HOVNANIAN ENTERPRISES INC
Form 10-K
December 20, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT

OF 1934

For the fiscal year ended OCTOBER 31, 2018

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

Commission file number: 1-8551

Hovnanian Enterprises, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**22-1851059**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
90 Matawan Road, Fifth Floor, Matawan, NJ	**07747**
(Address of Principal Executive Offices)	(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered

Class A Common Stock, $0.01 par value per share	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange
Depositary Shares, each representing 1/1,000th of a share of 7.625% Series A Preferred Stock	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act:
Class B Common Stock, $0.01 par value per share
Preferred Stock Purchase Rights
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer	Accelerated Filer	Nonaccelerated Filer	Smaller Reporting Company	Emerging Growth Company

If an emerging growth company indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the voting and nonvoting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of April 30, 2018 (the last business day of the registrant's most recently completed second fiscal quarter) was $244,113,849.

As of the close of business on December 14, 2018, there were outstanding 132,835,722 shares of the Registrant's Class A Common Stock and 15,550,099 shares of its Class B Common Stock.

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HOVNANIAN ENTERPRISES, INC.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III — Those portions of the registrant's definitive proxy statement to be filed pursuant to Regulation 14A in connection with registrant's annual meeting of stockholders to be held on March 19, 2019, which are responsive to those parts of Part III, Items 10, 11, 12, 13 and 14 as identified herein.

FORM 10-K

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Part I

ITEM 1

BUSINESS

Business Overview

Hovnanian Enterprises, Inc. ("HEI") conducts all of its homebuilding and financial services operations through its subsidiaries (references herein to the "Company", "we", "us" or "our" refer to HEI and its consolidated subsidiaries and should be understood to reflect the consolidated business of HEI's subsidiaries). Through its subsidiaries, HEI designs, constructs, markets, and sells single-family detached homes, attached townhomes and condominiums, urban infill, and active lifestyle homes in planned residential developments and is one of the nation's largest builders of residential homes. Founded in 1959 by Kevork Hovnanian, HEI was incorporated in New Jersey in 1967 and reincorporated in Delaware in 1983. Since the incorporation of HEI's predecessor company, the Company combined with its unconsolidated joint ventures have delivered in excess of 336,000 homes, including 5,831 homes in fiscal 2018. The Company has two distinct operations: homebuilding and financial services. Our homebuilding operations consist of six segments: Northeast, Mid-Atlantic, Midwest, Southeast, Southwest and West. Our financial services operations provide mortgage loans and title services to the customers of our homebuilding operations.

We are currently, excluding unconsolidated joint ventures, offering homes for sale in 123 communities in 25 markets in 14 states throughout the United States. We market and build homes for first-time buyers, first-time and second-time move-up buyers, luxury buyers, active lifestyle buyers and empty nesters. We offer a variety of home styles at base prices ranging from $144,000 to $2,252,000 with an average sales price, including options, of $393,000 nationwide in fiscal 2018.

Our operations span all significant aspects of the home-buying process – from design, construction, and sale, to mortgage origination and title services.

The following is a summary of our growth history:

1959 - Founded by Kevork Hovnanian as a New Jersey homebuilder.

1983 - Completed initial public offering.

1986 - Entered the North Carolina market through the investment in New Fortis Homes.

1992 - Entered the greater Washington, D.C. market.

1994 - Entered the Coastal Southern California market.

1998 - Expanded in the greater Washington, D.C. market through the acquisition of P.C. Homes.

1999 - Entered the Dallas, Texas market through our acquisition of Goodman Homes. Further diversified and strengthened our position as New Jersey’s largest homebuilder through the acquisition of Matzel & Mumford.

2001 - Continued expansion in the greater Washington D.C. and North Carolina markets through the acquisition of Washington Homes. This acquisition further strengthened our operations in each of these markets.

2002 - Entered the Central Valley market in Northern California and Inland Empire region of Southern California through the acquisition of Forecast Homes.

2003 - Expanded operations in Texas and entered the Houston market through the acquisition of Parkside Homes and Brighton Homes. Entered the greater Ohio market through our acquisition of Summit Homes and entered the greater metro Phoenix market through our acquisition of Great Western Homes.

2004 - Entered the greater Tampa, Florida market through the acquisition of Windward Homes and started operations in the Minneapolis/St. Paul, Minnesota market.

2005 - Entered the Orlando, Florida market through our acquisition of Cambridge Homes and entered the greater Chicago, Illinois market and expanded our position in Florida and Minnesota through the acquisition of the operations of Town & Country Homes, which occurred concurrently with our entering into a joint venture with affiliates of Blackstone Real Estate Advisors to own and develop Town & Country Homes' existing residential communities. We also entered the Cleveland, Ohio market through the acquisition of Oster Homes.

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2006 - Entered the coastal markets of South Carolina and Georgia through the acquisition of Craftbuilt Homes.

During fiscal 2016, we exited the Minneapolis, Minnesota and Raleigh, North Carolina markets and sold land portfolios in those markets. During fiscal 2018, we completed a wind down of our operations in the San Francisco Bay area in Northern California and in Tampa, Florida.

Geographic Breakdown of Markets by Segment

The Company markets and builds homes that are constructed in 17 of the nation’s top 50 housing markets. We segregate our homebuilding operations geographically into the following six segments:

Northeast: New Jersey and Pennsylvania

Mid-Atlantic: Delaware, Maryland, Virginia, Washington, D.C. and West Virginia

Midwest: Illinois and Ohio

Southeast: Florida, Georgia and South Carolina

Southwest: Arizona and Texas

West: California

For financial information about our segments, see Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Employees

We employed 1,851 full-time employees (whom we refer to as associates) as of October 31, 2018.

Corporate Offices and Available Information

Our corporate offices are located at 90 Matawan Road, Fifth Floor, Matawan, New Jersey 07747 (See Item 2-Properties). Our telephone number is 732-747-7800, and our Internet web site address is www.khov.com. Information available on or through our web site is not a part of this Form 10-K. We make available free of charge through our web site our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(d) or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), as soon as reasonably practicable after they are filed with, or furnished to, the Securities and Exchange Commission (SEC). Copies of the Company's Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports are available free of charge upon request. The SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

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Business Strategies

Given the relatively low levels of total U.S. housing starts, and our belief in the long-term recovery of the homebuilding market, we remain focused on identifying new land parcels, which are critical to improving our financial performance. As discussed in previous quarters, we were limited in our ability to invest in land purchases in fiscal 2016 and 2017 due to significant debt maturities that we were unable to refinance and therefore had to pay at maturity. This reduction of investment has led to a decrease in community count and revenues, which impacts our overall profitability. In the fourth quarter of fiscal 2016 and in July 2017, we were able to refinance certain of our debt maturities and in fiscal 2018 the Company entered into certain financing transactions with GSO Capital Partners LP ("GSO") which extended our debt maturities. These transactions provided us with the long term capital needed to implement our strategy to invest in land to grow the business to more significant profitability. However, there is typically a significant time lag from when we first control lots until the time that we open a community for sale. This timeline can vary significantly from a few months (in a market such as Houston) to three to five plus years (in a market such as New Jersey). We continue to see opportunities to purchase land at prices that make economic sense in light of our current sales prices and sales paces and plan to continue actively pursuing such land acquisitions. New land purchases at pricing that we believe will generate appropriate investment returns and drive greater operating efficiencies are needed to return to sustained profitability.

In addition to our current focus on maintaining adequate liquidity and evaluating new investment opportunities, we intend to continue to focus on our historic key business strategies, as enumerated below. We believe that these strategies separate us from our competitors in the residential homebuilding industry and the adoption, implementation and adherence to these principles will continue to benefit our business.

Our goal is to become a significant builder in each of the selected markets in which we operate, which will enable us to achieve powers and economies of scale and differentiate ourselves from most of our competitors.

As noted above, we offer a broad product array to provide housing to a wide range of customers. Our customers consist of first-time buyers, first-time and second-time move-up buyers, luxury buyers, active lifestyle buyers and empty nesters. Our diverse product array includes single-family detached homes, attached townhomes and condominiums, urban infill and active lifestyle homes.

We are committed to customer satisfaction and quality in the homes that we build. We recognize that our future success rests in the ability to deliver quality homes to satisfied customers. We seek to expand our commitment to customer service through a variety of quality initiatives. In addition, our focus remains on attracting and developing quality associates. We use several leadership development and mentoring programs to identify key individuals and prepare them for positions of greater responsibility within our Company.

We focus on achieving high return on invested capital. Each new community is evaluated based on its ability to meet or exceed internal rate of return requirements. Our belief is that the best way to create lasting value for our shareholders is through a strong focus on return on invested capital.

We prefer to use a risk-averse land acquisition strategy. We attempt to acquire land with a minimum cash investment and negotiate takedown options, thereby limiting the financial exposure to the amounts invested in property and predevelopment costs. This approach significantly reduces our risk and generally allows us to obtain necessary development approvals before acquisition of the land.

Our strategy includes homebuilding and land development joint ventures as a means of controlling lot positions, expanding our market opportunities, establishing strategic alliances, reducing our risk profile, leveraging our capital base and enhancing our returns on capital. Our homebuilding joint ventures are generally entered into with third-party investors to develop land and construct homes that are sold directly to home buyers. Our land development joint ventures include those with developers and other homebuilders, as well as financial investors to develop finished lots for sale to the joint venture's members or other third parties.

We manage our financial services operations to better serve all of our home buyers. Our current mortgage financing and title service operations enhance our contact with customers and allow us to coordinate the home-buying experience from beginning to end.

Operating Policies and Procedures

We attempt to reduce the effect of certain risks inherent in the housing industry through the following policies and procedures:

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Training - Our training is designed to provide our associates with the knowledge, attitudes, skills and habits necessary to succeed in their jobs. Our training department regularly conducts online or webinar training in sales, construction, administration and managerial skills.

Land Acquisition, Planning, and Development - Before entering into a contract to acquire land, we complete extensive comparative studies and analyses which assist us in evaluating the economic feasibility of such land acquisition. We generally follow a policy of acquiring options to purchase land for future community developments.

Where possible, we acquire land for future development through the use of land options, which need not be exercised before the completion of the regulatory approval process. We attempt to structure these options with flexible takedown schedules rather than with an obligation to take down the entire parcel upon receiving regulatory approval. If we are unable to negotiate flexible takedown schedules, we will buy parcels in a single bulk purchase. Additionally, we purchase improved lots in certain markets by acquiring a small number of improved lots with an option on additional lots. This allows us to minimize the economic costs and risks of carrying a large land inventory, while maintaining our ability to commence new developments during favorable market periods.

Our option and purchase agreements are typically subject to numerous conditions, including, but not limited to, our ability to obtain necessary governmental approvals for the proposed community. Generally, the deposit on the agreement will be returned to us if all approvals are not obtained, although predevelopment costs may not be recoverable. By paying an additional nonrefundable deposit, we have the right to extend a significant number of our options for varying periods of time. In most instances, we have the right to cancel any of our land option agreements by forfeiture of our deposit on the agreement. In fiscal 2018, 2017 and 2016, rather than purchase additional lots in underperforming communities, we took advantage of this right and walked away from 2,777 lots, 3,930 lots and 6,102 lots, respectively, out of 20,387 total lots, 17,837 total lots and 19,210 total lots, respectively, under option, resulting in pretax charges of $1.4 million, $2.7 million and $8.9 million, respectively.

Design - Our residential communities are generally located in urban and suburban areas easily accessible through public and personal transportation. Our communities are designed as neighborhoods that fit existing land characteristics. We strive to create diversity within the overall planned community by offering a mix of homes with differing architecture, textures and colors. Recreational amenities, such as swimming pools, tennis courts, clubhouses, open areas and tot lots, are frequently included.

Construction - We design and supervise the development and building of our communities. Our homes are constructed according to standardized prototypes, which are designed and engineered to provide innovative product design while attempting to minimize costs of construction. We generally employ subcontractors for the installation of site improvements and construction of homes. Agreements with subcontractors are generally short term and provide for a fixed price for labor and materials. We rigorously control costs through the use of computerized monitoring systems.

Because of the risks involved in speculative building, our general policy is to construct an attached condominium or townhouse building only after signing contracts for the sale of at least 50% of the homes in that building. A majority of our single-family detached homes are constructed after the signing of a sales contract and mortgage approval has been obtained. This limits the buildup of inventory of unsold homes and the costs of maintaining and carrying that inventory.

Materials and Subcontractors - We attempt to maintain efficient operations by utilizing standardized materials available from a variety of sources. In addition, we generally contract with subcontractors to construct our homes. We have reduced construction and administrative costs by consolidating the number of vendors serving certain markets and by executing national purchasing contracts with select vendors. In recent years, we have experienced some construction delays due to shortage of labor in certain markets like Houston, Dallas and Northern California; and we cannot predict the extent to which shortages in necessary materials or labor may occur in these or other markets in the future.

Marketing and Sales - Our residential communities are sold principally through on-site sales offices. In order to respond to our customers' needs and trends in housing design, we rely upon our internal market research group to analyze information gathered from, among other sources, buyer profiles, exit interviews at model sites, focus groups and demographic databases. We make use of our website, internet, newspaper, radio, television, magazine, billboard, video and direct mail advertising, special and promotional events, illustrated brochures and full-sized and scale model homes in our comprehensive marketing program. In addition, we have home design galleries in our Florida, Illinois, New Jersey and Virginia markets, which offer a wide range of customer options to satisfy individual customer tastes.

Customer Service and Quality Control - In many of our markets, associates are responsible for customer service and preclosing quality control inspections as well as responding to postclosing customer needs. Prior to closing, each home is inspected and any necessary completion work is undertaken by us or our subcontractors. Our homes are enrolled in a standard limited warranty program which, in general, provides a homebuyer with a limited warranty for the home's materials and workmanship which follows each State's applicable statute of repose. All of the warranties contain standard exceptions, including, but not limited to, damage caused by the customer.

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Customer Financing - We sell our homes to customers who generally finance their purchases through mortgages. Our financial services segment provides our customers with competitive financing and coordinates and expedites the loan origination transaction through the steps of loan application, loan approval, and closing and title services. We originate loans in each of the states in which we build homes, except Ohio. We believe that our ability to offer financing to customers on competitive terms as a part of the sales process is an important factor in completing sales.

During the year ended October 31, 2018, for the markets in which our mortgage subsidiaries originated loans, 12.9% of our home buyers paid in cash and 72.4% of our noncash home buyers obtained mortgages from our mortgage banking subsidiary. The loans we originated in fiscal 2018 were 69.8% prime and 24.6% Federal Housing Administration/Veterans Affairs ("FHA/VA"). The remaining 5.6% of our loan originations represent jumbo and/or USDA loans.

We sell virtually all of the loans and loan-servicing rights that we originate within a short period of time. Loans are sold either individually or against forward commitments to institutional investors, including banks, mortgage banking firms, and savings and loan associations.

Residential Development Activities

Our residential development activities include site planning and engineering, obtaining environmental and other regulatory approvals and constructing roads, sewer, water, and drainage facilities, recreational facilities, and other amenities and marketing and selling homes. These activities are performed by our associates, together with independent architects, consultants and contractors. Our associates also carry out long-term planning of communities. A residential development generally includes single-family detached homes and/or a number of residential buildings containing from two to 24 individual homes per building, together with amenities, such as club houses, swimming pools, tennis courts, tot lots and open areas.

Current base prices for our homes in contract backlog at October 31, 2018, range from $403,000 to $866,000 in the Northeast, from $235,000 to $2,252,000 in the Mid-Atlantic, from $144,000 to $831,000 in the Midwest, from $239,000 to $997,000 in the Southeast, from $183,000 to $582,000 in the Southwest and from $231,000 to $962,000 in the West. Closings generally occur and are typically reflected in revenues within six to nine months of when sales contracts are signed.

Information on homes delivered by segment for the year ended October 31, 2018, is set forth below:

(Housing revenue in thousands)	Housing Revenues	Homes Delivered	Average Price
Northeast	$96,012	178	$539,393
Mid-Atlantic	354,153	672	527,013
Midwest	196,307	662	296,536
Southeast	237,948	596	399,242
Southwest	637,568	1,873	340,399
West	384,240	866	443,695
Consolidated total	$1,906,228	4,847	$393,280
Unconsolidated joint ventures (1)	$599,979	984	$609,735

(1) Represents housing revenues and home deliveries for our unconsolidated homebuilding joint ventures for the period. We provide this data as a supplement to our consolidated results as an indicator of the volume managed in our unconsolidated joint ventures. See Note 20 to the Consolidated Financial Statements for a further discussion of our unconsolidated joint ventures.

The value of our net sales contracts, excluding unconsolidated joint ventures, decreased 11.9% to $1.8 billion for the year ended October 31, 2018 from $2.1 billion for the year ended October 31, 2017. The number of homes contracted decreased 10.1% to 4,671 in fiscal 2018 from 5,196 in fiscal 2017. The decrease in the number of homes contracted occurred along with a 12.2% decrease in the average number of open-for-sale communities from 148 for fiscal 2017 to 130 for fiscal 2018. We contracted an average of 35.9 homes per average active selling community in fiscal 2018 compared to 35.1 homes per average active selling community in fiscal 2017, a 2.3% increase in sales pace per community as our performance per community improved in fiscal 2018 as compared to fiscal 2017.

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Information on the value of net sales contracts by segment for the years ended October 31, 2018 and 2017, is set forth below:

(Value of net sales contracts in thousands)	2018	2017	Percentage of Change	
Northeast	$74,730	$119,018	(37.2	%)
Mid-Atlantic	340,963	399,420	(14.6	%)
Midwest	204,487	193,451	5.7	%
Southeast	225,703	232,278	(2.8	%)
Southwest	640,604	718,595	(10.9	%)
West	348,726	421,335	(17.2	%)
Consolidated total	$1,835,213	$2,084,097	(11.9	%)
Unconsolidated joint ventures(1)	$556,745	$436,538	27.5	%

(1) Represents net contract dollars for our unconsolidated homebuilding joint ventures for the period. We provide this data as a supplement to our consolidated results as an indicator of the volume managed in our unconsolidated joint ventures. See Note 20 to the Consolidated Financial Statements for a further discussion of our unconsolidated joint ventures.

