2010, respectively. The valuation allowance increased during the three months ended January 31, 2011 primarily due to additional reserves recorded for the federal tax benefits related to the losses incurred during the period.

15. Our operating segments are components of our business for which discrete financial information is available and reviewed regularly by the chief operating decision-maker, our Chief Executive Officer, to evaluate performance and make operating decisions. Based on this criteria, each of our communities qualifies as an operating segment, and therefore, it is impractical to provide segment disclosures for this many segments. As such, we have aggregated the homebuilding operating segments into six reportable segments.

Our homebuilding operating segments are aggregated into reportable segments based primarily upon geographic proximity, similar regulatory environments, land acquisition characteristics and similar methods used to construct and sell homes. The Company's reportable segments consist of the following six homebuilding segments and a financial services segment:

Homebuilding:
(1) Northeast (New Jersey, New York, and Pennsylvania)
(2) Mid-Atlantic (Delaware, Maryland, Virginia, West Virginia, and Washington D.C.)
(3) Midwest (Illinois, Kentucky, Minnesota, and Ohio)
(4) Southeast (Florida, Georgia, North Carolina, and South Carolina)
(5) Southwest (Arizona and Texas)
(6) West (California)

Financial Services

Operations of the Company's Homebuilding segments primarily include the sale and construction of single-family attached and detached homes, attached townhomes and condominiums, mid-rise condominiums, urban infill and active adult homes in planned residential developments. In addition, from time to time, operations of the homebuilding segments include sales of land. Operations of the Company's Financial Services segment include mortgage banking and title services provided to the homebuilding operations' customers. We do not retain or service mortgages that we originate but rather sell the mortgages and related servicing rights to investors.

Corporate and unallocated primarily represents operations at our headquarters in Red Bank, New Jersey. This includes our executive offices, information services, human resources, corporate accounting, training, treasury, process redesign, internal audit, construction services, and administration of insurance, quality, and safety. It also includes interest income and interest expense resulting from interest incurred that cannot be capitalized in inventory in the Homebuilding segments, as well as the gains or losses on extinguishment of debt from debt repurchases or exchanges.

Evaluation of segment performance is based primarily on operating earnings from continuing operations before provision for income taxes ("(Loss) income before income taxes"). (Loss) income before income taxes for the Homebuilding segments consists of revenues generated from the sales of homes and land, (loss) income from unconsolidated entities, management fees and other income, less the cost of homes and land sold, selling, general and administrative expenses, interest expense and non-controlling interest expense. Income before income taxes for the Financial Services segment consists of revenues generated from mortgage financing, title insurance and closing services, less the cost of such services and certain selling, general and administrative expenses and interest expenses incurred by the Financial Services segment.

Operational results of each segment are not necessarily indicative of the results that would have occurred had the segment been an independent stand-alone entity during the periods presented.

Financial information relating to the Company's segment operations was as follows:

	Three Months Ended January 31,	
(In thousands)	2011	2010
Revenues:		
Northeast	$45,341	$69,461
Mid-Atlantic	46,422	67,023
Midwest	14,090	23,432
Southeast	15,521	24,785
Southwest	91,393	82,548
West	32,749	44,479
Total homebuilding	245,516	311,728
Financial services	7,094	7,606
Corporate and unallocated	(43)	311
Total revenues	$252,567	$319,645
(Loss) income before income taxes:		
Northeast	$(14,638)	$(10,221)
Mid-Atlantic	(3,159)	599
Midwest	(1,926)	(2,240)
Southeast	(3,020)	(2,188)
Southwest	5,403	3,891
West	(8,614)	(5,873)
Homebuilding loss before income taxes	(25,954)	(16,032)
Financial services	1,624	2,211
Corporate and unallocated	(40,233)	(41,147)
Loss before income taxes	$(64,563)	$(54,968)

