KB HOME
Form 10-Q
July 10, 2009

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 May 31, 2009.

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 o 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 (Do not check if a smaller reporting company)	Smaller reporting company o

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 May 31, 2009.

Common stock, par value $1.00 per share: 88,072,926 shares outstanding, including 11,762,882 shares held by the registrant s Grantor Stock Ownership Trust and excluding 27,047,379 shares held in treasury.

KB HOME
FORM 10-Q
INDEX

	Page Number
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Statements of Operations Six Months and Three Months Ended May 31, 2009 and 2008	3
Consolidated Balance Sheets May 31, 2009 and November 30, 2008	4
Consolidated Statements of Cash Flows Six Months Ended May 31, 2009 and 2008	5
Notes to Consolidated Financial Statements	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3. Quantitative and Qualitative Disclosures About Market Risk	55
Item 4. Controls and Procedures	55
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	56
Item 1A. Risk Factors	57
Item 4. Submission of Matters to a Vote of Security Holders	57
Item 6. Exhibits	57
SIGNATURES	58
INDEX OF EXHIBITS	59

Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	Six Months Ended May 31, 2009	Six Months Ended May 31, 2008	Three Months Ended May 31, 2009	Three Months Ended May 31, 2008
Total revenues	$ 691,831	$ 1,433,289	$ 384,470	$ 639,065
Homebuilding:				
Revenues	$ 688,666	$ 1,428,402	$ 382,925	$ 637,094
Construction and land costs	(667,768)	(1,668,481)	(376,810)	(755,840)
Selling, general and administrative expenses	(133,769)	(246,703)	(72,594)	(119,065)
Goodwill impairment		(24,570)		(24,570)
Operating loss	(112,871)	(511,352)	(66,479)	(262,381)
Interest income	5,279	22,554	1,766	9,522
Interest expense, net of amounts capitalized	(20,123)		(11,471)	
Equity in loss of unconsolidated joint ventures	(21,496)	(45,361)	(11,754)	(5,483)
Homebuilding pretax loss	(149,211)	(534,159)	(87,938)	(258,342)
Financial services:				
Revenues	3,165	4,887	1,545	1,971
Expenses	(1,654)	(2,232)	(794)	(1,113)
Equity in income of unconsolidated joint venture	4,545	8,302	3,604	2,154
Financial services pretax income	6,056	10,957	4,355	3,012
Total pretax loss	(143,155)	(523,202)	(83,583)	(255,330)
Income tax benefit (expense)	6,700	(900)	5,200	(600)
Net loss	$ (136,455)	$ (524,102)	$ (78,383)	$ (255,930)
Basic and diluted loss per share	$ (1.78)	$ (6.77)	$ (1.03)	$ (3.30)
Basic and diluted average shares outstanding	76,822	77,413	76,281	77,462

Cash dividends declared per common share	$	.1250	$	.75	$	.0625	$	.50

See accompanying notes.

Table of Contents

KB HOME
CONSOLIDATED BALANCE SHEETS
(In Thousands Unaudited)

	May 31, 2009	November 30, 2008
Assets		
Homebuilding:		
Cash and cash equivalents	$ 997,357	$ 1,135,399
Restricted cash	102,160	115,404
Receivables	144,542	357,719
Inventories	1,893,963	2,106,716
Investments in unconsolidated joint ventures	171,181	177,649
Other assets	98,761	99,261
	3,407,964	3,992,148
Financial services	21,930	52,152
Total assets	$ 3,429,894	$ 4,044,300
Liabilities and stockholders equity		
Homebuilding:		
Accounts payable	$ 454,027	$ 541,294
Accrued expenses and other liabilities	571,015	721,397
Mortgages and notes payable	1,711,726	1,941,537
	2,736,768	3,204,228
Financial services	10,029	9,467
Common stock	115,120	115,120
Paid-in capital	862,705	865,123
Retained earnings	781,345	927,324
Accumulated other comprehensive loss	(17,402)	(17,402)
Grantor stock ownership trust, at cost	(127,821)	(129,326)
Treasury stock, at cost	(930,850)	(930,234)
Total stockholders equity	683,097	830,605

Total liabilities and stockholders equity	$ 3,429,894	$ 4,044,300

See accompanying notes.

4

Table of Contents

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

	Six Months Ended May 31, 2009	Six Months Ended May 31, 2008
Cash flows from operating activities:		
Net loss	$ (136,455)	$ (524,102)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Equity in loss of unconsolidated joint ventures	16,951	37,059
Distributions of earnings from unconsolidated joint ventures	7,662	8,975
Amortization of discounts and issuance costs	682	1,180
Depreciation and amortization	2,920	5,161
Tax benefits from stock-based compensation	4,093	2,046
Stock-based compensation expense	1,489	2,631
Inventory impairments and land option contract abandonments	66,980	361,948
Goodwill impairment		24,570
Change in assets and liabilities:		
Receivables	213,978	107,594
Inventories	120,738	218,121
Accounts payable, accrued expenses and other liabilities	(209,651)	(188,471)
Other, net	(5,865)	10,008
Net cash provided by operating activities	83,522	66,720
Cash flows from investing activities:		
Investments in unconsolidated joint ventures	7,310	(59,190)
Sales (purchases) of property and equipment, net	(914)	4,378
Net cash provided (used) by investing activities	6,396	(54,812)
Cash flows from financing activities:		
Change in restricted cash	13,244	
Repayment of senior subordinated notes	(200,000)	
Payments on mortgages, land contracts and other loans	(36,718)	(1,335)
Issuance of common stock under employee stock plans	1,691	3,593
Payments of cash dividends	(9,524)	(38,723)
Repurchases of common stock	(616)	(557)
Net cash used by financing activities	(231,923)	(37,022)
Net decrease in cash and cash equivalents	(142,005)	(25,114)
Cash and cash equivalents at beginning of period	1,141,518	1,343,742

Cash and cash equivalents at end of period	$ 999,513	$ 1,318,628

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 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 May 31, 2009, the results of its consolidated operations for the six months and three months ended May 31, 2009 and 2008, and its consolidated cash flows for the six months ended May 31, 2009 and 2008. The results of operations for the six months and three months ended May 31, 2009 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, 2008 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, 2008, 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 U.S. generally accepted accounting principles and, therefore, include amounts based on informed estimates and judgments of management. Actual results could differ from these estimates.

