KB HOME
Form 10-Q
October 08, 2010

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended August 31, 2010.

or

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

For the transition period from [________] to [________].

Commission File No. 001-09195

KB HOME

(Exact name of registrant as specified in its charter)

Delaware	95-3666267
(State of incorporation)	(IRS employer identification number)

10990 Wilshire Boulevard
Los Angeles, California 90024
(310) 231-4000
(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of August 31, 2010.
Common stock, par value $1.00 per share: 88,047,838 shares outstanding, including 11,099,923 shares held by the registrant s Grantor Stock Ownership Trust and excluding 27,095,467 shares held in treasury.

KB HOME
FORM 10-Q
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

KB HOME
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts Unaudited)

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2010	2009	2010	2009
Total revenues	$ 1,139,033	$ 1,150,282	$ 501,003	$ 458,451
Homebuilding:				
Revenues	$ 1,133,846	$ 1,145,014	$ 498,821	$ 456,348
Construction and land costs	(945,196)	(1,082,343)	(411,813)	(414,575)
Selling, general and administrative expenses	(233,795)	(217,647)	(78,602)	(83,878)
Operating income (loss)	(45,145)	(154,976)	8,406	(42,105)
Interest income	1,628	6,410	603	1,131
Interest expense, net of amounts capitalized/loss on early redemption	(52,108)	(35,502)	(16,183)	(15,379)
Equity in loss of unconsolidated joint ventures	(4,679)	(47,811)	(1,947)	(26,315)
Homebuilding pretax loss	(100,304)	(231,879)	(9,121)	(82,668)
Financial services:				
Revenues	5,187	5,268	2,182	2,103
Expenses	(2,639)	(2,569)	(754)	(915)
Equity in income of unconsolidated joint venture	5,946	8,977	996	4,432
Financial services pretax income	8,494	11,676	2,424	5,620
Total pretax loss	(91,810)	(220,203)	(6,697)	(77,048)
Income tax benefit	5,000	17,700	5,300	11,000
Net loss	$ (86,810)	$ (202,503)	$ (1,397)	$ (66,048)
Basic and diluted loss per share	$ (1.13)	$ (2.64)	$ (.02)	$ (.87)

Basic and diluted average shares outstanding		76,866		76,656		76,909		76,329
Cash dividends declared per common share	$	.1875	$	.1875	$	.0625	$	.0625

See accompanying notes.

Table of Contents

KB HOME
CONSOLIDATED BALANCE SHEETS
(In Thousands Unaudited)

	August 31, 2010	November 30, 2009
Assets		
Homebuilding:		
Cash and cash equivalents	$ 919,851	$ 1,174,715
Restricted cash	116,384	114,292
Receivables	137,337	337,930
Inventories	1,721,468	1,501,394
Investments in unconsolidated joint ventures	101,435	119,668
Other assets	150,610	154,566
	3,147,085	3,402,565
Financial services	29,367	33,424
Total assets	$ 3,176,452	$ 3,435,989
Liabilities and stockholders equity		
Homebuilding:		
Accounts payable	$ 288,974	$ 340,977
Accrued expenses and other liabilities	468,398	560,368
Mortgages and notes payable	1,800,919	1,820,370
	2,558,291	2,721,715
Financial services	4,711	7,050
Common stock	115,143	115,120
Paid-in capital	867,505	860,772
Retained earnings	705,218	806,443
Accumulated other comprehensive loss	(22,244)	(22,244)
Grantor stock ownership trust, at cost	(120,629)	(122,017)
Treasury stock, at cost	(931,543)	(930,850)
Total stockholders equity	613,450	707,224

Total liabilities and stockholders equity	$ 3,176,452	$ 3,435,989

See accompanying notes.

4

Table of Contents

KB HOME
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands Unaudited)

	Nine Months Ended August 31, 2010	2009
Cash flows from operating activities:		
Net loss	$ (86,810)	$ (202,503)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Equity in (income) loss of unconsolidated joint ventures	(1,267)	38,834
Distributions of earnings from unconsolidated joint ventures	10,000	7,662
Amortization of discounts and issuance costs	1,605	1,111
Depreciation and amortization	2,628	4,243
Loss on voluntary termination of revolving credit facility/early redemption of debt	1,802	976
Tax benefits from stock-based compensation	1,599	4,093
Stock-based compensation expense	5,975	2,218
Inventory impairments and land option contract abandonments	16,739	91,469
Change in assets and liabilities:		
Receivables	182,762	236,305
Inventories	(149,021)	170,070
Accounts payable, accrued expenses and other liabilities	(147,323)	(249,674)
Other, net	(2,832)	8,413
Net cash provided (used) by operating activities	(164,143)	113,217
Cash flows from investing activities:		
Investments in unconsolidated joint ventures, net	(1,533)	(19,971)
Purchases of property and equipment, net	(642)	(1,245)
Net cash used by investing activities	(2,175)	(21,216)
Cash flows from financing activities:		
Change in restricted cash	(2,092)	11,224
Proceeds from issuance of senior notes		259,737
Payment of senior notes issuance costs		(4,294)
Repayment of senior and senior subordinated notes		(453,105)
Payments on mortgages, land contracts and other loans	(73,371)	(78,983)
Issuance of common stock under employee stock plans	1,609	2,196
Excess tax benefit associated with exercise of stock options	583	
Payments of cash dividends	(14,415)	(14,295)
Repurchases of common stock	(350)	(616)

Net cash used by financing activities		(88,036)		(278,136)
Net decrease in cash and cash equivalents		(254,354)		(186,135)
Cash and cash equivalents at beginning of period		1,177,961		1,141,518
Cash and cash equivalents at end of period	$	923,607	$	955,383

See accompanying notes.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles (GAAP) have been condensed or omitted.

In the opinion of KB Home (the Company), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company s consolidated financial position as of August 31, 2010, the results of its consolidated operations for the nine months and three months ended August 31, 2010 and 2009, and its consolidated cash flows for the nine months ended August 31, 2010 and 2009. The results of consolidated operations for the nine months and three months ended August 31, 2010 are not necessarily indicative of the results to be expected for the full year, due to seasonal variations in operating results and other factors. The consolidated balance sheet at November 30, 2009 has been taken from the audited consolidated financial statements as of that date. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended November 30, 2009, which are contained in the Company s Annual Report on Form 10-K for that period.

Use of Estimates

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP and, therefore, include amounts based on informed estimates and judgments of management. Actual results could differ from these estimates.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid debt instruments and other short-term investments purchased with an original maturity of three months or less to be cash equivalents. The majority of the Company s cash and cash equivalents were invested in money market accounts and U.S. government securities. Restricted cash of $116.4 million at August 31, 2010 consisted of $91.6 million of cash deposited with various banks that is required as collateral for the Company s cash-collateralized letter of credit facilities (the LOC Facilities), and $24.8 million of cash in a deposit account required as collateral for the mortgages and notes payable associated with a multi-level residential building the Company is operating as a rental property.

Restricted cash of $114.3 million at November 30, 2009 consisted solely of cash deposited in an interest reserve account with the administrative agent of the Company s unsecured revolving credit facility (the Credit Facility) pursuant to the Credit Facility s terms. The Credit Facility was terminated effective March 31, 2010 and the cash deposited in the interest reserve account was withdrawn.

Loss per share

Basic loss per share is calculated by dividing the net loss by the average number of common shares outstanding for the period. Diluted loss per share is calculated by dividing the net loss by the average number of common shares outstanding including all potentially dilutive shares issuable under outstanding stock options. All outstanding stock options were excluded from the diluted loss per share calculation for the three months and nine months ended August 31, 2010 and 2009 because the effect of their inclusion would be antidilutive, or would decrease the reported loss per share.

Comprehensive loss

The Company s comprehensive loss was $1.4 million for the three months ended August 31, 2010 and $66.0 million for the three months ended August 31, 2009. The Company s comprehensive loss was $86.8 million for the nine months ended August 31, 2010 and $202.5 million for the nine months ended August 31, 2009. The accumulated balances of other comprehensive loss in the consolidated balance sheets as of August 31, 2010 and November 30, 2009 are comprised solely of adjustments recorded directly to accumulated other comprehensive loss in accordance with Accounting Standards Codification Topic No. 715, Compensation Retirement Benefits (ASC 715). ASC 715 requires an employer to

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies (continued)

recognize the funded status of defined postretirement benefit plans as an asset or liability on the balance sheet and requires any unrecognized prior service costs and actuarial gains/losses to be recognized in accumulated other comprehensive income (loss).