The following table summarizes our active selling communities under development as of October 31, 2018. The contracted not delivered and remaining homes available in our active selling communities are included in the consolidated total homesites under the total residential real estate chart in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Active Selling Communities

	Communities	Approved Homes	Homes Delivered	Contracted Not Delivered(1)	Remaining Homes Available(2)
Northeast	4	975	284	51	640
Mid-Atlantic	20	3,436	1,755	296	1,385
Midwest	14	2,669	895	394	1,380
Southeast	14	3,236	913	251	2,072
Southwest	56	10,220	6,336	523	3,361
West	15	3,628	1,588	311	1,729
Total	123	24,164	11,771	1,826	10,567

(1) Includes 252 home sites under option.

(2) Of the total remaining homes available, 642 were under construction or completed (including 71 models and sales offices), and 3,905 were under option.

Backlog

At October 31, 2018 and 2017, including unconsolidated joint ventures, we had a backlog of signed contracts for 2,192 homes and 2,437 homes, respectively, with sales values aggregating $977.3 million and $1.1 billion, respectively. The majority of our backlog at October 31, 2018 is expected to be completed and closed within the next six to nine months. At November 30, 2018 and 2017, our backlog of signed contracts, including unconsolidated joint ventures, was 2,248 homes and 2,606 homes, respectively, with sales values aggregating $1.0 billion and $1.2 billion, respectively. For information on our backlog excluding unconsolidated joint ventures, see the table on page 43 under Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations -Homebuilding.”

Sales of our homes typically are made pursuant to a standard sales contract that provides the customer with a statutorily mandated right of rescission for a period ranging up to 15 days after execution. This contract requires a nominal customer deposit at the time of signing. In addition, in the Northeast, and some sections of the Mid-Atlantic and Midwest, we typically obtain an additional 5% to 10% down payment due within 30 to 60 days after signing. In most markets, an additional deposit is required when a customer selects and commits to optional upgrades in the home. The contract may include a financing contingency, which permits customers to cancel their obligation in the event mortgage financing at prevailing interest rates (including financing arranged or provided by us) is unobtainable within the period specified in the contract. This contingency period typically is four to eight weeks following the date of execution of the contract. When housing values decline in certain markets, some customers cancel their contracts and forfeit their deposits. Cancellation rates are discussed further in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Sales contracts are included in backlog once the sales contract is signed by the customer, which in some cases includes contracts that are in the rescission or cancellation periods. However, revenues from sales of homes are recognized in the Consolidated Statements of Operations, when title to the home is conveyed to the buyer, adequate initial and continuing investments have been received, and there is no continued involvement.

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Residential Land Inventory in Planning

It is our objective to control a supply of land, primarily through options, whenever possible, consistent with anticipated homebuilding requirements in each of our housing markets. Controlled land (land owned and under option) as of October 31, 2018, exclusive of communities under development described above under "Active Selling Communities" and excluding unconsolidated joint ventures, is summarized in the following table. The proposed developable home sites in communities in planning are included in the 30,557 consolidated total home sites under the total residential real estate table in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" on page 37.

Communities in Planning

(Dollars in thousands)	Number of Proposed Communities	Proposed Developable Home Sites	Total Land Option Price	Book Value	(1)
Northeast:					
Under option	28	3,038	$233,739	$6,564	
Owned	4	191		$9,099	
Total	32	3,229		$15,663	
Mid-Atlantic:					
Under option	22	1,749	$186,537	$5,364	
Owned	12	1,365		$36,786	
Total	34	3,114		$42,150	
Midwest:					
Under option	18	2,601	$105,098	$2,404	
Owned	8	383		$5,782	
Total	26	2,984		$8,186	
Southeast:					
Under option	16	2,333	$84,844	$2,417	
Owned	2	15		$5,633	
Total	18	2,348		$8,050	
Southwest:					
Under option	33	2,714	$157,662	$9,529	
Owned	2	185		$6,907	
Total	35	2,899		$16,436	
West:					
Under option	9	1,018	$80,678	$2,690	
Owned	16	2,572		$18,191	

Total	25	3,590		$20,881
Totals:				
Under option	126	13,453	$848,558	$28,968
Owned	44	4,711		$82,398
Combined total	170	18,164		$111,366

For comparison, below are the combined totals as of October 31, 2017. We are providing this information to demonstrate the growth in our total controlled lots during fiscal 2018.

(Dollars in thousands)			
Combined total	143	15,557	$140,924

(1) *Properties under option also include costs incurred on properties not under option but which are under evaluation. For properties under option, as of October 31, 2018, option fees and deposits aggregated approximately $19.2 million. As of October 31, 2018, we spent an additional $9.8 million in nonrefundable predevelopment costs on such properties, including properties not under option but under evaluation.*

We either option or acquire improved or unimproved home sites from land developers or other sellers. Under a typical agreement with the land developer, we purchase a minimal number of home sites. The balance of the home sites to be purchased is covered under an option agreement or a nonrecourse purchase agreement. During the declining homebuilding market, we decided to mothball (or stop development on) certain communities where we determined that current market conditions did not justify further investment at that time. When we decide to mothball a community, the inventory is reclassified on our Consolidated Balance Sheets from Sold and unsold homes and lots under development to Land and land options held for future development or sale. See Note 3 to the Consolidated Financial Statements for further discussion on mothballed communities. For additional financial information regarding our homebuilding segments, see Note 10 to the Consolidated Financial Statements.

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Raw Materials

The homebuilding industry has from time to time experienced raw material and labor shortages. In particular, shortages and fluctuations in the price of lumber or in other important raw materials could result in delays in the start or completion of or increase the cost of developing one or more of our residential communities. We attempt to maintain efficient operations by utilizing standardized materials available from a variety of sources. In recent years, we have experienced some construction delays due to shortage of labor in certain markets like Houston, Dallas and Northern California. We cannot predict, however, the extent to which shortages in necessary raw materials or labor may occur in the future. In addition, we generally contract with subcontractors to construct our homes. We have reduced construction and administrative costs by consolidating the number of vendors serving certain markets and by executing national purchasing contracts with select vendors.

Seasonality

Our business is seasonal in nature and, historically, weather-related problems, typically in the fall, late winter and early spring, can delay starts or closings and increase costs.

Competition

Our homebuilding operations are highly competitive. We are among the top 15 homebuilders in the United States in both homebuilding revenues and home deliveries. We compete with numerous real estate developers in each of the geographic areas in which we operate. Our competition ranges from small local builders to larger regional builders to publicly owned builders and developers, some of which have greater sales and financial resources than we do. Previously owned homes and the availability of rental housing provide additional competition. We compete primarily on the basis of reputation, price, location, design, quality, service and amenities.

Regulation and Environmental Matters

We are subject to extensive and complex laws and regulations that affect the development of land and home building, sales and customer financing processes concerning zoning, building design, construction, and similar matters, including local regulations which impose restrictive zoning and density requirements in order to limit the number of homes that can eventually be built within the boundaries of a particular locality. In addition, we are subject to registration and filing requirements in connection with the construction, advertisement and sale of our communities in certain states and localities in which we operate even if all necessary government approvals have been obtained. We

may also be subject to periodic delays or may be precluded entirely from developing communities due to building moratoriums that could be implemented in the future in the states in which we operate. Generally, such moratoriums relate to insufficient water or sewerage facilities or inadequate road capacity.

In addition, some state and local governments in markets where we operate have approved, and others may approve, slow-growth, or no-growth initiatives that could negatively affect the availability of land and building opportunities within those areas. Approval of these initiatives could adversely affect our ability to build and sell homes in the affected markets and/or could require the satisfaction of additional administrative and regulatory requirements, which could result in slowing the progress or increasing the costs of our homebuilding operations in these markets. Any such delays or costs could have a negative effect on our future revenues and earnings.

We are also subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment, including those regulating the emission or discharge of materials into the environment, the management of storm water runoff at construction sites, the handling, use, storage and disposal of hazardous substances, impacts to wetlands and other sensitive environments, and the remediation of contamination at properties that we have owned or developed or currently own or are developing ("environmental laws"). The particular environmental laws which apply to any given community vary greatly according to the community site, the site's environmental conditions and the present and former uses of the site. See Risk Factors – "*Homebuilders are subject to a number of federal, local, state, and foreign laws and regulations concerning the development of land, the homebuilding, sales, and customer financing processes and the protection of the environment, which can cause us to incur delays and costs associated with compliance and which can prohibit or restrict our activity in some regions or areas",* Item 3 "Legal Proceedings" and Note 18 to the Consolidated Financial Statements.

Despite our past ability to obtain necessary permits and approvals for our communities, we anticipate that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot reliably predict the extent of any effect these requirements may have on us, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, our ability to obtain or renew permits or approvals and the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules and regulations and their interpretation and application.

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ITEM 1A

RISK FACTORS

You should carefully consider the following risks in addition to the other information included in this Annual Report on Form 10-K, including the Consolidated Financial Statements and the notes thereto.

The homebuilding industry is significantly affected by changes in general and local economic conditions, real estate markets, and weather and other environmental conditions, which could affect our ability to build homes at prices our customers are willing or able to pay, could reduce profits that may not be recaptured, could result in cancellation of sales contracts, and could affect our liquidity.

The homebuilding industry is cyclical, has from time to time experienced significant difficulties, and is significantly affected by changes in general and local economic conditions such as:

- Employment levels and wage and job growth;
- Availability and affordability of financing for home buyers;
- Interest rates;
- Adverse changes in tax laws;
- Foreclosure rates;
- Inflation;
- Consumer confidence;
- Housing demand in general and for our particular community locations and product designs, as well as consumer interest in purchasing a home compared to other housing alternatives;
- Population growth; and
- Availability of water supply in locations in which we operate.

Turmoil in the financial markets could affect our liquidity. In addition, our cash balances are primarily invested in short-term government-backed instruments. The remaining cash balances are held at numerous financial institutions and may, at times, exceed insurable amounts. We seek to mitigate this risk by depositing our cash in major financial

institutions and diversifying our investments. In addition, our homebuilding operations often require us to obtain letters of credit. We have certain stand-alone letter of credit facilities and agreements pursuant to which letters of credit are issued. However, we may need additional letters of credit above the amounts provided under these facilities and letters of credit may not be issued under our current revolving credit facility. If we are unable to obtain such additional letters of credit as needed to operate our business, we would be adversely affected.

Weather conditions and man-made or natural disasters such as hurricanes, tornadoes, earthquakes, floods, droughts, fires and other environmental conditions can harm the local homebuilding business. For example, subsequent to our fiscal year-end, there have been significant wildfires throughout Southern California. While none of our communities have been directly affected, we could experience labor shortages, construction delays or utility company delays, which in turn could impact our fiscal 2019 results. In addition, in September 2017, Hurricane Harvey and Hurricane Irma caused disruption and delays in Houston and Florida. Similarly, our production process slowed and our cost of operations increased in Texas during fiscal 2015 as a result of record wet conditions in this state and, in August 2011 and October 2012, Hurricane Irene and Hurricane Sandy, respectively, caused widespread flooding and disruptions on the Atlantic seaboard, which impacted our sales and construction activity in affected markets during those months.

The difficulties described above could cause us to take longer and incur more costs to build our homes. In addition, our insurance may not fully cover business interruptions or losses caused by weather conditions and manmade or natural disasters and we may not be able to recapture increased costs by raising prices in many cases because we fix our prices up to 12 months in advance of delivery by signing home sales contracts. Some home buyers may also cancel or not honor their home sales contracts altogether.

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A significant downturn in the homebuilding industry could materially and adversely affect our business.

The homebuilding industry experienced a significant and sustained downturn that began in 2007, during which the lowest volumes of housing starts were significantly below troughs in previous downturns. This downturn resulted in an industry-wide softening of demand for new homes due to a lack of consumer confidence, decreased availability of mortgage financing, and large supplies of resale and new home inventories, among other factors. In addition, an oversupply of alternatives to new homes, such as rental properties, resale homes and foreclosures, depressed prices and reduced margins for the sale of new homes. Industry conditions had a material adverse effect on our business and results of operations in fiscal years 2007 through 2011. Further, we had substantially increased our inventory through fiscal 2006, which required significant cash outlays and which increased our price and margin exposure as we worked through this inventory. Although the homebuilding market has improved in the last few years, the recovery has been slow by historical standards and the volume of housing starts is still below normal historical averages and our business, liquidity and results of operations continue to be impacted by the lasting effects of the significant and sustained downturn and it may continue to materially adverse our business and results of operations in future years. If the homebuilding industry experiences another significant or sustained downturn, it would materially adversely affect our business and results of operations in future years.

Several challenges, such as general U.S. economic uncertainty and the potential for more rapid inflation, extreme weather conditions, increasing cycle times due to labor shortages, increasing labor and materials costs, the restrictive mortgage lending environment and rising mortgage interest rates and regulatory changes, could further impact the housing market and, consequently, our performance. For example, if rising house construction costs substantially outpace increases in the income of potential purchasers we may be limited in our ability to raise home sales prices, which may result in lower gross margins.

Our high leverage may restrict our ability to operate, may prevent us from fulfilling our obligations, and may adversely affect our financial condition.

We have a significant amount of debt.

Our debt (excluding nonrecourse secured debt and debt of our financial subsidiaries), as of October 31, 2018, including the debt of the subsidiaries that guarantee our debt, was $1,493.3 million ($1,453.3 million net of discount and premiums). Additionally, we have a $125.0 million senior secured credit facility, which was fully available for borrowing as of October 31, 2018.

Our debt service payments for the year ended October 31, 2018, were $322.8 million, which represented interest incurred and payments on the principal of our debt and do not include principal and interest on nonrecourse secured debt, debt of our financial subsidiaries and fees under our letter of credit and other credit facilities and agreements.

As of October 31, 2018, we had $12.5 million in aggregate outstanding face amount of letters of credit issued under various letter of credit and other credit facilities and agreements, certain of which were collateralized by $12.7 million of cash. Our fees for these letters of credit for the year ended October 31, 2018, which are based on both the used and unused portion of the facilities and agreements, were $1.3 million. We also had substantial contractual commitments and contingent obligations, including $192.5 million of performance bonds as of October 31, 2018. See Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations.”

Our significant amount of debt could have important consequences. For example, it could:

- Limit our ability to obtain future financing for working capital, capital expenditures, acquisitions, debt service requirements, or other requirements;
- Require us to dedicate a substantial portion of our cash flow from operations to the payment of our debt and reduce our ability to use our cash flow for other purposes, including land investments;
- Limit our flexibility in planning for, or reacting to, changes in our business;
- Place us at a competitive disadvantage because we have more debt than some of our competitors;
- Limit our ability to implement our strategies and operational actions;
- Require us to consider selling some of our assets or debt or equity securities, possibly on unfavorable terms, to satisfy obligations; and
- Make us more vulnerable to downturns in our business and general economic conditions.

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Our ability to meet our debt service and other obligations will depend upon our future performance. We are engaged in businesses that are substantially affected by changes in economic cycles. Our revenues and earnings vary with the level of general economic activity in the markets we serve. Our businesses are also affected by customer sentiment and financial, political, business, and other factors, many of which are beyond our control. The factors that affect our ability to generate cash can also affect our ability to raise additional funds for these purposes through the sale of equity or debt securities, the refinancing of debt, or the sale of assets. Changes in prevailing interest rates may affect our ability to meet our debt service obligations to the extent we have any floating rate indebtedness. A higher interest rate on our debt service obligations could result in lower earnings or increased losses.

Our sources of liquidity are limited and may not be sufficient to meet our needs.

We are largely dependent on our current cash balance and future cash flows from operations (which may not be positive) to enable us to service our indebtedness, to cover our operating expenses, and/or to fund our other liquidity needs. Cash used in and provided from operating activities in fiscal 2018 and fiscal 2017 were $66.8 million and $301.6 million, respectively. Depending on the levels of our land purchases, we could generate negative or positive cash flow in future years. In 2016, we used a significant portion of cash to repay debt because financing was unavailable to us in the capital and loan markets. If the homebuilding industry does not experience improved conditions over the next several years, our cash flows could be insufficient to fund our obligations and support land purchases; if we cannot buy additional land we would ultimately be unable to generate future revenues from the sale of houses. In addition, we will need to refinance all or a portion of our debt on or before maturity, which we may not be able to do on favorable terms or at all. If our cash flows and capital resources are insufficient to fund our debt service obligations or we are unable to refinance our indebtedness, we may be forced to reduce or delay investments and capital expenditures, sell assets, seek additional capital, or restructure our indebtedness. These alternative measures may not be successful or, if successful, made on desirable terms and may not permit us to meet our debt service obligations. We have also entered into certain cash collateralized letters of credit agreements and facilities that require us to maintain specified amounts of cash in segregated accounts as collateral to support our letters of credit issued thereunder. If our available cash and capital resources are insufficient to meet our debt service and other obligations, we could face liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. We may not be able to consummate those dispositions or the proceeds from the dispositions may not be permitted under the terms of our debt instruments to be used to service indebtedness or may not be adequate to meet any debt service obligations then due. For additional information about capital resources and liquidity, see Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Capital Resources and Liquidity.”

Our cash flows, liquidity and consolidated financial statements could be materially and adversely affected if we are unable to obtain letters of credit.

Our homebuilding operations often require us to obtain letters of credit. We have certain stand-alone letter of credit facilities and agreements pursuant to which letters of credit are issued. However, letters of credit may not be issued under our current revolving credit facility and we may need additional letters of credit above the amounts provided

under these stand-alone facilities and agreements. If we are unable to obtain such additional letters of credit as needed to operate our business, we would be adversely affected.

