KB HOME
Form 10-Q
April 06, 2018

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

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended February 28, 2018.
or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from [ ] to [ ].
Commission File No. 001-09195
KB HOME
(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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
Non-accelerated filer	(Do not check if a smaller reporting company)	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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of February 28, 2018.
There were 87,506,230 shares of the registrant’s common stock, par value $1.00 per share, outstanding on February 28, 2018. The registrant’s grantor stock ownership trust held an additional 8,460,265 shares of the registrant’s common stock on that date.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	Three Months Ended February 28,	
	2018	2017
Total revenues	$871,623	$818,596
Homebuilding:		
Revenues	$869,205	$816,246
Construction and land costs	(729,478)	(698,080)
Selling, general and administrative expenses	(95,724)	(92,889)
Operating income	44,003	25,277
Interest income	1,003	198
Interest expense	—	(6,307)
Equity in income (loss) of unconsolidated joint ventures	(845)	731
Homebuilding pretax income	44,161	19,899
Financial services:		
Revenues	2,418	2,350
Expenses	(953)	(819)
Equity in income of unconsolidated joint ventures	419	29
Financial services pretax income	1,884	1,560
Total pretax income	46,045	21,459
Income tax expense	(117,300)	(7,200)
Net income (loss)	$(71,255)	$14,259
Earnings (loss) per share:		
Basic	$(.82)	$.17
Diluted	$(.82)	$.15
Weighted average shares outstanding:		
Basic	87,155	85,122
Diluted	87,155	96,273
Cash dividends declared per common share	$.025	$.025

See accompanying notes.

KB HOME
CONSOLIDATED BALANCE SHEETS
(In Thousands – Unaudited)

	February 28, 2018	November 30, 2017
Assets		
Homebuilding:		
Cash and cash equivalents	$560,255	$720,630
Receivables	250,472	244,213
Inventories	3,441,574	3,263,386
Investments in unconsolidated joint ventures	68,176	64,794
Deferred tax assets, net	516,569	633,637
Other assets	108,498	102,498
	4,945,544	5,029,158
Financial services	11,557	12,357
Total assets	$4,957,101	$5,041,515
Liabilities and stockholders' equity		
Homebuilding:		
Accounts payable	$192,843	$213,463
Accrued expenses and other liabilities	551,069	575,930
Notes payable	2,359,570	2,324,845
	3,103,482	3,114,238
Financial services	897	966
Stockholders' equity:		
Common stock	118,214	117,946
Paid-in capital	729,439	727,483
Retained earnings	1,662,118	1,735,695
Accumulated other comprehensive loss	(16,924)	(16,924)
Grantor stock ownership trust, at cost	(91,760)	(96,509)
Treasury stock, at cost	(548,365)	(541,380)
Total stockholders' equity	1,852,722	1,926,311
Total liabilities and stockholders' equity	$4,957,101	$5,041,515

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands – Unaudited)

	Three Months Ended February 28,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$(71,255)	$14,259
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Equity in (income) loss of unconsolidated joint ventures	426	(760)
Distributions of earnings from unconsolidated joint ventures	1,300	—
Amortization of discounts and issuance costs	1,552	1,665
Depreciation and amortization	628	802
Deferred income taxes	117,068	7,100
Loss on early extinguishment of debt	—	5,685
Stock-based compensation	3,829	3,152
Inventory impairments and land option contract abandonments	4,985	4,008
Changes in assets and liabilities:		
Receivables	(6,024)	(6,788)
Inventories	(135,311)	(36,878)
Accounts payable, accrued expenses and other liabilities	(54,016)	(64,105)
Other, net	(4,862)	(5,182)
Net cash used in operating activities	(141,680)	(77,042)
Cash flows from investing activities:		
Contributions to unconsolidated joint ventures	(8,025)	(8,750)
Return of investments in unconsolidated joint ventures	1,099	1,107
Purchases of property and equipment, net	(1,924)	(1,015)
Net cash used in investing activities	(8,850)	(8,658)
Cash flows from financing activities:		
Repayment of senior notes	—	(105,326)
Payments on mortgages and land contracts due to land sellers and other loans	(3,362)	(45,428)
Issuance of common stock under employee stock plans	2,946	662
Payments of cash dividends	(2,322)	(2,215)
Tax payments associated with stock-based compensation awards	(6,787)	(2,543)
Net cash used in financing activities	(9,525)	(154,850)
Net decrease in cash and cash equivalents	(160,055)	(240,550)
Cash and cash equivalents at beginning of period	720,861	593,000
Cash and cash equivalents at end of period	$560,806	$352,450

See accompanying notes.

KB HOME
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

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

In our opinion, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly our consolidated financial position as of February 28, 2018, the results of our consolidated operations for the three months ended February 28, 2018 and 2017, and our consolidated cash flows for the three months ended February 28, 2018 and 2017. The results of our consolidated operations for the three months ended February 28, 2018 are not necessarily indicative of the results to be expected for the full year due to seasonal variations in operating results and other factors. The consolidated balance sheet at November 30, 2017 has been taken from the audited consolidated financial statements as of that date. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended November 30, 2017, which are contained in our Annual Report on Form 10-K for that period.

Unless the context indicates otherwise, the terms "we," "our," and "us" used in this report refer to KB Home, a Delaware corporation, and its subsidiaries.

Use of Estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents. We consider all highly liquid short-term investments purchased with an original maturity of three months or less to be cash equivalents. Our cash equivalents totaled $347.1 million at February 28, 2018 and $481.1 million at November 30, 2017. At February 28, 2018 and November 30, 2017, the majority of our cash and cash equivalents was invested in interest-bearing bank deposit accounts.

Comprehensive Income (Loss). Our comprehensive loss for the three months ended February 28, 2018 was $71.3 million. For the three months ended February 28, 2017, our comprehensive income was $14.3 million. Our comprehensive income (loss) for each of the three-month periods ended February 28, 2018 and 2017 was equal to our net income (loss) for the respective periods.

Recent Accounting Pronouncements Not Yet Adopted. In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). The core principle of this guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued Accounting Standards Update No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which delayed the effective date of ASU 2014-09 by one year. In 2016 and 2017, the FASB issued accounting standards updates that amended several aspects of ASU 2014-09. ASU 2014-09, as amended, is effective for us beginning December 1, 2018, and allows for full retrospective or modified retrospective methods of adoption. We expect to adopt ASU 2014-09 under the modified retrospective method in our 2019 first quarter. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements and disclosures, and have been involved in industry specific discussions with the FASB on the treatment of certain items. We do not believe the adoption of ASU 2014-09 will have a material impact on the amount or timing of our homebuilding revenues. We are also continuing to evaluate the impact adopting this guidance may have on other aspects of our business.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). ASU 2016-02 will require lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under this guidance, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Lessor accounting remains substantially similar to current GAAP. In addition, disclosures of leasing activities are to be expanded to include qualitative along with specific quantitative information. ASU 2016-02 is effective for us beginning December 1, 2019 (with early adoption permitted), and mandates a modified retrospective transition method. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02, "Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"), which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act ("TCJA"), and requires certain disclosures about stranded tax effects. ASU 2018-02 is effective for us beginning December 1, 2019 (with early adoption permitted), and shall be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the corporate income tax rate in the TCJA is recognized. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

Adoption of New Accounting Pronouncement. In March 2016, the FASB issued Accounting Standards Update No. 2016-09, "Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"), which simplified several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of excess tax benefits on the statement of cash flows, treatment of forfeitures, and statutory withholding requirements. We adopted this guidance effective December 1, 2017. ASU 2016-09 requires excess tax benefits and deficiencies from stock-based compensation awards to be recognized prospectively in our consolidated statements of operations as a component of income tax expense, whereas these items were previously recorded in paid-in capital in our consolidated balance sheets. This guidance also requires excess tax benefits to be classified within operating activities in the consolidated statements of cash flows. We previously recognized excess tax benefits as a cash inflow from financing activities and a corresponding cash outflow from operating activities. In connection with the adoption of this guidance, we elected to continue to estimate forfeitures in calculating our stock-based compensation expense, rather than account for forfeitures as they occur. The impact of recognizing excess tax benefits and deficiencies in our consolidated statements of operations resulted in a $2.2 million reduction in our income tax expense for the three months ended February 28, 2018. The remaining aspects of adopting this guidance did not have a material impact on our consolidated financial statements.