Reclassifications

Certain amounts in the consolidated financial statements of prior periods have been reclassified to conform to the 2010 presentation.

2. Stock-Based Compensation

The Company adopted the fair value recognition provisions of Accounting Standards Codification Topic No. 718, Compensation Stock Compensation (ASC 718), using the modified prospective transition method effective December 1, 2005. ASC 718 requires a public entity to measure compensation cost associated with awards of equity instruments based on the grant-date fair value of the awards over the requisite service period. ASC 718 requires public entities to initially measure compensation cost associated with awards of liability instruments based on their current fair value. The fair value of each such award is to be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period are recognized as compensation cost over that period.

Stock Options

In accordance with ASC 718, the Company estimates the grant-date fair value of its stock options using the Black-Scholes option-pricing model, which takes into account assumptions regarding the dividend yield, the risk-free interest rate, the expected stock-price volatility and the expected term of the stock options. The following table summarizes the stock options outstanding and stock options exercisable as of August 31, 2010, as well as stock options activity during the nine months then ended:

	Options	Weighted Average Exercise Price
Options outstanding at beginning of period	5,711,701	$ 27.39
Granted	1,363,532	18.40
Exercised	(23,000)	13.95
Cancelled	(274,683)	18.80
Options outstanding at end of period	6,777,550	25.97
Options exercisable at end of period	4,568,939	30.39

As of August 31, 2010, the weighted average remaining contractual life of stock options outstanding and stock options exercisable was 7.7 years and 7.2 years, respectively. There was $4.5 million of total unrecognized compensation cost related to unvested stock option awards as of August 31, 2010. For the three months ended

August 31, 2010 and 2009, stock-based compensation expense associated with stock options totaled $1.4 million and $.5 million, respectively. For the nine months ended August 31, 2010 and 2009, compensation expense associated with stock options totaled $4.3 million and $1.4 million, respectively. The aggregate intrinsic value of stock options outstanding and stock options exercisable were each less than $.1 million as of August 31, 2010. (The intrinsic value of a stock option is the amount by which the market value of a share of the underlying common stock exceeds the exercise price of the stock option.)

On August 13, 2010, the Company consummated an exchange offer (the Exchange Offer) pursuant to which eligible employees of the Company had the opportunity to exchange their outstanding cash-settled stock appreciation rights (SARs) granted on October 2, 2008 and January 22, 2009 for non-qualified options to purchase shares of KB Home

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. Stock-Based Compensation (continued)

common stock granted under the KB Home 2010 Equity Incentive Plan (the 2010 Plan). Each stock option granted in exchange for a SAR had an exercise price equal to the SAR s exercise price and the same number of underlying shares, vesting schedule and expiration date as each such SAR. The Exchange Offer did not include a re-pricing or any other changes impacting the value to the employees. The Company conducted the Exchange Offer in an effort to reduce the overall degree of variability in the expense recorded for employee equity-based compensation by replacing the SARs, which are accounted for as liability instruments, with stock options, which are accounted for as equity instruments.

Pursuant to the Exchange Offer, 19 eligible employees returned to the Company a total of 1,116,030 SARs, and those SARs were cancelled on August 13, 2010 in exchange for corresponding grants of stock options to 18 of those employees to purchase an aggregate of 1,073,737 shares of KB Home common stock at $19.90 per share and one grant of stock options to one employee to purchase 42,293 shares of KB Home common stock at $11.25 per share. The 1,116,030 stock options granted pursuant to the Exchange Offer are included in the stock options granted total in the above table.

Other Stock-Based Awards

From time to time, the Company grants restricted stock, phantom shares and SARs to various employees. The Company recognized total compensation income of $5.3 million in the three months ended August 31, 2010 and total compensation expense of $6.6 million in the three months ended August 31, 2009 related to these stock-based awards. The Company recognized total compensation income of $.4 million in the nine months ended August 31, 2010 and total compensation expense of $13.5 million in the nine months ended August 31, 2009 related to these stock-based awards.

Approval of the KB Home 2010 Equity Incentive Plan

At the Company s Annual Meeting of Stockholders held on April 1, 2010, the Company s stockholders approved the 2010 Plan, authorizing, among other things, the issuance of up to 3,500,000 shares of the Company s common stock for grants of stock-based awards to employees, non-employee directors and consultants of the Company. This pool of shares includes all of the shares that were available for grant as of April 1, 2010 under the Company s 2001 Stock Incentive Plan, and no new awards may be made under the 2001 Stock Incentive Plan. Accordingly, as of April 1, 2010, the 2010 Plan became the Company s only active equity compensation plan. Under the 2010 Plan, grants of stock options and other similar awards reduce the 2010 Plan s share capacity on a 1-for-1 basis, and grants of restricted stock and other similar full value awards reduce the 2010 Plan s share capacity on a 1.78-for-1 basis. In addition, subject to the 2010 Plan s terms and conditions, a stock-based award may also be granted under the 2010 Plan to replace an outstanding award granted under another Company plan (subject to the terms of such other plan) with terms substantially identical to those of the award being replaced. The 2010 Plan was filed as an exhibit to the Company s Quarterly Report on Form 10-Q for the quarter ended February 28, 2010.

3. Segment Information

As of August 31, 2010, the Company had identified five reporting segments, comprised of four homebuilding reporting segments and one financial services reporting segment, within its consolidated operations in accordance with Accounting Standards Codification Topic No. 280, Segment Reporting. As of August 31, 2010, the Company s homebuilding reporting segments conducted ongoing operations in the following states:

West Coast: California
Southwest: Arizona and Nevada
Central: Colorado and Texas
Southeast: Florida, Maryland, North Carolina, South Carolina and Virginia

The Company s homebuilding reporting segments are engaged in the acquisition and development of land primarily for residential purposes and offer a wide variety of homes that are designed to appeal to first-time, move-up and active adult homebuyers.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information (continued)

The Company s homebuilding reporting segments were identified based primarily on similarities in economic and geographic characteristics, product types, regulatory environments, methods used to sell and construct homes and land acquisition characteristics. The Company evaluates segment performance primarily based on segment pretax results.

The Company s financial services reporting segment provides title and insurance services to the Company s homebuyers. This segment also provides mortgage banking services to the Company s homebuyers indirectly through KBA Mortgage, LLC (KBA Mortgage), an unconsolidated joint venture with a subsidiary of Bank of America, N.A. The Company s financial services reporting segment conducts operations in the same markets as the Company s homebuilding reporting segments.

The Company s reporting segments follow the same accounting policies used for the Company s consolidated financial statements. 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, nor are they indicative of the results to be expected in future periods.

The following tables present financial information relating to the Company s reporting segments (in thousands):

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2010	2009	2010	2009
Revenues:				
West Coast	$ 483,383	$ 495,249	$ 211,294	$ 205,071
Southwest	149,364	149,214	55,914	52,768
Central	314,786	277,444	140,035	116,689
Southeast	186,313	223,107	91,578	81,820
Total homebuilding revenues	1,133,846	1,145,014	498,821	456,348
Financial services	5,187	5,268	2,182	2,103
Total revenues	$ 1,139,033	$ 1,150,282	$ 501,003	$ 458,451
Pretax income (loss):				
West Coast	$ 31,080	$ (49,573)	$ 15,024	$ 2,848
Southwest	(11,799)	(31,113)	(1,802)	(5,167)
Central	(3,666)	(27,123)	5,441	(16,610)
Southeast	(42,114)	(60,331)	(10,853)	(30,690)
Corporate and other (a)	(73,805)	(63,739)	(16,931)	(33,049)
Total homebuilding pretax loss	(100,304)	(231,879)	(9,121)	(82,668)
Financial services	8,494	11,676	2,424	5,620
Total pretax loss	$ (91,810)	$ (220,203)	$ (6,697)	$ (77,048)