We may have difficulty in obtaining the additional financing required to operate and develop our business.

Our operations require significant amounts of cash, and we may be required to seek additional capital, whether from sales of debt or equity securities or borrowing additional money, for the future growth and development of our business. The terms and/or availability of additional capital is uncertain. Moreover, the agreements governing our outstanding debt instruments contain provisions that restrict the debt we may incur in the future (including a requirement in the 9.50% Senior Secured Notes due 2020 that any new or refinancing indebtedness may not be scheduled to mature earlier than specified dates in 2021) and our ability to pay dividends on equity. If we are not successful in obtaining sufficient capital, it could reduce our sales and may hinder our future growth and results of operations. In addition, pledging substantially all of our assets to support our revolving credit facility and our senior secured notes may make it more difficult to raise additional financing in the future.

Restrictive covenants in our debt instruments may restrict our and certain of our subsidiaries' ability to operate, and if our financial performance worsens, we may not be able to undertake transactions within the restrictions of our debt instruments.

The indentures governing our outstanding debt securities, the term loan facility and our revolving credit facility impose certain restrictions on our and certain of our subsidiaries' operations and activities. The most significant restrictions relate to debt incurrence (including maturity date requirements), creating liens, sales of assets (including in certain land banking transactions), cash distributions, including paying dividends on common and preferred stock, capital stock and subordinated debt repurchases, and investments by us and certain of our subsidiaries. Because of these restrictions, we are currently prohibited from paying dividends on our common and preferred stock and anticipate that we will remain prohibited for the foreseeable future.

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The restrictions in our debt instruments could prohibit or restrict our and certain of our subsidiaries' activities, such as undertaking capital raising or restructuring activities or entering into other transactions. In such a situation, we may be unable to amend the instrument or obtain a waiver. In addition, if we fail to comply with these restrictions or to make timely payments on this debt and other material indebtedness, an event of default could occur and our debt under these debt instruments could become due and payable prior to maturity. Any such event of default could lead to cross defaults under certain of our other debt or negatively impact other covenants. In these situations, we may be unable to amend the applicable instrument or obtain a waiver without significant additional cost, or at all. In such a situation, there can be no assurance that we would be able to obtain alternative financing. Any such situation could have a material adverse effect on the solvency of the Company.

The terms of our debt instruments allow us to incur additional indebtedness.

Under the terms of our indebtedness under our indentures and credit facilities, we have the ability, subject to our debt covenants, to incur additional amounts of debt, including secured debt. The incurrence of additional indebtedness could magnify the risks described above. In addition, certain obligations, such as standby letters of credit and performance bonds issued in the ordinary course of business, including those issued under our stand-alone letter of credit agreements and facilities, are not considered indebtedness under our debt instruments (and may be secured), and therefore, are not subject to limits in our debt covenants.

We could be adversely affected by a negative change in our credit rating.

Our ability to access capital on favorable terms is a key factor in our ability to service our indebtedness to cover our operating expenses and to fund our other liquidity needs. Negative rating actions by credit agencies, including downgrades, may make it more difficult and costly for us to access capital. Therefore, any downgrade by any of the principal credit agencies may exacerbate these difficulties. There can be no assurances that our credit ratings will not be downgraded in the future, whether as a result of deteriorating general economic conditions, a more protracted downturn in the housing industry, failure to successfully implement our operating strategy, the adverse impact on our results of operations or liquidity position of any of the above, or otherwise.

Our business is seasonal in nature and our quarterly operating results fluctuate.

Our quarterly operating results generally fluctuate by season. The construction of a customer's home typically begins after signing the agreement of sale and can take six to nine months or more to complete. Weather-related problems, typically in the fall, winter and early spring, can delay starts or closings and increase costs and thus reduce profitability. In addition, delays in opening communities could have an adverse effect on our sales and revenues. Due to these factors, our quarterly operating results will likely continue to fluctuate.

Our success depends on the availability of suitable undeveloped land and improved lots at acceptable prices and our having sufficient liquidity to fund such investments.

Our success in developing land and in building and selling homes depends in part upon the continued availability of suitable undeveloped land and improved lots at acceptable prices. The homebuilding industry is highly competitive for land that is suitable for residential development and the availability of undeveloped land and improved lots for purchase at favorable prices depends on a number of factors outside of our control, including the risk of competitive overbidding on land and lots, geographical or topographical constraints and restrictive governmental regulation. Should suitable land opportunities become less available, our ability to implement our strategies and operational actions would be limited and the number of homes we may be able to build and sell would be reduced, which would reduce revenue and profits. In addition, our ability to make land purchases will depend upon us having sufficient liquidity to fund such purchases. We may be at a disadvantage in competing for land compared to others who have more substantial cash resources.

Raw material and labor shortages and price fluctuations could delay or increase the cost of home construction and adversely affect our operating results.

The homebuilding industry is vulnerable to raw material and labor shortages and has from time to time experienced such shortages. In particular, shortages and fluctuations in the price of lumber or in other important raw materials could result in delays in the start or completion of, or increase the cost of, developing one or more of our residential communities. For example, manufacturers increased the price of drywall in 2013 by approximately 20% as compared to the prior year, and there is a potential for significant future price increases. Delays or cost increases caused by raw material and labor shortages and price fluctuations, including as a result of inflation or wage increases, could harm our operating results, the impact of which may be further affected depending on our ability to raise sales prices to offset increased costs. We have experienced some labor shortages and increased labor costs over the past few years, including fiscal 2017 and 2018 during which we also experienced increased materials and construction costs. It is uncertain whether these shortages will continue as is, improve or worsen. The cost of labor may be adversely affected by changes in immigration laws and trends in labor migration. If rising labor and house construction costs substantially outpace increases in the income of potential purchasers we may be limited in our ability to raise home sale prices, which may result in lower gross margins.

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We rely on subcontractors to construct our homes and may incur costs or losses if these subcontractors fail to properly construct our homes or manage and pay their employees.

We engage subcontractors to perform the actual construction of our homes and, in some cases, to select and obtain building materials. Therefore, the timing and quality of our construction depends on the availability, skill, and cost of our subcontractors. Despite our quality control efforts, we may discover that our subcontractors failed to properly construct our homes or may use defective materials. The occurrence of such events could require us to repair the homes in accordance with our standards and as required by law. The cost of satisfying our legal obligations in these instances may be significant, and we may be unable to recover the cost of repair from subcontractors and insurers.

We also can suffer damage to our reputation, and may be exposed to possible liability, if subcontractors fail to comply with applicable laws. When we learn about possibly improper practices by subcontractors, we attempt to cause the subcontractors to discontinue them and may terminate the use of such subcontractors. However, attempts at mitigation may not avoid claims against us relating to actions of or matters relating to our subcontractors that are out of our control. For example, although we do not have the ability to control what these independent subcontractors pay their own employees, or their own subcontractors, or the work rules they impose on such personnel, federal and state governmental agencies, including the U.S. National Labor Relations Board, have sought, and may in the future seek, to hold contracting parties like us responsible for subcontractors' violations of wage and hour laws, or workers' compensation, collective bargaining and/or other employment-related obligations related to subcontractors' workforces. Governmental agency determinations or attempts by others to make us responsible for subcontractors' labor practices or obligations, could create substantial adverse exposure for us in these types of situations even though not within our control.

We also can suffer damage to our reputation, and may be exposed to possible liability, if subcontractors fail to comply with applicable laws, including laws involving actions or matters that are not within our control.

When we learn about possibly improper practices by subcontractors, we attempt to cause the subcontractors to discontinue them and may terminate the use of such subcontractors. However, attempts at mitigation may not avoid claims against us relating to actions of or matters relating to our subcontractors.

Products supplied to us and work done by subcontractors can expose us to risks that could adversely affect our business.

We rely on subcontractors to perform the actual construction of our homes, and, in some cases, to select and obtain building materials. Despite our detailed specifications and quality control procedures, in some cases, subcontractors may use improper construction processes or defective materials. Defective products widely used by the homebuilding

industry can result in the need to perform extensive repairs to large numbers of homes. The cost of complying with our warranty obligations may be significant if we are unable to recover the cost of repairs from subcontractors, materials suppliers and insurers.

Changes in economic and market conditions could result in the sale of homes at a loss or holding land in inventory longer than planned, the cost of which can be significant.

Land inventory risk can be substantial for homebuilders. We must continuously seek and make acquisitions of land for expansion into new markets and for replacement and expansion of land inventory within our current markets. We incur many costs even before we begin to build homes in a community. Depending on the stage of development of a land parcel when we acquire it, these may include costs of preparing land, finishing and entitling lots, installing roads, sewers, water systems and other utilities, taxes and other costs related to ownership of the land on which we plan to build homes. The market value of undeveloped land, buildable lots, and housing inventories can fluctuate significantly as a result of changing economic and market conditions. In the event of significant changes in economic or market conditions, we may have to sell homes at a loss or hold land in inventory longer than planned. In the case of land options, we could choose not to exercise them, in which case we would write-off the value of these options. Inventory carrying costs can be significant and can result in losses in a poorly performing project or market. The assessment of communities for indication of impairment is performed quarterly. While we consider available information to determine what we believe to be our best estimates as of the reporting period, these estimates are subject to change in future reporting periods as facts and circumstances change. See Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operation—Critical Accounting Policies.” For example, during more recent years, we did not have significant land option write-offs or impairments; however, during fiscal 2011, 2010 and 2009, we decided not to exercise many option contracts and walked away from land option deposits and predevelopment costs, which resulted in land option write-offs of $24.3 million, $13.2 million, and $45.4 million, respectively. Also, in fiscal 2011, 2010 and 2009, as a result of the difficult market conditions, we recorded inventory impairment losses on owned property of $77.5 million, $122.5 million and $614.1 million, respectively. If market conditions worsen, additional inventory impairment losses and land option write-offs will likely be necessary.

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We conduct a significant portion of our business in Arizona, California, Florida, New Jersey, Ohio, Texas and Virginia, and accordingly, regional factors affecting home sales and activities in these markets may have a large impact on our results of operations.

We presently conduct a significant portion of our business in Arizona, California, Florida, New Jersey, Ohio, Texas and Virginia, which subjects us to risks associated with the regional and local economies of these markets. Home prices and sales activities in these markets and in most of the other markets in which we operate have declined from time to time, particularly as a result of slow economic growth. These markets may also depend, to a degree, on certain sectors of the economy and any declines in those sectors may impact home sales and activities in that region. For example, to the extent the oil and gas industries, which can be very volatile, are negatively impacted by declining commodity prices, climate change, legislation or other factors, it could result in reduced employment, or other negative economic consequences, which in turn could adversely impact our home sales and activities in Texas. Furthermore, precarious economic and budget situations at the state government level may adversely affect the market for our homes in the affected areas. Weather-related or other events impacting these markets could also negatively affect these markets as well as the other markets in which we operate. If home prices and sales activity decline in one or more of the markets in which we operate, our costs may not decline at all or at the same rate and the Company's business, financial condition and results of operations could be materially adversely affected. See also "*—The homebuilding industry is significantly affected by changes in general and local economic conditions, real estate markets, and weather and other environmental conditions, which could affect our ability to build homes at prices our customers are willing or able to pay, could reduce profits that may not be recaptured, could result in cancellation of sales contracts, and could affect our liquidity.*"

Increases in cancellations of agreements of sale could have an adverse effect on our business.

Our backlog reflects agreements of sale with our home buyers for homes that have not yet been delivered. We have received a deposit from our home buyer for each home, which is reflected in our backlog, and we generally have the right to retain the deposit if the home buyer does not complete the purchase. In some situations, however, a home buyer may cancel the agreement of sale and receive a complete or partial refund of the deposit for reasons such as state and local law, his or her inability to obtain mortgage financing at prevailing interest rates (including financing arranged or provided by us), his or her inability to sell his or her current home, or our inability to complete and deliver the home within the specified time. At October 31, 2018, including unconsolidated joint ventures, we had a backlog of signed contracts for 2,192 homes with a sales value aggregating $977.3 million. If mortgage financing becomes less accessible, or if economic conditions deteriorate, more home buyers may cancel their agreements of sale with us, which could have an adverse effect on our business and results of operations.

Interest rates have been at historic lows over the last several years and are expected to increase. Because almost all of our customers require mortgage financing, increases in interest rates or the decreased availability of mortgage financing could impair the affordability of our homes, lower demand for our products, limit our marketing effectiveness, and limit our ability to fully realize our backlog.

Virtually all of our customers finance their acquisitions through lenders providing mortgage financing. Increases in interest rates (or the perception that interest rates will rise, including as a result of government actions), increases in the costs to obtain mortgages or decreases in availability of mortgage financing could lower demand for new homes because of the increased monthly mortgage costs and cash required to close on mortgages to potential home buyers. Even if potential customers do not need financing, changes in interest rates and mortgage availability could make it harder for them to sell their existing homes to potential buyers who need financing. This could prevent or limit our ability to attract new customers as well as our ability to fully realize our backlog because our sales contracts generally include a financing contingency. Financing contingencies permit the customer to cancel his/her obligation in the event mortgage financing at prevailing interest rates, including financing arranged or provided by us, is unobtainable within the period specified in the contract. This contingency period is typically four to eight weeks following the date of execution of the sales contract. We believe that the availability of mortgage financing, including through federal government agencies or government-sponsored enterprises (such as Federal National Mortgage Association, Federal Home Loan Mortgage Corporation and FHA/VA financing), is an important factor in marketing many of our homes. Any limitations or restrictions on the availability of mortgage financing could reduce our sales. Further, if we are unable to originate mortgages for any reason going forward, our customers may experience significant mortgage loan funding issues, which could have a material impact on our homebuilding business and our consolidated financial statements.

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Increases in the after-tax costs of owning a home could prevent potential customers from buying our homes and adversely affect our business or financial results.

Significant expenses of owning a home, including mortgage interest expenses and real estate taxes, have historically been deductible expenses for an individual's federal, and in some cases state, income taxes, subject to limitations under tax law and policy. The "Tax Cuts and Jobs Act" which was signed into law in December 2017 includes provisions which impose significant limitations with respect to these income tax deductions. For instance, the annual deduction for real estate taxes and state and local income taxes (or sales taxes in lieu of income taxes) is now generally limited to $10,000. Furthermore, through the end of 2025, the deduction for mortgage interest is generally only available with respect to the first $750,000 of a new mortgage and there is no longer a federal deduction for interest on home equity loans. In addition, if the federal government or a state government further changes its income tax laws to further eliminate or substantially limit these income tax deductions, the after-tax cost of owning a new home would further increase for many of our potential customers. The loss or reduction of these homeowner tax deductions that have historically been available has and could further reduce the perceived affordability of homeownership, and therefore the demand for and sales price of new homes, including ours. In addition, increases in property tax rates or fees on developers by local governmental authorities, as experienced in response to reduced federal and state funding or to fund local initiatives, such as funding schools or road improvements, or increases in insurance premiums can adversely affect the ability of potential customers to obtain financing or their desire to purchase new homes, and can have an adverse impact on our business and financial results.

We conduct certain of our operations through unconsolidated joint ventures with independent third parties in which we do not have a controlling interest. These investments involve risks and are highly illiquid.

We currently operate through a number of unconsolidated homebuilding and land development joint ventures with independent third parties in which we do not have a controlling interest. At October 31, 2018, we had invested an aggregate of $123.7 million in these joint ventures, including advances and a note receivable to these joint ventures of $4.6 million. In addition, as part of our strategy, we intend to continue to evaluate additional joint venture opportunities.

These investments involve risks and are highly illiquid. There are a limited number of sources willing to provide acquisition, development, and construction financing to land development and homebuilding joint ventures, and if market conditions become more challenging, it may be difficult or impossible to obtain financing for our joint ventures on commercially reasonable terms. Over the past few years, it has been difficult to obtain financing for newly created joint ventures. In addition, we lack a controlling interest in these joint ventures and, therefore, are usually unable to require that our joint ventures sell assets or return invested capital, make additional capital contributions, or take any other action without the vote of at least one of our venture partners. Therefore, absent partner agreement, we will be unable to liquidate our joint venture investments to generate cash.

Homebuilders are subject to a number of federal, local, state, and foreign laws and regulations concerning the development of land, the homebuilding, sales, and customer financing processes and the protection of the environment, which can cause us to incur delays and costs associated with compliance and which can prohibit or restrict our activity in some regions or areas.

We are subject to extensive and complex laws and regulations that affect the development of land and homebuilding, sales and customer financing processes, including zoning, density, building standards and mortgage financing. These laws and regulations often provide broad discretion to the administering governmental authorities. This can delay or increase the cost of development or homebuilding. In addition, some state and local governments in markets where we operate have approved, and others may approve, slow-growth or no-growth initiatives that could negatively impact the availability of land and building opportunities within those areas. Approval of these initiatives could adversely affect our ability to build and sell homes in the affected markets and/or could require the satisfaction of additional administrative and regulatory requirements, which could result in slowing the progress or increasing the costs of our homebuilding operations in these markets. Any of the above delays or costs could have a negative effect on our future revenues and earnings.

We also are subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment, including those regulating the emission or discharge of materials into the environment, the management of storm water runoff at construction sites, the handling, use, storage and disposal of hazardous substances, impacts to wetlands and other sensitive environments, and the remediation of contamination at properties that we have owned or developed or currently own or are developing (“environmental laws”). The particular environmental laws that apply to a site may vary greatly according to the community's site, for example, due to the community, the environmental conditions at or near the site, and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation and/or other costs, and can prohibit or severely restrict development and homebuilding activity. In addition, noncompliance with these laws and regulations could result in fines and penalties, obligations to remediate, permit revocations or other sanctions, and contamination or other environmental conditions at or in the vicinity of our developments may result in claims against us for personal injury, property damage or other losses.

