HOVNANIAN ENTERPRISES INC
Form 10-Q
March 12, 2007
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, 2007 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	22-1851059
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

110 West Front Street, P.O. Box 500, Red Bank, NJ 07701

(Address of Principal Executive Offices) (Zip Code)

732-747-7800

(Registrant's Telephone Number, Including Area Code)

Same (Former Name, Former Address and Former Fiscal Year, if Changed

Since Last Report)

Indicate by check mark whether the registrant: (l) has filed all reports required to be filed by Section l3 or l5(d) of the Securities Exchange Act of l934 during the preceding l2 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes

[X] No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer [X] Accelerated Filer [ ]
Non-Accelerated Filer [ ]

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. 47,330,587 shares of Class A Common Stock and 14,650,193 shares of Class B Common Stock were outstanding as of March 5, 2007.

HOVNANIAN ENTERPRISES, INC.

FORM 10-Q

INDEX

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share Amounts)

	January 31, 2007	October 31, 2006
ASSETS	(unaudited)	
Homebuilding:		
Cash and cash equivalents	$1,005	$43,635
Restricted cash	7,993	9,479
Inventories - at the lower of cost or fair value:		
Sold and unsold homes and lots under development	3,316,833	3,297,766
Land and land options held for future development or sale	379,843	362,760
Consolidated inventory not owned:		
Specific performance options	15,068	20,340
Variable interest entities	200,911	208,167
Other options	221,038	181,808
Total consolidated inventory not owned	437,017	410,315
Total inventories	4,133,693	4,070,841
Investments in and advances to unconsolidated joint ventures	206,180	212,581
Receivables, deposits, and notes	86,398	94,750
Property, plant, and equipment net	109,176	110,704
Prepaid expenses and other assets	182,329	175,603
Goodwill	32,658	32,658
Definite life intangibles	78,427	165,053
Total homebuilding	4,837,859	4,915,304
Financial services:		
Cash and cash equivalents	8,313	10,688
Restricted cash	8,550	1,585
Mortgage loans held for sale	166,409	281,958
Other assets	5,538	10,686
Total financial services	188,810	304,917
Income taxes receivable including deferred tax benefits	274,179	259,814
Total assets	$5,300,848	$5,480,035

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share Amounts)

	January 31, 2007 (unaudited)	October 31, 2006
LIABILITIES AND STOCKHOLDERS EQUITY		
Homebuilding:		
Nonrecourse land mortgages	$35,732	$26,088
Accounts payable and other liabilities	413,669	582,393
Customers deposits	142,528	184,943
Nonrecourse mortgages secured by operating Properties	23,514	23,684
Liabilities from inventory not owned	214,546	205,067
Total homebuilding	829,989	1,022,175
Financial services:		
Accounts payable and other liabilities	16,090	12,158
Mortgage warehouse line of credit	153,408	270,171
Total financial services	169,498	282,329
Notes payable:		
Revolving credit agreement	225,700	
Senior notes	1,650,053	1,649,778
Senior subordinated notes	400,000	400,000
Accrued interest	27,382	51,105
Total notes payable	2,303,135	2,100,883
Total liabilities	3,302,622	3,405,387
Minority interest from inventory not owned	116,772	130,221
Minority interest from consolidated joint ventures	1,633	2,264
Stockholders equity:		
Preferred stock, $.01 par value-authorized 100,000 shares; issued 5,600 shares at January 31, 2007 and at October 31, 2006 with a liquidation preference of $140,000	135,299	135,299
Common stock, Class A, $.01 par value-authorized 200,000,000 shares; issued 58,872,396 shares at January 31, 2007 and 58,653,723 shares at October 31, 2006 (including 11,694,720 shares at January 31, 2007 and 11,494,720 shares at October 31, 2006 held in Treasury)	589	587
Common stock, Class B, $.01 par value (convertible to Class A at time of sale) authorized 30,000,000 shares; issued 15,343,272 shares at January 31, 2007 and 15,343,410 shares at October 31, 2006 (including 691,748 shares at January 31, 2007 and October 31, 2006 held in Treasury)	153	153
Paid in capital common stock	254,504	253,262
Retained earnings	1,604,533	1,661,810
Treasury stock - at cost	(115,257)	(108,948)

Total stockholders equity	1,879,821	1,942,163
Total liabilities and stockholders equity	$5,300,848	$5,480,035

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, 2007	2006
Revenues:		
Homebuilding:		
Sale of homes	$1,135,916	$1,246,197
Land sales and other revenues	8,337	12,533
Total homebuilding	1,144,253	1,258,730
Financial services	21,548	19,262
Total revenues	1,165,801	1,277,992
Expenses:		
Homebuilding:		
Cost of sales, excluding interest	933,975	934,687
Cost of sales interest	26,872	16,569
Inventory impairment loss and land option write-offs	41,474	3,109
Total cost of sales	1,002,321	954,365
Selling, general and administrative	132,142	135,234
Total homebuilding	1,134,463	1,089,599
Financial services	13,070	13,530
Corporate general and administrative	22,633	27,722
Other interest	1,220	820
Other operations	1,453	7,001
Intangible amortization	61,556	11,669
Total expenses	1,234,395	1,150,341
Income from unconsolidated joint ventures	1,965	7,575
(Loss) income before income taxes	(66,629)	135,226
State and federal income tax (benefit)/provision:		
State	(2,346)	4,874
Federal	(9,675)	46,256

Total taxes	(12,021)	51,130
Net (loss) income	(54,608)	84,096
Less: preferred stock dividends	2,669	2,669
Net (loss) income available to common stockholders	$(57,277)	$81,427
Per share data:		
Basic:		
(Loss) income per common share	$(0.91)	$1.30
Weighted average number of common shares outstanding	62,904	62,810
Assuming dilution:		
(Loss) income per common share	$(0.91)	$1.25
Weighted average number of common shares outstanding	62,904	65,403

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(In Thousands Except Share Amounts)

(Unaudited)

	A Common Stock		B Common Stock		Preferred Stock		Paid-In			
	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount	Capital	Retained Earnings	Treasury Stock	Total
Balance, October 31, 2006	47,159,003	$587	14,651,662	$153	5,600	$135,299	$253,262	$1,661,810	$(108,948)	$1,942,163
Preferred dividend declared ($476.56 per share)								(2,669)		(2,669)
Stock options amortization										
and issuances, net of tax	46,037						3,677			3,677
Restricted stock										
amortization, issuances and										
forfeitures, net of tax	172,498	2					(2,435)			(2,433)
Conversion of Class B to										
Class A common stock	138		(138)							-
Treasury stock purchases	(200,000)								(6,309)	(6,309)
Net (loss)								(54,608)		(54,608)
Balance, January 31, 2007	47,177,676	$589	14,651,524	$153	5,600	$135,299	$254,504	$1,604,533	$(115,257)	$1,879,821

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, 2007	2006
Cash flows from operating activities:		
Net (loss) income	$(54,608)	$84,096
Adjustments to reconcile net (loss)/income to net cash used in operating activities:		
Depreciation	4,384	3,086
Intangible amortization	61,556	11,669
Compensation from stock options and awards	6,418	7,867
Amortization of bond discounts	275	251
Excess tax benefits from share-based payment	(255)	(3,443)
Loss (gain) on sale and retirement of property and assets	(76)	74
Income from unconsolidated joint ventures	(1,965)	(7,575)
Distributions from unconsolidated joint ventures	1,284	2,915
Deferred income taxes	(18,383)	(30,701)
Impairment and land option deposit write-offs	41,474	3,109
Decrease (increase) in assets:		
Mortgage notes receivable	115,557	58,854
Restricted cash, receivables, prepaids and other assets	29,040	58,726
Inventories	(70,560)	(446,247)
(Decrease) increase in liabilities:		
State and Federal income taxes	4,018	11,974
Customers deposits	(36,832)	(10,303)
Interest and other accrued liabilities	(179,270)	(24,275)
Accounts payable	(39,968)	(19,522)
Net cash used in operating activities	(137,911)	(299,445)
Cash flows from investing activities:		
Net proceeds from sale of property and assets	243	89
Purchase of property, equipment and other fixed assets and acquisitions	(24,475)	(9,147)
Investments in and advances to unconsolidated joint ventures	(6,711)	(7,080)
Distributions from unconsolidated joint ventures	13,811	2,711
Net cash used in investing activities	(17,132)	(13,427)
Cash flows from financing activities:		
Proceeds from mortgages and notes	18,798	18,246
Net proceeds (payments) related to revolving credit agreement	225,700	226,250
Net proceeds (payments) related to mortgage warehouse line of credit	(29,000)	(61,107)
Payments of issuance costs		(90)
Principal payments on mortgages and notes	(96,953)	(30,828)
Excess tax benefits from share-based payment	255	3,443
Preferred dividends paid	(2,669)	(2,669)
Purchase of treasury stock	(6,309)	(7,301)
Proceeds from sale of stock and employee stock plan	216	1,544
Net cash provided by financing activities	110,038	147,488