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 six months and three months ended May 31, 2009 and 2008 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 $78.4 million for the three months ended May 31, 2009 and $255.9 million for the three months ended May 31, 2008. The Company s comprehensive loss was $136.5 million for the six months ended May 31, 2009 and $524.1 million for the six months ended May 31, 2008. The accumulated balances of other comprehensive loss in the consolidated balance sheets as of May 31, 2009 and November 30, 2008 are comprised solely of adjustments recorded directly to accumulated other comprehensive loss in accordance with Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R), which requires an employer to recognize the funded status of a defined postretirement benefit plan 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 2009 presentation.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

2. Stock-Based Compensation

The Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS No. 123(R)), using the modified prospective transition method effective December 1, 2005. SFAS No. 123(R) 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. SFAS No. 123(R) requires public entities to initially measure compensation cost associated with awards of liability instruments based on their current fair value. The fair value of that award is to be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period.

Stock Options

In accordance with SFAS No. 123(R), 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 May 31, 2009, as well as stock options activity during the six months then ended:

	Options	Weighted Average Exercise Price	
Options outstanding at beginning of period	7,847,402	$	30.11
Granted			
Exercised			
Cancelled	(3,533,977)		28.67
Options outstanding at end of period	4,313,425	$	31.29
Options exercisable at end of period	3,896,709	$	30.95

As of May 31, 2009, the weighted average remaining contractual lives of stock options outstanding and stock options exercisable were 8.6 years and 8.7 years, respectively. There was $1.2 million of total unrecognized compensation cost related to unvested stock option awards as of May 31, 2009. For the three months ended May 31, 2009 and 2008, compensation expense associated with stock options totaled $.4 million and $1.3 million, respectively. For the six months ended May 31, 2009 and 2008, compensation expense associated with stock options totaled $.9 million and $2.6 million, respectively. The aggregate intrinsic value of stock options outstanding and stock options exercisable were each $.8 million as of May 31, 2009. (The intrinsic value of a stock option is the amount by which the market value of a share of the Company s common stock exceeds the exercise price of the stock option.)

On February 9, 2009, in connection with the settlement of certain stockholder derivative litigation, the Company s former chairman and chief executive officer relinquished 3,011,452 stock options to the Company and those stock options were cancelled.

Other Stock-Based Awards

From time to time, the Company grants restricted stock, phantom shares and stock appreciation rights to various employees. The Company recognized total compensation expense of $7.5 million in the three months ended May 31, 2009 and $3.7 million in the three months ended May 31, 2008 related to these stock-based awards. The Company recognized total compensation expense of $6.9 million in the six months ended May 31, 2009 and $6.6 million in the six months ended May 31, 2008 related to these stock-based awards.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information

As of May 31, 2009, the Company has identified five reporting segments, comprised of four homebuilding reporting segments and one financial services reporting segment, within its consolidated operations in accordance with Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information. As of May 31, 2009, 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, North Carolina and South Carolina

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, first move-up and active adult buyers.

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

The Company s financial services reporting segment provides title and insurance services to the Company s homebuyers. The financial services reporting segment also provides mortgage banking services to the Company s homebuyers indirectly through KB Home Mortgage, LLC (KB Home Mortgage), a joint venture between a Company subsidiary and CWB Venture Management Corporation, 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 its 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.

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

	Six Months Ended May 31,		Three Months Ended May 31,	
	2009	2008	2009	2008
Revenues:				
West Coast	$ 290,178	$ 440,939	$ 181,658	$ 199,863
Southwest	96,446	364,201	44,173	122,354
Central	160,755	300,475	83,110	148,586
Southeast	141,287	322,787	73,984	166,291
Total homebuilding revenues	688,666	1,428,402	382,925	637,094
Financial services	3,165	4,887	1,545	1,971

Total revenues	$ 691,831	$ 1,433,289	$ 384,470	$ 639,065

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information (continued)

	Six Months Ended May 31, 2009	Six Months Ended May 31, 2008	Three Months Ended May 31, 2009	Three Months Ended May 31, 2008
Pretax income (loss):				
West Coast	$ (52,421)	$ (173,436)	$ (40,100)	$ (101,449)
Southwest	(25,946)	(118,080)	(5,208)	(62,653)
Central	(10,513)	(41,780)	(4,356)	(11,838)
Southeast	(29,641)	(144,892)	(15,816)	(40,780)
Corporate and other (a)	(30,690)	(55,971)	(22,458)	(41,622)
Total homebuilding pretax loss	(149,211)	(534,159)	(87,938)	(258,342)
Financial services	6,056	10,957	4,355	3,012
Total pretax loss	$ (143,155)	$ (523,202)	$ (83,583)	$ (255,330)
Equity in income (loss) of unconsolidated joint ventures:				
West Coast	$ (8,040)	$ (10,806)	$ (8,235)	$ (1,432)
Southwest	(9,942)	(6,016)	(2,255)	(841)
Central	506	(4,594)	485	(3,080)
Southeast	(4,020)	(23,945)	(1,749)	(130)
Total	$ (21,496)	$ (45,361)	$ (11,754)	$ (5,483)
Inventory impairments:				
West Coast	$ 8,403	$ 132,969	$ 1,412	$ 80,855
Southwest	13,267	102,863	1,340	50,853
Central	1,617	20,539	1,617	3,254
Southeast	6,860	77,900	1,391	18,985
Total	$ 30,147	$ 334,271	$ 5,760	$ 153,947
Inventory abandonments:				
West Coast	$ 27,679	$ 9,186	$ 27,396	$ 9,186
Southwest		187		
Central				
Southeast	9,154	18,304	9,154	11,240