Equity in income (loss) of unconsolidated joint ventures:								
West Coast	$	877	$	(7,852)	$	230	$	188
Southwest		(6,457)		(13,346)		(2,177)		(3,404)
Central				506				
Southeast		901		(27,119)				(23,099)
Total	$	(4,679)	$	(47,811)	$	(1,947)	$	(26,315)

(a) Corporate and other includes corporate general and administrative expenses.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information (continued)

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2010	2009	2010	2009
Inventory impairments:				
West Coast	$ 2,630	$ 16,182	$ 1,434	$ 7,779
Southwest	962	13,267		
Central		16,286		14,669
Southeast	4,677	7,193		333
Total	$ 8,269	$ 52,928	$ 1,434	$ 22,781
Land option contract abandonments:				
West Coast	$ 722	$ 27,679	$ 722	$
Southwest				
Central	6,340			
Southeast	1,408	10,862	1,221	1,708
Total	$ 8,470	$ 38,541	$ 1,943	$ 1,708
Joint venture impairments:				
West Coast	$	$ 7,190	$	$
Southwest		5,426		
Central				
Southeast		25,369		23,183
Total	$	$ 37,985	$	$ 23,183

	August 31, 2010	November 30, 2009
Assets:		
West Coast	$ 970,457	$ 838,510
Southwest	377,763	346,035
Central	349,750	357,688
Southeast	397,755	361,551
Corporate and other	1,051,360	1,498,781
Total homebuilding assets	3,147,085	3,402,565
Financial services	29,367	33,424

Total assets	$ 3,176,452	$ 3,435,989
Investments in unconsolidated joint ventures:		
West Coast	$ 38,694	$ 54,795
Southwest	54,575	56,779
Central		
Southeast	8,166	8,094
Total	$ 101,435	$ 119,668

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

4. Financial Services

The following tables present financial information relating to the Company s financial services reporting segment (in thousands):

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2010	2009	2010	2009
Revenues				
Interest income	$ 4	$ 29	$ 2	$ 1
Title services	736	740	350	292
Insurance commissions	4,447	4,499	1,830	1,810
Total	5,187	5,268	2,182	2,103
Expenses				
General and administrative	(2,639)	(2,569)	(754)	(915)
Operating income	2,548	2,699	1,428	1,188
Equity in income of unconsolidated joint venture	5,946	8,977	996	4,432
Pretax income	$ 8,494	$ 11,676	$ 2,424	$ 5,620

	August 31, 2010	November 30, 2009
Assets		
Cash and cash equivalents	$ 3,756	$ 3,246
Receivables	873	1,395
Investment in unconsolidated joint venture	24,694	28,748
Other assets	44	35
Total assets	$ 29,367	$ 33,424
Liabilities		
Accounts payable and accrued expenses	$ 4,711	$ 7,050
Total liabilities	$ 4,711	$ 7,050

5. Inventories

Inventories consisted of the following (in thousands):

	August 31, 2010	November 30, 2009
Homes, lots and improvements in production	$ 1,282,013	$ 1,091,851
Land under development	439,455	409,543
Total	$ 1,721,468	$ 1,501,394

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

5. Inventories (continued)

The Company s interest costs were as follows (in thousands):

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2010	2009	2010	2009
Capitalized interest at beginning of period	$ 291,279	$ 361,619	$ 275,405	$ 355,401
Capitalized interest related to consolidation of previously unconsolidated joint ventures	9,914			
Interest incurred (a)	91,907	88,168	30,001	30,891
Interest expensed (a)	(52,108)	(35,502)	(16,183)	(15,379)
Interest amortized	(79,454)	(78,832)	(27,685)	(35,460)
Capitalized interest at end of period (b)	$ 261,538	$ 335,453	$ 261,538	$ 335,453

(a) Amounts for the nine months ended August 31, 2010 include a total of $1.8 million of debt issuance costs written off in connection with the Company s voluntary reduction of the aggregate commitment under the Credit Facility from $650.0 million to $200.0 million during the first quarter of 2010 and the voluntary termination of the Credit Facility during the second quarter of 2010. Amounts for the three months and nine months ended August 31, 2009 include a $1.0 million loss on the early redemption of debt.

(b) Inventory impairment charges are recognized against all inventory costs of a community, such as land, land improvements, costs of home construction and capitalized interest. Capitalized interest amounts presented in the table reflect the gross amount of capitalized interest because impairment charges recognized are not generally allocated to specific components of inventory.

6. Inventory Impairments and Land Option Contract Abandonments

Each land parcel or community in the Company s owned inventory is assessed to determine if indicators of potential impairment exist. Impairment indicators are assessed separately for each land parcel or community on a quarterly basis and include, but are not limited to: significant decreases in sales rates, average selling prices, volume of homes delivered, gross margins on homes delivered or projected margins on homes in backlog or future housing sales; significant increases in budgeted land development and construction costs or cancellation rates; or projected losses on expected future land sales. If indicators of potential impairment exist for a land parcel or community, the identified inventory is evaluated for recoverability in accordance with Accounting Standards Codification Topic No. 360, Property, Plant and Equipment (ASC 360). When an indicator of potential impairment is identified, the Company tests the asset for recoverability by comparing the carrying amount of the asset to the undiscounted future net cash flows expected to be generated by the asset. The undiscounted future net cash flows are impacted by trends and factors known to the Company at the time they are calculated and the Company s expectations related to: market supply and demand, including estimates concerning average selling prices; sales and cancellation rates; and anticipated land development, construction and overhead costs to be incurred. These estimates, trends and expectations are specific to each land parcel or community and may vary among land parcels or communities.

A real estate asset is considered impaired when its carrying amount is greater than the undiscounted future net cash flows the asset is expected to generate. Impaired real estate assets are written down to fair value, which is primarily based on the estimated future cash flows discounted for inherent risk associated with each asset. These discounted cash flows are impacted by: the risk-free rate of return; expected risk premium based on estimated land development, construction and delivery timelines; market risk from potential future price erosion; cost uncertainty due to development or construction cost increases; and other risks specific to the asset or conditions in the market in which the asset is located at the time the assessment is made. These factors are specific to each land parcel or community and may vary among land parcels or communities.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

6. Inventory Impairments and Land Option Contract Abandonments (continued)

Based on the results of its evaluations, the Company recognized $1.4 million of pretax, noncash inventory impairment charges in the three months ended August 31, 2010 and $22.8 million of such charges in the three months ended August 31, 2009. In the nine months ended August 31, 2010 and 2009, the Company recognized pretax, noncash inventory impairment charges of $8.2 million and $52.9 million, respectively. As of August 31, 2010, the aggregate carrying value of inventory impacted by pretax, noncash inventory impairment charges was $479.2 million, representing 86 communities and various other land parcels. As of November 30, 2009, the aggregate carrying value of inventory impacted by pretax, noncash inventory impairment charges was $603.9 million, representing 128 communities and various other land parcels.

The Company s optioned inventory is assessed to determine whether it continues to meet the Company s internal investment standards and marketing strategy. Assessments are made separately for each optioned parcel on a quarterly basis and are affected by, among other factors: current and/or anticipated sales rates, average selling prices and home delivery volume; estimated land development and construction costs; and projected profitability on expected future housing or land sales. When a decision is made not to exercise certain land option contracts due to market conditions and/or changes in market strategy, the Company writes off the costs, including non-refundable deposits and pre-acquisition costs, related to the abandoned projects. Based on the results of its assessments, the Company recognized $1.9 million of land option contract abandonment charges in the three months ended August 31, 2010 and $1.7 million of such charges in the three months ended August 31, 2009. In the nine months ended August 31, 2010 and 2009, the Company recognized land option contract abandonment charges of $8.5 million and $38.5 million, respectively.

The inventory impairment and land option contract abandonment charges are included in construction and land costs in the Company s consolidated statements of operations.

Due to the judgment and assumptions applied in the estimation process with respect to inventory impairments and land option contract abandonments, it is possible that actual results could differ substantially from those estimated.

7. Fair Value Disclosures

Accounting Standards Codification Topic No. 820, Fair Value Measurements and Disclosures, provides a framework for measuring the fair value of assets and liabilities under GAAP and establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy can be summarized as follows:

Level 1 Fair value determined based on quoted prices in active markets for identical assets or liabilities.