Net (decrease) in cash	(45,005)	(165,384)
Cash and cash equivalents balance, beginning of period	54,323	211,273
Cash and cash equivalents balance, end of period	$9,318	$45,889

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands - Unaudited)

(Continued)

	Three Months Ended January 31, 2007	2006
Supplemental disclosures of cash flow:		
Cash paid during the period for:		
Interest	$53,918	$26,642
Income taxes	$1,941	$38,885
Supplemental disclosures of noncash operating activities:		
Consolidated inventory not owned:		
Specific performance options	$13,846	$8,075
Variable interest entities	181,216	227,983
Other options	219,473	137,834
Total inventory not owned	$414,535	$373,892

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments for interim periods presented have been made, which include only normal recurring accruals and deferrals necessary for a fair presentation of our consolidated financial position, results of operations, and changes in cash flows. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. For the three months ended January 31, 2007 and 2006, the Company s total stock-based compensation expense was $6.4 million ($5.3 million net of tax) and $7.9 million ($4.9 million net of tax), respectively. Included in this total stock-based compensation expense was expense for stock options of $3.3 million ($2.7 million net of tax) and $3.3 million ($2.1 million net of tax) for the three months ended January 31, 2007 and 2006, respectively.

3. Interest costs incurred, expensed and capitalized were:

	Three Months Ended January 31,	
	2007	2006
	(Dollars in Thousands)	
Interest capitalized at Beginning of period(1)	$102,849	$48,366
Plus interest incurred(2)	45,297	30,804
Less cost of sales interest Expensed(3)	26,872	16,569
Less other interest expensed	1,220	820
Interest capitalized at end of period	$120,054	$61,781

(1) Beginning balance for 2006 does not include interest incurred of $2.3 million which is capitalized in property, plant, and equipment.

(2) Data does not include interest incurred by our mortgage and finance subsidiaries.

(3) Represents interest on borrowings for construction, land and development costs, which are charged to interest expense when homes are delivered.

4. Accumulated depreciation at January 31, 2007 and October 31, 2006 amounted to $47.5 million and $43.7 million, respectively, for our homebuilding assets.

5. In accordance with Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment of or Disposal of Long Lived Assets , we record impairment losses on inventories related to communities under 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 carrying amounts. For the three months ended January 31, 2007 and 2006, these amounts were $46.5 million and $1.6 million, respectively. Of the fiscal 2007 amount, $41.9 million of inventory impairments were for our Fort Myers Cape Coral (Fort

Myers) operations in the Southeast, as a result of a continued decline in sales pace and general market conditions, as well as increased cancellation rates during the quarter. The remaining inventory impairments recorded during the quarter were $1.4 million in the Northeast and $3.2 million in the Midwest. In addition, from time to time, we will write off certain residential land options including approval and engineering costs for land we decided not to purchase at the earlier of the option expiration or the decision to terminate. We wrote off such costs in the amount of $3.0 million and $1.5 million during the three months ended January 31, 2007 and 2006, respectively. The write-offs of $3 million in the first quarter of fiscal 2007 were offset by $8 million in recovered deposits that had been written off in the prior year as walk-away costs. In certain instances where we walked away from option contracts in the fourth quarter of fiscal 2006, we took legal action to recover our deposits. In two of these cases we were successful and received a portion of our deposit back in the first quarter of fiscal 2007. Residential inventory impairment losses and option write-offs are reported in the Condensed Consolidated Statements of Income as Homebuilding-inventory impairment loss and land option write-offs .

6. We provide a warranty accrual for repair costs over $1,000, not covered by our general liability insurance, 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 under our general liability insurance deductible as part of selling, general and administrative costs. For fiscal 2007, our deductible is $20 million per occurrence with an aggregate $20 million for premise liability claims and an aggregate $21.5 million for construction defect claims under our general liability insurance. Additions and charges incurred in the warranty accrual and general liability accrual for the three months ended January 31, 2007 and 2006 are as follows:

	Three Months Ended January 31,	
	2007	2006
Balance, beginning of period	$93,516	$86,706
Additions	8,427	7,264
Charges incurred	(10,272)	(6,339)
Balance, end of period	$91,671	$87,631

Warranty accruals are based upon historical experience. We engage a third party actuary that uses our historical warranty data to estimate our 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 $0.8 million and $3.5 million for the three months ended January 31, 2007 and 2006, 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 which 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 in certain environmentally sensitive regions or areas.

In March 2005, we received two requests for information pursuant to Section 308 of the Clean Water Act from Region 3 of the Environmental Protection Agency (the "EPA"). These requests sought information concerning storm water discharge practices in connection with completed, ongoing and planned homebuilding projects by subsidiaries in the states and district that comprise EPA Region 3. We also received a notice of violations for one project in Pennsylvania and requests for sampling plan implementation in two projects in Pennsylvania. The amount requested by the EPA to settle the asserted violations at the one project was less than $100,000. We provided the EPA with information in response to its requests. We have since been advised by the Department of Justice ("DOJ") that it will be involved in the review of our storm water discharge practices. We cannot predict the outcome of the review of these practices or estimate the costs that may be involved in resolving the matter. To the extent that the EPA or the DOJ asserts violations of regulatory requirements and requests injunctive relief or penalties, we will defend and attempt to resolve such asserted violations.

In addition, in November 2005, we received two notices from the California Regional Water Quality Control Board alleging violations in Riverside County, California and El Dorado County, California of certain storm water discharge rules. The Riverside County notice assessed an administrative civil liability of $236,895 and in March 2006, we agreed to make a donation of $118,447 to the County of Riverside, California and paid a fine of $118,448 to the State of California. In October 2006, we agreed to pay a fine of $300,000 to the County of El Dorado, California and have tentatively agreed to a pay a fine of $300,000 to the State of California with respect to the El Dorado notice.

It can be anticipated 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.

Our sales and customer financing processes are subject to the jurisdiction of the U. S. Department of Housing and Urban Development ("HUD"). In connection with the Real Estate Settlement Procedures Act, HUD has inquired about our process of referring business to our affiliated mortgage company and has separately requested documents related to customer financing. We have responded to HUD's inquiries. In connection with these inquiries, the Inspector General of HUD has recommended to the Secretary of HUD that we indemnify HUD for any losses that it may sustain in connection with nine loans that it alleges were improperly underwritten. We cannot predict the outcome of HUD's inquiry or estimate the costs that may be involved in resolving the matter. We do not expect the ultimate cost to be material.

On September 26, 2006, a stockholder derivative action was filed in the Superior Court of New Jersey, Monmouth County, against certain of our current and former officers and directors, captioned as *Michael Crady v. Ara K. Hovnanian et al.*, Civil Action No. L-4380-06. The complaint alleges, among other things, breach of fiduciary duty in connection with certain of our historical stock option grants. An amended complaint, containing similar allegations, was filed on January 11, 2007. The amended complaint seeks an award of damages, disgorgement of certain stock options and any proceeds of certain stock options, equitable relief and an award of fees and expenses. The parties have agreed to extend the time we have to respond to the amended complaint. We have engaged counsel with respect to the claims.

8. As of January 31, 2007 and October 31, 2006, respectively, we are obligated under various performance letters of credit amounting to $421.4 million and $453.4 million.

9. Our amended and restated unsecured Revolving Credit Agreement ("Agreement") with a group of lenders provides a revolving credit line and letter of credit line of $1.5 billion through May 2011. The facility contains an accordion feature under which the aggregate commitment can be increased to $2.0 billion subject to the availability of additional commitments. Loans under the Agreement bear interest at various rates based on (1) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus $^1/_2$% or (2) a margin ranging from 0.65% to 1.50% per annum, depending on our Leverage Ratio, as defined in the Agreement, and our debt ratings plus a LIBOR-based rate for a one, two, three, or six month interest period as selected by us. In addition, we pay a fee ranging from 0.15% to 0.25% per annum on the unused portion of the revolving credit line depending on our Leverage Ratio and our debt ratings and the average percentage unused portion of the revolving credit line. As of January 31, 2007 and October 31, 2006, the outstanding balance under the

Agreement was $225.7

million and zero, excluding letters of credit of $179.3 million and $329.8 million, respectively. We currently are in compliance and intend to maintain compliance with the covenants under the Agreement.