2. Segment Information

We have identified five operating reporting segments, comprised of four homebuilding reporting segments and one financial services reporting segment. As of February 28, 2018, our homebuilding reporting segments conducted ongoing operations in the following states:

West Coast: California

Southwest: Arizona and Nevada

Central: Colorado and Texas

Southeast: Florida and North Carolina

Our homebuilding reporting segments are engaged in the acquisition and development of land primarily for residential purposes and offer a wide variety of homes that are designed to appeal to first-time, first move-up and active adult homebuyers. Our homebuilding operations generate most of their revenues from the delivery of completed homes to homebuyers. They also earn revenues from the sale of land.

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

Our financial services reporting segment offers property and casualty insurance and, in certain instances, earthquake, flood and personal property insurance to our homebuyers in the same markets as our homebuilding reporting segments, and provides title services in the majority of our markets located within our Central and Southeast homebuilding reporting segments. This segment earns revenues primarily from insurance commissions and from the provision of title services.

In 2016, a subsidiary of ours and a subsidiary of Stearns Lending, LLC ("Stearns") formed KBHS Home Loans, LLC ("KBHS"), an unconsolidated mortgage banking joint venture to offer mortgage banking services, including mortgage loan originations, to our homebuyers. We and Stearns each have a 50.0% ownership interest in KBHS, with Stearns providing management oversight of KBHS' operations. KBHS was operational in all of our served markets as of June 2017. The financial services reporting segment is separately reported in our consolidated financial statements.

Corporate and other is a non-operating segment that develops and oversees the implementation of company-wide strategic initiatives and provides support to our reporting segments by centralizing certain administrative functions.

Corporate management is responsible for, among other things, evaluating and selecting the geographic markets in which we operate, consistent with our overall business strategy; allocating capital resources to markets for land acquisition and development activities; making major personnel decisions related to employee compensation and benefits; and monitoring the financial

and operational performance of our divisions. Corporate and other includes general and administrative expenses related to operating our corporate headquarters. A portion of the expenses incurred by Corporate and other is allocated to our homebuilding reporting segments.

Our reporting segments follow the same accounting policies used for our consolidated financial statements. The results of each reporting segment are not necessarily indicative of the results that would have occurred had the segment been an independent, stand-alone entity during the periods presented, nor are they indicative of the results to be expected in future periods.

The following tables present financial information relating to our homebuilding reporting segments (in thousands):

	Three Months Ended February 28,	
	2018	2017
Revenues:		
West Coast	$386,652	$355,832
Southwest	151,899	117,636
Central	244,181	242,256
Southeast	86,473	100,522
Total	$869,205	$816,246
Pretax income (loss):		
West Coast	$31,593	$22,853
Southwest	14,977	8,672
Central	19,095	19,678
Southeast	1,320	(2,213)
Corporate and other	(22,824)	(29,091)
Total	$44,161	$19,899

Inventory impairment charges:		
West Coast	$4,699	$—
Southwest	—	1,343
Central	—	—
Southeast	—	1,874
Total	$4,699	$3,217
Land option contract abandonments:		
West Coast	$208	$791
Southwest	—	—
Central	78	—
Southeast	—	—
Total	$286	$791

	February 28, 2018	November 30, 2017
Inventories:		
Homes under construction		
West Coast	$ 666,333	$ 638,639
Southwest	188,344	179,240
Central	329,996	320,205
Southeast	109,242	98,764
Subtotal	1,293,915	1,236,848
Land under development		
West Coast	844,556	723,761
Southwest	289,603	309,672
Central	443,261	435,373
Southeast	188,614	182,533
Subtotal	1,766,034	1,651,339
Land held for future development or sale		
West Coast	230,592	233,188
Southwest	64,386	62,475
Central	18,890	12,654
Southeast	67,757	66,882
Subtotal	381,625	375,199
Total	$ 3,441,574	$ 3,263,386

Assets:		
West Coast	$ 1,890,866	$ 1,747,786
Southwest	588,495	586,666
Central	917,837	901,516
Southeast	375,322	359,307
Corporate and other	1,173,024	1,433,883
Total	$ 4,945,544	$ 5,029,158

3. Financial Services

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

	Three Months Ended February 28,	
	2018	2017
Revenues		
Insurance commissions	$ 1,352	$ 1,210
Title services	1,066	1,135
Interest income	—	5
Total	2,418	2,350

	Three Months Ended February 28,	
	2018	2017
Expenses		
General and administrative	(953)	(819)
Operating income	1,465	1,531
Equity in income of unconsolidated joint ventures	419	29
Pretax income	$1,884	$1,560

	February 28, 2018	November 30, 2017
Assets		
Cash and cash equivalents	$ 551	$ 231
Receivables	1,489	1,724
Investments in unconsolidated joint ventures	9,460	10,340
Other assets	57	62
Total assets	$ 11,557	$ 12,357
Liabilities		
Accounts payable and accrued expenses	$ 897	$ 966
Total liabilities	$ 897	$ 966

4. Earnings (Loss) Per Share

Basic and diluted earnings (loss) per share were calculated as follows (in thousands, except per share amounts):

	Three Months Ended February 28,	
	2018	2017
Numerator:		
Net income (loss)	$(71,255)	$14,259
Less: Distributed earnings allocated to nonvested restricted stock	—	(15)
Less: Undistributed earnings allocated to nonvested restricted stock	—	(85)
Numerator for basic earnings (loss) per share	(71,255)	14,159
Effect of dilutive securities:		
Interest expense and amortization of debt issuance costs associated with convertible senior notes, net of taxes	—	663
Add: Undistributed earnings allocated to nonvested restricted stock	—	85
Less: Undistributed earnings reallocated to nonvested restricted stock	—	(75)
Numerator for diluted earnings (loss) per share	$(71,255)	$14,832

	Three Months Ended February 28,	
	2018	2017
Denominator:		
Weighted average shares outstanding — basic	87,155	85,122
Effect of dilutive securities:		
Share-based payments	—	2,749
Convertible senior notes	—	8,402
Weighted average shares outstanding — diluted	87,155	96,273
Basic earnings (loss) per share	$(.82)	$ .17
Diluted earnings (loss) per share	$(.82)	$ .15

We compute earnings (loss) per share using the two-class method, which is an allocation of earnings (losses) between the holders of common stock and a company's participating security holders. Our outstanding nonvested shares of restricted stock contain non-forfeitable rights to dividends and, therefore, are considered participating securities for purposes of computing earnings per share pursuant to the two-class method. We had no other participating securities at February 28, 2018 or 2017.