Total	$	36,833	$	27,677	$	36,550	$	20,426
Joint venture impairments:								
West Coast	$	7,190	$	8,106	$	7,190	$	
Southwest		5,426		4,944				
Central				2,629				2,158
Southeast		2,186		22,835				
Total	$	14,802	$	38,514	$	7,190	$	2,158

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

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Segment Information (continued)

	May 31, 2009	November 30, 2008
Assets:		
West Coast	$ 953,016	$ 1,086,503
Southwest	446,605	497,034
Central	426,104	443,168
Southeast	405,791	453,771
Corporate and other	1,176,448	1,511,672
Total homebuilding assets	3,407,964	3,992,148
Financial services	21,930	52,152
Total assets	$ 3,429,894	$ 4,044,300
Investments in unconsolidated joint ventures:		
West Coast	$ 55,745	$ 55,856
Southwest	109,848	113,564
Central		3,339
Southeast	5,588	4,890
Total	$ 171,181	$ 177,649

4. Financial Services

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

	Six Months Ended May 31,		Three Months Ended May 31,	
	2009	2008	2009	2008
Revenues				
Interest income	$ 28	$ 105	$ 11	$ 58
Title services	448	983	261	545
Insurance commissions	2,689	3,799	1,273	1,368
Total	3,165	4,887	1,545	1,971
Expenses				
General and administrative	(1,654)	(2,232)	(794)	(1,113)
Operating income	1,511	2,655	751	858
Equity in income of unconsolidated joint venture	4,545	8,302	3,604	2,154

Pretax income	$	6,056	$	10,957	$	4,355	$	3,012

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

4. Financial Services (continued)

	May 31, 2009	November 30, 2008
Assets		
Cash and cash equivalents	$ 2,156	$ 6,119
Receivables	439	1,240
Investment in unconsolidated joint venture	19,278	44,733
Other assets	57	60
Total assets	$ 21,930	$ 52,152
Liabilities		
Accounts payable and accrued expenses	$ 10,029	$ 9,467
Total liabilities	$ 10,029	$ 9,467

5. Inventories

Inventories consisted of the following (in thousands):

	May 31, 2009	November 30, 2008
Homes, lots and improvements in production	$ 1,443,024	$ 1,649,838
Land under development	450,939	456,878
Total	$ 1,893,963	$ 2,106,716

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

	Six Months Ended May 31,		Three Months Ended May 31,	
	2009	2008	2009	2008
Capitalized interest at beginning of period	$ 361,619	$ 348,084	$ 365,333	$ 358,010
Interest incurred	57,277	76,905	28,019	38,403
Interest expensed	(20,123)		(11,471)	
Interest amortized	(43,372)	(54,898)	(26,480)	(26,322)

Capitalized interest at end of period (a)	$ 355,401	$ 370,091	$ 355,401	$ 370,091

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

6. Inventory Impairments and Abandonments

Each 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 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

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

6. Inventory Impairments and Abandonments (continued)

projected losses on expected future land sales. If indicators of potential impairment exist for a parcel or community, the identified inventory is evaluated for recoverability in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144). 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 community and may vary among 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 community and may vary among communities.

Based on the results of its evaluations, the Company recognized pretax, noncash inventory impairment charges of $5.8 million in the three months ended May 31, 2009 and $154.0 million in the three months ended May 31, 2008. In the six months ended May 31, 2009 and 2008, the Company recognized pretax, noncash inventory impairment charges of $30.2 million and $334.3 million, respectively. As of May 31, 2009, the aggregate carrying value of inventory impacted by pretax, noncash impairment charges was $888.4 million, representing 148 communities and various other land parcels. As of November 30, 2008, the aggregate carrying value of inventory impacted by pretax, noncash impairment charges was $1.01 billion, representing 163 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. 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 land option contract abandonment charges of $36.5 million in the three months ended May 31, 2009 and $20.4 million in the three months ended May 31, 2008. In the six months ended May 31, 2009 and 2008, the Company recognized land option contract abandonment charges of $36.8 million and $27.7 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

Effective December 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157), for its assets and liabilities measured at fair value on a nonrecurring

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

7. Fair Value Disclosures (continued)

basis. SFAS No. 157 provides guidance for using fair value to measure assets and liabilities, defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, expands disclosures about fair value measurements, 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.

The Company s assets measured at fair value on a nonrecurring basis are summarized below (in thousands):

		Fair Value Measurements Using			
Description	Six Months Ended May 31, 2009 (a)	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Long-lived assets held and used	$ 39,159	$	$ 7,707	$ 31,452	$ (30,147)

(a) Amounts represent 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 SFAS No. 144, long-lived assets held and used with a carrying amount of $69.3 million were written down to their fair value of $39.2 million during the six months ended May 31, 2009, resulting in noncash inventory impairment charges of $30.2 million. These inventory impairment charges were included in the Company s construction and land costs in the consolidated statement of operations.