On October 11, 2006, (a) we, K. Hovnanian Enterprises, Inc. ("K. Hovnanian") and certain of our subsidiaries as guarantors entered into a Credit Agreement (the "Credit Agreement") with Citicorp USA, Inc., as administrative agent and issuing bank, the lenders from time to time party thereto, and The Bank of New York, as paying agent, and (b) K. Hovnanian entered into an Agreement for Letter of Credit (the "LC Agreement") with Citibank, N.A ("Citibank"). Under the Credit Agreement, K. Hovnanian has the right to borrow and to obtain the issuance, renewal, extension and increase of a letter of credit (the "Security Letter of Credit") up to an aggregate availability of $125 million. On November 14, 2006, per the accordion feature provided for in the Credit Agreement, the aggregate commitments under the Credit Agreement were increased to $250 million. The Security Letter of Credit will serve as security for any letters of credit that may be issued under the LC Agreement. Under the LC Agreement, K. Hovnanian may request Citibank to issue letters of credit up to the aggregate maximum amount of the Security Letter of Credit. Loans under the Credit Agreement will bear interest at various rates based on (1) an alternate base rate determined by reference to the higher of (a) Citibank's base rate and (b) the federal funds rate plus $^{1}/_{2}$% or (2) a LIBOR-based rate for a one day, one or two week, or one, two, three or six month interest period as selected by K. Hovnanian.

The Credit Agreement has covenants that restrict Hovnanian and certain of its subsidiaries', including K. Hovnanian's, ability to grant liens and enter into consolidations, mergers and transfers of all or substantially all of their respective assets. The Credit Agreement contains events of default which would permit the lenders to accelerate the loans if not cured within applicable grace periods, including the failure to make timely payments under the Credit Agreement or other material indebtedness, the failure to satisfy covenants and specified events of bankruptcy and insolvency. Borrowings under the Credit Agreement may be used for general corporate purposes. As of January 31, 2007 and October 31, 2006, the outstanding balance under the Credit Agreement was zero, excluding letters of credit of $242.1 million and $123.6 million, respectively. As of January 31, 2007, we were in compliance with our loan covenants.

Our amended secured mortgage loan warehouse agreement with a group of banks, which is a short-term borrowing facility, provides up to $200 million through November 9, 2007. Interest is payable monthly at the LIBOR Rate plus 1.0%. The loan is repaid when we sell the underlying mortgage loans to permanent investors. We also have a commercial paper facility which was amended on September 29, 2006. Pursuant to the amended agreement, the commercial paper facility amount increased from $100 million to $150 million. The facility expires on April 20, 2007 and interest is payable monthly at the LIBOR Rate plus 0.40%. We believe that we will be able to extend this facility beyond April 2007 or negotiate a replacement facility, but there can be no assurance of such extension or replacement facility. As of January 31, 2007 and October 31, 2006, borrowings under both agreements were $153.4 million and $270.2 million, respectively.

10. At January 31, 2007, we had $1,655.3 million of outstanding senior notes ($1,650.1 million, net of discount), comprised of $140.3 million 10 1/2% Senior Notes due 2007, $100 million 8% Senior Notes due 2012, $215 million 6 1/2% Senior Notes due 2014, $150 million 6 3/8% Senior Notes due 2014, $200 million 6 1/4% Senior Notes due 2015, $300 million 6 1/4% Senior Notes due 2016, $300 million 7 1/2% Senior Notes due 2016, and $250 million 8 5/8% Senior Notes due 2017. At January 31, 2007, we had $400.0 million of outstanding senior subordinated notes, comprised of $150 million 8 7/8% Senior Subordinated Notes due 2012, $150 million 7 3/4% Senior Subordinated Notes due 2013, and $100 million 6% Senior Subordinated Notes due 2010.

Under the terms of the indentures governing our debt securities, we have the right to make certain redemptions and depending on market conditions, may do so from time to time.

11. Per Share Calculations - Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to non-vested stock and outstanding options to purchase common stock, of 2.6 million for the three months ended January 31, 2006. For the three months ended January 31, 2007 there were no incremental shares attributed to non-vested stock and outstanding options to purchase

common stock because we had a net loss for the period, and any incremental shares would be anti-dilutive.

12. On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of $25,000 per share for net proceeds of $135 million. Dividends on the Series A Preferred Stock are not cumulative and are paid 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 . The net proceeds from the offering, reflected in Preferred Stock in the Condensed Consolidated Balance Sheets, were used for the partial repayment of the outstanding balance under our revolving credit facility as of July 12, 2005. In January 2007 and 2006, we paid $2.7 million of dividends on the Series A Preferred Stock.

13. Operating and Reporting Segments - SFAS 131, *Disclosures About Segments of an Enterprise and Related Information* ("SFAS 131") defines operating segments as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. The Company has identified its chief operating decision-maker as the Chief Executive Officer. Under the definition, we have more than 70 homebuilding operating segments, and therefore, in accordance with paragraph 24 of SFAS 131, it is impractical to provide segment disclosures for this many segments. As such, we have aggregated the homebuilding operating segments into six reportable segments.

The Company s operating segments are aggregated into reportable segments in accordance with SFAS 131, 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:

Homebuilding:
(1) Northeast (New Jersey, New York, Pennsylvania)
(2) Mid-Atlantic (Delaware, Maryland, Virginia, West Virginia, Washington D.C.)
(3) Midwest (Illinois, Kentucky, Michigan, Minnesota, Ohio)
(4) Southeast (Florida, Georgia, North Carolina, South Carolina)
(5) Southwest (Arizona, 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 and high-rise condominiums, urban infill and active adult homes in planned residential developments. Operations of the Company s Financial Services segment include mortgage banking and title services 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.

Evaluation of segment performance is based primarily on operating earnings from continuing operations before provision for income taxes. Operating earnings for the Homebuilding segments consist of revenues generated from the sales of homes and land, equity in earnings from unconsolidated entities and management fees and other income, net, less the cost of homes and land sold, selling, general and administrative expenses and minority interest expense, net. Operating earnings for the Financial Services segment consist of revenues generated from mortgage banking and title services, less the cost of such services and certain selling, general and administrative 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 operations was as follows:

	Three Months Ended January 31,	
(In thousands)	2007	2006
Revenues:		
Northeast	$214,094	$206,960
Mid-Atlantic	223,742	198,282
Midwest	38,824	27,522
Southeast	219,937	270,045
Southwest	177,012	183,854
West	270,515	369,865
Total homebuilding revenues	1,144,124	1,256,528
Financial services	21,548	19,262
Corporate and unallocated	129	2,202
Total revenues	$1,165,801	$1,277,992
(Loss)/income before income taxes:		
Northeast	$16,460	$35,658
Mid-Atlantic	26,297	36,577
Midwest	(10,532)	(5,343)
Southeast	(87,759)	23,031
Southwest	6,669	13,473
West	(677)	51,354
Homebuilding (loss)/income before income taxes	(49,542)	154,750
Financial services	8,478	5,732
Corporate and unallocated	(25,565)	(25,256)
(Loss)/income before income taxes	$(66,629)	$135,226

	January 31, 2007	October 31, 2006
(In thousands)		
Assets		
Northeast	$1,222,897	$1,164,801
Mid-Atlantic	699,997	726,777
Midwest	167,919	177,362
Southeast	531,371	647,374
Southwest	607,288	596,391
West	1,410,828	1,399,412
Total homebuilding assets	4,640,300	4,712,117
Financial services	188,810	304,917
Corporate and unallocated	471,738	463,001
Total assets	$5,300,848	$5,480,035

14. Variable Interest Entities - In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). A Variable Interest Entity

(VIE) is created when (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 or (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 if they occur. If an entity is deemed to be a VIE pursuant to FIN 46, an enterprise that absorbs a majority of the expected losses of the VIE is considered the primary beneficiary and must consolidate the VIE.

Based on the provisions of FIN 46, we have concluded that whenever we option land or lots from an entity and pay a non-refundable deposit, a VIE is created under condition (ii) (b) and (c) of the previous paragraph. 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 theoretical losses if they occur. For each VIE created with a significant nonrefundable option fee (we currently define significant as greater than $100,000 because we have determined that in the aggregate the VIEs related to deposits of this size or less are not material), we compute expected losses and residual returns based on the probability of future cash flows as outlined in FIN 46. If we are deemed to be the primary beneficiary of the VIE, we consolidate it on our balance sheet. The fair value of the VIE s inventory is reported as Consolidated inventory not owned variable interest entities .

Typically, the determining factor in whether or not we are the primary beneficiary is the deposit amount as a percentage of the total purchase price, because it determines the amount of the first risk of loss we take on the contract. The higher this percentage deposit, the more likely we are to be the primary beneficiary. Other important criteria that impact the outcome of the analysis, are the probability of getting the property through the approval process for residential homes, because this impacts the ultimate value of the property, as well as who is the responsible party (seller or buyer) for funding the approval process and development work that will take place prior to the decision to exercise the option.