Level 2 Fair value determined using significant observable inputs, such as quoted prices for similar assets or liabilities or quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data, by correlation or other means.

Level 3 Fair value determined using significant unobservable inputs, such as pricing models, discounted cash flows, or similar techniques.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

7. Fair Value Disclosures (continued)

The following table presents the Company s assets measured at fair value on a nonrecurring basis (in thousands):

Description	Nine Months Ended August 31, 2010 (a)	Fair Value Measurements Using: Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Long-lived assets held and used	$ 6,609	$	$	$ 6,609	$ (8,269)

(a) Amount represents the aggregate fair values for communities where the Company recognized noncash inventory impairment charges during the period, as of the date that the fair value measurements were made. The carrying value for these communities may have subsequently increased or decreased from the fair value reflected due to activity that has occurred since the measurement date.

In accordance with the provisions of ASC 360, long-lived assets held and used with a carrying amount of $14.9 million were written down to their fair value of $6.6 million during the nine months ended August 31, 2010, resulting in noncash inventory impairment charges of $8.2 million.

The fair values for long-lived assets held and used, determined using Level 3 inputs, were primarily based on the estimated future cash flows discounted for inherent risk associated with each asset. These discounted cash flows are impacted by: the risk-free rate of return; expected risk premium based on estimated land development, construction and delivery timelines; market risk from potential future price erosion; cost uncertainty due to development or construction cost increases; and other risks specific to the asset or conditions in the market in which the asset is located at the time the assessment is made. These factors are specific to each land parcel or community and may vary among land parcels or communities.

The following table presents the carrying values and estimated fair values of the Company s financial instruments, except those for which the carrying values approximate fair values (in thousands):

	August 31, 2010		November 30, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial Liabilities:				
Senior notes due 2011 at 6 3/8%	$ 99,886	$ 101,250	$ 99,800	$ 100,250
Senior notes due 2014 at 5 3/4%	249,463	233,750	249,358	234,375
Senior notes due 2015 at 5 7/8%	299,018	273,750	298,875	276,000
Senior notes due 2015 at 6 1/4%	449,733	411,750	449,698	419,063
Senior notes due 2017 at 9.1%	260,231	266,325	259,884	276,263
Senior notes due 2018 at 7 1/4%	298,866	273,000	298,787	281,250

The fair values of the Company s senior notes are estimated based on quoted market prices.

The carrying amounts reported for cash and cash equivalents, restricted cash, and mortgages and land contracts due to land sellers and other loans approximate fair values.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

8. Variable Interest Entities

In June 2009, the Financial Accounting Standards Board (FASB) revised the authoritative guidance for determining the primary beneficiary of a variable interest entity (VIE). In December 2009, the FASB issued Accounting Standards Update No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (ASU 2009-17), which provided amendments to Accounting Standards Codification Topic No. 810, Consolidation (ASC 810) to reflect the revised guidance. The amendments to ASC 810 replaced the quantitative-based risk and rewards calculation for determining which reporting entity, if any, has a controlling interest in a VIE with an approach focused on identifying which reporting entity has the power to direct the activities of a VIE that most significantly impact the VIE s economic performance and (i) the obligation to absorb losses of the VIE or (ii) the right to receive benefits from the VIE. The amendments also require additional disclosures about a reporting entity s involvement with VIEs. The Company adopted the amended provisions of ASC 810 effective December 1, 2009. The adoption of the amended provisions of ASC 810 did not have a material effect on the Company s consolidated financial position or results of operations.

The Company participates in joint ventures from time to time for the purpose of conducting land acquisition, development and/or other homebuilding activities. Its investments in these joint ventures may create a variable interest in a VIE, depending on the contractual terms of the arrangement. The Company analyzes its joint ventures in accordance with ASC 810 to determine whether they are VIEs and, if so, whether the Company is the primary beneficiary. All of the Company s joint ventures at August 31, 2010 and November 30, 2009 were determined under the provisions of ASC 810 applicable at each such date to be unconsolidated joint ventures, either because they were not VIEs or, if they were VIEs, the Company was not the primary beneficiary of the VIEs.

In the ordinary course of its business, the Company enters into land option contracts, or similar contracts, to procure land for the construction of homes. The use of such land option and other similar contracts generally allows the Company to reduce the risks associated with direct land ownership and development, reduces the Company s capital and financial commitments, including interest and other carrying costs, and minimizes the amount of the Company s land inventories on its consolidated balance sheets. Under such contracts, the Company will pay a specified option deposit or earnest money deposit in consideration for the right to purchase land in the future, usually at a predetermined price. Under the requirements of ASC 810, certain of these contracts may create a variable interest for the Company, with the land seller being identified as a VIE.

In compliance with ASC 810, the Company analyzes its land option and other similar contracts to determine whether the corresponding land sellers are VIEs and, if so, whether the Company is the primary beneficiary. Although the Company does not have legal title to the optioned land, ASC 810 requires the Company to consolidate a VIE if the Company is determined to be the primary beneficiary. As a result of its analyses, the Company determined that as of August 31, 2010 it was not the primary beneficiary of any VIEs from which it is purchasing land under land option or other similar contracts. Since adopting the amended provisions of ASC 810, in determining whether it is the primary beneficiary, the Company considers, among other things, whether it has the power to direct the activities of the VIE that most significantly impact the VIE s economic performance. Such activities would include, among other things, determining or limiting the scope or purpose of the VIE, selling or transferring property owned or controlled by the VIE, or arranging financing for the VIE. The Company also considers whether it has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE.

Based on its analyses as of November 30, 2009, which were performed before the Company adopted the amended provisions of ASC 810, the Company determined that it was the primary beneficiary of certain VIEs from which it was purchasing land under land option or other similar contracts and, therefore, consolidated such VIEs. Prior to its adoption of the amended provisions of ASC 810, in determining whether it was the primary beneficiary, the Company considered, among other things, the size of its deposit relative to the contract price, the risk of obtaining land entitlement approval, the risk associated with land development required under the land option or other similar contract, and the risk of changes in the market value of the optioned land during the contract period. The consolidation of VIEs in which the Company determined it was the primary beneficiary increased inventories, with a corresponding increase to accrued expenses and other liabilities, on the Company s consolidated balance sheet by $21.0 million at November 30, 2009. The liabilities related to the Company s consolidation of VIEs from which it has arranged to purchase land under option and other similar contracts represent the difference between the purchase price of land not yet purchased and the Company s cash deposits. The Company s cash deposits related to these land option and other similar contracts totaled $4.1 million at November 30, 2009. Creditors, if any, of these VIEs have no recourse against the Company.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

8. Variable Interest Entities (continued)

As of August 31, 2010, the Company had cash deposits totaling $2.3 million associated with land option and other similar contracts that the Company determined to be unconsolidated VIEs, having an aggregate purchase price of $92.3 million, and had cash deposits totaling $15.0 million associated with land option and other similar contracts that the Company determined were not VIEs, having an aggregate purchase price of $328.0 million.

The Company s exposure to loss related to its land option and other similar contracts with third parties and unconsolidated entities consisted of its non-refundable deposits, which totaled $17.3 million at August 31, 2010 and $9.6 million at November 30, 2009. In addition, the Company had outstanding letters of credit of $4.4 million at August 31, 2010 and $8.7 million at November 30, 2009 in lieu of cash deposits under certain land option or other similar contracts.

The Company also evaluates its land option and other similar contracts in accordance with Accounting Standards Codification Topic No. 470, Debt (ASC 470), and, as a result of its evaluations, increased inventories, with a corresponding increase to accrued expenses and other liabilities, on its consolidated balance sheets by $19.5 million at August 31, 2010 and $36.1 million at November 30, 2009.

9. Investments in Unconsolidated Joint Ventures

The Company participates in unconsolidated joint ventures that conduct land acquisition, development and/or other homebuilding activities in various markets, typically where the Company s homebuilding operations are located. The Company s partners in these unconsolidated joint ventures are unrelated homebuilders, land developers and other real estate entities, or commercial enterprises. Through these unconsolidated joint ventures, the Company seeks to reduce and share market and development risks and to reduce its investment in land inventory, while potentially increasing the number of homesites it controls or will own. In some instances, participating in unconsolidated joint ventures enables the Company to acquire and develop land that it might not otherwise have access to due to a project s size, financing needs, duration of development or other circumstances. While the Company views its participation in unconsolidated joint ventures as beneficial to its homebuilding activities, it does not view such participation as essential.