The fair value for long-lived assets held and used, determined using Level 2 inputs, was based on a bona fide letter of intent from an outside party or an executed contract. 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 community and may vary among communities.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

8. Consolidation of Variable Interest Entities

FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities, (FASB Interpretation No. 46(R)) requires a variable interest entity (VIE) to be consolidated in the financial statements of a company if that company is the primary beneficiary of the VIE. Under FASB Interpretation No. 46(R), the primary beneficiary of a VIE absorbs a majority of the VIE s expected losses, receives a majority of the VIE s expected residual returns, or both.

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 FASB Interpretation No. 46(R) when they are entered into or upon a reconsideration event. All of the Company s joint ventures at May 31, 2009 and November 30, 2008 were determined 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 agreements) in order to procure land for the construction of homes. The use of such option and other 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 sheet. Under such land option 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 FASB Interpretation No. 46(R), certain of the Company s land option contracts may create a variable interest for the Company, with the land seller being identified as a VIE.

In compliance with FASB Interpretation No. 46(R), the Company analyzes its land option contracts and other contractual arrangements when they are entered into or upon a reconsideration event, and as a result has consolidated the fair value of certain VIEs from which the Company is purchasing land under option contracts. Although the Company does not have legal title to the land, FASB Interpretation No. 46(R) requires the Company to consolidate the VIE if the Company is determined to be the primary beneficiary. In determining whether it is the primary beneficiary, the Company considers, 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 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 was determined to be the primary beneficiary increased its inventories, with a corresponding increase to accrued expenses and other liabilities, on the Company s consolidated balance sheets by $15.5 million at both May 31, 2009 and November 30, 2008. The liabilities related to the Company s consolidation of VIEs from which it has arranged to purchase land under option and other 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 contracts totaled $3.4 million at both May 31, 2009 and November 30, 2008. Creditors, if any, of these VIEs have no recourse against the Company. As of May 31, 2009, excluding consolidated VIEs, the Company had cash deposits totaling $16.7 million associated with land option and other contracts having an aggregate purchase price of $433.8 million.

The Company s exposure to loss related to its land option and other contracts with third parties and unconsolidated entities consisted of its non-refundable deposits totaling $20.1 million at May 31, 2009 and

$33.1 million at November 30, 2008. In addition, the Company posted letters of credit of $12.9 million at May 31, 2009 and $32.5 million at November 30, 2008 in lieu of cash deposits under certain land option contracts.

The Company also evaluates land option and other contracts in accordance with Statement of Financial Accounting Standards No. 49, Accounting for Product Financing Arrangements (SFAS No. 49), 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 $49.9 million at May 31, 2009 and $81.5 million at November 30, 2008.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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 U.S. generally accepted accounting principles. The Company shares in profits and losses of these unconsolidated joint ventures generally in accordance with its respective equity interests.

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

	Six Months Ended May 31,		Three Months Ended May 31,	
	2009	2008	2009	2008
Revenues	$ 34,207	$ 55,285	$ 22,731	$ 27,902
Construction and land costs	(50,371)	(150,458)	(31,870)	(111,818)
Other expenses, net	(23,259)	(22,370)	(17,124)	(14,800)
Loss	$ (39,423)	$ (117,543)	$ (26,263)	$ (98,716)

With respect to the Company s investment in unconsolidated joint ventures, its equity in loss of unconsolidated joint ventures included pretax, noncash impairment charges of $7.2 million for the three months ended May 31, 2009 and $2.1 million for the three months ended May 31, 2008. In the six months ended May 31, 2009 and 2008, the Company s equity in loss of unconsolidated joint ventures included pretax, noncash impairment charges of $14.8 million and $38.5 million, respectively.

15

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

The following table presents combined condensed balance sheet information for the Company s unconsolidated joint ventures (in thousands):

	May 31, 2009	November 30, 2008
Assets		
Cash	$ 17,589	$ 29,194
Receivables	143,228	143,926
Inventories	966,551	1,029,306
Other assets	58,336	55,289
Total assets	$ 1,185,704	$ 1,257,715
Liabilities and equity		
Accounts payable and other liabilities	$ 122,025	$ 85,064
Mortgages and notes payable	785,977	871,279
Equity	277,702	301,372
Total liabilities and equity	$ 1,185,704	$ 1,257,715

The following table presents 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):

	May 31, 2009	November 30, 2008
Number of investments in unconsolidated joint ventures:		
With recourse debt (a)		1
With limited recourse debt (b)	2	4
With non-recourse debt (c)	9	10
Other (d)	8	10
Total	19	25
Investments in unconsolidated joint ventures:		
With recourse debt	$	$ 3,339
With limited recourse debt		1,360

With non-recourse debt		19,317		24,590
Other		151,864		148,360
Total	$	171,181	$	177,649
Outstanding debt of unconsolidated joint ventures:				
With recourse debt	$		$	3,249
With limited recourse debt		32,500		112,700
With non-recourse debt		379,979		381,393
Other		373,498		373,937
Total (e)	$	785,977	$	871,279

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

(a) This category consists of an unconsolidated joint venture as to which the Company has entered into a several guaranty with respect to the repayment of a portion of the unconsolidated joint venture s outstanding debt. This unconsolidated joint venture was dissolved during the quarter ended May 31, 2009.

(b) 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.

(c) 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.

(d) 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 that, 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 (d) as further described below.

(e) 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, many 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 unconsolidated joint ventures had outstanding debt, substantially all of which was secured, of approximately $786.0 million at May 31, 2009 and $871.3 million at November 30, 2008. The unconsolidated joint ventures are subject to various financial and non-financial covenants in conjunction with their debt, primarily related to fair value of collateral and minimum land purchase or sale requirements within a specified period. In a few instances, the financial covenants are based on the Company s financial position. The inability of an unconsolidated joint venture to comply with its 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 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

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

venture in which an unconsolidated joint venture or its partners collude or which the unconsolidated joint venture fails to contest.