Management believes FIN 46 was not clearly thought out for application in the homebuilding industry for land and lot options. Under FIN 46, we can have an option and put down a small deposit as a percentage of the purchase price and still have to consolidate the entity. Our exposure to loss as a result of our involvement with the VIE is only the deposit, not its total assets consolidated on our balance sheet. In certain cases, we will have to place inventory the VIE has optioned to other developers on our balance sheet. In addition, if the VIE has creditors, its debt will be placed on our balance sheet even though the creditors have no recourse against us. Based on these observations, we believe consolidating VIEs based on land and lot option deposits does not reflect the economic realities or risks of owning and developing land.

At January 31, 2007, all 31 VIEs we were required to consolidate were the result of our options to purchase land or lots from the selling entities. We paid cash or issued letters of credit deposits to these VIEs totaling $29.7 million. Our option deposits represent our maximum exposure to loss. The fair value of the property owned by these VIEs was $200.9 million. Since we do not own an equity interest in any of the unaffiliated variable interest entities that we must consolidate pursuant to FIN 46, we generally have little or no control or influence over the operations of these entities or their owners. When our requests for financial information are denied by the land sellers, certain assumptions about the assets and liabilities of such entities are required. In most cases, we determine the fair value of the assets of the consolidated entities based on the remaining contractual purchase price of the land or lots we are purchasing. In these cases, it is assumed that the entities have no debt obligations and the only asset recorded is the land or lots we have the option to buy with a related offset to minority interest for the assumed third party investment in the variable interest equity. At January 31, 2007, the balance reported in minority interest from inventory not owned was $116.8 million. Creditors of these VIEs have no recourse against us.

We will continue to control land and lots using options. Not all of our deposits are with VIEs. Including the deposits with the 31 VIEs described above, at January 31, 2007, we have total cash and letters of credit deposits amounting to approximately $338.0 million to purchase land and lots with a total purchase price of $3.5 billion. The maximum exposure to loss is limited to the deposits, although some deposits are refundable at our request or refundable if certain conditions are not met.

15. Investments in Unconsolidated Homebuilding and Land Development Joint Ventures - 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, other homebuilders, and financial investors to develop finished lots for sale to the joint venture s members or other third parties. 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.

		January 31, 2007	
	Homebuilding	Land Development	Total
Assets:			
Cash and cash equivalents	$23,278	$6,857	$30,135
Inventories	703,180	208,371	911,551
Other assets	85,564	4,540	90,104
Total assets	$812,022	$219,768	$1,031,790
Liabilities and equity:			
Accounts payable and accrued liabilities	$93,179	$18,306	$111,485
Notes payable	322,432	42,483	364,915
Equity of:			
Hovnanian Enterprises, Inc.	93,180	95,571	188,751
Others	303,231	63,408	366,639
Total equity	396,411	158,979	555,390
Total liabilities and equity	$812,022	$219,768	$1,031,790
Debt to capitalization ratio	45%	21%	40%

		October 31, 2006	
	Homebuilding	Land Development	Total
Assets:			
Cash and cash equivalents	$58,632	$7,436	$66,068
Inventories	691,942	215,803	907,745
Other assets	86,826	3,990	90,816
Total assets	$837,400	$227,229	$1,064,629
Liabilities and equity:			
Accounts payable and accrued liabilities	$117,658	$22,415	$140,073
Notes payable	342,068	47,126	389,194
Equity of:			
Hovnanian Enterprises, Inc.	88,486	95,163	183,649
Others	289,188	62,525	351,713
Total equity	377,674	157,688	535,362
Total liabilities and equity	$837,400	$227,229	$1,064,629
Debt to capitalization ratio	48%	23%	42%

As of January 31, 2007 and October 31, 2006, we had advances outstanding of approximately $17.4 million and $29.1 million, respectively, to these unconsolidated joint ventures, which were included in the accounts payable and accrued liabilities balances in the table above. On our Hovnanian Enterprises, Inc. Condensed Consolidated Balance Sheets our Investments in and advances to unconsolidated joint ventures amounted to $206.2 million and

$212.6 million at January 31, 2007 and October 31, 2006, respectively. The minor difference between the Hovnanian equity balance plus advances to unconsolidated joint ventures balance disclosed here compared to the Hovnanian Enterprises, Inc. Condensed Consolidated Balance Sheets is due to a different inside basis versus outside basis in certain joint ventures.

	For the Three Months Ended January 31, 2007		
	Homebuilding	Land Development	Total
Revenues	$115,561	$7,422	$122,983
Cost of sales and expenses	(104,176)	(6,978)	(111,154)
Net income	$11,385	$444	$11,829
Our share of net earnings	$1,698	$172	$1,870

	For the Three Months Ended January 31, 2006		
	Homebuilding	Land Development	Total
Revenues	$ 216,048	$ 8,400	$ 224,448
Cost of sales and expenses	(193,332)	(7,648)	(200,980)
Net income	$ 22,716	$ 752	$ 23,468
Our share of net earnings	$ 7,296	$ 586	$ 7,882

Income (loss) from unconsolidated joint ventures is reflected as a separate line in the accompanying Condensed Consolidated Financial Statements and reflects our proportionate share of the income or loss of these unconsolidated homebuilding and land development joint ventures. The minor difference between our share of the income or loss from these unconsolidated joint ventures disclosed here compared to the Hovnanian Enterprises, Inc. Condensed Consolidated Income Statements is due to the reclass 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 less than or equal to 50 percent. In determining whether or not we must consolidate joint ventures where we are the manager of the joint venture, we consider the guidance in EITF 04-5 in assessing 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 for each venture. Generally, the amount of such financing is limited to no more than 50% of the joint venture s total assets, and such financing is obtained on a non-recourse basis, with guarantees from us limited only to performance and completion guarantees and limited environmental indemnifications, 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 (VIE) under FIN 46 due to the returns being capped to the equity holders; however, in these instances, we are not the primary beneficiary, therefore we do not consolidate these entities.

16. Recent Accounting Pronouncements - In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets," which provides an approach to simplify efforts to obtain hedge-like (offset) accounting by allowing the Company the option to carry mortgage servicing rights at fair value. This new Statement amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125," with respect to the accounting for separately recognized servicing assets and

servicing liabilities. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities as of the beginning of an entity's fiscal year that begins after September 15, 2006, with earlier adoption permitted in certain circumstances. Since we do not retain the servicing rights when we sell our mortgage loans held for sale, the adoption of SFAS No. 156 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Earlier application is encouraged provided that the reporting entity has not yet issued financial statements for that fiscal year including financial statements for an interim period within that fiscal year. We are currently evaluating the impact, if any, that SFAS 157 may have on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("SFAS 158"). SFAS 158 requires the balance sheet recognition of the funded status of defined benefit pension and other postretirement plans, along with a corresponding after-tax adjustment to stockholders' equity. The recognition of funded status provision of SFAS 158 applies prospectively and is effective for fiscal years ending after December 15, 2006. SFAS 158 also requires measurement of plan assets and benefit obligations at the fiscal year end effective for fiscal years ending after December 15, 2008. We do not expect SFAS 158 to have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission (SEC) Staff issued Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which addresses how the effects of prior year uncorrected financial statement misstatements should be considered in current year financial statements. The SAB requires registrants to quantify misstatements using both balance sheet and income statement approaches and to evaluate whether either approach results in quantifying an error that is material in light of relative quantitative and qualitative factors. The requirements of SAB No. 108 are effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The adoption of SAB No. 108 did not have a material impact on our consolidated financial position, results of operations or cash flows.

On November 29, 2006, the FASB ratified EITF Issue No. 06-8, "Applicability of the Assessment of a Buyer's Continuing Investment Under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums." EITF 06-8 states that the adequacy of the buyer's continuing investment under SFAS 66 should be assessed in determining whether to recognize profit under the percentage-of-completion method on the sale of individual units in a condominium project. This consensus could require that additional deposits be collected by developers of condominium projects that wish to recognize profit during the construction period under the percentage-of-completion method. EITF 06-8 is effective for fiscal years beginning after March 15, 2007. We do not expect EITF No. 06-8 to have a material impact on our consolidated financial position, results of operations or cash flows.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting to Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109. FIN 48 also 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. The new FASB standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for the Company s first quarter ending January 31, 2008. We are in the process of assessing the impact, if any, this will have on our consolidated financial position, results of operations or cash flows.