For the three months ended February 28, 2018, all outstanding stock options, contingently issuable shares associated with outstanding performance-based restricted stock units (each, a "PSU"), and the impact of our 1.375% convertible senior notes due 2019 ("1.375% Convertible Senior Notes due 2019"), were excluded from the diluted loss per share calculation because the effect of their inclusion would be antidilutive. For the three months ended February 28, 2017, outstanding stock options to purchase 5.1 million shares of our common stock were excluded from the diluted earnings per share calculation because the effect of their inclusion would be antidilutive. Contingently issuable shares associated with outstanding PSUs were not included in the basic earnings per share calculations for the periods presented, as the applicable vesting conditions had not been satisfied.

5. Receivables

Receivables consisted of the following (in thousands):

	February 28, 2018	November 30, 2017
Due from utility companies, improvement districts and municipalities	$ 115,398	$ 113,744
Recoveries related to self-insurance and other legal claims	91,727	91,763
Refundable deposits and bonds	13,121	13,829
Recoveries related to warranty and other claims	4,037	4,073
Other	38,829	33,797
Subtotal	263,112	257,206
Allowance for doubtful accounts	(12,640)	(12,993)
Total	$ 250,472	$ 244,213

6. Inventories

Inventories consisted of the following (in thousands):

	February 28, 2018	November 30, 2017
Homes under construction	$ 1,293,915	$ 1,236,848
Land under development	1,766,034	1,651,339
Land held for future development or sale (a)	381,625	375,199
Total	$ 3,441,574	$ 3,263,386

(a) Land held for sale totaled $27.8 million at February 28, 2018 and $21.8 million at November 30, 2017.

Interest is capitalized to inventories while the related communities or land are being actively developed and until homes are completed or the land is available for immediate sale. Capitalized interest is amortized to construction and land costs as the related inventories are delivered to homebuyers or land buyers (as applicable). Interest and real estate taxes are not capitalized on land held for future development or sale.

Our interest costs were as follows (in thousands):

	Three Months Ended February 28,	
	2018	2017
Capitalized interest at beginning of period	$262,191	$306,723
Interest incurred (a)	39,944	50,079
Interest expensed (a)	—	(6,307)
Interest amortized to construction and land costs (b)	(42,350)	(39,384)
Capitalized interest at end of period (c)	$259,785	$311,111

(a) Interest incurred and interest expensed for the three months ended February 28, 2017 included a charge of $5.7 million for the early extinguishment of debt.

(b) Interest amortized to construction and land costs for the three months ended February 28, 2018 and 2017 included $1.0 million and $.5 million, respectively, related to land sales during those periods.

(c) Capitalized interest amounts reflect the gross amount of capitalized interest, as inventory impairment charges recognized, if any, are not generally allocated to specific components of inventory.

7. Inventory Impairments and Land Option Contract Abandonments

Each community or land parcel in our owned inventory is assessed on a quarterly basis to determine if indicators of potential impairment exist. We record an inventory impairment charge on a community or land parcel that is active or held for future development when indicators of potential impairment exist and the carrying value of the real estate asset is greater than the undiscounted future net cash flows the asset is expected to generate. These real estate assets are written down to fair value, which is primarily determined based on the estimated future net cash flows discounted for inherent risk associated with each such asset, or other valuation techniques. We record an inventory impairment charge on land held for sale when the carrying value of a land parcel is greater than its fair value. These real estate assets are written down to fair value, less associated costs to sell. The estimated fair values of such assets are generally based on bona fide letters of intent from outside parties, executed sales contracts, broker quotes or similar information.

We evaluated 29 and 39 communities or land parcels for recoverability during the three months ended February 28, 2018 and 2017, respectively. The carrying value of those communities or land parcels evaluated during the three months ended February 28, 2018 and 2017 was $200.1 million and $366.4 million, respectively. The communities or land parcels evaluated during the three months ended February 28, 2018 included certain communities or land parcels previously held for future development that were reactivated during 2016 or 2017 as part of our efforts to improve our asset efficiency under our Returns-Focused Growth Plan.

Based on the results of our evaluations, we recognized inventory impairment charges of $4.7 million for the three months ended February 28, 2018 and $3.2 million for the three months ended February 28, 2017. The inventory impairment charges for the three months ended February 28, 2018 and 2017 reflected our decisions to make changes in our operational strategies aimed at more quickly monetizing our investment in certain communities by accelerating the overall pace for selling, building and delivering homes on land previously held for future development.

The following table summarizes ranges for significant quantitative unobservable inputs we utilized in our fair value measurements with respect to the impaired communities written down to fair value during the periods presented:

	Three Months Ended February 28,	
Unobservable Input (a)	2018	2017
Average selling price	$774,100	$299,800 - $307,900
Deliveries per month	3	3 - 4
Discount rate	18%	17%

(a) The ranges of inputs used in each period primarily reflect differences between the housing markets where each impacted community is located, rather than fluctuations in prevailing market conditions.

As of February 28, 2018, the aggregate carrying value of our inventory that had been impacted by inventory impairment charges was $178.4 million, representing 20 communities and various other land parcels. As of November 30, 2017, the aggregate carrying value of our inventory that had been impacted by inventory impairment charges was $177.8 million, representing 24 communities and various other land parcels.

Our inventory controlled under land option contracts and other similar contracts is assessed on a quarterly basis to determine whether it continues to meet our investment return standards. When a decision is made not to exercise certain land option contracts and other similar contracts due to market conditions and/or changes in our marketing strategy, we write off the related inventory costs, including non-refundable deposits and unrecoverable pre-acquisition costs. Based on the results of our assessments, we recognized land option contract abandonment charges of $.3 million for the three months ended February 28, 2018 and $.8 million for the three months ended February 28, 2017.

Due to the judgment and assumptions applied in our inventory impairment and land option contract abandonment assessment processes, particularly as to land held for future development, it is possible that actual results could differ substantially from those estimated.

8. Variable Interest Entities

Unconsolidated Joint Ventures. We participate in joint ventures from time to time that conduct land acquisition, land development and/or other homebuilding activities in various markets where our homebuilding operations are located. Our investments in these joint ventures may create a variable interest in a variable interest entity (“VIE”), depending on the contractual terms of the arrangement. We analyze our joint ventures under the variable interest model to determine whether they are VIEs and, if so, whether we are the primary beneficiary. Based on our analyses, we determined that one of our joint ventures at February 28, 2018 and November 30, 2017 was a VIE, but we were not the primary beneficiary of the VIE. All of our joint ventures at February 28, 2018 and November 30, 2017 were unconsolidated and accounted for under the equity method because we did not have a controlling financial interest.

Land Option Contracts and Other Similar Contracts. In the ordinary course of our business, we enter into land option contracts and other similar contracts with third parties and unconsolidated entities to acquire rights to land for the construction of homes. Under these contracts, we typically make a specified option payment or earnest money deposit in consideration for the right to purchase land in the future, usually at a predetermined price. We analyze each of our land option contracts and other similar contracts under the variable interest model to determine whether the land seller is a VIE and, if so, whether we are the primary beneficiary. Although we do not have legal title to the underlying land, we are required to consolidate a VIE if we are the primary beneficiary. As a result of our analyses, we determined that as of February 28, 2018 and November 30, 2017, we were not the primary beneficiary of any VIEs from which we have acquired rights to land under land option contracts and other similar contracts. We perform ongoing reassessments of whether we are the primary beneficiary of a VIE.