The Company and/or its unconsolidated joint venture partners typically obtain options or enter into other arrangements to have the right to purchase portions of the land held by the unconsolidated joint ventures. The prices for these land options or other arrangements are generally negotiated prices that approximate fair value. When an unconsolidated joint venture sells land to the Company s homebuilding operations, the Company defers recognition of its share of such unconsolidated joint venture earnings until a home sale is closed and title passes to a homebuyer, at which time the Company accounts for those earnings as a reduction of the cost of purchasing the land from the unconsolidated joint venture.

The Company and its unconsolidated joint venture partners make initial or ongoing capital contributions to these unconsolidated joint ventures, typically on a pro rata basis. The obligations to make capital contributions are governed by each unconsolidated joint venture s respective operating agreement and related documents.

Each unconsolidated joint venture is obligated to maintain financial statements in accordance with GAAP. The Company shares in profits and losses of these unconsolidated joint ventures generally in accordance with its respective equity interests. In some instances, the Company recognizes profits and losses that differ from its pro rata share of profits and losses recognized by an unconsolidated joint venture. Such differences may arise from impairments recognized by the Company related to its investment in an unconsolidated joint venture which differ from the recognition of impairments by the unconsolidated joint venture, differences between the Company s basis in assets transferred to an unconsolidated joint venture and the unconsolidated joint venture s basis in those assets, the deferral of unconsolidated joint venture profits from land sales to the Company, or other items.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

The following table presents information from the combined condensed statements of operations of the Company s unconsolidated joint ventures (in thousands):

	Nine Months Ended August 31, 2010	Nine Months Ended August 31, 2009	Three Months Ended August 31, 2010	Three Months Ended August 31, 2009
Revenues	$ 110,455	$ 47,810	$ 10,376	$ 13,603
Construction and land costs	(109,929)	(100,911)	(9,194)	(50,540)
Other expenses, net	(14,173)	(39,216)	(5,336)	(16,123)
Loss	$ (13,647)	$ (92,317)	$ (4,154)	$ (53,060)

With respect to the Company s investment in unconsolidated joint ventures, its equity in loss of unconsolidated joint ventures for the three months and nine months ended August 31, 2009 included pretax, noncash impairment charges of $23.2 million and $38.0 million, respectively. There were no such charges for the three months or nine months ended August 31, 2010. Due to the judgment and assumptions applied in the estimation process with respect to joint venture impairments, it is possible that actual results could differ substantially from those estimated.

The following table presents combined condensed information from the balance sheets of the Company s unconsolidated joint ventures (in thousands):

	August 31, 2010	November 30, 2009
Assets		
Cash	$ 13,251	$ 12,816
Receivables	147,156	142,639
Inventories	574,996	709,130
Other assets	51,860	56,939
Total assets	$ 787,263	$ 921,524
Liabilities and equity		
Accounts payable and other liabilities	$ 64,218	$ 94,533
Mortgages and notes payable	374,434	514,172
Equity	348,611	312,819
Total liabilities and equity	$ 787,263	$ 921,524

The following tables present information relating to the Company s investments in unconsolidated joint ventures and the aggregate outstanding debt of its unconsolidated joint ventures as of the dates specified, categorized by the nature of the Company s potential responsibility under a guaranty, if any, for such debt (dollars in thousands):

	August 31, 2010	November 30, 2009
Number of investments in unconsolidated joint ventures:		
With limited recourse debt (a)	1	2
With non-recourse debt (b)		2
Other (c)	9	9
Total	10	13

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

	August 31, 2010	November 30, 2009
Investments in unconsolidated joint ventures:		
With limited recourse debt	$	$ 1,277
With non-recourse debt		9,983
Other	101,435	108,408
Total	$ 101,435	$ 119,668
Outstanding debt of unconsolidated joint ventures:		
With limited recourse debt	$ 2,052	$ 11,198
With non-recourse debt		130,025
Other	372,382	372,949
Total (d)	$ 374,434	$ 514,172

(a) This category consists of unconsolidated joint ventures as to which the Company has entered into a loan-to-value maintenance guaranty with respect to a portion of each such unconsolidated joint venture s outstanding secured debt.

(b) This category consists of unconsolidated joint ventures as to which the

Company does not have a guaranty or any other obligation to repay or to support the value of the collateral (which collateral includes any letters of credit) underlying such unconsolidated joint ventures respective outstanding secured debt.

(c) This category consists of unconsolidated joint ventures with no outstanding debt and an unconsolidated joint venture as to which the Company has entered into a several guaranty. This guaranty, by its terms, purports to require the Company to guarantee the repayment of a portion of the unconsolidated joint venture s outstanding debt in the event an involuntary bankruptcy proceeding is filed against the unconsolidated joint venture that is not dismissed within 60 days or for which an order approving relief under bankruptcy law is entered, even if the unconsolidated joint venture or its partners do not collude in the filing and the unconsolidated joint venture contests the filing, as further described below.

In most cases, the Company may have also entered into a completion guaranty and/or a carve-out guaranty with the lenders for the unconsolidated joint ventures identified in categories (a) through (c) as further described below.

(d) The Total amounts represent the aggregate outstanding debt of the unconsolidated joint ventures in which the Company participates. These amounts do not represent the Company s potential responsibility for such debt, if any. In most cases, the Company s maximum potential responsibility for any portion of such debt, if any, is limited to either a specified maximum amount or an amount equal to its pro rata interest in the relevant unconsolidated joint venture, as further described below.

The unconsolidated joint ventures finance land and inventory investments through a variety of arrangements. To finance their respective land acquisition and development activities, certain of the Company s unconsolidated joint ventures have obtained loans from third-party lenders that are secured by the underlying property and related project assets. The Company s unconsolidated joint ventures had aggregate outstanding debt, substantially all of which was secured, of approximately $374.4 million at August 31, 2010 and $514.2 million at November 30, 2009. Various financial and non-financial covenants apply to the outstanding debt of the unconsolidated joint ventures, and a failure to comply with any applicable debt covenants could result in a default and cause lenders to seek to enforce guarantees, if applicable, as described below.

In certain instances, the Company and/or its partner(s) in an unconsolidated joint venture provide guarantees and indemnities to the unconsolidated joint venture s lenders that may include one or more of the following: (a) a completion guaranty; (b) a loan-to-value maintenance guaranty; and/or (c) a carve-out guaranty. A completion guaranty refers to the actual physical completion of improvements for a project and/or the obligation to contribute equity to an unconsolidated joint venture to enable it to fund its completion obligations. A loan-to-value maintenance guaranty refers to the payment of

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

funds to maintain the applicable loan balance at or below a specific percentage of the value of an unconsolidated joint venture s secured collateral (generally land and improvements). A carve-out guaranty refers to the payment of (i) losses a lender suffers due to certain bad acts or omissions by an unconsolidated joint venture or its partners, such as fraud or misappropriation, or due to environmental liabilities arising with respect to the relevant project, or (ii) outstanding principal and interest and certain other amounts owed to lenders upon the filing by an unconsolidated joint venture of a voluntary bankruptcy petition or the filing of an involuntary bankruptcy petition by creditors of the unconsolidated joint venture in which an unconsolidated joint venture or its partners collude or which the unconsolidated joint venture fails to contest.

The Company s maximum potential responsibility under these guarantees and indemnities is limited to either a specified maximum dollar amount or an amount equal to its pro rata interest in the relevant unconsolidated joint venture.

The Company s potential responsibility under its completion guarantees, if triggered, is highly dependent on the facts of a particular case. In any event, the Company believes its actual responsibility under these guarantees is limited to the amount, if any, by which an unconsolidated joint venture s outstanding borrowings exceed the value of its assets, but may be substantially less than this amount.

At August 31, 2010, the Company s potential responsibility under its loan-to-value maintenance guaranty relating to approximately $2.0 million of outstanding debt held by one unconsolidated joint venture totaled approximately $1.0 million, if any liability were determined to be due thereunder. This amount represents the Company s maximum responsibility under such loan-to-value maintenance guaranty assuming the underlying collateral has no value and without regard to defenses that could be available to the Company against any attempted enforcement of such guaranty.