17. Intangible Assets The intangible assets recorded on our balance sheet are goodwill, which has an indefinite life, and definite life intangibles, including tradenames, architectural designs, distribution processes, and contractual agreements resulting from our acquisitions. We no longer amortize goodwill, but instead assess it periodically for impairment. In the first quarter of fiscal 2007, we determined that the intangible assets associated with our Fort Myers operations in the Southeast were impaired, and wrote off the intangible asset balance of $76.5

million at January 31, 2007. Of this charge $51.5 million was recorded to intangible amortization on the Condensed Consolidated Statement of Income. The remaining $25 million was recorded against Accrued expenses on the Condensed Consolidated Balance Sheets because at the time of acquisition this was an accrual for contingent purchase price; however, this payment will no longer be made as the operations have not generated the profits necessary to require the payment. Certain of the impairment charges associated with our Fort Myers operations were not deductible for tax purposes and therefore did not provide a tax benefit. As a result, our effective rate for the three months ended January 31, 2007 was 18% compared to 37.8% in the prior year first quarter.

We are amortizing the remaining definite life intangibles over their expected useful lives, ranging from three to eight years.

18. Acquisitions - On April 17, 2006, we acquired for cash the assets of CraftBuilt Homes, a privately held homebuilder headquartered in Bluffton, South Carolina. The acquisition expanded our operations into the coastal markets of South Carolina and Georgia. CraftBuilt Homes designs, markets and sells single family detached homes. Due to its close proximity to Hilton Head, CraftBuilt Homes focuses on first-time, move-up, empty-nester and retiree homebuyers. This acquisition was accounted for as a purchase with the results of its operations included in our consolidated financial statements as of the date of the acquisition.

In connection with the CraftBuilt Homes acquisition, we have definite life intangible assets equal to the excess purchase price over the fair value of net tangible assets of $4.5 million in the aggregate. We are amortizing the definite life intangibles over their estimated lives.

On May 1, 2006, we acquired through the issuance of 175,936 shares of Class A common stock substantially all of the assets of two mechanical contracting businesses. These acquisitions were accounted for as purchases with the results of their operations included in our consolidated financial statements as of the date of acquisition.

All fiscal 2006 acquisitions provide for other payments to be made, generally dependent upon achievement of certain future operating and return objectives.

19. Hovnanian Enterprises, Inc., the parent company (the "Parent"), is the issuer of publicly traded common stock and preferred stock. One of its wholly owned subsidiaries, K. Hovnanian Enterprises, Inc. (the Subsidiary Issuer), acts as a finance entity that as of January 31, 2007 had issued and outstanding $400 million of Senior Subordinated Notes, $1,655.3 million face value of Senior Notes, and $225.7 million drawn on a Revolving Credit Agreement. The Senior Subordinated Notes, Senior Notes, the Revolving Credit Agreement and the Revolving and Letter of Credit Facility described in Note 9 are fully and unconditionally guaranteed by the Parent.

In addition to the Parent, each of the wholly owned subsidiaries of the Parent other than the Subsidiary Issuer (collectively, the Guarantor Subsidiaries), with the exception of various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, our mortgage lending subsidiaries, a subsidiary formerly engaged in homebuilding activity in Poland, our title insurance subsidiaries, joint ventures, and certain other subsidiaries (collectively, the Non-guarantor Subsidiaries), have guaranteed fully and unconditionally, on a joint and several basis, the obligations of the Subsidiary Issuer to pay principal and interest under the Senior Notes, Senior Subordinated Notes, the Revolving Credit Agreement, and the Revolving and Letter of Credit Facility described in Note 9.

In lieu of providing separate audited financial statements for the Guarantor Subsidiaries we have included the accompanying condensed consolidating financial statements. Management does not believe that separate financial statements of the Guarantor Subsidiaries are material to investors. Therefore, separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented.

The following condensed consolidating financial information presents the results of operations, financial position, and cash flows of (i) the Parent, (ii) the Subsidiary Issuer, (iii) the Guarantor Subsidiaries, (iv) the Non-guarantor Subsidiaries, and (v) the eliminations to arrive at the information for Hovnanian Enterprises, Inc. on a consolidated basis.

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
CONDENSED CONSOLIDATING BALANCE SHEET
JANUARY 31, 2007
(Dollars in Thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS:						
Homebuilding	$314	$84,460	$4,481,983	$271,102	$	$4,837,859
Financial services			42	188,768		188,810
Income taxes (payable) receivable	66,114	(2,977)	211,589	(547)		274,179
Investments in and amounts due to and from consolidated subsidiaries	1,813,393	2,735,068	(2,835,789)	(216,649)	(1,496,023)	-
Total assets	$1,879,821	$2,816,551	$1,857,825	$242,674	$(1,496,023)	$5,300,848
LIABILITIES AND STOCKHOLDERS EQUITY:						
Homebuilding	$	$(67)	$802,937	$27,119	$	$829,989
Financial services			35	169,463		169,498
Notes payable		2,301,389	1,746			2,303,135
Minority interest			116,772	1,633		118,405
Stockholders equity	1,879,821	515,229	936,335	44,459	(1,496,023)	1,879,821
Total liabilities and stockholders equity	$1,879,821	$2,816,551	$1,857,825	$242,674	$(1,496,023)	$5,300,848

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CONDENSED CONSOLIDATING BALANCE SHEET
OCTOBER 31, 2006
(Dollars in Thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS;						
Homebuilding	$273	$93,148	$4,542,365	$279,518	$	$4,915,304
Financial services			47	304,870		304,917
Income taxes (payable) receivable	71,430	(2,977)	190,974	387		259,814
Investments in and amounts due to and from consolidated subsidiaries	1,870,460	2,478,566	(2,570,100)	(231,569)	(1,547,357)	-
Total assets	$1,942,163	$2,568,737	$2,163,286	$353,206	$(1,547,357)	$5,480,035
LIABILITIES AND STOCKHOLDERS EQUITY:						
Homebuilding	$	$(65)	$994,965	$27,275	$	$1,022,175
Financial services			65	282,264		282,329
Notes payable		2,099,598	1,285			2,100,883
Minority interest			130,221	2,264		132,485
Stockholders equity	1,942,163	469,204	1,036,750	41,403	(1,547,357)	1,942,163
Total liabilities and						

stockholders equity	$1,942,163	$2,568,737	$2,163,286	$353,206	$(1,547,357)	$5,480,035

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
THREE MONTHS ENDED JANUARY 31, 2007
(Dollars in Thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues:						
Homebuilding	$	$149	$1,138,035	$6,090	$	$1,144,253
Financial services			1,057	20,491		21,548
Intercompany charges		71,552	71,182		(142,734)	
Equity in pretax income of consolidated subsidiaries	(66,629)				66,629	
Total revenues	(66,629)	71,701	1,210,274	26,560	(76,105)	1,165,801
Expenses:						
Homebuilding		519	1,260,028	5,344	(44,566)	1,221,325
Financial services			483	12,658	(71)	13,070
Total expenses		519	1,260,511	18,002	(44,637)	1,234,395
Income from unconsolidated joint ventures			1,965			1,965
Income (loss) before income taxes	(66,629)	71,182	(48,272)	8,558	(31,468)	(66,629)
State and federal income (benefit)/taxes	(12,021)	23,535	(4,447)	3,225	(22,313)	(12,021)
Net income (loss)	$(54,608)	$47,647	$(43,825)	$5,333	$(9,155)	$(54,608)

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
THREE MONTHS ENDED JANUARY 31, 2006
(Dollars in Thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenues:						
Homebuilding	$	$ 153	$1,256,427	$ 2,150	$	$1,258,730
Financial services			2,255	17,007		19,262
Intercompany charges		66,758	66,703		(133,461)	-
Equity in pretax income of consolidated subsidiaries	135,226				(135,226)	-
Total revenues	135,226	66,911	1,325,385	19,157	(268,687)	1,277,992
Expenses:						
Homebuilding		208	1,165,341	1,455	(30,193)	1,136,811
Financial services			883	12,892	(245)	13,530
Total expenses		208	1,166,224	14,347	(30,438)	1,150,341
Income from unconsolidated joint			7,575			7,575

ventures						
Income (loss) before income taxes	135,226	66,703	166,736	4,810	(238,249)	135,226
State and federal income (benefit)/taxes	51,130	23,411	61,864	1,912	(87,187)	51,130
Net income (loss)	$ 84,096	$ 43,292	$ 104,872	$ 2,898	$ (151,062)	$ 84,096

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
THREE MONTHS ENDED JANUARY 31, 2007
(Dollars in Thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:						
Net income (loss)	$(54,608)	$47,647	$(43,825)	$5,333	$(9,155)	$(54,608)
Adjustments to reconcile net income to net cash provided by (used in) operating activities	(17,196)	(24,067)	(178,724)	127,529	9,155	(83,303)
Net cash provided by (used in) operating activities	(71,804)	23,580	(222,549)	132,862	-	$(137,911)
Net cash (used in) investing activities			(13,926)	(3,206)		(17,132)
Net cash provided by (used in) financing activities	14,737	225,700	(13,459)	(116,940)		110,038
Intercompany investing and financing activities net	57,067	(256,502)	214,355	(14,920)		-
Net increase (decrease) in cash	-	(7,222)	(35,579)	(2,204)		(45,005)
Cash and cash equivalents balance, beginning of period	16	59,529	(16,122)	10,900		54,323
Cash and cash equivalents balance, end of period	$16	$52,307	$(51,701)	$8,696	$	$9,318