In most cases, 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. In a few cases, the Company has entered into agreements with its unconsolidated joint venture partners to be reimbursed or indemnified with respect to the guarantees the Company has provided to an unconsolidated joint venture s lenders for any amounts the Company may pay pursuant to such guarantees above its pro rata interest in the unconsolidated joint venture. If the Company s unconsolidated joint venture partners are unable to fulfill their reimbursement or indemnity obligations, or otherwise fail to do so, the Company could incur more than its allocable share under the relevant guaranty. Should there be indications that advances (if made) will not be voluntarily repaid by an unconsolidated joint venture partner under any such reimbursement arrangements, the Company vigorously pursues all rights and remedies available to it under the applicable agreements, at law or in equity to enforce its rights.

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 May 31, 2009, the Company s potential responsibility under its loan-to-value maintenance guarantees totaled approximately $16.3 million, if any liability were determined to be due thereunder. This amount represents the Company s maximum responsibility under such loan-to-value maintenance guarantees 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 guarantees.

Notwithstanding the Company s potential unconsolidated joint venture guaranty and indemnity responsibilities and 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 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, results of operations or liquidity. As a result of resolutions reached with their lenders in the 2009 second quarter with respect to potential guaranty responsibilities, certain unconsolidated joint ventures are now classified as having non-recourse debt (as described in the table above).

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. 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, but there is no assurance that the parties involved will reach satisfactory resolutions. The Company does not believe, however, that the outcome of these lawsuits should have a material impact on 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 May 31, 2009, this unconsolidated joint venture had total outstanding indebtedness of approximately $373.5 million and, if this guaranty were then enforced, the Company s

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

9. Investments in Unconsolidated Joint Ventures (continued)

maximum potential responsibility under the guaranty would have been approximately $182.7 million, which amount does not account for any offsets or defenses that could be available to the Company.

Certain of the Company s other unconsolidated joint ventures operating in difficult market conditions are in default of their debt agreements with their lenders or are at risk of defaulting. In addition, certain of the Company s unconsolidated joint venture partners have curtailed funding of their allocable joint venture obligations. The Company is carefully managing its investments in these particular unconsolidated joint ventures and is working with the relevant lenders and unconsolidated joint venture partners to reach satisfactory resolutions. In some instances, the Company may decide to purchase its partners interests and consolidate the joint venture, which could result in an increase in the amount of mortgages and notes payable on the Company s consolidated balance sheets. However, such purchases may not resolve a claimed default by the joint venture under its debt agreements. Based on the terms and amounts of the debt involved for these particular unconsolidated joint ventures and the terms of the applicable joint venture operating agreements, the Company does not believe that its exposure related to any defaults by or with respect to these particular unconsolidated joint ventures is material to the Company s consolidated financial position, results of operations or liquidity.

10. Mortgages and Notes Payable

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

	May 31, 2009	November 30, 2008
Mortgages and land contracts due to land sellers and other loans	$ 66,144	$ 96,368
Senior subordinated notes due December 15, 2008 at 8 5/8%		200,000
Senior notes due 2011 at 6 3/8%	349,096	348,908
Senior notes due 2014 at 5 3/4%	249,292	249,227
Senior notes due 2015 at 5 7/8%	298,782	298,692
Senior notes due 2015 at 6 1/4%	449,675	449,653
Senior notes due 2018 at 7 1/4%	298,737	298,689
Total	$ 1,711,726	$ 1,941,537

The Company has an unsecured revolving credit facility (the Credit Facility) with a syndicate of lenders that matures in November 2010. Interest on the Credit Facility is payable monthly at the London Interbank Offered Rate plus an applicable spread on amounts borrowed. At May 31, 2009, the Company had no cash borrowings outstanding and $193.5 million in letters of credit outstanding under the Credit Facility. The aggregate commitment under the Credit Facility, in accordance with its terms, was permanently reduced from $800.0 million to $650.0 million in the second quarter of 2009 because the Company s consolidated tangible net worth was below $800.0 million at February 28, 2009. Under the terms of the Credit Facility, the Company is required, among other things, to maintain a minimum consolidated tangible net worth and certain financial statement ratios, and is subject to limitations on acquisitions, inventories and indebtedness.

On December 15, 2008, the Company repaid $200.0 million of 8 5/8% senior subordinated notes (the $200 Million Senior Subordinated Notes), which matured on 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; engage in sale-leaseback transactions

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

10. Mortgages and Notes Payable (continued)

involving property or assets above a certain specified value; or engage in mergers, consolidations, or sales of assets.

As of May 31, 2009, the Company was in compliance with the applicable terms of all of its covenants under its Credit Facility and senior notes indenture. The Company s ability to continue to borrow funds depends in part on its ability to remain in such compliance. The Company s inability to do so could make it more difficult and expensive to maintain its current level of external debt financing or to obtain additional financing.

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 the 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):

	Six Months Ended May 31,		Three Months Ended May 31,	
	2009	2008	2009	2008
Balance at beginning of period	$ 145,369	$ 151,525	$ 142,224	$ 150,917
Warranties issued	4,226	10,769	2,233	3,834
Payments and adjustments	(11,905)	(16,244)	(6,767)	(8,701)
Balance at end of period	$ 137,690	$ 146,050	$ 137,690	$ 146,050

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 FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Based 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 bodily injury and construction defect coverage), auto, 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

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

11. Commitments and Contingencies (continued)

Company s estimated liabilities for such items were $104.5 million at May 31, 2009 and $101.5 million at November 30, 2008. These amounts are included in accrued expenses and other liabilities in the consolidated balance sheets.