Notwithstanding the Company s potential unconsolidated joint venture guaranty and indemnity responsibilities and the resolutions it has reached in certain instances with unconsolidated joint venture lenders with respect to those potential responsibilities, at this time the Company does not believe, except as described in the next two paragraphs below, that its existing exposure under its outstanding completion, loan-to-value and carve-out guarantees and indemnities related to unconsolidated joint venture debt is material to the Company s consolidated financial position or results of operations.

In addition to the above-described guarantees and indemnities, the Company has also provided a several guaranty to the lenders of one of the Company s unconsolidated joint ventures. By its terms, the guaranty purports to guarantee the repayment of principal and interest and certain other amounts owed to the unconsolidated joint venture s lenders when an involuntary bankruptcy proceeding is filed against the unconsolidated joint venture that is not dismissed within 60 days or for which an order approving relief under bankruptcy law is entered, even if the unconsolidated joint venture or its partners do not collude in the filing and the unconsolidated joint venture contests the filing. The Company s potential responsibility under this several guaranty fluctuates with the unconsolidated joint venture s debt and with the Company s and its partners respective land purchases from the unconsolidated joint venture. At August 31, 2010, this unconsolidated joint venture had total outstanding indebtedness of approximately $372.4 million and, if this guaranty were then enforced, the Company s maximum potential responsibility under the guaranty would have been approximately $182.7 million in principal amount, which amount does not account for any offsets or defenses that could be available to the Company.

The lenders for two of the Company s unconsolidated joint ventures have filed lawsuits against some of the unconsolidated joint ventures members, and certain of those members parent companies, seeking to recover damages under completion guarantees, among other claims *(JP Morgan Chase Bank, N.A. v. KB HOME Nevada, et al., U.S. District Court, District of Nevada (Case No. 08-CV-01711 PMP-RJJ); Wachovia Bank, N.A. v. Focus Kyle Group LLC, et al. U.S. District Court, Southern District of New York (Case No. 08-cv-8681(LTS)(GWG)))*. The Company and the other parent companies, together with the members, are defending the lawsuits in which they have been named and are currently exploring resolutions with the lenders. In a separate proceeding, the members (including the Company) of one of these unconsolidated joint ventures participated in an arbitration regarding their respective performance obligations in order to address one member s claims for specific performance and, in the alternative, damages. On July 6, 2010, a decision was issued in this arbitration proceeding. In its decision, the arbitration panel denied the specific performance claims and awarded damages in an amount well below the amount claimed. The Company s potential proportional responsibility for the damages awarded is not considered to be material to the Company s consolidated financial position or results of operations. The litigation commenced by the lenders remains ongoing, and there is no assurance that the parties involved will reach satisfactory resolutions. Further, if

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

satisfactory resolutions are not reached, there is no assurance that the ultimate outcome of any of the litigation would not be material to the Company s consolidated financial position or results of operations.

10. Mortgages and Notes Payable

Mortgages and notes payable consisted of the following (in thousands):

	August 31, 2010	November 30, 2009
Mortgages and land contracts due to land sellers and other loans	$ 143,722	$ 163,968
Senior notes due 2011 at 6 3/8%	99,886	99,800
Senior notes due 2014 at 5 3/4%	249,463	249,358
Senior notes due 2015 at 5 7/8%	299,018	298,875
Senior notes due 2015 at 6 1/4%	449,733	449,698
Senior notes due 2017 at 9.1%	260,231	259,884
Senior notes due 2018 at 7 1/4%	298,866	298,787
Total	$ 1,800,919	$ 1,820,370

At November 30, 2009, the Company maintained the Credit Facility with a syndicate of lenders that was scheduled to mature in November 2010. To reduce costs associated with maintaining the Credit Facility, effective December 28, 2009, the Company voluntarily reduced the aggregate commitment under the Credit Facility from $650.0 million to $200.0 million, and effective March 31, 2010, the Company voluntarily terminated the Credit Facility.

With the Credit Facility s termination, the Company proceeded to enter into the LOC Facilities with various banks to obtain letters of credit in the ordinary course of its business. As of August 31, 2010, $88.9 million of letters of credit were outstanding under the LOC Facilities. The LOC Facilities require the Company to deposit and maintain cash with the banks as collateral for its letters of credit outstanding. As of August 31, 2010, the amount of cash maintained for the LOC Facilities totaled $91.6 million and was included in restricted cash on the Company s consolidated balance sheet as of that date. In the future, the Company may enter into similar facilities with other financial institutions.

The termination of the Credit Facility also released and discharged six of the Company s subsidiaries from guaranteeing any obligations with respect to the Company s senior notes (the Released Subsidiaries). Each of the Released Subsidiaries is not a significant subsidiary, as defined under Rule 1-02(w) of Regulation S-X, and does not guarantee any other indebtedness of the Company. Each Released Subsidiary may be required to again provide a guarantee with respect to the Company s senior notes if it becomes a significant subsidiary. Three of the Company s subsidiaries (the Guarantor Subsidiaries) continue to provide a guarantee with respect to the Company s senior notes.

In the second quarter of 2010, the Company voluntarily replaced letters of credit it previously posted as collateral for certain mortgages and notes payable with cash collateral deposited in an account. As of August 31, 2010, this required cash collateral, which is associated with a multi-level residential building the Company is operating as a rental property, totaled $24.8 million and was included in restricted cash on the Company s consolidated balance sheet as of that date.

The indenture governing the Company s senior notes does not contain any financial maintenance covenants. Subject to specified exceptions, the senior notes indenture contains certain restrictive covenants that, among other things, limit the Company s ability to incur secured indebtedness, or engage in sale-leaseback transactions involving property or assets above a certain specified value. The terms governing the Company s senior notes due 2017 contain certain limitations related to mergers, consolidations, and sales of assets.

As of August 31, 2010, the Company was in compliance with the applicable terms of all of its covenants under the Company s senior notes, senior notes indenture, and mortgages and land contracts due to land sellers and other loans. The Company s ability to secure future debt financing may depend in part on its ability to remain in such compliance.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

11. Commitments and Contingencies

The Company provides a limited warranty on all of its homes. The specific terms and conditions of warranties vary depending upon the market in which the Company does business. The Company generally provides a structural warranty of 10 years, a warranty on electrical, heating, cooling, plumbing and other building systems each varying from two to five years based on geographic market and state law, and a warranty of one year for other components of a home. The Company estimates the costs that may be incurred under each limited warranty and records a liability in the amount of such costs at the time the revenue associated with the sale of each home is recognized. Factors that affect the Company s warranty liability include the number of homes delivered, historical and anticipated rates of warranty claims, and cost per claim. The Company s primary assumption in estimating the amounts it accrues for warranty costs is that historical claims experience is a strong indicator of future claims experience. The Company periodically assesses the adequacy of its recorded warranty liabilities, which are included in accrued expenses and other liabilities in the consolidated balance sheets, and adjusts the amounts as necessary based on its assessment.

The changes in the Company s warranty liability are as follows (in thousands):

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2010	2009	2010	2009
Balance at beginning of period	$ 135,749	$ 145,369	$ 117,753	$ 137,690
Warranties issued	4,777	12,380	2,127	8,154
Payments and adjustments	(38,596)	(17,945)	(17,950)	(6,040)
Balance at end of period	$ 101,930	$ 139,804	$ 101,930	$ 139,804

The Company s warranty liability of $101.9 million at August 31, 2010 includes $14.5 million associated with approximately 330 homes that have been identified as containing or suspected of containing allegedly defective drywall manufactured in China. These homes, which have repairs remaining to be completed and/or repair costs remaining to be paid, were primarily delivered in 2006 and 2007 and are located in Florida. The Company believes that its overall warranty liability at August 31, 2010 is sufficient with respect to its general limited warranty obligations and the estimated costs remaining to repair the identified homes affected by the allegedly defective drywall. The Company is continuing to review whether there are any additional homes delivered in Florida or other locations that contain or may contain this drywall material. Depending on the outcome of its review and its actual claims experience, the Company may need to increase its warranty liability in future periods. The amount accrued to repair these homes is based largely on the Company s estimates of future costs. If the actual costs to repair these homes differ from the estimated costs, the Company may revise its warranty estimate for this issue. During the three months and nine months ended August 31, 2010, the Company made payments totaling $8.4 million and $19.4 million, respectively, for the repair of homes that had been identified as containing or suspected of containing allegedly defective drywall manufactured in China. Such payments totaled less than $.1 million in the three months and nine months ended August 31, 2009.