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
THREE MONTHS ENDED JANUARY 31, 2006
(Dollars in Thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:						
Net income	$ 84,096	$ 43,292	$ 104,872	$ 2,898	$(151,062)	$ 84,096
Adjustments to reconcile net income to net cash provided by (used in) operating activities	2,815	(6,934)	(416,755)	(113,729)	151,062	(383,541)
Net cash provided by (used in) operating activities	86,911	36,358	(311,883)	(110,831)		(299,445)
Net cash (used in) investing activities			(8,023)	(5,404)		(13,427)
Net cash provided by (used in) financing activities	4,166	226,250	(26,149)	(56,779)		147,488

Intercompany investing and financing activities net	(91,077)	(481,263)	396,005	176,335		
Net increase (decrease) in cash		(218,655)	49,950	3,321		(165,384)
Cash and cash equivalents balance, beginning of period	16	298,596	(97,024)	9,685		211,273
Cash and cash equivalents balance, end of period	$ 16	$ 79,941	$ (47,074)	$ 13,006	$	$ 45,889

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

CRITICAL ACCOUNTING POLICIES

Management believes that the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements:

Business Combinations When we make an acquisition of another company, we use the purchase method of accounting in accordance with the Statement of Financial Accounting Standards (SFAS) No. 141 Business Combinations . Under SFAS No. 141, we record as our cost the estimated fair value of the acquired assets less liabilities assumed. Any difference between the cost of an acquired company and the sum of the fair values of tangible and intangible assets less liabilities is recorded as goodwill. The reported income of an acquired company includes the operations of the acquired company from the date of acquisition.

Income Recognition from Home and Land Sales We are primarily engaged in the development, construction, marketing and sale of residential single-family and multi-family homes where the planned construction cycle is less than 12 months. For these homes, in accordance with SFAS No. 66, Accounting for Sales of Real Estate (SFAS 66), revenue is recognized when title is conveyed to the buyer, adequate cash payment has been received and there is no continued involvement. In situations where the buyer s financing is originated by our mortgage subsidiary and the buyer has not made an adequate initial or continuing investment as prescribed by SFAS No. 66, the profit on such sales is deferred until the sale of the related mortgage loan to a third-party investor has been completed.

Additionally, in certain markets, we sell lots to customers, transferring title, collecting proceeds, and entering into contracts to build homes on these lots. In these cases, we do not recognize the revenue from the lot sale until we deliver the completed home and have no continued involvement related to that home. The cash received on the lot is recorded as a component of inventory until the revenue is recognized.

Income Recognition from High-Rise/Mid-Rise Projects We are developing several high-rise/mid-rise projects that will take more than 12 months to complete. If these projects qualify, revenues and costs are recognized using the percentage of completion method of accounting in accordance with SFAS 66. Under the percentage of completion method, revenues and costs are to be recognized when construction is beyond the preliminary stage, the buyer is committed to the extent of having a sufficient deposit that the buyer cannot require be refunded except for non-delivery of the home, sufficient units in the project have been sold to ensure that the property will not be converted to rental property, the sales prices are collectible and the aggregate sales proceeds and the total cost of the project can be reasonably estimated. We currently do not have any projects that meet these criteria, therefore the revenues from delivering homes in high-rise/mid-rise projects are recognized when title is conveyed to the buyer, adequate cash payment has been received and there is no continued involvement with respect to that home.

Income Recognition from Mortgage Loans Profits and losses relating to the sale of mortgage loans are recognized when legal control passes to the buyer of the mortgage and the sales price is collected.

Interest Income Recognition for Mortgage Loans Receivable and Recognition of Related Deferred Fees and Costs - Interest income is recognized as earned for each mortgage loan during the period from the loan closing date to the sale date when legal control passes to the buyer and the sale price is collected. All fees related to the origination of mortgage loans and direct loan origination costs are deferred and recorded as either (a) an adjustment to the related mortgage loans upon the closing of a loan or (b) recognized as a deferred asset or deferred revenue while the loan is in process. These fees and costs include loan origination fees, loan discount, and salaries and wages. Such deferred fees and costs relating to the closed loans are recognized over the life of the loans as an adjustment of yield or taken into operations upon sale of the loan to a permanent investor.

Inventories - Inventories and long-lived assets held for sale are recorded at the lower of cost or fair value less direct costs to sell. Fair value is defined as the amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Construction costs are accumulated during the period of construction and charged to cost of sales under specific identification methods. Land, land development, and common facility costs are allocated based on buildable acres to product types within each community then charged to cost of sales equally based upon the number of homes to be constructed in each product type. For inventories of communities under development, a loss is recorded when events and circumstances indicate impairment and the undiscounted future cash flows generated are less than the related carrying amounts. The impairment loss is the difference between the book value of the individual community and the discounted future cash flows generated from expected revenue of the community, less the associated costs to complete and direct costs to sell.

Insurance Deductible Reserves For homes delivered in fiscal 2007 and 2006, our deductible is $20 million per occurrence with an aggregate $20 million for premise liability claims and an aggregate $21.5 million for construction defect claims under our general liability insurance. Our worker s compensation insurance deductible is $1 million per occurrence in fiscal 2007 and fiscal 2006. Reserves have been established based upon actuarial analysis of estimated losses for fiscal 2007 and fiscal 2006. We engage a third party actuary that uses our historical warranty data to estimate our 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. No significant premise liability claims have arisen.

Interest In accordance with SFAS 34 Capitalization of Interest Cost , interest incurred is first capitalized to properties under development during the land development and home construction period and expensed along with the associated cost of sales as the related inventories are sold. Interest in excess of interest capitalized or interest incurred on borrowings directly related to properties not under development is expensed immediately in Other interest .

Land Options - Costs are capitalized when incurred and either included as part of the purchase price when the land is acquired or charged to operations when we determine we will not exercise the option. In accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46R (FIN 46R) Consolidation of Variable Interest Entities , an interpretation of Accounting Research Bulletin No. 51, SFAS No. 49 Accounting for Product Financing Arrangements (SFAS 49), SFAS No. 98 Accounting for Leases (SFAS 98), and Emerging Issues Task Force (EITF) No. 97-10 The Effects of Lessee Involvement in Asset Construction (EITF 97-10), we record on the Condensed Consolidated Balance Sheets specific performance options, options with variable interest entities, and other options under Consolidated inventory not owned with the offset to Liabilities from inventory not owned , Minority interest from inventory not owned and Minority interest from consolidated joint ventures .

Unconsolidated Homebuilding and Land Development Joint Ventures - Investments in unconsolidated homebuilding and land development joint ventures are accounted for under the equity method of accounting. Under the equity method, we recognize our proportionate share of earnings and losses earned by the joint venture upon the delivery of lots or homes to third parties. Our ownership interest in joint ventures varies but is generally less than or equal to 50%. In determining whether or not we must consolidate joint ventures where we are the managing member of the joint venture, we consider the guidance in EITF 04-5 in assessing 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.

Intangible Assets The intangible assets recorded on our balance sheet are goodwill, which has an indefinite life, and definite life intangibles, including trade names, architectural designs, distribution processes, and contractual agreements resulting from our acquisitions. We no longer amortize goodwill, but instead assess it periodically for impairment. We are amortizing the definite life intangibles over their expected useful lives, ranging from three to eight years.

Post Development Completion and Warranty Costs - In those instances where a development is substantially completed and sold and we have additional construction work to be incurred, an estimated liability is provided to cover the cost of such work. In addition, we accrue warranty costs as part of cost of sales for repair costs over $1,000 to homes, community amenities and land development infrastructure. Also, we accrue for warranty costs under our general liability insurance deductible as part of selling, general and administrative costs.

As previously stated, the deductible for our general liability insurance for homes delivered in fiscal 2007 is $20 million per occurrence with an aggregate $20 million for premise liability claims, and an aggregate $21.5 million for construction defect claims. Both of these liabilities are recorded in Accounts payable and other liabilities in the Condensed Consolidated Balance Sheets.

CAPITAL RESOURCES AND LIQUIDITY

Our operations consist primarily of residential housing development and sales in the Northeast (New Jersey, New York, Pennsylvania), the Midwest (Ohio, Illinois, Kentucky, Michigan, Minnesota), the Mid-Atlantic (Delaware, Maryland, Virginia, West Virginia, Washington D. C.), the Southeast (Florida, Georgia, North Carolina, South Carolina,), the Southwest (Arizona, Texas), and the West (California). In addition, we provide financial services to our homebuilding customers.