The following table presents a summary of our interests in land option contracts and other similar contracts (in thousands):

	February 28, 2018		November 30, 2017	
	Cash Deposits	Aggregate Purchase Price	Cash Deposits	Aggregate Purchase Price
Unconsolidated VIEs	$18,995	$463,115	$43,171	$653,858
Other land option contracts and other similar contracts	25,632	466,109	21,531	440,229
Total	$44,627	$929,224	$64,702	$1,094,087

In addition to the cash deposits presented in the table above, our exposure to loss related to our land option contracts and other similar contracts with third parties and unconsolidated entities consisted of pre-acquisition costs of $31.3 million at February 28, 2018 and $26.8 million at November 30, 2017. These pre-acquisition costs and cash deposits were included in inventories in our consolidated balance sheets.

For land option contracts and other similar contracts where the land seller entity is not required to be consolidated under the variable interest model, we consider whether such contracts should be accounted for as financing arrangements. Land option contracts and other similar contracts that may be considered financing arrangements include those we enter into with third-party land financiers or developers in conjunction with such third parties acquiring a specific land parcel(s) on our behalf, at our direction, and those with other landowners where we or our designee make improvements to the optioned land parcel(s) during the applicable option period. For these land option contracts and other similar contracts, we record the remaining purchase price of the associated land parcel(s) in inventories in our consolidated balance sheets with a corresponding financing obligation if we determine that we are effectively compelled to exercise the option to purchase the land parcel(s). In making this determination with respect to a land option contract or other similar contract, we consider the non-refundable deposit(s) we have made and any non-reimbursable expenditures we have incurred for land improvement activities or other items up to the assessment date; additional costs associated with abandoning the contract; and our commitments, if any, to incur non-reimbursable costs associated with the contract. As a result of our evaluations of land option contracts and other similar contracts for financing arrangements, we recorded inventories in our consolidated balance sheets, with a corresponding increase to accrued expenses and other liabilities, of $14.2 million at February 28, 2018 and $5.7 million at November 30, 2017.

9. Investments in Unconsolidated Joint Ventures

We have investments in unconsolidated joint ventures that conduct land acquisition, land development and/or other homebuilding activities in various markets where our homebuilding operations are located. We and our unconsolidated joint venture partners make initial and/or ongoing capital contributions to these unconsolidated joint ventures, typically on a pro rata basis, according to our respective equity interests. The obligations to make capital contributions are governed by each such unconsolidated joint venture’s respective operating agreement and related governing documents.

We typically have obtained rights to acquire portions of the land held by the unconsolidated joint ventures in which we currently participate. When an unconsolidated joint venture sells land to our homebuilding operations, we defer recognition of our share of such unconsolidated joint venture’s earnings (losses) until a home sale is closed and title passes to a homebuyer, at which time we account for those earnings (losses) as a reduction (increase) to the cost of purchasing the land from the unconsolidated joint venture. We defer recognition of our share of such unconsolidated joint venture losses only to the extent profits are to be generated from the sale of the home to a homebuyer.

We share in the earnings (losses) of these unconsolidated joint ventures generally in accordance with our respective equity interests. In some instances, we recognize earnings (losses) related to our investment in an unconsolidated joint venture that differ from our equity interest in the unconsolidated joint venture. This typically arises from our deferral of the unconsolidated joint venture’s earnings (losses) from land sales to us, or other items.

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

	Three Months Ended February 28,	
	2018	2017
Revenues	$8,797	$19,722
Construction and land costs	(8,816)	(17,895)
Other expense, net	(1,372)	(1,096)
Income (loss)	$(1,391)	$731

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

	February 28, 2018	November 30, 2017
Assets		
Cash	$ 19,992	$ 21,193
Receivables	507	688
Inventories	140,288	145,519
Other assets	1,180	1,398
Total assets	$ 161,967	$ 168,798
Liabilities and equity		
Accounts payable and other liabilities	$ 19,850	$ 25,426
Notes payable (a)	14,464	20,040
Equity	127,653	123,332
Total liabilities and equity	$ 161,967	$ 168,798

(a) As of February 28, 2018 and November 30, 2017, two of our unconsolidated joint ventures had separate construction loan agreements with different third-party lenders to finance their respective land development activities. The outstanding debt under these agreements is secured by the corresponding underlying property and related project assets and is non-recourse to us. Of this outstanding secured debt at February 28, 2018, $14.1 million is scheduled to mature in August 2018 and the remainder is scheduled to mature in February 2020. None of our other unconsolidated joint ventures had outstanding debt at February 28, 2018 or November 30, 2017.

The following table presents additional information relating to our investments in unconsolidated joint ventures (dollars in thousands):

	February 28, 2018	November 30, 2017
Number of investments in unconsolidated joint ventures	7	7
Investments in unconsolidated joint ventures	$ 68,176	$ 64,794
Number of unconsolidated joint venture lots controlled under land option contracts and other similar contracts	365	377

We and our partners in the unconsolidated joint ventures that have the above-noted construction loan agreements provide certain guarantees and indemnities to the applicable lender, including a guaranty to complete the construction of improvements for the applicable project; a guaranty against losses the lender suffers due to certain bad acts or failures to act by the unconsolidated joint venture or its partners; an indemnity of the lender from environmental issues; and in one case, a guaranty of interest payments on the outstanding balance of the secured debt under the construction loan agreement. In each instance, our actual responsibility under the foregoing guaranty and indemnity obligations is limited to our pro rata interest in the unconsolidated joint venture. We do not have a guaranty or any other obligation to repay or to support the value of the collateral underlying the outstanding secured debt of these unconsolidated joint ventures. However, various financial and

non-financial covenants apply with respect to the outstanding secured debt and the related guaranty and indemnity obligations, and a failure to comply with such covenants could result in a default and cause an applicable lender to seek to enforce such guaranty and indemnity obligations, if and as may be applicable. As of February 28, 2018, we were in compliance with the applicable terms of our relevant covenants with respect to the construction loan agreements. We do not believe that our existing exposure under our guaranty and indemnity obligations related to the outstanding secured debt of these unconsolidated joint ventures is material to our consolidated financial statements.
Of the unconsolidated joint venture lots controlled under land option and other similar contracts at February 28, 2018, we are committed to purchase 67 lots from one of our unconsolidated joint ventures in quarterly takedowns over the next three years for an aggregate purchase price of $30.0 million under agreements that we entered into with the unconsolidated joint venture in 2016.

10. Other Assets

Other assets consisted of the following (in thousands):

	February 28, 2018	November 30, 2017
Cash surrender value of corporate-owned life insurance contracts	$ 74,761	$ 75,236
Property and equipment, net	20,807	19,521
Prepaid expenses	10,711	5,360
Debt issuance costs associated with unsecured revolving credit facility	2,219	2,381
Total	$ 108,498	$ 102,498

11. Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consisted of the following (in thousands):

	February 28, 2018	November 30, 2017
Self-insurance and other litigation liabilities	$ 222,379	$ 222,808
Employee compensation and related benefits	106,719	143,992
Accrued interest payable	76,324	65,343
Warranty liability	71,845	69,798
Inventory-related obligations (a)	36,858	30,108
Customer deposits	19,537	16,863
Real estate and business taxes	10,659	16,874
Other	6,748	10,144
Total	$ 551,069	$ 575,930

(a) Represents liabilities for financing arrangements discussed in Note 8 – Variable Interest Entities, as well as liabilities for fixed or determinable amounts associated with tax increment financing entity (“TIFE”) assessments. As homes are delivered, our obligation to pay the remaining TIFE assessments associated with each underlying lot is transferred to the homebuyer. As such, these assessment obligations will be paid by us only to the extent we do not deliver homes on applicable lots before the related TIFE obligations mature.