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For example, in March 2013, we received a letter from the U.S. Environmental Protection Agency ("EPA") requesting information about our involvement in a housing redevelopment project in Newark, New Jersey that a Company entity undertook during the 1990s. We understand that the development is in the vicinity of a former lead smelter and that tests on soil samples from properties within the development conducted by the EPA show elevated levels of lead. We also understand that the smelter ceased operations many years before the Company entity involved acquired the properties in the area and carried out the re-development project. We responded to the EPA's request. In August 2013, we were notified that the EPA considers us a potentially responsible party (or "PRP") with respect to the site, that the EPA will clean up the site, and that the EPA is proposing that we fund and/or contribute towards the cleanup of the contamination at the site. We began preliminary discussions with the EPA concerning a possible resolution but do not know the scope or extent of the Company's obligations, if any, that may arise from the site and therefore cannot provide any assurance that this matter will not have a material impact on the Company. The EPA requested additional information in April 2014 and again in March 2017 and the Company responded to the information requests. On May 2, 2018 the EPA sent a letter to the Company entity demanding reimbursement for 100% of the EPA's costs to clean-up the site in the amount of $2.7 million. The Company responded to the EPA's demand letter on June 15, 2018 setting forth the Company's defenses and expressing its willingness to enter into settlement negotiations. We believe that we have adequate reserves for this matter.

We anticipate that increasingly stringent requirements will be imposed on developers and homebuilders in the future. For example, for a number of years, the EPA and U.S. Army Corps of Engineers have been engaged in rulemakings to clarify the scope of federally regulated wetlands, which included a June 2015 rule many affected businesses contend impermissibly expanded the scope of such wetlands that was challenged in court, stayed, and remains in litigation. A proposal was made in June 2017 to formally rescind the June 2015 rule and reinstate the rule scheme previously in place while the agencies initiate a new substantive rulemaking on the issue. A February 2018 rule delays the effective date of the June 2015 rule until February 2020, but was enjoined nationwide in August 2018 by a federal district court in South Carolina in response to a lawsuit by a coalition of environmental advocacy groups (the result of which, according to the EPA, is that the June 2015 rule applies in 22 states, the District of Columbia, and the United States territories, and that the pre-June 2015 regime applies in the rest). The district court's August 2018 decision is being appealed, and the EPA and U.S. Army Corps of Engineers are seeking a stay of the decision. It is unclear how these and related developments, including at the state or local level, ultimately may affect the scope of regulated wetlands where we operate. Although we cannot reliably predict the extent of any effect these developments regarding wetlands, or any other requirements that may take effect may have on us, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, our ability to obtain or renew permits or approvals and the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules and regulations and their interpretations and application.

Legal claims not resolved in our favor, such as product liability litigation and warranty claims may be costly.

As discussed in Item 3 – "Legal Proceedings," in the ordinary course of business we are involved in litigation from time to time, including with home owners associations, home buyers and other persons with whom we have relationships. For example, as a homebuilder, we are subject to construction defect and home warranty claims, including moisture intrusion and related claims, arising in the ordinary course of business. Such claims are common in the homebuilding

industry and can be costly. For example, in the past we have received construction defect and home warranty claims associated with, and we were involved in a multidistrict litigation concerning, allegedly defective drywall manufactured in China ("Chinese Drywall") that may have been responsible for noxious smells and accelerated corrosion of certain metals in certain homes we have constructed. We remediated certain homes in response to such claims and settled the litigation.

With regard to certain general liability exposures such as product liability claims, construction defect claims and related claims, assessment of claims and the related liability and reserve estimation process is highly judgmental and subject to a high degree of variability due to uncertainties such as trends in construction defect claims relative to our markets and the types of products we build, claim settlement patterns, insurance industry practices and legal interpretations, among others. Because of the high degree of judgment required in determining these estimated liability amounts, actual future costs could differ significantly from our currently estimated amounts. Furthermore, after claims are asserted for construction defects, it can be difficult to determine the extent to which assertions of such claims will expand geographically. For example, the Company has been a party to litigation in New Jersey concerning alleged defects in construction (see Item 3 – "Legal Proceedings" and Note 18 to our Consolidated Financial Statements for the year ended October 31, 2018). In addition, the amount and scope of coverage offered by insurance companies is currently limited, and this coverage may be further restricted and become more costly. If we are not able to obtain adequate insurance against such claims, if the costs associated with such claims significantly exceed the amount of our insurance coverage, or if our insurers do not pay on claims under our policies (whether because of dispute, inability, or otherwise), we may experience losses that could hurt our financial results.

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Our financial results could also be adversely affected if we were to experience an unusually high number of claims or unusually severe claims. Our insurance companies have the right to review our claims and claims history, and do so from time to time, and could decline to pay on such claims if such reviews determine the claims did not meet the terms for coverage. Additionally, we may need to significantly increase our construction defect and home warranty reserves as a result of insurance not being available for any of the reasons discussed above, such claims or the results of our annual actuarial study.

Mortgage investors could seek to have us buy back loans or compensate them for losses incurred on mortgages we have sold based on claims that we breached our limited representations or warranties.

Our financial services segment originates mortgages, primarily for our homebuilding customers. Substantially all of the mortgage loans originated are sold within a short period of time in the secondary mortgage market on a servicing released, nonrecourse basis, although we remain liable for certain limited representations, such as fraud, and warranties related to loan sales. Accordingly, mortgage investors have in the past and could in the future seek to have us buy back loans or compensate them for losses incurred on mortgages we have sold based on claims that we breached our limited representations or warranties. While we believe these reserves are adequate for known losses and projected repurchase requests, given the volatility in the mortgage industry and the uncertainty regarding the ultimate resolution of these claims, if either actual repurchases or the losses incurred resolving those repurchases exceed our expectations, additional expense may be incurred. There can be no assurance that we will not have significant liabilities in respect of such claims in the future, which could exceed our reserves, or that the impact of such claims on our results of operations will not be material. Further, an increase in the default rate on the mortgages we originate may adversely affect our ability to sell mortgages or the pricing we receive upon the sale of mortgages.

We compete on several levels with homebuilders that may have greater sales and financial resources, which could hurt future earnings.

We compete not only for home buyers but also for desirable properties, financing, raw materials, and skilled labor often within larger subdivisions designed, planned, and developed by other homebuilders. Our competitors include other local, regional and national homebuilders, some of which have greater sales and financial resources or more established relationships with suppliers and subcontractors in the markets in which we operate. In addition, we compete with other housing alternatives, such as existing homes and rental housing. In the homebuilding industry, we compete primarily on the basis of reputation, price, location, design, quality, service and amenities. Our financial services segment competes with other mortgage providers, primarily on the basis of fees, interest rates and other features of mortgage loan products.

The competitive conditions in the homebuilding industry together with current market conditions have, and could continue to, result in:

difficulty in acquiring suitable land at acceptable prices (see also "–*Our success depends on the availability of suitable undeveloped land and improved lots at acceptable prices and our having sufficient liquidity to fund such investments*");

increased selling incentives;

lower sales;

delays in construction; or

impairment of our ability to implement our strategies and operational actions.

Any of these problems could increase costs and/or lower profit margins.

Our future growth may include additional acquisitions of companies that may not be successfully integrated and may not achieve expected benefits.

Acquisitions of companies have contributed to our historical growth and may again be a component of our growth strategy in the future. In the future, we may acquire businesses, some of which may be significant. As a result of acquisitions of companies, we may need to seek additional financing and integrate product lines, dispersed operations, and distinct corporate cultures. These integration efforts may not succeed or may distract our management from operating our existing business. Additionally, we may not be able to enhance our earnings as a result of acquisitions. Our failure to successfully identify and manage future acquisitions could harm our operating results.

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Our controlling stockholders are able to exercise significant influence over us.

Members of the Hovnanian family, including Ara K. Hovnanian, our chairman of the board, president, and chief executive officer, have voting control, through personal holdings, the limited partnership and the limited liability company established for members of Mr. Hovnanian's family and family trusts of Class A and Class B common stock that enabled them to cast approximately 57% of the votes that could be cast by the holders of our outstanding Class A and Class B common stock combined as of October 31, 2018. Their combined stock ownership enables them to exert significant control over us, including power to control the election of the Board of Directors and to approve matters presented to our stockholders. This concentration of ownership may also make some transactions, including mergers or other changes in control, more difficult or impossible without their support. Also, because of their combined voting power, circumstances may occur in which their interests could be in conflict with the interests of other stakeholders.

Our net operating loss carryforwards could be substantially limited if we experience an ownership change as defined in the Internal Revenue Code.

Based on past impairments and our current financial performance, we generated a federal net operating loss carryforward of $1.6 billion through the fiscal year ended October 31, 2018, and we may generate net operating loss carryforwards in future years.

Section 382 of the United States Internal Revenue Code of 1986, as amended (the "Code"), contains rules that limit the ability of a company that undergoes an ownership change, which is generally any change in ownership of more than 50% of its stock over a three-year period, to utilize its net operating loss carryforwards and certain built-in losses recognized in years after the ownership change. These rules generally operate by focusing on ownership shifts among stockholders owning directly or indirectly 5% or more of the stock of a company and any change in ownership arising from a new issuance of stock by the company.

If we undergo an ownership change for purposes of Section 382 as a result of future transactions involving our stock, including purchases or sales of stock between 5% shareholders, our ability to use our net operating loss carryforwards and to recognize certain built-in losses would be subject to the limitations of Section 382. Depending on the resulting limitation, a significant portion of our net operating loss carryforwards could expire before we would be able to use them. A limitation imposed under Section 382 on our ability to utilize our net operating loss carryforwards could have a negative impact on our financial position and results of operations.

The value of our deferred tax assets is also dependent upon the tax rates expected to be in effect at the time the taxable income is expected to be generated. A decrease in enacted corporate tax rates in our major jurisdictions, especially the U.S. federal corporate rate, would decrease the value of our deferred tax assets, which could be material.

Our Board of Directors has adopted, and our shareholders have approved, a shareholder rights plan (the “Rights Plan”) designed to preserve shareholder value and the value of certain tax assets primarily associated with net operating loss carryforwards and built-in losses under Section 382 of the Code. The Rights Plan is intended to act as a deterrent to any person or group acquiring 4.9% or more of our outstanding Class A common stock (any such person an “Acquiring Person”), without the approval of the Company’s Board of Directors. Subject to the terms, provisions and conditions of the Rights Plan, if and when they become exercisable, each right would entitle its holder to purchase from the Company one ten-thousandth of a share of the Company’s Series B Junior Preferred Stock for a purchase price of $16.60 per share (the “purchase price”). The rights will not be exercisable until the earlier of (i) 10 business days after a public announcement by us that a person or group has become an Acquiring Person and (ii) 10 business days after the commencement of a tender or exchange offer by a person or group for 4.9% of the Class A common stock (the “distribution date”). If issued, each fractional share of Series B Junior Preferred Stock would give the stockholder approximately the same dividend, voting and liquidation rights as does one share of the Company’s Class A common stock. However, prior to exercise, a right does not give its holder any rights as a stockholder of the Company, including without limitation any dividend, voting or liquidation rights. After the distribution date, each holder of a right, other than rights beneficially owned by the Acquiring Person (which will thereupon become void), will thereafter have the right to receive upon exercise of a right and payment of the purchase price, that number of shares of Class A common stock or Class B common stock, as the case may be, having a market value of two times the purchase price. After the distribution date, our Board of Directors may exchange the rights (other than rights owned by an Acquiring Person which will have become void), in whole or in part, at an exchange ratio of one share of common stock, or a fractional share of Series B Junior Preferred Stock (or of a share of a similar class or series of Hovnanian’s preferred stock having similar rights, preferences and privileges) of equivalent value, per right (subject to adjustment).

In addition, our Restated Certificate of Incorporation restricts certain transfers of our common stock in order to preserve the tax treatment of our net operating loss carryforwards and built-in losses under Section 382 of the Code. Subject to certain exceptions pertaining to pre-existing 5% stockholders and Class B stockholders, the transfer restrictions in our Restated Certificate of Incorporation generally restrict any direct or indirect transfer (such as transfers of the Company’s stock that result from the transfer of interests in other entities that own the Company’s stock) if the effect would be to: (i) increase the direct or indirect ownership of the Company’s stock by any person (or public group) from less than 5% to 5% or more of the Company’s stock; (ii) increase the percentage of the Company’s stock owned directly or indirectly by a person (or public group) owning or deemed to own 5% or more of the Company’s stock; or (iii) create a new “public group” (as defined in the applicable United States Treasury regulations).

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Utility shortages and outages or rate fluctuations could have an adverse effect on our operations.

In prior years, the areas in which we operate in California have experienced power shortages, including periods without electrical power, as well as significant fluctuations in utility costs. We may incur additional costs and may not be able to complete construction on a timely basis if such power shortages and outages and utility rate fluctuations continue. Furthermore, power shortages and outages and rate fluctuations may adversely affect the regional economies in which we operate, which may reduce demand for our homes. Our operations may be adversely affected if further rate fluctuations and/or power shortages and outages occur in California, the Northeast or in our other markets.

Geopolitical risks and market disruption could adversely affect our operating results and financial condition.

Geopolitical events, acts of war or terrorism, civil unrest, or any outbreak or escalation of hostilities throughout the world or health pandemics, may have a substantial impact on the economy, consumer confidence, the housing market, our associates and our customers. Further, perceived threats to national security and other actual or potential conflicts or wars and related geopolitical risks have created many economic and political uncertainties. If any such events were to occur, it could have a material adverse impact on our results of operations and financial condition.

We could be adversely impacted by the loss of key management personnel or if we fail to attract qualified personnel.

To a significant degree, our future success depends on the efforts of our senior management, many of whom have been with the Company for a significant number of years, and our ability to attract qualified personnel. Our operations could be adversely affected if key members of our senior management leave the Company or if we cannot attract qualified personnel to manage growth in our business.

Information technology failures and data security breaches could harm our business.

We use information technology, digital telecommunications and other computer resources to carry out important operational activities and to maintain our business records. In addition, we rely on the systems of third parties, such as third-party vendors. Our computer systems, including our backup systems, and those of the third-parties on whose systems we rely, are subject to damage or interruption from computer and telecommunications failures, computer viruses, power outages, security breaches (including through data-theft and cyber-attack), usage errors by our associates and catastrophic events, such as fires, floods, hurricanes and tornadoes. If our computer systems and our backup systems, or those of the third-parties on whose systems we rely, are breached, compromised, damaged, or otherwise cease to function properly, we could suffer interruptions in our operations or the misappropriation of

proprietary or confidential information, including information about our business partners and home buyers. Our failure to maintain the security of the data we are required to protect could result in damage to our reputation, financial obligations to third parties, fines, penalties, regulatory proceedings and private litigation with potentially large costs, and also in deterioration in customers' confidence in us and other competitive disadvantages. Further, we are continuously working to develop and maintain our systems and protect them from the threats enumerated above. These measures, which require ongoing monitoring and updating as technologies change and efforts to overcome security measures become increasingly sophisticated, are costly and may not be effective in preventing or mitigating significant negative occurrences or irregularities in our systems or those of third-parties on whose systems we rely.

Negative publicity could adversely affect our reputation and our business, financial results and stock price.

Unfavorable media related to our industry, company, brand, personnel, operations, business performance, or prospects may impact our stock price and the performance of our business, regardless of its accuracy or inaccuracy. The speed at which negative publicity is disseminated has increased dramatically through the use of electronic communication, including social media outlets, websites, "tweets", and blogs. Our success in maintaining and expanding our brand image depends on our ability to adapt to this rapidly changing media environment. Adverse publicity or negative commentary from any media outlets could damage our reputation and reduce the demand for our homes, which would adversely affect our business.

ITEM 1B

UNRESOLVED STAFF COMMENTS

None.

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ITEM 2

PROPERTIES

We rent approximately 57,000 square feet of office space in the Northeast for our corporate headquarters. We own 215,000 square feet of office and warehouse space throughout the Midwest. We lease approximately 346,000 square feet of space for our segments located in the Northeast, Mid-Atlantic, Midwest, Southeast, Southwest and West. Included in this amount is 6,800 square feet of abandoned lease space.

ITEM 3

LEGAL PROCEEDINGS

We are involved in litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on our financial position, results of operations or cash flows, and we are subject to extensive and complex laws and regulations that affect the development of land and home building, sales and customer financing processes, including zoning, density, building standards and mortgage financing. These laws and regulations often provide broad discretion to the administering governmental authorities. This can delay or increase the cost of development or homebuilding. The significant majority of our litigation matters are related to construction defect claims. Our estimated losses from construction defect litigation matters, if any, are included in our construction defect reserves as discussed in Note 16 to the Consolidated Financial Statements.

We also are subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment, including those regulating the emission or discharge of materials into the environment, the management of storm water runoff at construction sites, the handling, use, storage and disposal of hazardous substances, impacts to wetlands and other sensitive environments, and the remediation of contamination at properties that we have owned or developed or currently own or are developing (“environmental laws”). The particular environmental laws that apply to a site may vary greatly according to the community site, for example, due to the community, the environmental conditions at or near the site, and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation and/or other costs, and can prohibit or severely restrict development and homebuilding activity. In addition, noncompliance with these laws and regulations could result in fines and penalties, obligations to remediate, permit revocations or other sanctions; and contamination or other environmental conditions at or in the vicinity of our developments may result in claims against us for personal injury, property damage or other losses.

We anticipate that increasingly stringent requirements will be imposed on developers and homebuilders in the future. For example, for a number of years, the EPA and U.S. Army Corps of Engineers have been engaged in rulemakings to clarify the scope of federally regulated wetlands, which included a June 2015 rule many affected businesses contend

impermissibly expanded the scope of such wetlands that was challenged in court, stayed, and remains in litigation. A proposal was made in June 2017 to formally rescind the June 2015 rule and reinstate the rule scheme previously in place while the agencies initiate a new substantive rulemaking on the issue. A February 2018 rule delays the effective date of the June 2015 rule until February 2020, but was enjoined nationwide in August 2018 by a federal district court in South Carolina in response to a lawsuit by a coalition of environmental advocacy groups (the result of which, according to the EPA, is that the June 2015 rule applies in 22 states, the District of Columbia and the United States territories, and that the pre-June 2015 regime applies in the rest). The district court's August 2018 decision is being appealed, and the EPA and U.S. Army Corps of Engineers are seeking a stay of the decision. It is unclear how these and related developments, including at the state or local level, ultimately may affect the scope of regulated wetlands where we operate. Although we cannot reliably predict the extent of any effect these developments regarding wetlands, or any other requirements that may take effect may have on us, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, our ability to obtain or renew permits or approvals and the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules and regulations and their interpretations and application.