The Company has been named as a defendant in nine lawsuits relating to this drywall material, and it may in the future be subject to other similar litigation or claims that could cause the Company to incur significant costs. Given the preliminary stages of the proceedings, the Company has not concluded whether the outcome of any of these lawsuits, if unfavorable, is likely to be material to its consolidated financial position or results of operations.

The Company intends to seek and is undertaking efforts, including legal proceedings, to obtain reimbursement from various sources for the costs it has or expects to incur to investigate and complete repairs and to defend itself in litigation associated with this drywall material. At this early stage of its efforts to investigate and complete repairs and to respond to litigation, however, the Company has not recorded any amounts for potential recoveries as of August 31, 2010.

In the normal course of its business, the Company issues certain representations, warranties and guarantees related to its home sales and land sales that may be affected by Accounting Standards Codification Topic No. 460, Guarantees. Based

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

11. Commitments and Contingencies (continued)

on historical evidence, the Company does not believe any of these representations, warranties or guarantees would result in a material effect on its consolidated financial position or results of operations.

The Company has, and requires the majority of its subcontractors to have, general liability insurance (including construction defect coverage) and workers compensation insurance. These insurance policies protect the Company against a portion of its risk of loss from claims related to its homebuilding activities, subject to certain self-insured retentions, deductibles and other coverage limits. In Arizona, California, Colorado and Nevada, the Company s general liability insurance takes the form of a wrap-up policy, where eligible subcontractors are enrolled as insureds on each project. The Company self-insures a portion of its overall risk through the use of a captive insurance subsidiary. The Company records expenses and liabilities based on the costs required to cover its self-insured retention and deductible amounts under its insurance policies, and on the estimated costs of potential claims and claim adjustment expenses above its coverage limits or that are not covered by its policies. These estimated costs are based on an analysis of the Company s historical claims and include an estimate of construction defect claims incurred but not yet reported. The Company s estimated liabilities for such items were $95.2 million at August 31, 2010 and $107.0 million at November 30, 2009. These amounts are included in accrued expenses and other liabilities in the Company s consolidated balance sheets. The Company s expenses associated with self-insurance totaled $1.6 million for the three months ended August 31, 2010 and $1.8 million for the three months ended August 31, 2009. The Company s expenses associated with self-insurance totaled $5.2 million for the nine months ended August 31, 2010 and $5.3 million for the nine months ended August 31, 2009.

The Company is often required to obtain performance bonds and letters of credit in support of its obligations to various municipalities and other government agencies in connection with community improvements such as roads, sewers and water, and to certain unconsolidated joint ventures. At August 31, 2010, the Company had $499.1 million of performance bonds and $88.9 million of letters of credit outstanding. In the event any such performance bonds or letters of credit were called, the Company would be obligated to reimburse the issuer of the performance bond or letter of credit. The Company does not believe that a material amount of any currently outstanding performance bonds or letters of credit will be called. Performance bonds do not have stated expiration dates. Rather, the Company is released from the performance bonds as the underlying performance is completed. The expiration dates of some letters of credit issued in connection with community improvements coincide with the expected completion dates of the related projects or obligations. Most letters of credit, however, are issued with an initial term of one year and are typically extended on a year-to-year basis until the related performance obligation is completed.

In the ordinary course of its business, the Company enters into land option contracts, or similar contracts, to procure land for the construction of homes. At August 31, 2010, the Company had total deposits of $21.7 million, comprised of cash deposits of $17.3 million and letters of credit of $4.4 million, to purchase land having an aggregate purchase price of $420.3 million. The Company s land option and other similar contracts generally do not contain provisions requiring the Company s specific performance.

12. Legal Matters

ERISA Litigation

On March 16, 2007, plaintiffs Reba Bagley and Scott Silver filed an action brought under Section 502 of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1132, *Bagley et al., v. KB Home, et al.*, in the United States District Court for the Central District of California. The action was brought against the Company, its directors, certain of its current and former officers, and the board of directors committee that oversees the KB Home 401(k) Savings Plan (401(k) Plan). After the court allowed leave to file an amended complaint, plaintiffs filed an amended complaint adding Tolan Beck and Rod Hughes as additional plaintiffs and dismissing certain individuals as defendants. All four plaintiffs claimed to be former employees of KB Home who participated in the 401(k) Plan. Plaintiffs alleged on behalf of themselves and on behalf of all others similarly situated that all defendants breached fiduciary duties owed to plaintiffs and purported class members under ERISA by failing to disclose information to and providing misleading information to participants in the 401(k) Plan about the Company s alleged prior stock option backdating practices and by failing to remove the Company s stock as an investment option under the 401(k) Plan. Plaintiffs alleged that this breach of fiduciary duties caused plaintiffs to earn less on their 401(k) Plan accounts than they would have earned but for defendants alleged breach of duties.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

12. Legal Matters (continued)

The parties to the litigation executed a settlement agreement on February 26, 2010 and an amended settlement agreement on April 5, 2010. On September 8, 2010, the court approved the amended settlement agreement and dismissed the case. The settlement is not material to the Company s consolidated financial position or results of operations.

Other Matters

On October 2, 2009, the staff of the SEC notified the Company that a formal order of investigation had been issued regarding possible accounting and disclosure issues. In August 2010, the Company received a letter from the staff of the SEC advising the Company that the staff had completed its investigation and did not intend to recommend any enforcement action by the SEC.

In addition to those described in this report, the Company is involved in litigation and government proceedings incidental to its business. These proceedings are in various procedural stages and, based on reports of counsel, the Company believes as of the date of this report that provisions or accruals made for any potential losses (to the extent estimable) are adequate and that any liabilities or costs arising out of these proceedings are not likely to have a materially adverse effect on its consolidated financial position or results of operations. The outcome of any of these proceedings, however, is inherently uncertain, and if unfavorable outcomes were to occur, there is a possibility that they would, individually or in the aggregate, have a materially adverse effect on the Company s consolidated financial position or results of operations.

13. Stockholders Equity

As of August 31, 2010, the Company was authorized to repurchase four million shares of its common stock under a board-approved share repurchase program. The Company did not repurchase any shares of its common stock under this program in the nine months ended August 31, 2010. The Company has not repurchased common shares pursuant to a common stock repurchase plan for the past several years and any resumption of such stock repurchases will be at the discretion of the Company s board of directors. The Company acquired $.4 million of common stock in the nine months ended August 31, 2010, which were previously issued shares delivered to the Company by employees to satisfy withholding taxes on the vesting of restricted stock awards. These transactions are not considered repurchases under the share repurchase program.

During the quarter ended February 28, 2010, the Company s board of directors declared a cash dividend of $.0625 per share of common stock, which was paid on February 18, 2010 to stockholders of record on February 4, 2010. During the quarter ended May 31, 2010, the Company s board of directors declared a cash dividend of $.0625 per share of common stock, which was paid on May 20, 2010 to stockholders of record on May 6, 2010. During the quarter ended August 31, 2010, the Company s board of directors declared a cash dividend of $.0625 per share of common stock, which was paid on August 19, 2010 to stockholders of record on August 5, 2010.