12. Income Taxes

On December 22, 2017, the TCJA was enacted into law. The TCJA made significant changes to U.S. tax laws, including, but not limited to, the following: (a) reducing the federal corporate income tax rate from 35% to 21%, effective January 1, 2018; (b) eliminating the federal corporate alternative minimum tax (“AMT”) and changing how existing AMT credits can be realized; and (c) eliminating several business deductions and credits, including deductions for certain executive compensation in excess of $1 million. Overall, we expect the TCJA to favorably impact our effective tax rate, net income and cash flows in future periods.

In December 2017, the SEC issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the income tax effects of the TCJA. SAB 118 provides a measurement period that should not extend beyond one year from the TCJA enactment date for companies to complete the accounting relating to the TCJA under Accounting Standards Codification Topic 740, “Income Taxes” (“ASC 740”). In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the TCJA for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for TCJA-related income tax effects is incomplete, but the company is able to determine a reasonable estimate, it must record a provisional estimate in its financial statements. If a company cannot determine a provisional estimate to be included in its financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the TCJA.
We have not completed our analysis of the TCJA’s income tax effects; however, as described below, we have provided provisional estimates of the TCJA’s impact on our income tax expense for the three months ended February 28, 2018 in accordance with the guidance and interpretations available. In total, we recorded a non-cash charge of $111.2 million to income tax expense for TCJA-related impacts. In accordance with SAB 118, TCJA-related income tax effects initially reported as provisional estimates may be refined as additional analysis is completed based on obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enactment date. In addition, the provisional amounts may be affected by our results for the year ending November 30, 2018 as well as additional regulatory guidance or related interpretations that may be issued by the Internal Revenue Service (“IRS”), changes in accounting standards, or federal or state legislative actions. We anticipate finalizing our analysis within SAB 118’s one-year measurement period. The following provisional estimates of TCJA-related impacts were reflected in our financial statements for the three months ended February 28, 2018:

- We recorded a charge of $107.9 million in income tax expense due to the accounting re-measurement of our deferred tax assets based on the lower federal corporate income tax rate under the TCJA. However, we are still analyzing certain aspects of the TCJA and refining our calculations, which could potentially affect the measurement of our deferred tax assets or result in new deferred tax amounts.
- We have AMT credit carryforwards that do not expire and can be used to offset regular income taxes in future years. Under the TCJA, we may claim a refund of 50% of our remaining AMT credits in 2019, 2020, and 2021 to the extent the credits exceed regular tax for any such year. Any AMT credits remaining after our fiscal year ending November 30, 2021 will be refunded in 2022. We currently estimate our refund will total approximately $50.0 million. As the refund is subject to a sequestration reduction rate of approximately 6.6%, we established a federal deferred tax valuation allowance of $3.3 million during the three months ended February 28, 2018. Our accounting policy regarding the balance sheet presentation of the AMT credits is to maintain the balance in deferred tax assets until a tax return is filed claiming a refund of a portion of the credit, at which time the amount will be presented in receivables.

We evaluated the future deductibility of executive compensation due to the TCJA’s elimination of a federal tax law provision that permitted certain performance-based compensation to be deductible, as well as its modification of who is a covered employee with respect to the deduction limit, and a transition rule that would preserve the deductibility of certain 2018 performance-based compensation payable under written binding contracts in place prior to November 2, 2017 that have not been modified in any material respect. We are still analyzing the applicable aspects of the TCJA and anticipate that the IRS will provide future guidance in this area. Based on our analysis of the current transition rule standards, we did not record an impact for this change in tax law in our 2018 first quarter.
Income Tax Expense. Our income tax expense and effective tax rates were as follows (dollars in thousands):

	Three Months Ended February 28,	
	2018	2017
Income tax expense	$117,300	$7,200
Effective tax rate	254.8 %	33.6 %

Our income tax expense and effective tax rate for the three months ended February 28, 2018 included the above-described charge of $111.2 million for TCJA-related impacts; the favorable effect of the reduction in the federal corporate income tax rate under the TCJA; the favorable net impact of federal energy tax credits of $4.0 million that we earned from building energy efficient homes; and excess tax benefits of $2.2 million related to

stock-based compensation due to our adoption of ASU 2016-09, as further described in Note 1 – Basis of Presentation and Significant Accounting Policies. The TCJA requires us to use a blended federal tax rate for our 2018 fiscal year by applying a prorated percentage of days before and after the January 1, 2018 effective date. As a result, our 2018 annual federal statutory tax rate has been reduced to 22.2%. The federal energy

tax credits for the three months ended February 28, 2018 resulted from legislation enacted on February 9, 2018, which among other things, extended the availability of a business tax credit for building new energy efficient homes through December 31, 2017. Prior to this legislation, the tax credit expired on December 31, 2016.

Our income tax expense and effective tax rate for the three months ended February 28, 2017 included the favorable net impact of federal energy tax credits of $1.1 million that we earned from building energy efficient homes through December 31, 2016.

Excluding the TCJA-related charge of $111.2 million, our adjusted income tax expense and adjusted effective tax rate for the three months ended February 28, 2018 were $6.1 million and 13.2%, respectively. Without the above-mentioned federal energy tax credits and excess tax benefits, our adjusted effective tax rate for the three months ended February 28, 2018 would have approximated 27%.

Deferred Tax Asset Valuation Allowance. We evaluate our deferred tax assets quarterly to determine if adjustments to our valuation allowance are required based on the consideration of all available positive and negative evidence using a "more likely than not" standard with respect to whether deferred tax assets will be realized. Our evaluation considers, among other factors, our historical operating results, our expectation of future profitability, the duration of the applicable statutory carryforward periods, and conditions in the housing market and the broader economy. The ultimate realization of our deferred tax assets depends primarily on our ability to generate future taxable income during the periods in which the related deferred tax assets become deductible. The value of our deferred tax assets depends on applicable income tax rates.

Our deferred tax assets of $543.5 million as of February 28, 2018, after the above-described accounting re-measurement, and $657.2 million as of November 30, 2017 were partly offset by valuation allowances of $26.9 million and $23.6 million, respectively. As part of our analysis of the TCJA's income tax effects described above, we increased our deferred tax asset valuation allowance by $3.3 million during the three months ended February 28, 2018. The deferred tax asset valuation allowances as of February 28, 2018 and November 30, 2017 were primarily related to certain state net operating losses ("NOLs") that had not met the "more likely than not" realization standard at those dates. Based on our evaluation of our deferred tax assets as of February 28, 2018, we determined that most of our deferred tax assets would be realized. Therefore, other than the $3.3 million discussed above, no adjustments to our deferred tax valuation allowance were needed for the three months ended February 28, 2018.

We will continue to evaluate both the positive and negative evidence on a quarterly basis in determining the need for a valuation allowance with respect to our deferred tax assets. The accounting for deferred tax assets is based upon estimates of future results. Changes in positive and negative evidence, including differences between estimated and actual results, could result in changes in the valuation of our deferred tax assets that could have a material impact on our consolidated financial statements. Changes in existing federal and state tax laws and corporate income tax rates could also affect actual tax results and the realization of deferred tax assets over time.

Unrecognized Tax Benefits. At both February 28, 2018 and November 30, 2017, our gross unrecognized tax benefits (including interest and penalties) totaled $.1 million, all of which, if recognized, would affect our effective tax rate. We anticipate that these gross unrecognized tax benefits will decrease by an amount ranging from zero to $.1 million during the 12 months from this reporting date. The fiscal years ending 2014 and later remain open to federal examinations, while 2013 and later remain open to state examinations.