(In thousands)	January 31, 2011	October 31, 2010
Assets:		
Northeast	$435,562	$456,544
Mid-Atlantic	198,242	177,503
Midwest	48,183	47,818
Southeast	67,232	58,765
Southwest	185,949	206,001
West	158,116	195,808
Total homebuilding	1,093,284	1,142,439
Financial services	49,985	101,795
Corporate and unallocated	526,814	573,326
Total assets	$1,670,083	$1,817,560

16. The Company enters into land and lot option purchase contracts to procure land or lots for the construction of homes. Under these contracts, the Company will fund a stated deposit in consideration for the right, but not the obligation, to purchase land or lots at a future point in time with predetermined terms. Under the terms of the option purchase contracts, many of the option deposits are not refundable at the Company's discretion.

Certain option purchase contracts result in the creation of a variable interest in the entity that owns the land parcel under option. In June 2009, the FASB revised its guidance regarding the determination of a primary beneficiary of a variable interest entity. The revisions were effective for the Company as of November 1, 2010 and amend the existing quantitative guidance used in determining the primary beneficiary of a variable interest entity by requiring entities to qualitatively assess whether an enterprise is a primary beneficiary, based on whether the entity has (i) power to direct the significant activities of the entity and (ii) an obligation to absorb losses or the right to receive benefits that could be potentially significant to the entity. The revised guidance also increased the required disclosures about a reporting entity's involvement with variable interest entities. The Company has determined it did not have the power to direct the activities that most significantly impact such entities' economic performance, therefore, all of the variable interest entities that were previously reported as consolidated inventory not owned on the Company's balance sheets were deconsolidated which reduced, as of November 1, 2010, Consolidated inventory not owned and Liabilities from inventory not owned by $32.7 million.

We will continue to secure land and lots using options, some of which are with variable interest entities. Including deposits on our unconsolidated variable interest entities, at January 31, 2011, we had total cash and letters of credit deposits amounting to approximately $28.4 million to purchase land and lots with a total purchase price of $717.4 million. The maximum exposure to loss with respect to our land and lot options is limited to the deposits, although some deposits are refundable at our request or refundable if certain conditions are not met.

17. We enter into homebuilding and land development joint ventures from time to time as a means of accessing lot positions, expanding our market opportunities, establishing strategic alliances, managing our risk profile, leveraging our capital base and enhancing returns on capital. Our homebuilding joint ventures are generally entered into with third-party investors to develop land and construct homes that are sold directly to third-party homebuyers. Our land development joint ventures include those entered into with developers and other homebuilders as well as financial investors to develop finished lots for sale to the joint venture’s members or other third parties.

During the three months ended January 31, 2011, we entered into a joint venture agreement to acquire a portfolio of homebuilding projects, including land we previously owned in the consolidated group. We sold the land we owned to the joint venture for net proceeds of $36.1 million, which was equal to our basis in the land at that time, and recorded an investment in unconsolidated joint ventures of $19.7 million for our interest in the venture. Separately, during the three months ended January 31, 2011, our partner in a land development joint venture transferred its interest in the venture to us. The consolidation resulted in increases in inventory and non-recourse land mortgages of $9.5 million and $18.5 million, respectively, and a decrease in other liabilities of $9.0 million.

The tables set forth below summarize the combined financial information related to our unconsolidated homebuilding and land development joint ventures that are accounted for under the equity method.

(Dollars in thousands)		January 31, 2011	
	Homebuilding	Land Development	Total
Assets:			
Cash and cash equivalents	$21,646	$324	$21,970
Inventories	306,308	15,790	322,098
Other assets	20,317	643	20,960
Total assets	$348,271	$16,757	$365,028
Liabilities and equity:			
Accounts payable and accrued liabilities	$14,190	$12,455	$26,645
Notes payable	200,107	21	200,128
Total liabilities	214,297	12,476	226,773
Equity of:			
Hovnanian Enterprises, Inc.	48,950	2,147	51,097
Others	85,024	2,134	87,158
Total equity	133,974	4,281	138,255
Total liabilities and equity	$348,271	$16,757	$365,028
Debt to capitalization ratio	60%	0%	59%