In March 2013, we received a letter from the Environmental Protection Agency ("EPA") requesting information about our involvement in a housing redevelopment project in Newark, New Jersey that a Company entity undertook during the 1990s. We understand that the development is in the vicinity of a former lead smelter and that tests on soil samples from properties within the development conducted by the EPA showed elevated levels of lead. We also understand that the smelter ceased operations many years before the Company entity involved acquired the properties in the area and carried out the re-development project. We responded to the EPA's request. In August 2013, we were notified that the EPA considers us a potentially responsible party (or "PRP") with respect to the site, that the EPA will clean up the site, and that the EPA is proposing that we fund and/or contribute towards the cleanup of the contamination at the site. We began preliminary discussions with the EPA concerning a possible resolution but do not know the scope or extent of the Company's obligations, if any, that may arise from the site and therefore cannot provide any assurance that this matter will not have a material impact on the Company. The EPA requested additional information in April 2014 and again in March 2017 and the Company responded to the information requests. On May 2, 2018 the EPA sent a letter to the Company entity demanding reimbursement for 100% of the EPA's costs to clean-up the site in the amount of $2.7 million. The Company responded to the EPA's demand letter on June 15, 2018 setting forth the Company's defenses and expressing its willingness to enter into settlement negotiations. We believe that we have adequate reserves for this matter.

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The Grandview at Riverwalk Port Imperial Condominium Association, Inc. (the “Grandview Plaintiff”) filed a construction defect lawsuit against Hovnanian Enterprises, Inc. and several of its affiliates, including K. Hovnanian at Port Imperial Urban Renewal II, LLC, K. Hovnanian Construction Management, Inc., K. Hovnanian Companies, LLC, K. Hovnanian Enterprises, Inc., K. Hovnanian North East, Inc. aka and/or dba K. Hovnanian Companies North East, Inc., K. Hovnanian Construction II, Inc., K. Hovnanian Cooperative, Inc., K. Hovnanian Developments of New Jersey, Inc., and K. Hovnanian Holdings NJ, LLC, as well as the project architect, the geotechnical engineers and various construction contractors for the project alleging various construction defects, design defects and geotechnical issues totaling approximately $41.3 million. The lawsuit included claims against the geotechnical engineers for differential soil settlement under the building, against the architects for failing to design the correct type of structure allowable under the New Jersey Building Code, and against the Hovnanian-affiliated developer entity (K. Hovnanian at Port Imperial Urban Renewal II, LLC) alleging that it: (1) had knowledge of and failed to disclose the improper building classification to unit purchasers and was therefore liable for treble damages under the New Jersey Consumer Fraud Act; and (2) breached an express warranty set forth in the Public Offering Statements that the common elements at the building were fit for their intended purpose. The Grandview Plaintiff further alleged that Hovnanian Enterprises, Inc., K. Hovnanian Holdings NJ, LLC, K. Hovnanian Developments of New Jersey, Inc., and K. Hovnanian Developments of New Jersey II, Inc. were jointly liable for any damages owed by the Hovnanian development entity under a veil piercing theory.

After the parties reached a pre-trial settlement on the construction defect issues, trial commenced on April 17, 2017 in Hudson County, New Jersey. The Hovnanian-affiliated defendants resolved the geotechnical claims mid-trial for an amount immaterial to the Company, but the balance of the case continued to be tried before the jury. On June 1, 2017, the jury rendered a verdict against K. Hovnanian at Port Imperial Urban Renewal II, LLC on the breach of warranty and New Jersey Consumer Fraud claims in the total amount of $3 million, which resulted in a total verdict of $9 million against that entity due to statutory trebling, plus a portion of Grandview Plaintiff’s attorneys’ fees and costs. The Court subsequently awarded $1.4 million in attorneys’ fees and costs. The jury also found in favor of Grandview Plaintiff on its veil piercing theory. After the Court denied the Hovnanian-affiliated defendants’ filed post-trial motions, including a motion for contractual indemnification against the project architect, the Court entered final judgment in the amount of approximately $10.4 million on January 12, 2018.

On January 24, 2018, the relevant Hovnanian-affiliated defendants appealed all aspects of the verdict against them. On February 16, 2018, the Court entered an order staying execution of the judgment provided that the Hovnanian-affiliated defendants post a bond in the amount of approximately $11.1 million. On March 9, 2018, the Hovnanian-affiliated defendants filed the Court-approved bond. On July 30, 2018, during the pendency of the appeal, the Hovnanian-affiliated defendants settled the Grandview Plaintiff's claims for an amount less than the bond, which amount was paid on September 12, 2018. As part of the settlement, all appeals were dismissed other than the appeal of the Court’s denial of the Hovnanian-affiliated defendant’s contractual indemnification claim against the project architect.

In 2015, the condominium association of the Four Seasons at Great Notch condominium community (the “Great Notch Plaintiff”) filed a lawsuit in the Superior Court of New Jersey, Law Division, Passaic County (the “Court”) alleging various construction defects, design defects, and geotechnical issues relating to the community. The operative complaint (“Complaint”) asserts claims against Hovnanian Enterprises, Inc. and several of its affiliates, including K.

Hovnanian at Great Notch, LLC, K. Hovnanian Construction Management, Inc., and K. Hovnanian Companies, LLC. The Complaint also asserts claims against various other design professionals and contractors. The Great Notch Plaintiff has also filed a motion, which remains pending, to permit it to pursue a claim to pierce the corporate veil of K. Hovnanian at Great Notch, LLC to hold its alleged parent entities liable for any damages awarded against it. To date, the Hovnanian-affiliated defendants have reached a partial settlement with the Great Notch Plaintiff as to a portion of the Great Notch Plaintiff's claims against them for an amount immaterial to the Company. On its remaining claims against the Hovnanian-affiliated defendants, the Great Notch Plaintiff recently asserted damages of approximately $119.5 million, which amount is potentially subject to treble damages pursuant to the Great Notch Plaintiff's claim under the New Jersey Consumer Fraud Act. On August 17, 2018, the Hovnanian-affiliated defendants filed a motion for summary judgment seeking dismissal of all of the Great Notch Plaintiff's remaining claims against them, which remains pending. Trial is currently scheduled for March 25, 2019. Court ordered mediation sessions have been scheduled for January 2019. The Hovnanian-affiliated defendants intend to defend these claims vigorously.

ITEM 4

MINE SAFETY DISCLOSURES

Not applicable

EXECUTIVE OFFICERS OF THE REGISTRANT

Information on executive officers of the registrant is incorporated herein from Part III, Item 10.

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Part II

ITEM 5

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Our Class A Common Stock is traded on the New York Stock Exchange under the symbol "HOV" and was held by 436 stockholders of record at December 14, 2018. There is no established public trading market for our Class B Common Stock, which was held by 227 stockholders of record at December 14, 2018. If a shareholder desires to sell shares of Class B Common Stock (other than to Permitted Transferees (as defined in the Company's amended Certificate of Incorporation)), such stock must be converted into shares of Class A Common Stock at a one to one conversion rate.

Recent Sales of Unregistered Equity Securities

None.

Issuer Purchases of Equity Securities

No shares of our Class A Common Stock or Class B Common Stock were purchased by or on behalf of the Company or any affiliated purchaser during the fiscal fourth quarter of 2018. The maximum number of shares that may yet be purchased under the Company's repurchase plans or programs is 0.5 million.

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ITEM 6

SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial data and should be read in conjunction with Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K.

Summary of Consolidated Statements of Operations Data	**Year Ended October 31,**	**October 31,**	**October 31,**	**October 31,**	**October 31,**
(In thousands, except per share data)	**2018**	**2017**	**2016**	**2015**	**2014**
Revenues	$1,991,233	$2,451,665	$2,752,247	$2,148,480	$2,063,380
Expenses excluding inventory impairment loss and land option write-offs	1,996,083	2,437,195	2,708,912	2,162,370	2,044,718
Inventory impairment loss and land option write-offs	3,501	17,813	33,353	12,044	5,224
Total expenses	1,999,584	2,455,008	2,742,265	2,174,414	2,049,942
Loss on extinguishment of debt	(7,536)	(34,854)	(3,200)	-	(1,155)
Income (loss) from unconsolidated joint ventures	24,033	(7,047)	(4,346)	4,169	7,897
Income (loss) before income taxes	8,146	(45,244)	2,436	(21,765)	20,180
State and federal income tax provision (benefit)	3,626	286,949	5,255	(5,665)	(286,964)
Net Income (loss)	$4,520	$(332,193)	$(2,819)	$(16,100)	$307,144
Per share data:					
Basic:					
Net income (loss) per common share	$0.03	$(2.25)	$(0.02)	$(0.11)	$2.05
Weighted-average number of common shares outstanding	148,515	147,703	147,451	146,899	146,271
Assuming dilution:					
Net income (loss) per common share	$0.03	$(2.25)	$(0.02)	$(0.11)	$1.87
Weighted-average number of common shares outstanding	151,786	147,703	147,451	146,899	162,441

Summary of Consolidated Balance Sheet Data

(In thousands)	**October 31,**	**October 31,**	**October 31,**	**October 31,**	**October 31,**

	2018	2017	2016	2015	2014
Total assets(1)	$1,662,042	$1,900,898	$2,354,956	$2,577,398	$2,264,433
Mortgages and lines of credit (1)	$208,733	$244,088	$294,015	$310,672	$193,104
Term loans and revolving loans, senior notes, senior amortizing notes, senior exchangeable notes and tangible equity unit (“TEU”) senior subordinated amortizing notes (net of discount and premium)	$1,439,238	$1,585,837	$1,573,333	$1,827,924	$1,636,402
Total equity deficit	$(453,504)	$(460,371)	$(128,510)	$(128,084)	$(117,799)

(1) In connection with our adoption of Accounting Standards Update 2015-03 in November 2016, certain prior year amounts for unamortized debt issuance costs were reclassified between the lines “Total assets” and “Mortgages and lines of credit” and “Term loans and revolving loans, senior notes, senior amortizing notes, senior exchangeable notes and tangible equity unit (“TEU”) senior subordinated amortizing note (net of discount and premium)”.

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ITEM 7

MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Hovnanian Enterprises, Inc. (“HEI”) conducts all of its homebuilding and financial services operations through its subsidiaries (references herein to the “Company,” “we,” “us” or “our” refer to HEI and its consolidated subsidiaries and should be understood to reflect the consolidated business of HEI’s subsidiaries).

Overview

As discussed in previous quarters, we were limited in our ability to invest in land purchases in fiscal 2016 and 2017 due to significant debt maturities that we were unable to refinance and therefore had to pay at maturity. This reduction of investment has led to a decrease in community count and revenues, which impacts our overall profitability. Our total number of lots controlled increased in the quarter ended October 31, 2018, as compared to the same period of the prior year, which is the fourth consecutive quarter for which we have experienced a year-over-year quarterly increase. We believe continued growth in lots controlled should ultimately lead to community count growth and our fiscal 2017 and 2018 financing transactions have provided us with the long term capital needed to implement our investment strategy to grow our business. However, there is typically a significant time lag from when we first control lots until the time that we open a community for sale.

Our cash position in fiscal 2018 allowed us to spend $566.8 million on land purchases and land development during fiscal 2018, along with using $211.4 million of cash to pay down debt, and still have $187.9 million of homebuilding cash and cash equivalents as of October 31, 2018. We continue to see opportunities to purchase land at prices that make economic sense in light of our current sales prices and sales pace and plan to continue actively pursuing such land acquisitions. New land purchases at pricing that we believe will generate appropriate investment returns and drive greater operating efficiencies are needed to return to sustained profitability.

The factors discussed above for fiscal 2016 and 2017 led to a decrease in our community count from 130 at October 31, 2017 to 123 at October 31, 2018, and as a result, for the year ended October 31, 2018 we experienced mixed operating results compared to the prior year. More specifically:

Net contracts per average active selling community increased slightly to 35.9 for the year ended October 31, 2018 compared to 35.1 in the prior year.

Active selling communities decreased 5.4% over last year, and our average active selling communities decreased by 12.2% over last year. Net contracts decreased 10.1% for the year ended October 31, 2018, compared to the prior year.

For the year ended October 31, 2018, sale of homes revenues decreased 18.5% as compared to the prior year, as a result of a 13.5% decrease in deliveries, primarily due to our decreased community count.

Gross margin percentage increased from 13.2% for the year ended October 31, 2017 to 15.2% for the year ended October 31, 2018. Gross margin percentage, before cost of sales interest expense and land charges, increased from 17.2% for the year ended October 31, 2017 to 18.4% for the year ended October 31, 2018. The improvements in both gross margin percentage and gross margin percentage, before cost of sales interest expense and land charges, are primarily the result of the mix of communities delivering, as well as the benefit of a one-time $6.3 million credit related to a land development reimbursement from a municipality in California.

Selling, general and administrative costs (including corporate general and administrative expenses) decreased $26.9 million for the year ended October 31, 2018 as compared to the prior year. As a percentage of total revenue, such costs increased from 10.4% for the year ended October 31, 2017 to 11.5% for the year ended October 31, 2018. The dollar decrease for year ended October 31, 2018 was primarily due to the reduction of our warranty reserves, as a result of our annual actuarial analysis, along with an adjustment to our insurance reserves in the third quarter of fiscal 2018, resulting from a recent legal settlement. There was also an increase in management fees received from our joint ventures, due to increased unconsolidated joint venture deliveries during the period, and $12.5 million of additional reserves recorded in fiscal 2017 related to the Grandview litigation discussed in Note 18 to the Consolidated Financial Statements. Partially offsetting the decrease for the year ended October 31, 2018, were higher stock compensation costs and legal (including litigation) fees incurred related to our fiscal 2018 financing transactions. We received insurance coverage, less the deductible, for these litigation costs. Also offsetting the decreased costs for the year ended October 31, 2018 was rent expense related to (i) the sale and leaseback of our former corporate headquarters building for the period from November 2017 to February 2018 and (ii) rent on our new headquarters building. The increase in selling, general and administrative costs (including corporate general and administrative expenses) as a percentage of total revenue for the year ended October 31, 2018 was mainly due to the decrease in total revenues for fiscal 2018 as compared to the prior year.

When comparing sequentially from the third quarter of fiscal 2018 to the fourth quarter of fiscal 2018, our gross margin percentage increased from 15.4% to 16.5% and our gross margin percentage, before cost of sales interest expense and land charges, increased from 18.4% to 19.2%. Our gross margin percentage, and gross margin percentage, before cost of sales interest expense and land charges, increased primarily as a result of product mix, as well as the benefit of a one-time $6.3 million credit related to a land development reimbursement from a municipality in California. Selling, general and administrative costs (including corporate general and administrative expenses) as a percentage of total revenues decreased from 11.8% to 8.3%, as compared to the third quarter of fiscal 2018 primarily due to a $10.2 million reduction in our construction defect reserves in the fourth quarter of fiscal 2018, as a result of our annual actuarial analysis, along with an increase in management fees received from our joint ventures, due to increased unconsolidated joint venture deliveries during the period. Partially offsetting the decrease was an adjustment to our insurance reserves in the third quarter of fiscal 2018, resulting from a recent legal settlement. Improving the efficiency of our selling, general and administrative expenses will continue to be a significant area of focus.

We had 1,826 homes in backlog with a dollar value of $745.6 million at October 31, 2018 (a decrease of 7.7% in dollar value compared to the prior year). As expected, due to our use of cash for significant debt repayments in prior fiscal years as discussed above, our community count decreased during fiscal 2018. Further, our net contracts per community declined in the fourth quarter of fiscal 2018 compared to the fourth quarter of fiscal 2017 consistent with data for the overall housing market. In light of these results, we remain cautious and are carefully evaluating market conditions when evaluating new land acquisitions. As discussed above, we have invested $566.8 million in land purchases and land development during fiscal 2018, which along with continued land acquisitions, is expected to lead to future community count growth. However, there is typically a significant time lag from when we first control lots until the time that we open a community for sale. This timeline can vary significantly from a few months (in a market such as Houston) to three to five plus years (in a market such as New Jersey). We continue to see opportunities to purchase land at prices that make economic sense in light of our current sales prices and sales paces and plan to continue actively pursuing such land acquisitions. Given the mix of land that we currently control and the land investment we currently anticipate, we currently believe that our community count growth will begin in the first half of fiscal 2019. Ultimately, community count growth, absent adverse market factors, should lead to delivery and revenue growth in the future.

Subsequent to our fiscal year-end, there have been significant wildfires throughout Southern California. While none of our communities have been directly affected, we could experience labor shortages, construction delays or utility company delays, which in turn could impact our fiscal 2019 results.

Critical Accounting Policies

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

Income Recognition from Mortgage Loans - Our Financial Services segment originates mortgages, primarily for our homebuilding customers. We use mandatory investor commitments and forward sales of mortgage backed securities (“MBS”) to hedge our mortgage-related interest rate exposure on agency and government loans.

We elected the fair value option for our mortgage loans held for sale in accordance with Accounting Standards Codification (“ASC”) 825, “Financial Instruments,” which permits us to measure our loans held for sale at fair value. Management believes that the election of the fair value option for loans held for sale improves financial reporting by mitigating volatility in reported earnings caused by measuring the fair value of the loans and the derivative instruments used to economically hedge them without having to apply complex hedge accounting provisions.