13. Notes Payable

Notes payable consisted of the following (in thousands):

	February 28, 2018	November 30, 2017
Mortgages and land contracts due to land sellers and other loans	$ 43,538	$ 10,203
7 1/4% Senior notes due June 15, 2018	299,924	299,867
4.75% Senior notes due May 15, 2019	398,663	398,397
8.00% Senior notes due March 15, 2020	346,614	346,238
7.00% Senior notes due December 15, 2021	446,791	446,608
7.50% Senior notes due September 15, 2022	347,355	347,234
7.625% Senior notes due May 15, 2023	247,811	247,726
1.375% Convertible senior notes due February 1, 2019	228,874	228,572
Total	$ 2,359,570	$ 2,324,845

The carrying amounts of our senior notes listed above are net of debt issuance costs and discounts, which totaled $14.0 million at February 28, 2018 and $15.4 million at November 30, 2017.

Unsecured Revolving Credit Facility. We have a $500.0 million unsecured revolving credit facility with various banks (“Credit Facility”) that will mature on July 27, 2021. The Credit Facility contains an uncommitted accordion feature under which the aggregate principal amount of available loans can be increased to a maximum of $600.0 million under certain conditions, including obtaining additional bank commitments. The Credit Facility also contains a sublimit of $250.0 million for the issuance of letters of credit, which may be utilized in combination with, or to replace, our cash-collateralized letter of credit facility with a financial institution (“LOC Facility”). Interest on amounts borrowed under the Credit Facility is payable at least quarterly in arrears at a rate based on either a Eurodollar or a base rate, plus a spread that depends on our consolidated leverage ratio (“Leverage Ratio”), as defined under the Credit Facility. The Credit Facility also requires the payment of a commitment fee at a per annum rate ranging from .30% to .45% of the unused commitment, based on our Leverage Ratio. Under the terms of the Credit Facility, we are required, among other things, to maintain compliance with various covenants, including financial covenants relating to our consolidated tangible net worth, Leverage Ratio, and either a consolidated interest coverage ratio (“Interest Coverage Ratio”) or minimum level of liquidity, each as defined therein. The amount of the Credit Facility available for cash borrowings or the issuance of letters of credit depends on the total cash borrowings and letters of credit outstanding under the Credit Facility and the maximum available amount under the terms of the Credit Facility. As of February 28, 2018, we had no cash borrowings and $36.9 million of letters of credit outstanding under the Credit Facility. Therefore, as of February 28, 2018, we had $463.1 million available for cash borrowings under the Credit Facility, with up to $213.1 million of that amount available for the issuance of letters of credit.

LOC Facility. We maintain the LOC Facility to obtain letters of credit from time to time in the ordinary course of operating our business. As of February 28, 2018 and November 30, 2017, we had no letters of credit outstanding under the LOC Facility.

Mortgages and Land Contracts Due to Land Sellers and Other Loans. As of February 28, 2018, inventories having a carrying value of $130.9 million were pledged to collateralize mortgages and land contracts due to land sellers and other loans.

Shelf Registration. We have an automatically effective universal shelf registration statement that was filed with the SEC on July 14, 2017 (“2017 Shelf Registration”). Issuances of securities under our 2017 Shelf Registration require the filing of a prospectus supplement identifying the amount and terms of the securities to be issued. Our ability to issue securities is subject to market conditions and other factors impacting our borrowing capacity.

Senior Notes. All of our senior notes outstanding at February 28, 2018 and November 30, 2017 represent senior unsecured obligations and rank equally in right of payment with all of our existing and future indebtedness. Interest on each of these senior notes is payable semi-annually. At any time prior to the close of business on the business day immediately preceding the maturity date, holders may convert all or any portion of our 1.375% Convertible Senior Notes due 2019. These notes are initially convertible into shares of our common stock at a conversion rate of 36.5297 shares for each $1,000 principal amount of the notes, which represents an initial conversion price of approximately $27.37 per share. This initial conversion rate equates to 8,401,831 shares of our common stock and is subject to

adjustment upon the occurrence of certain events, as described in the instruments governing these notes.

The indenture governing our senior notes does not contain any financial covenants. Subject to specified exceptions, the indenture contains certain restrictive covenants that, among other things, limit our ability to incur secured indebtedness, or engage in sale-leaseback transactions involving property or assets above a certain specified value. In addition, our senior notes, with the exception of our 7 1/4% senior notes due 2018 ("7 1/4% Senior Notes due 2018"), contain certain limitations related to mergers, consolidations, and sales of assets.

As of February 28, 2018, we were in compliance with the applicable terms of all our covenants and other requirements under the Credit Facility, the senior notes, the indenture, and the mortgages and land contracts due to land sellers and other loans. Our ability to access the Credit Facility for cash borrowings and letters of credit and our ability to secure future debt financing depend, in part, on our ability to remain in such compliance.

Principal payments on senior notes, mortgages and land contracts due to land sellers and other loans are due as follows: 2018 – $300.0 million; 2019 – $673.5 million; 2020 – $350.0 million; 2021 – $0; 2022 – $800.0 million; and thereafter – $250.0 million.

14. Fair Value Disclosures

Fair value measurements of assets and liabilities are categorized based on the following hierarchy:

Level 1	Fair value determined based on quoted prices in active markets for identical assets or liabilities.
Level 2	Fair value determined using significant observable inputs, such as quoted prices for similar assets or liabilities or quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data, by correlation or other means.
Level 3	Fair value determined using significant unobservable inputs, such as pricing models, discounted cash flows, or similar techniques.

Fair value measurements are used for inventories on a nonrecurring basis when events and circumstances indicate that their carrying value is not recoverable. The following table presents the fair value hierarchy, pre-impairment value, inventory impairment charges and fair value for our assets measured at fair value on a nonrecurring basis for the three months ended February 28, 2018 and the year ended November 30, 2017 (in thousands):

		February 28, 2018			November 30, 2017		
Description	Fair Value Hierarchy	Pre-Impairment Value	Inventory Impairment Charges	Fair Value (a)	Pre-Impairment Value	Inventory Impairment Charges	Fair Value (a)
Inventories	Level 3	$17,301	$ (4,699)	$12,602	$58,962	$ (20,605)	$38,357

(a) Amounts represent the aggregate fair value for real estate assets impacted by inventory impairment charges during the applicable period as of the date the fair value measurements were made. The carrying value for these real estate assets may have subsequently increased or decreased from the fair value reflected due to activity that has occurred since the measurement date.

The fair values for inventories that were determined using Level 3 inputs were based on the estimated future net cash flows discounted for inherent risk associated with each underlying asset.

The following table presents the fair value hierarchy, carrying values and fair values of our financial instruments, except those for which the carrying values approximate fair values (in thousands):

		February 28, 2018		November 30, 2017	
	Fair Value Hierarchy	Carrying Value (a)	Fair Value	Carrying Value (a)	Fair Value
Financial Liabilities:					
Senior notes	Level 2	$2,087,158	$2,235,750	$2,086,070	$2,292,250
Convertible senior notes	Level 2	228,874	253,575	228,572	278,300

(a) The carrying values for the senior notes and convertible senior notes, as presented, include unamortized debt issuance costs. Debt issuance costs are not factored into the estimated fair values of these notes.