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 May 31, 2009, the Company had $612.8 million of performance bonds and $193.5 million of letters of credit outstanding. In the event any such performance bonds or letters of credit are called, the Company would be obligated to reimburse the issuer of the performance bond or letter of credit. At this time, 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 letters of credit issued in connection with community improvements and certain unconsolidated joint ventures coincide with the expected completion dates of the related projects or obligations. If the obligations related to a project are ongoing, the relevant letters of credit are typically extended on a year-to-year basis.

Borrowings outstanding, if any, and letters of credit issued under the Company s Credit Facility are guaranteed by certain of the Company s subsidiaries (the Guarantor Subsidiaries).

In the ordinary course of its business, the Company enters into land option contracts to procure land for the construction of homes. At May 31, 2009, the Company had total deposits of $33.0 million, comprised of cash deposits of $20.1 million and letters of credit of $12.9 million, to purchase land with a total remaining purchase price of $452.7 million. The Company s land option 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, and certain of its current and former officers. 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 claim to be former employees of the Company who participated in the KB Home 401(k) Savings Plan (the Plan). Plaintiffs allege 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 Plan about alleged prior stock option backdating practices of the Company and by failing to remove the Company s stock as an investment option under the Plan. Plaintiffs allege that this breach of fiduciary duties caused plaintiffs to earn less on their Plan accounts than they would have earned but for defendants alleged breach of duties. Plaintiffs seek unspecified money damages and injunctive and other equitable relief.

The case is now in discovery, and the court has tentatively scheduled the trial to begin on November 9, 2010. While the Company believes it has strong defenses to the ERISA claims, it has not concluded whether an unfavorable outcome is likely to be material to its consolidated financial position or results of operations.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

12. Legal Matters (continued)

Other Matters

The Company is also involved in litigation and governmental proceedings incidental to its business. These cases are in various procedural stages and, based on reports of counsel, the Company believes that provisions or reserves made for potential losses are adequate and any liabilities or costs arising out of currently pending litigation should not have a materially adverse effect on its consolidated financial position or results of operations.

13. Stockholders Equity

On January 22, 2009, the Company adopted an amendment to the Rights Agreement between the Company and ChaseMellon Shareholder Services L.L.C., as rights agent, dated February 4, 1999 (the 1999 Rights Agreement). The amendment to the 1999 Rights Agreement was designed to preserve the value of certain of the Company s deferred tax assets. Under the 1999 Rights Agreement as amended, under certain circumstances, each preferred share purchase right that was issued pursuant to the 1999 Rights Agreement as a dividend on March 5, 1999 entitled the holder to purchase 1/100th of a share of the Company s Series A Participating Cumulative Preferred Stock at an exercise price of $85.00, subject to adjustment. The terms relating to the exercise and redemption of these rights is described in the Company s Annual Report on Form 10-K for the year ended November 30, 2008. These rights expired on March 5, 2009.

On January 22, 2009, the Company also adopted a Rights Agreement between the Company and Mellon Investor Services LLC, as rights agent, dated as of that date (the 2009 Rights Agreement), and declared a dividend distribution of one preferred share purchase right for each outstanding share of common stock that was payable to stockholders of record as of the close of business on March 5, 2009. Subject to the terms, provisions and conditions of the 2009 Rights Agreement, if these rights become exercisable, each right would initially represent the right to purchase from the Company 1/100th of a share of its Series A Participating Cumulative Preferred Stock for a purchase price of $85.00 (the Purchase Price). If issued, each fractional share of preferred stock would generally give a stockholder approximately the same dividend, voting and liquidation rights as does one share of the Company s common stock. However, prior to exercise, a right does not give its holder any rights as a stockholder, including without limitation any dividend, voting or liquidation rights. The rights will not be exercisable until the earlier of (i) ten calendar days after a public announcement by the Company that a person or group has become an Acquiring Person (as defined under the 2009 Rights Agreement) and (ii) ten business days after the commencement of a tender or exchange offer by a person or group if upon consummation of the offer the person or group would beneficially own 4.9% or more of the Company s outstanding common stock.

Until these rights become exercisable (the Distribution Date), common stock certificates will evidence the rights and may contain a notation to that effect. Any transfer of shares of the Company s common stock prior to the Distribution Date will constitute a transfer of the associated rights. After the Distribution Date, the rights may be transferred other than in connection with the transfer of the underlying shares of the Company s common stock. If there is an Acquiring Person on the Distribution Date or a person or group becomes an Acquiring Person after the Distribution Date, each holder of a right, other than rights that are or were beneficially owned by an Acquiring Person, which will be void, will thereafter have the right to receive upon exercise of a right and payment of the Purchase Price, that number of shares of the Company s common stock having a market value of two times the Purchase Price. After the later of the Distribution Date and the time the Company publicly announces that an Acquiring Person has become such, the Company s board of directors may exchange the rights, other than rights

that are or were beneficially owned by an Acquiring Person, which will be void, in whole or in part, at an exchange ratio of one share of common stock per right, subject to adjustment.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