Substantially all of the mortgage loans originated are sold within a short period of time in the secondary mortgage market on a servicing released, nonrecourse basis, although the Company remains liable for certain limited representations, such as fraud, and warranties related to loan sales. Mortgage investors could seek to have us buy back loans or compensate them for losses incurred on mortgages we have sold based on claims that we breached our limited representations and warranties. We have established reserves for probable losses. While we believe these reserves are adequate for known losses and projected repurchase requests, given the volatility in the mortgage industry and the uncertainty regarding the ultimate resolution of these claims, if either actual repurchases or the losses incurred resolving those repurchases exceed our expectations, additional expense may be incurred.

Inventories - Inventories consist of land, land development, home construction costs, capitalized interest, construction overhead and property taxes. Construction costs are accumulated during the period of construction and charged to cost of sales under specific identification methods. Land, land development and common facility costs are allocated based on buildable acres to product types within each community, then charged to cost of sales equally based upon the number of homes to be constructed in each product type.

We record inventories in our consolidated balance sheets at cost unless the inventory is determined to be impaired, in which case the inventory is written down to its fair value. Our inventories consist of the following three components: (1) sold and unsold homes and lots under development, which includes all construction, land, capitalized interest and land development costs related to started homes and land under development in our active communities; (2) land and land options held for future development or sale, which includes all costs related to land in our communities in planning or mothballed communities; and (3) consolidated inventory not owned, which includes all costs related to specific performance options, variable interest entities and other options, which consists primarily of model homes financed with an investor and inventory related to land banking arrangements accounted for as financings.

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We decide to mothball (or stop development on) certain communities when we determine that the current performance does not justify further investment at the time. When we decide to mothball a community, the inventory is reclassified on our Consolidated Balance Sheets from "Sold and unsold homes and lots under development" to "Land and land options held for future development or sale." As of October 31, 2018, the net book value associated with our 18 mothballed communities was $24.5 million, net of impairment charges recorded in prior periods of $186.1 million. We regularly review communities to determine if mothballing is appropriate. During fiscal 2018, we did not mothball any communities, but we sold two previously mothballed communities and re-activated two previously mothballed communities.

From time to time we enter into option agreements that include specific performance requirements, whereby we are required to purchase a minimum number of lots. Because of our obligation to purchase these lots, for accounting purposes in accordance with ASC 360-20-40-38, we are required to record this inventory on our Consolidated Balance Sheets. As of October 31, 2018, we had no specific performance options recorded on our Consolidated Balance Sheets. Consolidated inventory not owned also consists of other options that were included on our Consolidated Balance Sheets in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

We sell and lease back certain of our model homes with the right to participate in the potential profit when each home is sold to a third party at the end of the respective lease. As a result of our continued involvement, for accounting purposes in accordance with ASC 360-20-40-38, these sale and leaseback transactions are considered a financing rather than a sale. Therefore, for purposes of our Consolidated Balance Sheets, at October 31, 2018, inventory of $50.5 million was recorded to "Consolidated inventory not owned," with a corresponding amount of $43.9 million recorded to "Liabilities from inventory not owned."

We have land banking arrangements, whereby we sell our land parcels to the land banker and they provide us an option to purchase back finished lots on a quarterly basis. Because of our options to repurchase these parcels, for accounting purposes, in accordance with ASC 360-20-40-38, these transactions are considered financings rather than sales. For purposes of our Consolidated Balance Sheets, at October 31, 2018, inventory of $37.4 million was recorded as "Consolidated inventory not owned," with a corresponding amount of $19.5 million recorded to "Liabilities from inventory not owned" for the amount of net cash received from the transactions.

The recoverability of inventories and other long-lived assets is assessed in accordance with the provisions of ASC 360-10, "Property, Plant and Equipment – Overall" ("ASC 360-10"). ASC 360-10 requires long-lived assets, including inventories, held for development to be evaluated for impairment based on undiscounted future cash flows of the assets at the lowest level for which there are identifiable cash flows. As such, we evaluate inventories for impairment at the individual community level, the lowest level of discrete cash flows that we measure.

We evaluate inventories of communities under development and held for future development for impairment when indicators of potential impairment are present. Indicators of impairment include, but are not limited to, decreases in local housing market values, decreases in gross margins or sales absorption rates, decreases in net sales prices (base sales price net of sales incentives), or actual or projected operating or cash flow losses. The assessment of communities for indication of impairment is performed quarterly. As part of this process, we prepare detailed budgets for all of our communities at least semi-annually and identify those communities with a projected operating loss. For those communities with projected losses, we estimate the remaining undiscounted future cash flows and compare those to the carrying value of the community, to determine if the carrying value of the asset is recoverable.

The projected operating profits, losses, or cash flows of each community can be significantly impacted by our estimates of the following:

- future base selling prices;
- future home sales incentives;
- future home construction and land development costs; and
- future sales absorption pace and cancellation rates.

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These estimates are dependent upon specific market conditions for each community. While we consider available information to determine what we believe to be our best estimates as of the end of a quarterly reporting period, these estimates are subject to change in future reporting periods as facts and circumstances change. Local market-specific conditions that may impact our estimates for a community include:

- the intensity of competition within a market, including available home sales prices and home sales incentives offered by our competitors;
- the current sales absorption pace for both our communities and competitor communities;
- community specific attributes, such as location, availability of lots in the market, desirability and uniqueness of our community, and the size and style of homes currently being offered;
- potential for alternative product offerings to respond to local market conditions;
- changes by management in the sales strategy of the community;
- current local market economic and demographic conditions and related trends of forecasts; and
- existing home inventory supplies, including foreclosures and short sales.

These and other local market-specific conditions that may be present are considered by management in preparing projection assumptions for each community. The sales objectives can differ between our communities, even within a given market. For example, facts and circumstances in a given community may lead us to price our homes with the objective of yielding a higher sales absorption pace, while facts and circumstances in another community may lead us to price our homes to minimize deterioration in our gross margins, although it may result in a slower sales absorption pace. In addition, the key assumptions included in our estimate of future undiscounted cash flows may be interrelated. For example, a decrease in estimated base sales price or an increase in homes sales incentives may result in a corresponding increase in sales absorption pace. Additionally, a decrease in the average sales price of homes to be sold and closed in future reporting periods for one community that has not been generating what management believes to be an adequate sales absorption pace may impact the estimated cash flow assumptions of a nearby community. Changes in our key assumptions, including estimated construction and development costs, absorption pace and selling strategies, could materially impact future cash flow and fair-value estimates. Due to the number of possible scenarios that would result from various changes in these factors, we do not believe it is possible to develop a sensitivity analysis with a level of precision that would be meaningful to an investor.

If the undiscounted cash flows are more than the carrying value of the community, then the carrying amount is recoverable, and no impairment adjustment is required. However, if the undiscounted cash flows are less than the carrying amount, then the community is deemed impaired and is written down to its fair value. We determine the estimated fair value of each community by determining the present value of its estimated future cash flows at a discount rate commensurate with the risk of the respective community, or in limited circumstances, prices for land in recent comparable sale transactions, market analysis studies, which include the estimated price a willing buyer would pay for the land (other than in a forced liquidation sale), and recent bona fide offers received from outside third

parties. Our discount rates used for all impairments recorded from October 31, 2016 to October 31, 2018 ranged from 16.8% to 19.8%. The estimated future cash flow assumptions are virtually the same for both our recoverability and fair value assessments. Should the estimates or expectations used in determining estimated cash flows or fair value, including discount rates, decrease or differ from current estimates in the future, we may be required to recognize additional impairments related to current and future communities. The impairment of a community is allocated to each lot on a relative fair value basis.

From time to time, we write off deposits and approval, engineering and capitalized interest costs when we determine that it is no longer probable that we will exercise options to buy land in specific locations or when we redesign communities and/or abandon certain engineering costs. In deciding not to exercise a land option, we take into consideration changes in market conditions, the timing of required land takedowns, the willingness of land sellers to modify terms of the land option contract (including timing of land takedowns), and the availability and best use of our capital, among other factors. The write-off is recorded in the period it is deemed not probable that the optioned property will be acquired. In certain instances, we have been able to recover deposits and other pre-acquisition costs that were previously written off. These recoveries have not been significant in comparison to the total costs written off.

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Inventories held for sale are land parcels ready for sale in their current condition, where we have decided not to build homes but are instead actively marketing for sale. These land parcels represented $6.4 million and $23.6 million of our total inventories at October 31, 2018 and 2017, respectively, and are reported at the lower of carrying amount or fair value less costs to sell. In determining fair value for land held for sale, management considers, among other things, prices for land in recent comparable sale transactions, market analysis studies, which include the estimated price a willing buyer would pay for the land (other than in a forced liquidation sale) and recent bona fide offers received from outside third parties.

Unconsolidated Homebuilding and Land Development Joint Ventures - Investments in unconsolidated homebuilding and land development joint ventures are accounted for under the equity method of accounting. Under the equity method, we recognize our proportionate share of earnings and losses earned by the joint venture upon the delivery of lots or homes to third parties. Our ownership interests in the joint ventures vary but our voting interests are generally 50% or less. In determining whether or not we must consolidate joint ventures where we are the managing member of the joint venture, we assess whether the other partners have specific rights to overcome the presumption of control by us as the manager of the joint venture. In most cases, the presumption is overcome because the joint venture agreements require that both partners agree on establishing the significant operating and capital decisions of the partnership, including budgets, in the ordinary course of business. The evaluation of whether or not we control a venture can require significant judgment. In accordance with ASC 323-10, "Investments - Equity Method and Joint Ventures – Overall," we assess our investments in unconsolidated joint ventures for recoverability, and if it is determined that a loss in value of the investment below its carrying amount is other than temporary, we write down the investment to its fair value. We evaluate our equity investments for impairment based on the joint venture's projected cash flows. This process requires significant management judgment and estimates. During fiscal 2017, we wrote down certain joint venture investments by $2.8 million. There were no write-downs in fiscal 2018 or 2016.

Post-Development Completion, Warranty Costs and *Insurance Deductible Reserves* - In those instances where a development is substantially completed and sold and we have additional construction work to be incurred, an estimated liability is provided to cover the cost of such work. We accrue for warranty costs that are covered under our existing general liability and construction defect policy as part of our general liability insurance deductible. This accrual is expensed as selling, general, and administrative costs. For homes delivered in fiscal 2018 and 2017, our deductible under our general liability insurance is a $20 million aggregate for construction defect and warranty claims. For bodily injury claims, our deductible per occurrence in fiscal 2018 and 2017 is $0.25 million, up to a $5 million limit. Our aggregate retention for construction defect, warranty and bodily injury claims is $20 million for fiscal 2018 and $21 million for fiscal 2017. We do not have a deductible on our worker's compensation insurance. Reserves for estimated losses for construction defects, warranty and bodily injury claims have been established using the assistance of a third-party actuary. We engage a third-party actuary that uses our historical warranty and construction defect data to assist our management in estimating our unpaid claims, claim adjustment expenses and incurred but not reported claims reserves for the risks that we are assuming under the general liability and construction defect programs. The estimates include provisions for inflation, claims handling and legal fees. These estimates are subject to a high degree of variability due to uncertainties such as trends in construction defect claims relative to our markets and the types of products we build, claim settlement patterns, insurance industry practices and legal interpretations, among others. Because of the high degree of judgment required in determining these estimated liability amounts, actual future costs could differ significantly from our currently estimated amounts. In addition, we establish a warranty accrual for lower cost-related issues to cover home repairs, community amenities and land development infrastructure that are not covered under our general liability and construction defect policy. We accrue

an estimate for these warranty costs as part of cost of sales at the time each home is closed and title and possession have been transferred to the homebuyer. See Note 16 to the Consolidated Financial Statements for additional information on the amount of warranty costs recognized in cost of goods sold and administrative expenses.

Recent Accounting Pronouncements

See Note 3 to the Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K.

Capital Resources and Liquidity

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

We have historically funded our homebuilding and financial services operations with cash flows from operating activities, borrowings under our credit facilities, the issuance of new debt and equity securities and other financing activities. Due to covenant restrictions in our debt instruments, we are currently limited in the amount of debt we can incur that does not qualify as refinancing indebtedness with certain maturity requirements (a limitation that we expect to continue for the foreseeable future), even if market conditions would otherwise be favorable, which could also impact our ability to grow our business. In fiscal 2017, we transferred four communities to an existing joint venture, which resulted in $11.2 million of net cash proceeds to us during the period. During fiscal 2018, we completed a wind down of our operations in the San Francisco Bay area in Northern California and in Tampa, Florida. Any liquidity-enhancing or other capital raising/refinancing transaction will depend on identifying counterparties, negotiation of documentation and applicable closing conditions and any required approvals.

Operating, Investing and Financing Activities – Overview

Our homebuilding cash balance, including $12.7 million of cash collateralizing our letter of credit agreements, at October 31, 2018 was $200.6 million, a decrease of $264.8 million from October 31, 2017. However, as of October 31, 2018 we have $125.0 million of borrowing capacity under our Secured Credit Facility (defined below), and therefore, our total liquidity at October 31, 2018 was $325.6 million, which is above our target liquidity range of $170.0 million to $245.0 million. In addition to using cash to pay down debt during fiscal 2018, we spent $566.8 million on land and land development. After considering this land and land development and all other operating activities, including revenue received from deliveries, we used $66.8 million of cash in operations. During fiscal 2018, cash provided by investing activities was $35.5 million, primarily related to the sale of our former corporate headquarters building, along with distributions from joint ventures, partially offset by investments in new and existing joint ventures. Cash used in financing activities was $229.4 million during fiscal 2018, which included net payments of $211.4 million for debt repayments and $27.5 million used for model finance and land banking programs. We intend to continue to use nonrecourse mortgage financings, model sale leaseback, joint ventures, and, subject to covenant restrictions in our debt instruments, land banking programs as our business needs dictate.

Our cash uses during the year ended October 31, 2018 and 2017 were for operating expenses, land purchases, land deposits, land development, construction spending, debt payments, state income taxes, interest payments, litigation matters and investments in joint ventures. During these periods, we provided for our cash requirements from available cash on hand, housing and land sales, financing transactions, model sale leasebacks, land banking transactions, joint ventures, financial service revenues and other revenues. We believe that these sources of cash together with our Secured Credit Facility will be sufficient through fiscal 2019 to finance our working capital requirements.

Our net income (loss) historically does not approximate cash flow from operating activities. The difference between net income (loss) and cash flow from operating activities is primarily caused by changes in inventory levels together with changes in receivables, prepaid and other assets, mortgage loans held for sale, interest and other accrued liabilities, deferred income taxes, accounts payable and other liabilities, and noncash charges relating to depreciation, stock compensation awards and impairment losses for inventory. When we are expanding our operations, inventory levels, prepaids and other assets increase causing cash flow from operating activities to decrease. Certain liabilities also increase as operations expand and partially offset the negative effect on cash flow from operations caused by the increase in inventory levels, prepaids and other assets. Similarly, as our mortgage operations expand, net income from these operations increases, but for cash flow purposes net income is partially offset by the net change in mortgage assets and liabilities. The opposite is true as our investment in new land purchases and development of new communities decrease, causing us to generate positive cash flow from operations. In fiscal 2017, with spending on land purchases and land development relatively flat as compared to fiscal 2016, we continued to generate cash from operations. As we continue to increase spending on land purchases and land development, cash flow from operations will decrease. As we continue to actively seek land investment opportunities, we will also remain focused on liquidity.

See “Inventory Activities” below for a detailed discussion of our inventory position.

Debt Transactions

As of October 31, 2018, we had $1,111.0 million of outstanding senior secured notes ($1,093.4 million, net of discount and debt issuance costs), comprised of $53.2 million 2.0% 2021 Notes (defined below), $141.8 million 5.0% 2021 Notes (defined below), $75.0 million 9.5% 2020 Notes (defined below), $440.0 million 10.0% Senior Secured Notes due 2022 and $400.0 million 10.5% Senior Secured Notes due 2024. As of October 31, 2018, we also had $180.7 million of outstanding senior notes ($144.4 million net of discount, premium and debt issuance costs), comprised of $90.1 million 5.0% Senior Notes due 2040 and $90.6 million 13.5% Senior Notes due 2026 ($26.0 million of 8.0% Senior Notes due 2019 are owned by a wholly-owned consolidated subsidiary of HEI and therefore, in accordance with GAAP, such notes are not reflected on the Consolidated Balance Sheets of HEI). In addition, as of October 31, 2018, there were $202.5 million ($201.4 million net of debt issuance costs) of borrowings under our senior unsecured term loan facility (“Term Loan Facility”).

Except for K. Hovnanian, the issuer of the notes and borrower under the Credit Facilities, (as defined below) our home mortgage subsidiaries, joint ventures and subsidiaries holding interests in our joint ventures and certain of our title insurance subsidiaries, we and each of our subsidiaries are guarantors of the Credit Facilities, the senior secured notes and senior notes outstanding at October 31, 2018 (collectively, the “Notes Guarantors”). In addition to the Notes Guarantors, the 5.0% Senior Secured Notes due 2021 (the “5.0% 2021 Notes”), the 2.0% Senior Secured Notes due 2021 (the “2.0% 2021 Notes” and together with the 5.0% 2021 Notes, the “2021 Notes”) and the 9.50% Senior Secured Notes due 2020 (the “9.50% 2020 Notes” and collectively with the 2021 Notes, the “JV Holdings Secured Group Notes”) are guaranteed by K. Hovnanian JV Holdings, L.L.C. and its subsidiaries, except for certain joint ventures and joint venture holding companies (collectively, the “JV Holdings Secured Group”). Members of the JV Holdings Secured Group do not guarantee K. Hovnanian's other indebtedness.