(Dollars in thousands)		October 31, 2010	
	Homebuilding	Land Development	Total
Assets:			
Cash and cash equivalents	$17,538	$161	$17,699
Inventories	247,790	73,864	321,654
Other assets	20,321		20,321
Total assets	$285,649	$74,025	$359,674
Liabilities and equity:			
Accounts payable and accrued liabilities	$19,076	$17,266	$36,342
Notes payable	159,715	36,791	196,506
Total liabilities	178,791	54,057	232,848
Equity of:			
Hovnanian Enterprises, Inc.	29,208	2,510	31,718
Others	77,650	17,458	95,108
Total equity	106,858	19,968	126,826
Total liabilities and equity	$285,649	$74,025	$359,674
Debt to capitalization ratio	60%	65%	61%

As of January 31, 2011 and October 31, 2010, we had advances outstanding of approximately $13.9 million and $13.5 million, respectively, to these unconsolidated joint ventures, which were included in the "Accounts payable and accrued liabilities" balances in the table above. On our Condensed Consolidated Balance Sheets our "Investments in and advances to unconsolidated joint ventures" amounted to $57.8 million and $38.0 million at January 31, 2011 and October 31, 2010, respectively. In some cases, our net investment in these joint ventures is less than our proportionate share of the equity reflected in the table above because of the differences between asset impairments recorded against our joint venture investments and any impairments recorded in the applicable joint venture. During the first three months of fiscal 2011, we did not write down any joint venture investments based on our determination that none of the investments in our joint ventures sustained an other than temporary impairment during that period.

	For the Three Months Ended January 31, 2011		
(In thousands)	Homebuilding	Land Development	Total
Revenues	$23,031	$4,894	$27,925
Cost of sales and expenses	(24,905)	(4,739)	(29,644)
Joint venture net (loss) income	$(1,874)	$155	$(1,719)
Our share of net (loss) income	$(1,002)	$143	$(859)

	For the Three Months Ended January 31, 2010		
In thousands)	Homebuilding	Land Development	Total
Revenues	$21,711	$6,271	$27,982
Cost of sales and expenses	(21,294)	(3,124)	(24,418)
Joint venture net income	$417	$3,147	$3,564
Our share of net income (loss)	$9	$(441)	$(432)

Loss from unconsolidated joint ventures is reflected as a separate line in the accompanying Condensed Consolidated Statements of Operations and reflects our proportionate share of the loss of these unconsolidated homebuilding and land development joint ventures. The difference between our share of the loss from these unconsolidated joint ventures disclosed in the tables above for the three months ended January 31, 2011 and January 31, 2010 compared to the Condensed Consolidated Statements of Operations is due primarily to one joint venture that had net income for which we do not get any share of the profit because of the cumulative equity position of the joint venture, the reclassification of the intercompany portion of management fee income from certain joint ventures and the deferral of income for lots purchased by us from certain joint ventures. Our ownership interests in the joint ventures vary but are generally 50% or less. In determining whether or not we must consolidate joint ventures where we are the manager of the joint venture, we assess whether the other partners have specific rights to overcome the presumption of control by us as the manager of the joint venture. In most cases, the presumption is overcome because the joint venture agreements require that both partners agree on establishing the operating and capital decisions of the partnership, including budgets in the ordinary course of business.

Typically, our unconsolidated joint ventures obtain separate project specific mortgage financing, however, most of our more recently established joint ventures have not obtained any financing, therefore the capital is all equity for these joint ventures. Generally, the amount of such financing is targeted to be no more than 50% of the joint venture's total assets. However, because of impairments realized in the joint ventures the average debt to capitalization ratio of all our joint ventures is currently 59%. Financing is on a nonrecourse basis, with guarantees from us limited only to performance and completion of development, environmental indemnification, standard warranty and representation against fraud, misrepresentation and other similar actions, including a voluntary bankruptcy filing. In some instances, the joint venture entity is considered a variable interest entity under ASC 810-10 "Consolidation – Overall" due to the returns being capped to the equity holders; however, in these instances, we are not the primary beneficiary, and therefore we do not consolidate these entities.