The fair values of our senior notes and convertible senior notes are generally estimated based on quoted market prices for these instruments. The carrying values reported for cash and cash equivalents, and mortgages and land contracts due to land sellers and other loans approximate fair values. The carrying value of corporate-owned life insurance is based on the cash surrender value of the policies and, accordingly, approximates fair value.

15. Commitments and Contingencies

Commitments and contingencies include typical obligations of homebuilders for the completion of contracts and those incurred in the ordinary course of business.

Warranty. We provide a limited warranty on all of our homes. The specific terms and conditions of our limited warranty program vary depending upon the markets in which we do business. We generally provide a structural warranty of 10 years, a warranty on electrical, heating, cooling, plumbing and certain other building systems each varying from two to five years based on geographic market and state law, and a warranty of one year for other components of the home. Our limited warranty program is ordinarily how we respond to and account for homeowners' requests to local division offices seeking repairs of certain conditions or defects, including claims where we could have liability under applicable state statutes or tort law for a defective condition in or damages to a home. Our warranty liability covers our costs of repairs associated with homeowner claims made under our limited warranty program. These claims are generally made directly by a homeowner and involve their individual home.

We estimate the costs that may be incurred under each limited warranty and record a liability in the amount of such costs at the time the revenue associated with the sale of each home is recognized. Our primary assumption in estimating the amounts we accrue for warranty costs is that historical claims experience is a strong indicator of future claims experience. Factors that affect our warranty liability include the number of homes delivered, historical and anticipated rates of warranty claims, and cost per claim. We periodically assess the adequacy of our accrued warranty liability, which is included in accrued expenses and other liabilities in our consolidated balance sheets, and adjust the amount as necessary based on our assessment. Our assessment includes the review of our actual warranty costs incurred to identify trends and changes in our warranty claims experience, and considers our home construction quality and customer service initiatives and outside events. While we believe the warranty liability currently reflected in our consolidated balance sheets to be adequate, unanticipated changes or developments in the legal environment, local weather, land or environmental conditions, quality of materials or methods used in the construction of homes or customer service practices and/or our warranty claims experience could have a significant impact on our actual warranty costs in future periods and such amounts could differ significantly from our current estimates.

The changes in our warranty liability were as follows (in thousands):

	Three Months Ended February 28,	
	2018	2017
Balance at beginning of period	$69,798	$56,682
Warranties issued	7,764	7,140
Payments	(5,717)	(6,112)
Balance at end of period	$71,845	$57,710

Guarantees. In the normal course of our business, we issue certain representations, warranties and guarantees related to our home sales and land sales. Based on historical experience, we do not believe any potential liability with respect to these representations, warranties or guarantees would be material to our consolidated financial statements.
Self-Insurance. We maintain, and require the majority of our independent subcontractors to maintain, general liability insurance (including construction defect and bodily injury coverage) and workers' compensation insurance. These insurance policies protect us against a portion of our risk of loss from claims related to our homebuilding activities, subject to certain self-insured retentions, deductibles and other coverage limits. We also maintain certain other insurance policies. In Arizona, California, Colorado and Nevada, our subcontractors' general liability insurance primarily takes the form of a wrap-up policy under a program where eligible independent subcontractors are enrolled as insureds on each community. Enrolled subcontractors contribute toward the cost of the insurance and agree to pay a contractual amount in the future if there is a claim related to their work. To the extent provided under the wrap-up program, we absorb the enrolled subcontractors' general liability associated with the work performed on our homes within the applicable community as part of our overall general liability insurance and our self-insurance.
We self-insure a portion of our overall risk through the use of a captive insurance subsidiary, which provides coverage for our exposure to construction defect, bodily injury and property damage claims and related litigation or regulatory actions, up to certain limits. Our self-insurance liability generally covers our costs of settlements and/or repairs, if any, as well as our costs to defend and resolve the following types of claims:

- Construction defect: Construction defect claims, which represent the largest component of our self-insurance liability, typically originate through a legal or regulatory process rather than directly by a homeowner and involve the alleged occurrence of a condition affecting two or more homes within the same community, or they involve a common area or homeowners' association property within a community. These claims typically involve higher costs to resolve than individual homeowner warranty claims, and the rate of claims is highly variable.
- Bodily injury: Bodily injury claims typically involve individuals (other than our employees) who claim they were injured while on our property or as a result of our operations.
- Property damage: Property damage claims generally involve claims by third parties for alleged damage to real or personal property as a result of our operations. Such claims may occasionally include those made against us by owners of property located near our communities.

Our self-insurance liability at each reporting date represents the estimated costs of reported claims, claims incurred but not yet reported, and claim adjustment expenses. The amount of our self-insurance liability is based on an analysis performed by a third-party actuary that uses our historical claim and expense data, as well as industry data to estimate these overall costs. Key assumptions used in developing these estimates include claim frequencies, severities and resolution patterns, which can occur over an extended period of time. These estimates are subject to variability due to the length of time between the delivery of a home to a homebuyer and when a construction defect claim is made, and the ultimate resolution of such claim; uncertainties regarding such claims relative to our markets and the types of product we build; and legal or regulatory actions and/or interpretations, among other factors. Due to the degree of judgment involved and the potential for variability in these underlying assumptions, our actual future costs could differ from those estimated. In addition, changes in the frequency and severity of reported claims and the estimates to resolve claims can impact the trends and assumptions used in the actuarial analysis, which could be material to our consolidated financial statements. Though state regulations vary, construction defect claims are reported and resolved over a long period of time, which can extend for 10 years or more. As a result, the majority of the estimated self-insurance liability based on the actuarial analysis relates to claims incurred but not yet reported. Therefore, adjustments related to individual existing claims generally do not significantly impact the overall estimated liability. Adjustments to our liabilities related to homes delivered in prior years are recorded in the period in which a change in our estimate occurs.
Our self-insurance liability is presented on a gross basis without consideration of insurance recoveries and amounts we have paid on behalf of and expect to recover from other parties, if any. Estimated probable insurance and other recoveries of $71.2 million and $71.3 million are included in receivables in our consolidated balance sheets at February 28, 2018 and November 30, 2017, respectively. These self-insurance recoveries are principally based on actuarially determined amounts and depend on various factors, including, among other things, the above-described claim cost estimates, our insurance policy coverage limits for the applicable policy year(s), historical third-party

recovery rates, insurance industry practices, the regulatory environment, and legal precedent, and are subject to a high degree of variability from period to period. Because of the inherent uncertainty and variability in these assumptions, our actual insurance recoveries could differ significantly from amounts currently estimated.

The changes in our self-insurance liability were as follows (in thousands):

	Three Months Ended February 28,	
	2018	2017
Balance at beginning of period	$177,695	$158,584
Self-insurance expense (a)	4,401	4,640
Payments	(1,365)	(2,040)
Adjustments (b)	(36)	(1,302)
Balance at end of period	$180,695	$159,882

(a) These expenses are included in selling, general and administrative expenses and are largely offset by contributions from subcontractors participating in the wrap-up policy.

(b) The amount for each period reflects changes in our self-insurance liability that were offset by changes in the receivable for estimated probable insurance and other recoveries to present our self-insurance liability on a gross basis.

For most of our claims, there is no interaction between our warranty liability and self-insurance liability. Typically, if a matter is identified at its outset as either a warranty or self-insurance claim, it remains as such through its resolution. However, there can be instances of interaction between the liabilities, such as where individual homeowners in a community separately request warranty repairs to their homes to address a similar condition or issue and subsequently join together to initiate, or potentially initiate, a legal process with respect to that condition or issue and/or the repair work we have undertaken. In these instances, the claims and related repair work generally are initially covered by our warranty liability, and the costs associated with resolving the legal matter (including any additional repair work) are covered by our self-insurance liability.