Our cash uses during the three months ended January 31, 2007 were for operating expenses, increases in housing inventories, construction, income taxes, interest, and preferred stock dividends. We provided for our cash requirements from housing and land sales, the revolving credit facility, financial service revenues, and other revenues. We believe that these sources of cash are sufficient to finance our working capital requirements and other needs.

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. As of January 31, 2007, 3.4 million shares of Class A Common Stock have been purchased under this program, of which $.2 million was acquired during the three months ended January 31, 2007. On March 5, 2004, our Board of Directors authorized a 2-for-1 stock split in the form of a 100% stock dividend. All share information reflects this stock dividend.

On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of $25,000 per share for net proceeds of $135 million. Dividends on the Series A Preferred Stock are not cumulative and are paid 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 . The net proceeds from the offering, reflected in Preferred stock in the Condensed Consolidated Balance Sheets, were used for the partial repayment of the outstanding balance under our revolving credit facility as of July 12, 2005. In January 2007 and 2006, we paid $2.7 million of dividends on the Series A Preferred Stock.

Our homebuilding bank borrowings are made pursuant to an amended and restated unsecured Revolving Credit Agreement ("Agreement") with a group of lenders provides a revolving credit line and letter of credit line of $1.5 billion through May 2011. The facility contains an accordion feature under which the aggregate commitment can be increased to $2.0 billion subject to the availability of additional commitments. Loans under the Agreement bear interest at various rates based on (1) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus $^1/_2$% or (2) a margin ranging from 0.65% to 1.50% per annum, depending on our Leverage Ratio, as defined in the Agreement, and our debt ratings plus a LIBOR-based rate for a one, two, three, or six month interest period as selected by us. In addition, we pay a fee ranging from 0.15% to 0.25% per annum on the unused portion of the revolving credit line depending on our Leverage Ratio and our debt ratings and the average percentage unused portion of the revolving credit line. At January 31, 2007, there was $225.7 million drawn under this Agreement and we had approximately $1.0 million of unrestricted homebuilding cash. At January 31, 2007, we had issued $179.3 million of letters of credit which reduces cash available under the Agreement. We believe that we will be able either to extend the Agreement beyond May 2011 or negotiate a replacement facility, but there can be no assurance of such extension or replacement facility. We currently are in compliance and intend to maintain compliance with the covenants under the Agreement. We and each of our significant subsidiaries, except for K. Hovnanian Enterprises, Inc., the borrower, and various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, a subsidiary formerly engaged in homebuilding activity in Poland, our financial services subsidiaries, joint ventures, and certain other subsidiaries, is a guarantor under the Agreements.

On October 11, 2006, (a) we, K. Hovnanian Enterprises, Inc. ("K. Hovnanian") and certain of our subsidiaries as guarantors entered into a Credit Agreement (the "Credit Agreement") with Citicorp USA, Inc., as administrative agent and issuing bank, the lenders from time to time party thereto, and The Bank of New York, as paying agent, and (b) K. Hovnanian entered into an Agreement for Letter of Credit (the "LC Agreement") with Citibank, N.A ("Citibank"). Under the Credit Agreement, K. Hovnanian has the right to borrow and to obtain the issuance, renewal, extension and increase of a letter of credit (the "Security Letter of Credit") up to an aggregate availability of $125 million. On November 14, 2006, per the accordion feature provided for in the Credit Agreement, the aggregate commitments under the Credit Agreement were increased to $250 million. The Security Letter of Credit will serve as security for any letters of credit that may be issued under the LC Agreement. Under the LC Agreement, K. Hovnanian may request Citibank to issue letters of credit up to the aggregate maximum amount of the Security Letter of Credit. Loans under the Credit Agreement will bear interest at various rates based on (1) an alternate base rate determined by reference to the higher of (a) Citibank's base rate and (b) the federal funds rate plus $^1/_2$% or (2) a LIBOR-based rate for a one day, one or two week, or one, two, three or six month interest period as selected by K. Hovnanian. We and each of our significant subsidiaries, except for K. Hovnanian Enterprises, Inc., the borrower, and various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, a subsidiary formerly engaged in homebuilding activity in Poland, our financial services subsidiaries, joint ventures, and certain other subsidiaries, is a guarantor under the Credit Agreement.

The Credit Agreement has covenants that restrict Hovnanian and certain of its subsidiaries', including K. Hovnanian's ability to grant liens and enter into consolidations, mergers and transfers of all or substantially all of their respective assets. The Credit Agreement contains events of default which would permit the lenders to accelerate the loans if not cured within applicable grace periods, including the failure to make timely payments under the Credit Agreement or other material indebtedness, the failure to satisfy covenants and specified events of bankruptcy and insolvency. Borrowings under the Credit Agreement may be used for general corporate purposes. As of January 31, 2007 and October 31, 2006, the outstanding balance under the Credit Agreement was zero, excluding letters of credit of $242.1 million and $123.6 million, respectively. As of January 31, 2007, we were in compliance with our loan covenants.

At January 31, 2007, we had $1,655.3 million of outstanding senior notes ($1,650.1 million, net of discount), comprised of $140.3 million 10 1/2% Senior Notes due 2007, $100 million 8% Senior Notes due 2012, $215 million 6 1/2% Senior Notes due 2014, $150 million 6 3/8% Senior Notes due 2014, $200 million 6 1/4% Senior Notes due 2015, $300 million 6 1/4% Senior Notes due 2016, $300 million 7 1/2% Senior Notes due 2016, and $250 million 8 5/8% Senior Notes due 2017. At January 31, 2007, we had $400.0 million of outstanding senior subordinated notes, comprised of $150 million 8 7/8% Senior Subordinated Notes due 2012, $150 million 7 3/4% Senior Subordinated Notes due 2013, and $100 million 6% Senior Subordinated Notes due 2010. We and each of our wholly owned subsidiaries, except for K. Hovnanian Enterprises, Inc., the issuer of the senior and senior subordinated notes, and various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations,, a subsidiary formerly engaged in homebuilding activity in Poland, our financial services subsidiaries, joint ventures, and certain other subsidiaries, is a guarantor of the senior notes and senior subordinated notes.

Our amended secured mortgage loan warehouse agreement with a group of banks, which is a short-term borrowing facility, provides up to $200 million through November 9, 2007. Interest is payable monthly at the LIBOR Rate plus 1.0%. The loan is repaid when we sell the underlying mortgage loans to permanent investors. We also have a commercial paper facility which was amended on September 29, 2006. Pursuant to the amended agreement, the commercial paper facility amount increased from $100 million to $150 million. The facility expires on April 20, 2007 and interest is payable monthly at the LIBOR Rate plus 0.40%. We believe that we will be able to extend this facility beyond April 2007 or negotiate a replacement facility, but there can be no assurance of such extension or replacement facility. As of January 31, 2007, the aggregate principal amount of all borrowings under both agreements was $153.4 million.

Total inventory increased $36.2 million during the three months ended January 31, 2007. This increase excluded the increase in consolidated inventory not owned of $26.7 million consisting of specific performance options, options with variable interest entities, and other options that were added to our balance sheet in accordance with SFAS 49, SFAS 98, and EITF 97-10, and variable interest entities in accordance with FIN 46R. See Notes to Condensed Consolidated Financial Statements Note 14 for additional information on FIN 46R. Other options

increased during the first quarter of fiscal 2007 primarily due to land development costs associated with a property in the West that we do not own, but are required to consolidate under SFAS 49 Accounting for Product Financing Arrangements . Total inventory in the Northeast increased $64.9 million, and the Southwest increased $13.9 million. The increases in inventory were primarily the result of planned organic growth in our existing markets as we have increased the number of communities open for sale from 427 at October 31, 2006 to 436 at January 31, 2007. These increases were offset by decreases in the Mid-Atlantic of $3.1 million, the Southeast of $37.0 million, the Midwest of $2.0 million, and the West of $0.5 million. The decreases were primarily the result of deliveries in existing communities, a significant impairment in the Southeast (Fort Myers) totaling $41.9 million, as well as a small decrease due to impairments in the Midwest. Substantially all homes under construction or completed and included in inventory at January 31, 2007 are expected to be closed during the next twelve months. Most inventory completed or under development is partially financed through our line of credit, preferred stock and senior and senior subordinated indebtedness.

We usually option property for development prior to acquisition. By optioning property, we are only subject to the loss of the cost of the option and predevelopment costs if we choose not to exercise the option. As a result, our commitment for major land acquisitions is reduced. Inventory impairment losses, which include inventory that has been written-off or written-down, increased $38.4 million for the three months ended January 31, 2007, compared to the same period in the prior year. During the first quarter of fiscal 2007, we incurred $46.5 million in write-downs primarily attributable to significant impairments taken as a result of continued deterioration in our Fort Myers operations in the Southeast, as well as smaller impairments in the Northeast and Midwest. In addition, we wrote-off costs in the amount of $3.0 million. These write-offs of $3.0 million were offset by $8.0 million in partially recovered deposits that had been written-off in the prior year.