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The credit agreements governing the Credit Facilities and the indentures governing the notes (together, the "Debt Instruments") outstanding at October 31, 2018 do not contain any financial maintenance covenants, but do contain restrictive covenants that limit, among other things, the Company's ability and that of certain of its subsidiaries, including K. Hovnanian, to incur additional indebtedness (other than nonrecourse indebtedness, certain permitted indebtedness and refinancing indebtedness (under the 9.50% 2020 Notes, any new or refinancing indebtedness may not be scheduled to mature earlier than January 15, 2021 (so long as no member of the JV Holdings Secured Group is an obligor thereon), or February 15, 2021 (if otherwise), and under the 10.0% Senior Secured Notes due 2022 (the "10.0% 2022 Notes"), any refinancing indebtedness of the 7.0% Senior Notes due 2019 (the "7.0% Notes") (which includes the Term Loans (as defined below)) and 8.0% Senior Notes due 2019 (the "8.0% Notes" and together with the 7.0% Notes, the "2019 Notes") (which includes the New Notes (as defined below) and the Term Loans) may not be scheduled to mature earlier than July 16, 2024 (such restrictive covenant in respect of the 10.5% Senior Secured Notes due 2024 (the "10.5% 2024 Notes") was eliminated as described below)), pay dividends and make distributions on common and preferred stock, repurchase subordinated indebtedness and common and preferred stock, make other restricted payments, including investments, sell certain assets (including in certain land banking transactions), incur liens, consolidate, merge, sell or otherwise dispose of all or substantially all assets, enter into certain transactions with affiliates and make cash repayments of the 2019 Notes and refinancing indebtedness in respect thereof (with respect to the 10.0% 2022 Notes). The Debt Instruments also contain events of default which would permit the lenders or holders thereof to exercise remedies with respect to the collateral (as applicable), declare the loans made under the Term Loan Facility (defined below) (the "Term Loans") and loans made under the Secured Credit Facility (as defined below) (the "Secured Revolving Loans") or notes to be immediately due and payable if not cured within applicable grace periods, including the failure to make timely payments on the Term Loans, Secured Revolving Loans or notes or other material indebtedness, cross default to other material indebtedness, the failure to comply with agreements and covenants and specified events of bankruptcy and insolvency, with respect to the Term Loans and Secured Revolving Loans, material inaccuracy of representations and warranties and with respect to the Term Loans and Secured Revolving Loans, a change of control, and, with respect to the Secured Revolving Loans and senior secured notes, the failure of the documents granting security for the Secured Revolving Loans and senior secured notes to be in full force and effect, and the failure of the liens on any material portion of the collateral securing the Secured Revolving Loans and senior secured notes to be valid and perfected. As of October 31, 2018, we believe we were in compliance with the covenants of the Debt Instruments.

If our consolidated fixed charge coverage ratio, as defined in the agreements governing our debt instruments, is less than 2.0 to 1.0, we are restricted from making certain payments, including dividends, and from incurring indebtedness other than certain permitted indebtedness, refinancing indebtedness and nonrecourse indebtedness. As a result of this ratio restriction, we are currently restricted from paying dividends, which are not cumulative, on our 7.625% Series A Preferred Stock. We anticipate that we will continue to be restricted from paying dividends for the foreseeable future. Our inability to pay dividends is in accordance with covenant restrictions and will not result in a default under our debt instruments or otherwise affect compliance with any of the covenants contained in our debt instruments.

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

On December 1, 2017, our 6.0% Senior Exchangeable Note Units were paid in full, which units consisted of $53.9 million principal amount of our Senior Exchangeable Notes that matured and the final installment payment of $2.1 million on our 11.0% Senior Amortizing Notes.

On December 28, 2017, the Company and K. Hovnanian announced that they had entered into a commitment letter (the "Commitment Letter") in respect of certain financing transactions with GSO Capital Partners LP ("GSO") on its own behalf and on behalf of one or more funds managed, advised or sub-advised by GSO (collectively, the "GSO Entities"), and had commenced a private offer to exchange with respect to the 8.0% Notes (the "Exchange Offer").

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Pursuant to the Commitment Letter, the GSO Entities agreed to, among other things, provide the principal amount of the following: (i) a senior unsecured term loan credit facility (the "Term Loan Facility") to be borrowed by K. Hovnanian and guaranteed by the Company and the Notes Guarantors, pursuant to which the GSO Entities committed to lend K. Hovnanian Term Loans consisting of $132.5 million of initial term loans (the "Initial Term Loans") on the settlement date of the Exchange Offer for purposes of refinancing K. Hovnanian's 7.0% Notes, and up to $80.0 million of delayed draw term loans (the "Delayed Draw Term Loans") for purposes of refinancing certain of K. Hovnanian's 8.0% Notes, in each case, upon the terms and subject to the conditions set forth therein, and (ii) a senior secured first lien credit facility (the "Secured Credit Facility" and together with the Term Loan Facility, the "Credit Facilities") to be borrowed by K. Hovnanian and guaranteed by the Notes Guarantors, pursuant to which the GSO Entities committed to lend to K. Hovnanian the Secured Revolving Loans, consisting of up to $125.0 million of senior secured first priority loans to fund the repayment of K. Hovnanian's then outstanding secured term loans (the "Secured Term Loans") and for general corporate purposes, upon the terms and subject to the conditions set forth therein. In addition, pursuant to the Commitment Letter, the GSO Entities have committed to purchase, and K. Hovnanian has agreed to issue and sell, on January 15, 2019 (or such later date within five business days as mutually agreed by the parties working in good faith), $25.0 million in aggregate principal amount of additional 10.5% 2024 Notes (the "Additional 10.5% 2024 Notes") at a purchase price, for each $1,000 principal amount of Additional 10.5% 2024 Notes, that would imply a yield to maturity equal to (a) the volume weighted average yield to maturity (calculated based on the yield to maturity during the 30 calendar day period ending on one business day prior to the settlement date of the Additional 10.5% 2024 Notes, which is expected to be January 15, 2019) for the 10.5% 2024 Notes, minus (b) 0.50%, upon the terms and subject to conditions set forth therein.

On January 29, 2018, K. Hovnanian, the Notes Guarantors, Wilmington Trust, National Association, as administrative agent, and the GSO Entities entered into the Term Loan Facility. K. Hovnanian borrowed the Initial Term Loans on February 1, 2018 to fund, together with cash on hand, the redemption on February 1, 2018 of all $132.5 million aggregate principal amount of 7.0% Notes, which resulted in a loss on extinguishment of debt of $0.5 million. On May 29, 2018, K. Hovnanian completed the redemption of $65.7 million aggregate principal amount of the 8.0% Notes (representing all of the outstanding 8.0% Notes, excluding the $26 million of 8% Notes held by the Subsidiary Purchaser (as defined below)) with approximately $70.0 million in borrowings on the Delayed Draw Term Loans under the Term Loan Facility (with the completion of this redemption, the remaining committed amounts under the Delayed Draw Term Loans may not be borrowed). This transaction resulted in a loss on extinguishment of debt of $4.3 million for year ended October 31, 2018. The Term Loans bear interest at a rate equal to 5.0% per annum and interest is payable in arrears, on the last business day of each fiscal quarter. The Term Loans will mature on February 1, 2027, which is the ninth anniversary of the first closing date of the Term Loan Facility.

On January 29, 2018, K. Hovnanian, the Notes Guarantors, Wilmington Trust, National Association, as administrative agent, and the GSO Entities entered into the Secured Credit Facility. Availability under the Secured Credit Facility will terminate on December 28, 2019 and any outstanding Secured Revolving Loans on such date shall convert to secured term loans maturing on December 28, 2022. On September 10, 2018, K. Hovnanian borrowed $35.0 million of Secured Revolving Loans under the Secured Credit Facility and used $41.0 million of cash on hand to repay the Secured Term Loans in full, plus unpaid interest and closing costs (in the fourth quarter of fiscal 2018, K. Hovnanian repaid the borrowed Secured Revolving Loans and as of October 31, 2018 there were no amounts outstanding under the Secured Credit Facility). This transaction resulted in a loss on extinguishment of debt of $1.8 million for the year ended October 31, 2018. The Secured Revolving Loans and the guarantees thereof are secured (subject to perfection requirements under the terms of the Secured Credit Facility) by substantially all of the assets owned by K. Hovnanian

and the Notes Guarantors, subject to permitted liens and certain exceptions, on a first lien basis relative to the liens securing K. Hovnanian's 10.0% 2022 Notes and 10.5% 2024 Notes pursuant to an intercreditor agreement. The collateral securing the Secured Revolving Loans will be the same as that securing the 10.0% 2022 Notes and the 10.5% 2024 Notes. The Secured Revolving Loans bear interest at a rate equal to 10.0% per annum, and interest is payable in arrears, on the last business day of each fiscal quarter.

On February 1, 2018, K. Hovnanian accepted all of the $170.2 million aggregate principal amount of 8.0% Notes validly tendered and not validly withdrawn in the Exchange Offer (representing 72.14% of the aggregate principal amount of 8.0% Notes outstanding prior to the Exchange Offer), and in connection therewith, K. Hovnanian issued $90.6 million aggregate principal amount of its 13.5% Senior Notes due 2026 (the "New 2026 Notes") and $90.1 million aggregate principal amount of its 5.0% Senior Notes due 2040 (the "New 2040 Notes" and together with the New 2026 Notes, the "New Notes") under a new indenture. Also, as part of the Exchange Offer, K. Hovnanian at Sunrise Trail III, LLC, a wholly-owned subsidiary of the Company (the "Subsidiary Purchaser"), purchased for $26.5 million in cash an aggregate of $26.0 million in principal amount of the 8.0% Notes (the "Purchased 8.0% Notes"). The New Notes were issued by K. Hovnanian and guaranteed by the Notes Guarantors, except the Subsidiary Purchaser, which does not guarantee the New Notes. The New 2026 Notes bear interest at 13.5% per annum and mature on February 1, 2026. The New 2040 Notes bear interest at 5.0% per annum and mature on February 1, 2040. Interest on the New Notes is payable semi-annually on February 1 and August 1 of each year to holders of record at the close of business on January 15 or July 15, as the case may be, immediately preceding each such interest payment date. The Exchange Offer was treated as a substantial modification of debt. The New Notes were recorded at fair value (based on management's estimate using available trades for similar debt instruments) on the date of the issuance of the New Notes, which equaled $103.0 million for the New 2026 Notes and $44.0 million for the New 2040 Notes, resulting in a premium on the New 2026 Notes and a discount on the New 2040 Notes, and a loss on extinguishment of debt of $0.9 million for the year ended October 31, 2018.

On May 30, 2018, K. Hovnanian, the Notes Guarantors and Wilmington Trust, National Association, as Trustee, executed the Second Supplemental Indenture, dated as of May 30, 2018 (the “Supplemental Indenture”), to the Indenture governing the New Notes. The Supplemental Indenture eliminated the covenant restricting certain actions with respect to the Purchased 8.0% Notes, which covenant had included requirements that (A) K. Hovnanian and the guarantors of the New Notes would not, (i) prior to June 6, 2018, redeem, cancel or otherwise retire, purchase or acquire any Purchased 8.0% Notes or (ii) make any interest payments on the Purchased 8.0% Notes prior to their stated maturity, and (B) K. Hovnanian and the guarantors of the New Notes would not, and would not permit any of their subsidiaries to (i) sell, transfer, convey, lease or otherwise dispose of any Purchased 8.0% Notes other than to any subsidiary of the Company that is not K. Hovnanian or a guarantor of the New Notes or (ii) amend, supplement or otherwise modify the Purchased 8.0% Notes or the indenture under which they were issued with respect to the Purchased 8.0% Notes, subject to certain exceptions. In addition, the Supplemental Indenture eliminated events of default related to the eliminated covenant. On May 30, 2018, K. Hovnanian paid the overdue interest on the Purchased 8.0% Notes that was originally due on May 1, 2018 and as a result of such payment, the “Default” under the Indenture governing the 8.0% Notes was cured.

On January 16, 2018, K. Hovnanian, the Notes Guarantors and Wilmington Trust, National Association, as Trustee and Collateral Agent, executed the Second Supplemental Indenture, dated as of January 16, 2018, to the indenture governing the 10.0% 2022 Notes and 10.5% 2024 Notes, dated as of July 27, 2017 (as supplemented, amended or otherwise modified), among K. Hovnanian, the Notes Guarantors and Wilmington Trust, National Association, as Trustee and Collateral Agent, giving effect to the proposed amendments to such indenture solely with respect to the 10.5% 2024 Notes, which were obtained in a consent solicitation of the holders of the 10.5% 2024 Notes, and which eliminated the restrictions on K. Hovnanian’s ability to purchase, repurchase, redeem, acquire or retire for value the 2019 Notes and refinancing or replacement indebtedness in respect thereof.

See Note 9 to the Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K for a further discussion of K. Hovnanian’s Credit Facilities, senior secured notes and senior notes.

Mortgages and Notes Payable

We have nonrecourse mortgage loans for certain communities totaling $95.6 million and $64.5 million (net of debt issuance costs) at October 31, 2018 and October 31, 2017, respectively, which are secured by the related real property, including any improvements, with an aggregate book value of $241.9 million and $157.8 million, respectively. The weighted-average interest rate on these obligations was 6.1% and 5.3% at October 31, 2018 and October 31, 2017, respectively, and the mortgage loan payments on each community primarily correspond to home deliveries. We also had nonrecourse mortgage loans on our former corporate headquarters totaling $13.0 million at October 31, 2017. On November 1, 2017, these loans were paid in full in connection with the sale of this corporate headquarters building.

Our wholly owned mortgage banking subsidiary, K. Hovnanian American Mortgage, LLC (“K. Hovnanian Mortgage”), originates mortgage loans primarily from the sale of our homes. Such mortgage loans and related servicing rights are sold in the secondary mortgage market within a short period of time. In certain instances, we retain the servicing rights for a small amount of loans. The loans are secured by the mortgages held for sale and repaid when we sell the underlying mortgage loans to permanent investors. As of October 31, 2018 and October 31, 2017, we had an aggregate of $113.2 million and $114.6 million, respectively, outstanding under several of K. Hovnanian Mortgage’s short-term borrowing facilities.

See Note 8 to the Consolidated Financial Statements for a discussion of these agreements and facilities.

Equity

On July 3, 2001, our Board of Directors authorized a stock repurchase program to purchase up to 4 million shares of Class A Common Stock. We did not repurchase any shares under this program during fiscal 2018 or 2017. As of October 31, 2018, the maximum number of shares of Class A Common Stock that may yet be purchased under this program is 0.5 million. (See Part II, Item 5 for information on equity purchases).

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On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of $25,000 per share. Dividends on the Series A Preferred Stock are not cumulative and are payable at an annual rate of 7.625%. The Series A Preferred Stock is not convertible into the Company's common stock and is redeemable in whole or in part at our option at the liquidation preference of the shares. The Series A Preferred Stock is traded as depositary shares, with each depositary share representing 1/1000th of a share of Series A Preferred Stock. The depositary shares are listed on the NASDAQ Global Market under the symbol "HOVNP." In fiscal 2018, 2017 and 2016, we did not make any dividend payments on the Series A Preferred Stock as a result of covenant restrictions in our debt instruments. Certain debt instruments to which we are a party contain restrictions on the payment of cash dividends. As a result of the most restrictive of these provisions, we are not currently able to pay any cash dividends. We have never paid a cash dividend to common stockholders. We anticipate that we will continue to be restricted from paying dividends, which are not cumulative, for the foreseeable future.

Inventory Activities

Total inventory, excluding consolidated inventory not owned, increased $105.2 million during the year ended October 31, 2018 from October 31, 2017. Total inventory, excluding consolidated inventory not owned, increased in the Mid-Atlantic by $15.8 million, in the Midwest by $5.8 million, in the Southwest by $38.8 million and in the West by $57.9 million. These increases were partially offset by decreases in the Northeast of $10.7 million and in the Southeast of $2.4 million. These inventory fluctuations were primarily attributable to home deliveries and land sales during the period, partially offset by new land purchases and land development. During the year ended October 31, 2018, we had aggregate impairments in the amount of $2.1 million. We wrote-off costs in the amount of $1.4 million during the year ended October 31, 2018 related to land options that expired or that we terminated, as the communities' forecasted profitability was not projected to produce adequate returns on investment commensurate with the risk. In the last few years, we have been able to acquire new land parcels at prices that we believe will generate reasonable returns under current homebuilding market conditions. There can be no assurances that this trend will continue in the near term. Substantially all homes under construction or completed and included in inventory at October 31, 2018 are expected to be closed during the next six to nine months.

Consolidated inventory not owned decreased $36.9 million. Consolidated inventory not owned consists of options related to land banking and model financing transactions that were added to our Consolidated Balance Sheets in accordance with US GAAP. The decrease from October 31, 2017 to October 31, 2018 was primarily due to a decrease in land banking transactions along with a decrease in the sale and leaseback of certain model homes during the period. We have land banking arrangements, whereby we sell land parcels to the land bankers and they provide us an option to purchase back finished lots on a predetermined schedule. Because of our options to repurchase these parcels, for accounting purposes in accordance with ASC 360-20-40-38, these transactions are considered a financing rather than a sale. For purposes of our Consolidated Balance Sheet, at October 31, 2018, inventory of $50.5 million was recorded to "Consolidated inventory not owned," with a corresponding amount of $43.9 million (net of debt issuance costs) recorded to "Liabilities from inventory not owned" for the amount of net cash received from the transactions. In addition, we sell and lease back certain of our model homes with the right to participate in the potential profit when each home is sold to a third party at the end of the respective lease. As a result of our continued involvement, for accounting purposes in accordance with ASC 360-20-40-38, these sale and leaseback transactions are considered a financing rather than a sale. Therefore, for purposes of our Consolidated Balance Sheet, at October 31, 2018,

inventory of $37.4 million was recorded to “Consolidated inventory not owned,” with a corresponding amount of $19.5 million (net of debt issuance costs) recorded to “Liabilities from inventory not owned” for the amount of net cash received from the transactions.