18. Recent Accounting Pronouncements - In January 2010, the FASB issued ASU 2010-06, "Improving Disclosures about Fair Value Measurements," which requires additional disclosures about transfers between Levels 1 and 2 of the fair value hierarchy and disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. This guidance was effective for the Company in our second quarter of fiscal 2010, except for the Level 3 activity disclosures, which are effective for us in fiscal 2012. The adoption of this guidance, which is related to disclosure only, did not (with respect to Levels 1 and 2) and will not (with respect to Level 3 activity) have a material impact on our consolidated financial statements.

19. ASC 820, "Fair Value Measurements and Disclosures" ("ASC 820"), provides a framework for measuring fair value, expands disclosures about fair-value measurements and establishes a fair-value hierarchy which prioritizes the inputs used in measuring fair value summarized as follows:

Level 1	Fair value determined based on quoted prices in active markets for identical assets.
Level 2	Fair value determined using significant other observable inputs.
Level 3	Fair value determined using significant unobservable inputs.

Our financial instruments measured at fair value on a recurring basis are summarized below:

(In thousands)	Fair Value Hierarchy	Fair Value at January 31, 2011	Fair Value at October 31, 2010
Mortgage loans held for sale (1)	Level 2	$36,378	$85,358
Interest rate lock commitments	Level 2	11	79
Forward contracts	Level 2	(212)	(254)
		$36,177	$85,183

(1) The aggregate unpaid principal balance was $36.1 million and $84.1 million at January 31, 2011 and October 31, 2010, respectively.

We elected the fair value option for our loans held for sale for mortgage loans originated subsequent to October 31, 2008 in accordance with ASC 825, "Financial Instruments" ("ASC 825"), which permits us to measure financial instruments at fair value on a contract-by-contract basis. Management believes that the election of the fair value option for loans held for sale improves financial reporting by mitigating volatility in reported earnings caused by measuring the fair value of the loans and the derivative instruments used to economically hedge them without having to apply complex hedge accounting provisions. In addition, the fair value of servicing rights is included in the Company's loans held for sale as of January 31, 2011. Fair value of the servicing rights is determined based on values in the Company's servicing sales contracts. Fair value of loans held for sale is based on independent quoted market prices, where available, or the prices for other mortgage whole loans with similar characteristics.

For the financial instruments measured at fair value, gains and losses from initial measurement and subsequent changes in fair value are recognized in the Financial Services segment's earnings (loss). The changes in fair values that are included in earnings (loss) are shown, by financial instrument and financial statement line item, below:

	Three Months Ended January 31, 2011
(In thousands)	Loans Held

	For Sale	Interest Rate Lock Commitments	Forward Contracts
Changes in fair value included in net earnings (loss), all reflected in financial services revenues	$(967)	$(69)	$41

	Three Months Ended January 31, 2010		
(In thousands)	Loans Held For Sale	Interest Rate Lock Commitments	Forward Contracts
Changes in fair value included in net earnings (loss), all reflected in financial services revenues	$(473)	$6	$116

The Company's assets measured at fair value on a nonrecurring basis are those assets for which the Company has recorded valuation adjustments and write-offs during the three months ended January 31, 2011. The assets measured at fair value on a nonrecurring basis are all within the Company's Homebuilding operations and are summarized below:

Non-financial Assets

	Three Months Ended January 31, 2011			
(In thousands)	Fair Value Hierarchy	Pre-Impairment Amount	Total Losses	Fair Value
Sold and unsold homes and lots under development	Level 3	$12,132	$(2,204)	$9,928
Land and land options held for future development or sale	Level 3			