13. Stockholders Equity (continued)

At any time prior to the later of the Distribution Date and the time the Company publicly announces that an Acquiring Person becomes such, the Company s board of directors may redeem all of the then-outstanding rights in whole, but not in part, at a price of $0.001 per right, subject to adjustment (the Redemption Price). The redemption will be effective immediately upon the board of directors action, unless the action provides that such redemption will be effective at a subsequent time or upon the occurrence or nonoccurrence of one or more specified events, in which case the redemption will be effective in accordance with the provisions of the action. Immediately upon the effectiveness of the redemption of the rights, the right to exercise the rights will terminate and the only right of the holders of rights will be to receive the Redemption Price, with interest thereon. With the approval of the 2009 Rights Agreement by the Company s stockholders at the Company s 2009 Annual Meeting of Stockholders on April 2, 2009, the rights issued pursuant to the 2009 Rights Agreement will expire on the earliest of (a) the close of business on March 5, 2019, (b) the time at which the rights are redeemed, (c) the time at which the rights are exchanged, (d) the time at which the Company s board of directors determines that a related provision in the Company s Restated Certificate of Incorporation is no longer necessary, and (e) the close of business on the first day of a taxable year of the Company to which the Company s board of directors determines that no tax benefits may be carried forward.

As of May 31, 2009, the Company was authorized to repurchase four million shares under a board-approved stock repurchase program. The Company did not repurchase any of its common stock under this program in the six months ended May 31, 2009. The Company acquired $.6 million of common stock in the six months ended May 31, 2009, 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.

On February 9, 2009, in connection with the settlement of certain stockholder derivative litigation, the Company s former chairman and chief executive officer relinquished 1,379,594 shares of restricted stock to the Company. These shares were transferred to the Company and are reflected as treasury stock.

During the quarter ended February 28, 2009, the Company s board of directors declared a cash dividend of $.0625 per share of common stock, which was paid on February 19, 2009 to stockholders of record on February 5, 2009. During the quarter ended May 31, 2009, the Company s board of directors declared a cash dividend of $.0625 per share of common stock, which was paid on May 21, 2009 to stockholders of record on May 7, 2009.

14. Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) amends Statement of Financial Accounting Standards No. 141, Business Combinations, and provides revised guidance for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in the acquiree. It also provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and is to be applied prospectively. The Company is currently evaluating the potential impact of adopting SFAS No. 141(R) on its consolidated financial position and results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160

establishes accounting and reporting standards pertaining to ownership interests in subsidiaries held by parties other than the parent, the amount of net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of any retained noncontrolling equity investment when a subsidiary is deconsolidated. SFAS No. 160 also establishes

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

14. Recent Accounting Pronouncements (continued)

disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the potential impact of adopting SFAS No. 160 on its consolidated financial position and results of operations.

In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP No. EITF 03-6-1). Under FSP No. EITF 03-6-1, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP No. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years and requires retrospective application. The Company is currently evaluating the impact of adopting FSP No. EITF 03-6-1 on its earnings per share.

In April 2009, the FASB issued FASB Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP No. FAS 107-1 and APB 28-1). FSP No. FAS 107-1 and APB 28-1 requires fair value disclosures in both interim as well as annual financial statements in order to provide more timely information about the effects of current market conditions on financial instruments. FSP No. FAS 107-1 and APB 28-1 is effective for interim and annual periods ending after June 15, 2009. FSP No. FAS 107-1 and APB 28-1 concerns disclosure only and will not have an impact on the Company s consolidated financial position or results of operations.

In April 2009, the FASB issued FASB Staff Position No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP No. FAS 115-2 and FAS 124-2). FSP No. FAS 115-2 and FAS 124-2 changes the method for determining whether an other-than-temporary impairment exists for debt securities and the amount of the impairment to be recorded in earnings as well as expands and increases the frequency of existing disclosures about other-than-temporary impairments for debt and equity securities. FSP No. FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the potential impact of adopting FSP No. FAS 115-2 and FAS 124-2 on its consolidated financial position and results of operations.

In April 2009, the FASB issued FASB Staff Position No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP No. FAS 157-4). FSP No. FAS 157-4 provides additional guidance on factors to consider in estimating fair value for a financial asset or liability when there has been a significant decrease in market activity and guidance on identifying circumstances where a transaction is not orderly. FSP No. FAS 157-4 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the potential impact of FSP No. FAS 157-4 on its consolidated financial position and results of operations.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, Subsequent Events (SFAS No. 165). SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 requires disclosure of the date through which subsequent events have been evaluated and whether that date represents the date the financial statements were issued or were available to be issued. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the potential

impact of SFAS No. 165 on its consolidated financial position and results of operations.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretations No. 46(R) (SFAS No. 167). SFAS No. 167 revises the approach to determining the primary beneficiary of a VIE to be more qualitative in nature and requires companies to more frequently reassess whether they must consolidate a VIE. SFAS No. 167 is effective for fiscal years beginning after

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

14. Recent Accounting Pronouncements (continued)

November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The Company is currently evaluating the potential impact of adopting SFAS No. 167 on its consolidated financial position and results of operations.

15. Income Taxes

The Company s income tax benefit totaled $5.2 million for the three months ended May 31, 2009, compared to income tax expense of $.6 million for the three months ended May 31, 2008. The Company s effective income tax benefit rate was 6.2% in the second quarter of 2009 compared to an effective income tax expense rate of .2% for the second quarter of 2008. For the six months ended May 31, 2009, the Company s income tax benefit totaled $6.7 million compared to income tax expense of $.9 million for the six months ended May 31, 2008. The Company s effective income tax benefit rate was 4.7% in the six months ended May 31, 2009 compared to an income tax expense rate of .2% in the year-earlier period. The difference in the Company s effective tax rate for the three months ended May 31, 2009 compared to the year-earlier period resulted primarily from the recognition of a $4.6 million federal and state income tax receivable based on the current status of federal audits and amended state filings. For the six months ended May 31, 2009, the difference in the effective tax rate compared to the year-earlier period resulted primarily from the recognition of the $4.6 million receivable and the reversal of a $1.8 million liability for unrecognized federal and state tax benefits.

In accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS No. 109), the Company evaluates its deferred tax assets quarterly to determine if valuation allowances are required. SFAS No. 109 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. To the extent the Company generates taxable income in the future to utilize these tax benefits, the Company would expect to reverse the valuation allowance and decrease its effective tax rate on future income. However, to the extent the Company generates future operating losses, it would be required to increase the valuation allowance on its net deferred tax assets and its income tax provision would be adversely affected. During the three months ended May 31, 2009, the Company recorded a valuation allowance of $31.7 million against the net deferred tax assets generated from the net loss for the period. During the three months ended May 31, 2008, the Company recorded a similar valuation allowance of $98.9 million against net deferred tax assets. For the six months ended May 31, 2009 and 2008, the Company recorded valuation allowances of $54.4 million and $198.9 million, respectively, against the net deferred tax assets generated in those periods. The Company s net deferred tax assets totaled $1.1 million at both May 31, 2009 and November 30, 2008. The deferred tax asset valuation allowance increased to $910.8 million at May 31, 2009 from $878.8 million at November 30, 2008. This increase reflected the net impact of the $54.4 million valuation allowance recorded during the first six months of 2009, offset by a reduction of deferred tax assets due to the forfeiture of certain equity-based awards.

During the three months ended May 31, 2009, the Company had $6.9 million of additions and $9.3 million of reductions to its total gross unrecognized tax benefits primarily due to the resolution of a state audit and the status of potential state adjustments. During the six months ended May 31, 2009, additions and reductions to the Company s total gross unrecognized tax benefits were $10.2 million and $14.4 million, respectively. The total amount of gross unrecognized tax benefits, including interest and penalties, was $21.9 million as of May 31, 2009. The Company does not anticipate that total gross unrecognized tax benefits will significantly increase or decrease during the twelve months from this reporting date.

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 May 31, 2009, the Company does not believe it has experienced a change in ownership 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 at this time.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

16. Supplemental Disclosure to Consolidated Statements of Cash Flows

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

	Six Months Ended May 31,	
	2009	2008
Summary of cash and cash equivalents:		
Homebuilding	$ 997,357	$ 1,305,077
Financial services	2,156	13,551
Total	$ 999,513	$ 1,318,628
Supplemental disclosures of cash flow information:		
Interest paid, net of amounts capitalized	$ 27,653	$ (263)
Income taxes refunded	(230,449)	(105,737)
Supplemental disclosures of noncash activities:		
Cost of inventories acquired through seller financing	$ 6,494	$
Decrease in consolidated inventories not owned	(31,529)	(123,528)

17. Supplemental Guarantor Information

The Company s obligation to pay principal, premium, if any, and interest under certain debt instruments are guaranteed on a joint and several basis by certain of 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.

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

17. Supplemental Guarantor Information (continued)

Condensed Consolidating Statements of Operations
Six Months Ended May 31, 2009 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 601,682	$ 90,149	$	$ 691,831
Homebuilding:					
Revenues	$	$ 601,682	$ 86,984	$	$ 688,666
Construction and land costs		(583,815)	(83,953)		(667,768)
Selling, general and administrative expenses	(27,049)	(84,857)	(21,863)		(133,769)
Operating loss	(27,049)	(66,990)	(18,832)		(112,871)
Interest income	4,346	417	516		5,279
Interest expense, net of amounts capitalized	20,699	(39,195)	(1,627)		(20,123)
Equity in loss of unconsolidated joint ventures		(17,481)	(4,015)		(21,496)
Homebuilding pretax loss	(2,004)	(123,249)	(23,958)		(149,211)
Financial services pretax income			6,056		6,056
Total pretax loss	(2,004)	(123,249)	(17,902)		(143,155)
Income tax benefit	100	5,800	800		6,700
Equity in net loss of subsidiaries	(134,551)			134,551	
Net loss	$ (136,455)	$ (117,449)	$ (17,102)	$ 134,551	$ (136,455)

Condensed Consolidating Statements of Operations
Six Months Ended May 31, 2008 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 1,103,933	$ 329,356	$	$ 1,433,289

Homebuilding:					
Revenues	$	$ 1,103,933	$ 324,469	$	$ 1,428,402
Construction and land costs		(1,274,907)	(393,574)		(1,668,481)
Selling, general and administrative expenses	(37,430)	(141,373)	(67,900)		(246,703)
Goodwill impairment	(24,570)				(24,570)
Operating loss	(62,000)	(312,347)	(137,005)		(511,352)
Interest income	20,466	1,894	194		22,554
Interest expense, net of amounts capitalized	40,062	(22,454)	(17,608)		
Equity in loss of unconsolidated joint ventures		(4,115)	(41,246)		(45,361)
Homebuilding pretax loss	(1,472)	(337,022)	(195,665)		(534,159)
Financial services pretax income			10,957		10,957
Total pretax loss	(1,472)	(337,022)	(184,708)		(523,202)
Income tax expense		(600)	(300)		(900)
Equity in net loss of subsidiaries	(522,630)			522,630	
Net loss	$ (524,102)	$ (337,622)	$ (185,008)	$ 522,630	$ (524,102)

Table of Contents

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

17. Supplemental Guarantor Information (continued)

Condensed Consolidating Statements of Operations
Three Months Ended May 31, 2009 (in thousands)

	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Revenues	$	$ 341,461	$ 43,009	$	$ 384,470
Homebuilding:					
Revenues	$	$ 341,461	$ 41,464	$	$ 382,925
Construction and land costs		(338,102)	(38,708)		(376,810)