When possible, we option property for development prior to acquisition. By optioning property, we are only subject to the loss of the cost of the option and predevelopment costs if we choose not to exercise the option (other than with respect to specific performance options discussed above). As a result, our commitment for major land acquisitions is reduced. The costs associated with optioned properties are included in “Land and land options held for future development or sale” on the Consolidated Balance Sheets. Also included in “Land and land options held for future development or sale” are amounts associated with inventory in mothballed communities. We mothball (or stop development on) certain communities when we determine the current performance does not justify further investment at the time. That is, we believe we will generate higher returns if we decide against spending money to improve land today and save the raw land until such time as the markets improve or we determine to sell the property. As of October 31, 2018, we had mothballed land in 18 communities. The book value associated with these communities at October 31, 2018 was $24.5 million, which was net of impairment charges recorded in prior periods of $186.1 million. We continually review communities to determine if mothballing is appropriate. During fiscal 2018, we did not mothball any additional communities, but we sold two previously mothballed communities and re-activated two previously mothballed communities.

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Inventories held for sale, which are land parcels where we have decided not to build homes, represented $6.4 million and $23.6 million, respectively, of our total inventories at October 31, 2018 and October 31, 2017, and are reported at the lower of carrying amount or fair value less costs to sell. In determining fair value for land held for sale, management considers, among other things, prices for land in recent comparable sale transactions, market analysis studies, which include the estimated price a willing buyer would pay for the land (other than in a forced liquidation sale) and recent bona fide offers received from outside third parties.

The following tables summarize home sites included in our total residential real estate. The increase in remaining home sites available at October 31, 2018 compared to October 31, 2017 was primarily attributable to our ability to control new land during fiscal 2018. As previously discussed, we expect to continue to actively seek new land investment opportunities in fiscal 2019.

	Total Home Sites	**Contracted Not Delivered**	**Remaining Home Sites Available**
October 31, 2018:			
Northeast	3,920	51	3,869
Mid-Atlantic	4,795	296	4,499
Midwest	4,758	394	4,364
Southeast	4,671	251	4,420
Southwest	6,783	523	6,260
West	5,630	311	5,319
Consolidated total	30,557	1,826	28,731
Unconsolidated joint ventures	4,029	366	3,663
Owned	12,729	1,356	11,373
Optioned	17,610	252	17,358
Construction to permanent financing lots	218	218	-
Consolidated total	30,557	1,826	28,731
Lots controlled by unconsolidated joint ventures	4,029	366	3,663
October 31, 2017:			
Northeast	4,527	98	4,429
Mid-Atlantic	4,241	309	3,932
Midwest	3,392	382	3,010
Southeast	3,356	285	3,071
Southwest	5,433	509	4,924
West	4,600	400	4,200
Consolidated total	25,549	1,983	23,566
Unconsolidated joint ventures	5,770	454	5,316
Owned	11,422	1,462	9,960

Optioned	13,907	301	13,606
Construction to permanent financing lots	220	220	-
Consolidated total	25,549	1,983	23,566
Lots controlled by unconsolidated joint ventures	5,770	454	5,316

The following table summarizes our started or completed unsold homes and models, excluding unconsolidated joint ventures, in active and substantially completed communities. The decrease in the total homes from October 31, 2017 to October 31, 2018 is due to the decrease in community count during the period.

	October 31, 2018			**October 31, 2017**		
	Unsold Homes	**Models**	**Total**	**Unsold Homes**	**Models**	**Total**
Northeast	24	5	29	11	6	17
Mid-Atlantic	38	19	57	81	11	92
Midwest	19	10	29	21	13	34
Southeast	62	11	73	118	28	146
Southwest	335	14	349	348	15	363
West	93	12	105	23	10	33
Total	571	71	642	602	83	685
Started or completed unsold homes and models per active selling communities(1)	4.6	0.6	5.2	4.6	0.7	5.3

(1) *Active selling communities (which are communities that are open for sale with ten or more home sites available) were 123 and 130 at October 31, 2018 and 2017, respectively. Ratio does not include substantially completed communities, which are communities with less than ten home sites available.*

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Other Balance Sheet Activities

Homebuilding – Restricted cash and cash equivalents increased $10.7 million from October 31, 2017 to $12.8 million at October 31, 2018. The increase was primarily due to cash collateral required to collateralize certain of our letters of credit under our stand alone letter of credit facilities which had been previously issued under and collateralized by our unsecured revolving credit facility that had a final maturity in September 2018.

Investments in and advances to unconsolidated joint ventures increased $8.6 million during the fiscal year ended October 31, 2018 compared to October 31, 2017. The increase was primarily due to recording our share of income in excess of distributions and additional capital contributions on several existing joint ventures during the period, along with an increase for an investment in a new joint venture in the third quarter of fiscal 2018. These increases were partially offset by decreases related to the acquisition of the remaining assets of one of our joint ventures in the first quarter of fiscal 2018, along with partner distributions on another joint venture during the period. As of October 31, 2018 and October 31, 2017, we had investments in nine and ten homebuilding joint ventures, respectively, and one land development joint venture for both periods. We have no guarantees associated with our unconsolidated joint ventures, other than guarantees limited only to performance and completion of development, environmental indemnification and standard warranty and representation against fraud, misrepresentation and similar actions, including a voluntary bankruptcy.

Receivables, deposits and notes, net decreased $23.0 million from October 31, 2017 to $35.2 million at October 31, 2018. The decrease was primarily due to funds received in the third quarter of fiscal 2018 for receivables related to land sales in the fourth quarter of fiscal 2017 and the second quarter of fiscal 2018.

Property, Plant, and Equipment decreased $32.6 million from October 31, 2017 to October 31, 2018. The decrease was primarily due to the sale of our former corporate headquarters building on November 1, 2017, totaling $34.7 million, net of accumulated depreciation. The decrease was slightly offset by an increase for software costs capitalized during the period.

Prepaid expenses and other assets were as follows as of:

(In thousands)	**October 31, 2018**	**October 31, 2017**	**Dollar Change**
Prepaid insurance	$2,514	$1,893	$621
Prepaid project costs	28,667	30,360	(1,693)
Other prepaids	7,505	4,245	3,260

Other assets	464	528	(64)
Total	$39,150	$37,026	$2,124

Prepaid insurance increased due to the timing of premium payments. These costs are amortized over the life of the associated insurance policy, which can be one to three years. Prepaid project costs consist of community specific expenditures that are used over the life of the community. Such prepaids are expensed as homes are delivered and therefore have declined as our community count has declined. Other prepaids increased primarily due to costs related to our Term Loan Facility, along with new premiums for the renewal of certain software and related services during the period, partially offset by amortization of these costs.

Financial services assets consist primarily of residential mortgages receivable held for sale of which $129.0 million and $131.5 million at October 31, 2018 and 2017, respectively, were being temporarily warehoused and are awaiting sale in the secondary mortgage market. The slight decrease in mortgage loans held for sale from October 31, 2017 was related to a decrease in the volume of loans originated during the fourth quarter of 2018 compared to the fourth quarter of 2017, partially offset by an increase in the average loan value.

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Nonrecourse mortgages increased to $95.6 million at October 31, 2018, from $64.5 million at October 31, 2017. The increase was primarily due to new mortgages for communities in all segments obtained during the fiscal 2018, along with additional loan draws on existing mortgages, partially offset by the payment of existing mortgages, including a mortgage on a community which was transferred to a joint venture.

Accounts payable and other liabilities are as follows as of:

(In thousands)	October 31, 2018	October 31, 2017	Dollar Change
Accounts payable	$127,795	$128,844	$(1,049)
Reserves	99,229	134,089	(34,860)
Accrued expenses	14,884	12,900	1,984
Accrued compensation	53,200	47,209	5,991
Other liabilities	9,791	12,015	(2,224)
Total	$304,899	$335,057	$(30,158)

Reserves decreased during the period as payments for construction defect claims exceeded new accruals primarily due to litigation settlements, along with a reduction in our warranty reserves based on our annual assessment. Accrued expenses increased due to the timing of various accruals primarily related to legal and marketing services during the fourth quarter of fiscal 2018 as compared to the fourth quarter of fiscal 2017. The increase in accrued compensation was primarily due to accrued bonuses being higher in fiscal 2018 as compared to fiscal 2017 as a result of financial performance in 2018. Other liabilities decreased primarily due to deferred income recognized during the period for home closings that had been previously delayed in connection with the remediation of the Weyerhaeuser-manufacture I-joist issue as previously disclosed in our Form 10-K for the fiscal year ended October 31, 2017.

Customers' deposits decreased $3.7 million from October 31, 2017 to $30.1 million at October 31, 2018. The decrease was primarily related to the decrease in backlog during the year.

Nonrecourse mortgages secured by operating properties decreased $13.0 million from October 31, 2017 to October 31, 2018. The decrease was due to the payoff of our mortgage loans on our former corporate headquarters building, which was sold on November 1, 2017.

Liabilities from inventory not owned decreased $27.7 million to $63.4 million at October 31, 2018. The decrease was due a decrease in land banking transactions during the period, along with a decrease in the sale and leaseback of certain model homes, both of which are accounted for as financing transactions as described above.

Accrued interest decreased $6.2 million to $35.6 million at October 31, 2018. The decrease was primarily due to a combination of the timing of interest payments on our senior notes issued in fiscal 2018 as compared to our senior notes that were refinanced in fiscal 2018.

Results of Operations

Total Revenues

Compared to the prior period, revenues increased (decreased) as follows:

(Dollars in thousands)	Year Ended October 31, 2018	October 31, 2017	October 31, 2016
Homebuilding:			
Sale of homes	$(433,805)	$(260,757)	$512,661
Land sales	(24,319)	(27,445)	75,191
Other revenues	3,080	1,494	(37)
Financial services	(5,388)	(13,874)	15,952
Total change	$(460,432)	$(300,582)	$603,767
Total revenues percent change	(18.8)%	(10.9)%	28.1%

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Homebuilding

Sale of homes revenues decreased $433.8 million, or 18.5%, for the year ended October 31, 2018, decreased $260.8 million, or 10.0%, for the year ended October 31, 2017, and increased $512.7 million, or 24.6%, for the year ended October 31, 2016 as compared to the same period of the prior year. The decreased revenues in fiscal 2018 were primarily due to the number of home deliveries decreasing 13.5%, and the average price per home decreasing to $393,280 in fiscal 2018 from $417,714 in fiscal 2017. The decrease in deliveries in fiscal 2018 was primarily the result of a reduction in community count in fiscal 2018 by 5.4%. The decreased revenues in fiscal 2017 were primarily due to the number of home deliveries decreasing 13.3%, partially offset by the average price per home increasing to $417,714 in fiscal 2017 from $402,350 in fiscal 2016. The decrease in fiscal 2017 deliveries was primarily the result of a reduction in community count by 22.2%. The increased revenues in fiscal 2016 were primarily due to the 17.4% increase in deliveries, as well as the average price per home increasing to $402,350 in fiscal 2016 from $379,177 in fiscal 2015. For fiscal 2018, the fluctuations in average prices were primarily the result of geographic and community mix of our deliveries and home price decreases (which we increase or decrease in communities depending on the respective community’s performance), partially offset by price increases in some communities primarily in the West. For fiscal 2017, the fluctuations in average prices were primarily the result of the geographic and community mix of our deliveries, along with our ability to raise home prices in certain communities. For fiscal 2016, the fluctuations in average prices were primarily a result of the geographic and community mix of our deliveries, as opposed to home price increases. For further detail on changes in segment revenues see “Homebuilding Operations by Segment” below. For further detail on land sales and other revenue, see the section titled “Land Sales and Other Revenues” below.

Information on homes delivered by segment is set forth below:

(Housing Revenue in thousands)	Year Ended October 31, 2018	October 31, 2017	October 31, 2016
Northeast:			
Housing revenues	$96,012	$166,752	$274,126
Homes delivered	178	351	557
Average price	$539,393	$475,077	$492,147
Mid-Atlantic:			
Housing revenues	$354,153	$463,271	$457,906
Homes delivered	672	856	960
Average price	$527,013	$541,205	$476,985
Midwest:			
Housing revenues	$196,307	$199,009	$287,469
Homes delivered	662	640	921
Average price	$296,536	$310,951	$312,127
Southeast:			
Housing revenues	$237,948	$257,066	$214,585
Homes delivered	596	614	581

Average price	$399,242	$418,675	$369,339
Southwest:			
Housing revenues	$637,568	$826,422	$1,024,410
Homes delivered	1,873	2,357	2,750
Average price	$340,399	$350,624	$372,512
West:			
Housing revenues	$384,240	$427,513	$342,294
Homes delivered	866	784	695
Average price	$443,695	$545,297	$492,509
Consolidated total:			
Housing revenues	$1,906,228	$2,340,033	$2,600,790
Homes delivered	4,847	5,602	6,464
Average price	$393,280	$417,714	$402,350
Unconsolidated joint ventures:(1)			
Housing revenues	$599,979	$310,573	$140,576
Homes delivered	984	547	248
Average price	$609,735	$567,774	$566,836

(1) Represents housing revenue and home deliveries for our unconsolidated homebuilding joint ventures for the period. We provide this data as a supplement to our consolidated results as an indicator of the volume managed in our unconsolidated joint ventures. See Note 20 to the Consolidated Financial Statements for a further discussion of our joint ventures.

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The decrease in housing revenues during year ended October 31, 2018, as compared to year ended October 31, 2017, was primarily attributed to our decreased deliveries, as our community count has decreased year over year, and by the decrease in average sales price. Housing revenues in fiscal 2018 decreased in all of our homebuilding segments combined by 18.5%, and average sales price decreased by 5.8%, excluding unconsolidated joint ventures. In our homebuilding segments, homes delivered decreased in fiscal 2018 as compared to fiscal 2017 by 49.3%, 21.5%, 2.9% and 20.5% in the Northeast, Mid-Atlantic, Southeast and Southwest, respectively, and increased by 3.4% and 10.5% in the Midwest and West, respectively. Overall in fiscal 2018 as compared to fiscal 2017 homes delivered decreased 13.5% across all our segments, excluding unconsolidated joint ventures.

The decrease in housing revenues during year ended October 31, 2017, as compared to year ended October 31, 2016, was primarily attributed to our decreased deliveries, partially offset by an increase in average sales price. Housing revenues in fiscal 2017 decreased in all of our homebuilding segments combined by 10.0%, while average sales price increased by 3.8%, excluding joint ventures. In our homebuilding segments, homes delivered decreased in fiscal 2017 as compared to fiscal 2016 by 37.0%, 10.8%, 30.5% and 14.3% in the Northeast, Mid-Atlantic, Midwest and Southwest, respectively, and increased by 5.7% and 12.8% in the Southeast and West, respectively. Overall in fiscal 2017 as compared to fiscal 2016 homes delivered decreased 13.3% across all our segments, excluding unconsolidated joint ventures.

Quarterly housing revenues and net sales contracts by segment, excluding unconsolidated joint ventures, for the years ended October 31, 2018, 2017 and 2016 are set forth below (Net contracts are defined as new contracts executed during the period for the purchase of homes, less cancellations of contracts in the same period):

	Quarter Ended			
(In thousands)	**October 31,**	**July 31,**	**April 30,**	**January 31,**
	2018	**2018**	**2018**	**2018**
Housing revenues:				
Northeast	$25,606	$26,701	$23,513	$20,192
Mid-Atlantic	99,493	79,593	104,058	71,009
Midwest	67,395	45,579	42,816	40,517
Southeast	72,828	47,472	60,974	56,674
Southwest	193,000	157,406	158,958	128,204
West	135,353	86,108	77,798	84,981
Consolidated total	$593,675	$442,859	$468,117	$401,577
Sales contracts (net of cancellations):				
Northeast	$16,044	$18,045	$15,278	$25,363
Mid-Atlantic	84,027	76,324	117,399	63,213
Midwest	44,167	43,596	67,308	49,416
Southeast	41,126	71,381	62,741	50,455
Southwest	123,485	177,174	198,487	141,458

West	83,933	102,183	93,213	69,397
Consolidated total	$392,782	$488,703	$554,426	$399,302

	Quarter Ended			
	October 31,	**July 31,**	**April 30,**	**January 31,**
(In thousands)				
	2017	**2017**	**2017**	**2017**
Housing revenues:				
Northeast	$27,913	$40,015	$45,917	$52,907
Mid-Atlantic	149,881	113,111	100,120	100,159
Midwest	72,944	40,620	41,794	43,651
Southeast	78,267	68,408	54,005	56,386
Southwest	209,223	209,041	224,898	183,260
West	128,555	103,087	100,819	95,052
Consolidated total	$666,783	$574,282	$567,553	$531,415
Sales contracts (net of cancellations):				
Northeast	$24,407	$26,648	$29,918	$38,045
Mid-Atlantic	77,112	97,017	123,045	102,246
Midwest	38,139	48,257	61,489	45,566
Southeast	56,354	73,896	55,577	46,451
Southwest	142,926	177,285	227,500	170,884
West	91,048	103,342	142,522	84,423
Consolidated total	$429,986	$526,445	$640,051	$487,615

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(In thousands)	Quarter Ended October 31, 2016	July 31, 2016	April 30, 2016	January 31, 2016
Housing revenues:				
Northeast	$81,467	$66,308	$53,913	$72,438
Mid-Atlantic	162,902	111,579	89,873	93,552
Midwest	62,193	56,643	76,793	91,840
Southeast	67,690	56,471	51,230	39,194
Southwest	298,689	248,228	273,304	204,189
West	104,531	101,157	81,044	55,562
Consolidated total	$777,472	$640,386	$626,157	$556,775
Sales contracts (net of cancellations):				
Northeast	$50,179	$61,945	$74,727	$39,784
Mid-Atlantic	99,179	97,338	150,369	130,316
Midwest(1)	38,339	54,318	69,445	67,569
Southeast(2)	53,372	59,242	84,665	90,259
Southwest	190,426	225,929	262,344	208,642
West	102,819	99,284		