14. Income Taxes

The Company s income tax benefit totaled $5.3 million for the three months ended August 31, 2010, compared to $11.0 million for the three months ended August 31, 2009. For the nine months ended August 31, 2010, the Company s income tax benefit totaled $5.0 million, compared to $17.7 million for the nine months ended August 31, 2009. The income tax benefits for the three months and nine months ended August 31, 2010 resulted primarily from the recognition of a $5.4 million federal income tax benefit in the third quarter of 2010 due to an increase in the carryback of the Company s 2009 net operating loss to offset earnings it generated in 2004 and 2005. The income tax benefit for the three months ended August 31, 2009 was primarily due to the reversal of a $10.8 million liability for unrecognized federal tax benefits as a result of the resolution of a federal tax audit. For the nine months ended August 31, 2009, the income tax benefit resulted primarily from the reversal of a $13.1 million liability for unrecognized federal tax benefits and the recognition of a $5.0 million federal and state income tax receivable based on the status of federal tax audits and amended state filings. Due to the effects of the Company s deferred tax asset valuation allowance, net operating loss carryback, and changes in its unrecognized tax benefits, the Company s effective tax benefit rates in 2010 and 2009 are not meaningful items as its income tax benefits are not directly correlated to the amount of its pretax losses for those periods.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

14. Income Taxes (continued)

In accordance with Accounting Standards Codification Topic No. 740, Income Taxes (ASC 740), the Company evaluates its deferred tax assets quarterly to determine if valuation allowances are required. ASC 740 requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence using a more likely than not standard. During the three months ended August 31, 2010, the Company recorded a net reduction of $2.4 million to the valuation allowance against net deferred tax assets. The net reduction was comprised of the $5.4 million federal income tax benefit from the increased carryback of the Company s 2009 net operating loss to offset earnings it generated in 2004 and 2005, partially offset by a $3.0 million valuation allowance recorded against the net deferred tax assets generated from the loss for the period. During the three months ended August 31, 2009, the Company recorded a valuation allowance of $35.5 million against net deferred tax assets. For the nine months ended August 31, 2010, the Company recorded a net increase of $31.6 million to the valuation allowance against net deferred tax assets. The net increase was comprised of a $37.0 million valuation allowance recorded against the net deferred tax assets generated from the loss for the period, partially offset by the $5.4 million federal income tax benefit from the increased carryback of the Company s 2009 net operating loss to offset earnings it generated in 2004 and 2005. For the nine months ended August 31, 2009, the Company recorded a valuation allowance of $89.9 million against the net deferred tax assets generated from the loss for the period.

The Company s net deferred tax assets totaled $1.1 million at both August 31, 2010 and November 30, 2009. The deferred tax asset valuation allowance increased to $781.6 million at August 31, 2010 from $750.0 million at November 30, 2009, reflecting the impact of the $31.6 million net increase in the valuation allowance recorded during the first nine months of 2010 described above.

During the three months ended August 31, 2010, the Company had $.1 million of additions and $.2 million of reductions to its total gross unrecognized tax benefits as a result of the current status of federal and state audits. During the nine months ended August 31, 2010, additions and reductions to the Company s total gross unrecognized tax benefits were $.4 million and $.9 million, respectively. The total amount of gross unrecognized tax benefits, including interest and penalties, was $9.0 million as of August 31, 2010. The Company anticipates that total unrecognized tax benefits will decrease by an amount ranging from $3.0 million to $4.0 million during the twelve months from this reporting date due to various state filings associated with the resolution of the federal tax audit.

The benefits of the Company s net operating losses, built-in losses and tax credits would be reduced or potentially eliminated if the Company experienced an ownership change under Internal Revenue Code Section 382 (Section 382). Based on the Company s analysis performed as of August 31, 2010, the Company does not believe it has experienced an ownership change as defined by Section 382, and, therefore, the net operating losses, built-in losses and tax credits the Company has generated should not be subject to a Section 382 limitation as of this reporting date.

15. Supplemental Disclosure to Consolidated Statements of Cash Flows

The following are supplemental disclosures to the consolidated statements of cash flows (in thousands):

	Nine Months Ended August 31,	
	2010	2009
Summary of cash and cash equivalents at the end of the period:		
Homebuilding	$ 919,851	$ 953,510
Financial services	3,756	1,873
Total	$ 923,607	$ 955,383

Supplemental disclosures of cash flow information:				
Interest paid, net of amounts capitalized	$	72,113	$	67,833
Income taxes paid		523		5,527
Income taxes refunded		191,345		237,010

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

15. Supplemental Disclosure to Consolidated Statements of Cash Flows (continued)

	Nine Months Ended August 31, 2010	Nine Months Ended August 31, 2009
Supplemental disclosures of noncash activities:		
Increase in inventories in connection with consolidation of joint ventures	$ 72,300	$ 97,550
Increase in secured debt in connection with consolidation of joint ventures		133,051
Increase in accounts payable, accrued expenses and other liabilities in connection with consolidation of joint ventures	38,861	
Stock appreciation rights exchanged for stock options	1,816	
Cost of inventories acquired through seller financing	53,125	8,964
Decrease in consolidated inventories not owned	(37,633)	(40,374)

16. Supplemental Guarantor Information

The Company s obligations to pay principal, premium, if any, and interest under its senior notes are guaranteed on a joint and several basis by the Guarantor Subsidiaries. The guarantees are full and unconditional and the Guarantor Subsidiaries are 100% owned by the Company. The Company has determined that separate, full financial statements of the Guarantor Subsidiaries would not be material to investors and, accordingly, supplemental financial information for the Guarantor Subsidiaries is presented.

In connection with the Company s voluntary termination of the Credit Facility effective March 31, 2010, the Released Subsidiaries were released and discharged from guaranteeing any obligations with respect to the Company s senior notes. Accordingly, the supplemental financial information presented below reflects the relevant subsidiaries that were Guarantor Subsidiaries as of the respective periods then ended.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

16. Supplemental Guarantor Information (continued)

Condensed Consolidated Statements of Operations

Nine Months Ended August 31, 2010 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 307,427	$ 831,606	$	$ 1,139,033
Homebuilding:					
Revenues	$	$ 307,427	$ 826,419	$	$ 1,133,846
Construction and land costs		(263,301)	(681,895)		(945,196)
Selling, general and administrative expenses	(59,796)	(41,940)	(132,059)		(233,795)
Operating income (loss)	(59,796)	2,186	12,465		(45,145)
Interest income	1,377	21	230		1,628
Interest expense, net of amounts capitalized/loss on early redemption	11,430	(29,002)	(34,536)		(52,108)
Equity in loss of unconsolidated joint ventures		(148)	(4,531)		(4,679)
Homebuilding pretax loss	(46,989)	(26,943)	(26,372)		(100,304)
Financial services pretax income			8,494		8,494
Total pretax loss	(46,989)	(26,943)	(17,878)		(91,810)
Income tax benefit	2,600	1,500	900		5,000
Equity in net loss of subsidiaries	(42,221)			42,221	
Net loss	$ (86,610)	$ (25,443)	$ (16,978)	$ 42,221	$ (86,810)

Nine Months Ended August 31, 2009 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 1,012,120	$ 138,162	$	$ 1,150,282

Homebuilding:					
Revenues	$	$ 1,012,120	$ 132,894	$	$ 1,145,014
Construction and land costs		(956,354)	(125,989)		(1,082,343)
Selling, general and administrative expenses	(54,883)	(134,632)	(28,132)		(217,647)
Operating loss	(54,883)	(78,866)	(21,227)		(154,976)
Interest income	5,233	572	605		6,410
Interest expense, net of amounts capitalized/loss on early redemption	25,186	(56,293)	(4,395)		(35,502)
Equity in loss of unconsolidated joint ventures		(20,699)	(27,112)		(47,811)
Homebuilding pretax loss	(24,464)	(155,286)	(52,129)		(231,879)
Financial services pretax income			11,676		11,676
Total pretax loss	(24,464)	(155,286)	(40,453)		(220,203)
Income tax benefit	2,000	12,400	3,300		17,700
Equity in net loss of subsidiaries	(180,039)			180,039	
Net loss	$ (202,503)	$ (142,886)	$ (37,153)	$ 180,039	$ (202,503)

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

16. Supplemental Guarantor Information (continued)

Condensed Consolidated Statements of Operations
Three Months Ended August 31, 2010 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 124,534	$ 376,469	$	$ 501,003
Homebuilding:					
Revenues	$	$ 124,534	$ 374,287	$	$ 498,821
Construction and land costs		(106,649)	(305,164)		(411,813)
Selling, general and administrative expenses	(12,767)	(13,731)	(52,104)		(78,602)
Operating income (loss)	(12,767)	4,154	17,019		8,406
Interest income	512	15	76		603
Interest expense, net of amounts capitalized/loss on early redemption	7,247	(11,045)	(12,385)		(16,183)
Equity in loss of unconsolidated joint ventures		(69)	(1,878)		(1,947)