The following table summarizes the number of buildable homes included in our total residential real estate.

	Active Communities	Active Communities Homes	Proposed Developable Homes	Grand Total Homes
January 31, 2007:				
Northeast	45	7,293	10,235	17,528
Mid-Atlantic	83	7,290	8,924	16,214
Midwest	35	3,843	2,578	6,421
Southeast	92	12,759	9,440	22,199
Southwest	121	12,526	5,123	17,649
West	60	11,510	2,525	14,035
Consolidated total	436	55,221	38,825	94,046
Unconsolidated joint ventures		5,157	1,555	6,712
Total including unconsolidated joint ventures		60,378	40,380	100,758
Owned		28,480	5,347	33,827
Optioned		23,853	33,478	57,331
Controlled lots		52,333	38,825	91,158
Construction to permanent financing lots		2,888		2,888
Consolidated total		55,221	38,825	94,046
Lots controlled by unconsolidated joint ventures		5,157	1,555	6,712
Total including unconsolidated joint ventures		60,378	40,380	100,758

	Active Communities	Active Communities Homes	Proposed Developable Homes	Grand Total Homes
October 31, 2006:				
Northeast	45	7,228	11,293	18,521
Mid-Atlantic	84	7,476	9,352	16,828
Midwest	37	3,608	2,753	6,361
Southeast	85	12,956	10,363	23,319
Southwest	117	13,203	5,202	18,405
West	59	12,018	2,598	14,616
Consolidated total	427	56,489	41,561	98,050
Unconsolidated joint ventures		5,930	817	6,747
Total including unconsolidated joint ventures		62,419	42,378	104,797
Owned		28,546	5,358	33,904
Optioned		24,511	36,203	60,714
Controlled lots		53,057	41,561	94,618
Construction to permanent financing lots		3,432		3,432
Consolidated total		56,489	41,561	98,050
Lots controlled by unconsolidated joint ventures		5,930	817	6,747
Total including unconsolidated joint ventures		62,419	42,378	104,797

The following table summarizes our started unsold homes and models. The decrease in total started unsold homes compared to the prior year is primarily due to a focused effort to sell inventoried homes during the first quarter. In some instances, this required additional incentives to be given to homebuyers on completed unsold homes.

	January 31, 2007			October 31, 2006		
	Started Unsold Homes	Models	Total	Started Unsold Homes	Models	Total
Northeast	497	28	525	568	18	586
Mid-Atlantic	336	5	341	376	5	381
Midwest	153	32	185	139	34	173
Southeast	423	69	492	424	63	487
Southwest	706	113	819	809	97	906
West	466	208	674	626	165	791
Total	2,581	455	3,036	2,942	382	3,324

Investments in and advances to unconsolidated joint ventures decreased $6.4 million during the three months ended January 31, 2007. This decrease is due to distributions received during the three months ended January 31, 2007, offset by increases resulting from income from joint ventures not distributed and additional investment in joint ventures. As of January 31, 2007, we have investments in ten homebuilding joint ventures and ten land development joint ventures. Other than guarantees limited only to completion of development, environmental indemnification and standard indemnification for fraud and misrepresentation including voluntary bankruptcy, we have no guarantees associated with unconsolidated joint ventures.

Receivables, deposits, and notes decreased $8.4 million to $86.4 million at January 31, 2007. The decrease was primarily due to the reduction of receivables from home sales, which were in transit from various title companies at January 31, 2007.

Prepaid expenses and other assets are as follows:

	January 31, 2007	October 31, 2006	Dollar Change
Prepaid insurance	$14,318	$8,945	$5,373
Prepaid project costs	106,997	97,920	9,077
Senior residential rental properties	8,252	8,352	(100)
Other prepaids	27,924	30,082	(2,158)
Other assets	24,838	30,304	(5,466)
Total	$182,329	$175,603	$6,726

Prepaid insurance increased due to a payment of a full year of certain liability insurance premium costs during the first quarter of fiscal 2007. These costs are amortized over the life of the associated insurance policy. Prepaid project costs increased due to the growth in the number of communities. Prepaid project costs consist of community specific expenditures that are used over the life of the community. Such prepaids are expensed as homes are delivered. The decrease in other prepaids is partially due to a decrease in prepaid costs related to timing of

financing proceeds received on completed models. In addition, other assets decreased for our executive deferred compensation plan, as there were payouts in the first quarter and lower new contributions because of lower bonuses.

At January 31, 2007, we had $32.7 million of goodwill. This amount resulted from Company acquisitions prior to fiscal 2000.

Definite life intangibles decreased $86.6 million to $78.4 million at January 31, 2007. The decrease was the result of amortization during the three months of $10.1 million, and the write-off of $76.5 million for impaired intangible assets associated with the Fort Myers operations in the Southeast. In the first quarter of fiscal 2007, we determined that the intangible assets associated with our Fort Myers operations in the Southeast were impaired, and wrote off the assets of $76.5 million at January 31, 2007. Of this charge $51.5 million was recorded to intangible amortization on the Condensed Consolidated Statement of Income. The remaining $25 million was recorded against Accrued expenses on the Condensed Consolidated Balance Sheets because at the time of acquisition this was an accrual for contingent purchase price, however, because of the impairment payment will no longer be made.

Income taxes receivable increased $14.4 million as a result of temporary differences between book and tax related to the inventory and intangible impairment charges taken for the Fort Myers operations.

Accounts payable and other liabilities are as follows:

	January 31, 2007	October 31, 2006	Dollar Change
Accounts payable	$161,822	$201,785	$(39,963)
Reserves	103,259	104,734	(1,475)
Accrued expenses	53,673	102,794	(49,121)
Accrued compensation	44,060	65,313	(21,253)
Other liabilities	50,855	107,767	(56,912)
Total	$413,669	$582,393	$(168,724)

The decrease in accounts payable was primarily due to timing of payments made during the quarter related to the high level of invoices received and recorded in the fourth quarter of fiscal 2006. The decrease in accrued expenses is due to payments of accrued acquisition earnout obligations as well as cash payments made for land options that were terminated and accrued in the fourth quarter of fiscal 2006. The decrease in accrued compensation was primarily due to the payout of our fiscal year 2006 fourth quarter bonuses during the first quarter of 2007, combined with lower accrued bonuses for the first quarter of fiscal 2007. The decrease in other liabilities is mainly due to the reduction of an accrual for contingent purchase price on an acquisition. Also contributing to the decrease was a decrease in deferred revenue for homes financed through our wholly-owned mortgage subsidiary, in accordance with our revenue recognition policy.

Financial Services - Mortgage loans held for sale consist of residential mortgages receivable of which $166.4 million and $282 million at January 31, 2007 and October 31, 2006, respectively, are being temporarily warehoused and awaiting sale in the secondary mortgage market. We may incur risk with respect to mortgages that are delinquent, but only to the extent the losses are not covered by mortgage insurance or resale value of the house. Historically, we have incurred minimal credit losses. The decrease in the receivable from October 31, 2006 is directly related to a decrease in the amount of loans financed at January 31, 2007.

Nonrecourse land mortgages increased $9.6 million to $35.7 million at January 31, 2007. The increase is primarily due to new agreements entered into in the first quarter of fiscal 2007. These new agreements were executed in the Northeast and Mid-Atlantic in connection with land purchases in those segments.

Customer deposits decreased $42.4 million to $142.5 million at January 31, 2007. The decrease is partially due to the reduction in the number of homes in backlog from 8,496 at October 31, 2006 to 7,800 at January 31, 2007. Also contributing to the decrease was less cash received in excess of billings related to homes that have customer construction financing arrangements in the Southeast.

Mortgage warehouse line of credit decreased $116.8 million to $153.4 million at January 31, 2007. The decrease is directly correlated to the decrease in mortgage loans held for sale from October 31, 2006 to January 31, 2007.

Accrued interest decreased $23.7 million to $27.4 million at January 31, 2007. The decrease is primarily attributable to the first-time payments made on the senior notes we issued in fiscal 2006.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JANUARY 31, 2007 COMPARED TO THE THREE MONTHS ENDED JANUARY 31, 2006

Total revenues:

Compared to the same prior period, revenues increased as follows:

	Three Months Ended			
	January 31, 2007 (Dollars In Thousands)	January 31, 2006	Dollar Change	Percentage Change
Homebuilding:				
Sale of homes	$1,135,916	$1,246,197	$(110,281)	(8.9)%
Land sales and other revenues	8,337	12,533		