The payments we make in connection with claims and related repair work, whether covered within our warranty liability and/or our self-insurance liability, may be recovered from our insurers to the extent such payments exceed the self-insured retentions or deductibles under our general liability insurance policies. Also, in certain instances, in the course of resolving a claim, we pay amounts in advance of and/or on behalf of a subcontractor(s) or their insurer(s) and believe we will be reimbursed for such payments. Estimates of all such amounts, if any, are recorded as receivables in our consolidated balance sheets when any such recovery is considered probable. Such receivables associated with our warranty and other claims totaled $4.0 million at February 28, 2018 and $4.1 million at November 30, 2017. We believe collection of these receivables is probable based on our history of collections for similar claims.

Northern California Claims. In the 2017 third quarter, we received claims from a homeowners' association alleging approximately $100.0 million of damages from purported construction defects at a completed townhome community in Northern California. We are investigating these allegations, and we currently expect it may take up to several quarters to fully evaluate them. At February 28, 2018, we had an accrual for our estimated probable loss in this matter and a receivable for estimated probable insurance recoveries. While it is reasonably possible that our loss could exceed the amount accrued, at this preliminary stage of our investigation into these allegations, we are unable to estimate the total amount of the loss in excess of the accrued amount that is reasonably possible. Our investigation will also involve identifying potentially responsible parties, including insurers, to pay for or perform any necessary repairs.

Performance Bonds and Letters of Credit. We are often required to provide to various municipalities and other government agencies performance bonds and/or letters of credit to secure the completion of our projects and/or in support of obligations to build community improvements such as roads, sewers, water systems and other utilities, and to support similar development activities by certain of our unconsolidated joint ventures. At February 28, 2018, we had $593.8 million of performance bonds and $36.9 million of letters of credit outstanding. At November 30, 2017, we had $606.7 million of performance bonds and $37.6 million of letters of credit outstanding. If any such performance bonds or letters of credit are called, we would be obligated to reimburse the issuer of the performance bond or letter of credit. We do not believe that a material amount of any currently outstanding performance bonds or letters of credit will be called. Performance bonds do not have stated expiration dates. Rather, we are released from the performance bonds as the underlying performance is completed. The expiration dates of some letters of credit issued

in connection with community improvements coincide with the expected completion dates of the related projects or obligations. Most letters of credit, however, are issued with an initial term of one year and are typically extended on a year-to-year basis until the related performance obligations are completed.
Land Option Contracts and Other Similar Contracts. In the ordinary course of our business, we enter into land option contracts and other similar contracts to acquire rights to land for the construction of homes. At February 28, 2018, we had total cash

deposits of $44.6 million to purchase land having an aggregate purchase price of $929.2 million. Our land option contracts and other similar contracts generally do not contain provisions requiring our specific performance.

16. Legal Matters

We are involved in litigation and regulatory proceedings incidental to our business that are in various procedural stages. We believe that the accruals we have recorded for probable and reasonably estimable losses with respect to these proceedings are adequate and that, as of February 28, 2018, it was not reasonably possible that an additional material loss had been incurred in an amount in excess of the estimated amounts already recognized or disclosed in our consolidated financial statements. We evaluate our accruals for litigation and regulatory proceedings at least quarterly and, as appropriate, adjust them to reflect (a) the facts and circumstances known to us at the time, including information regarding negotiations, settlements, rulings and other relevant events and developments; (b) the advice and analyses of counsel; and (c) the assumptions and judgment of management. Similar factors and considerations are used in establishing new accruals for proceedings as to which losses have become probable and reasonably estimable at the time an evaluation is made. Based on our experience, we believe that the amounts that may be claimed or alleged against us in these proceedings are not a meaningful indicator of our potential liability. The outcome of any of these proceedings, including the defense and other litigation-related costs and expenses we may incur, however, is inherently uncertain and could differ significantly from the estimate reflected in a related accrual, if made. Therefore, it is possible that the ultimate outcome of any proceeding, if in excess of a related accrual or if an accrual had not been made, could be material to our consolidated financial statements.

17. Stockholders' Equity

A summary of changes in stockholders' equity is presented below (in thousands):

	Three Months Ended February 28, 2018									
	Number of Shares									
	Common Stock	Grantor Stock Ownership Trust	Treasury Stock	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Grantor Stock Ownership Trust	Treasury Stock	Total Stockholders' Equity
Balance at November 30, 2017	117,946	(8,898)	(22,021)	$117,946	$727,483	$1,735,695	$(16,924)	$(96,509)	$(541,380)	$1,926,311
Net loss	—	—	—	—	—	(71,255)	—	—	—	(71,255)
Dividends on common stock	—	—	—	—	—	(2,322)	—	—	—	(2,322)
Employee stock options/other	268	—	—	268	2,678	—	—	—	—	2,946
Stock awards	—	438	(10)	—	(4,551)	—	—	4,749	(198)	—
Stock-based compensation	—	—	—	—	3,829	—	—	—	—	3,829
Stock repurchases	—	—	(217)	—	—	—	—	—	(6,787)	(6,787)
Balance at February 28, 2018	118,214	(8,460)	(22,248)	$118,214	$729,439	$1,662,118	$(16,924)	$(91,760)	$(548,365)	$1,852,722

We maintain 12,602,735 shares of our common stock to meet conversions of our 1.375% Convertible Senior Notes due 2019 if and when they occur. This represents the maximum number of shares of our common stock potentially deliverable upon conversion to holders of our 1.375% Convertible Senior Notes due 2019 based on the terms of their governing instruments. The maximum number of shares would potentially be deliverable to holders only in certain limited circumstances as set forth in the instruments governing these notes.

On February 14, 2018, the management development and compensation committee of our board of directors approved the payout of 437,689 shares of our common stock in connection with the vesting of PSUs that were granted to certain

employees on October 9, 2014. The shares paid out under the PSUs reflected our achievement of certain performance measures that were based on average return on invested capital and cumulative earnings per share, and revenue growth relative to a peer group of high-production public homebuilding companies over the three-year period from December 1, 2014 through November 30, 2017. Of the shares of common stock paid out, 217,006 shares or $6.8 million, were purchased by us to satisfy the recipients' withholding taxes on the vesting of the PSUs. The shares purchased were not considered repurchases under the authorizations described below.
As of February 28, 2018, we were authorized to repurchase 1,627,000 shares of our common stock under a board of directors approved share repurchase program. We did not repurchase any of our common stock under this program in the three months ended February 28, 2018.

Unrelated to the share repurchase program, our board of directors authorized in 2014 the repurchase of not more than 680,000 shares of our outstanding common stock solely as necessary for director compensation elections with respect to settling outstanding stock appreciation rights awards granted under our Non-Employee Directors Compensation Plan. As of February 28, 2018, we have not repurchased any shares pursuant to the board of directors authorization.
During each of the three-month periods ended February 28, 2018 and 2017, our board of directors declared, and we paid, a quarterly cash dividend of $.025 per share of common stock.

18. Stock-Based Compensation

Stock Options. We estimate the grant-date fair value of stock options using the Black-Scholes option-pricing model. The following table summarizes stock option transactions for the three months ended February 28, 2018:

	Options	Weighted Average Exercise Price
Options outstanding at beginning of period	9,265,240	$ 17.64
Granted	—	—
Exercised	(268,954)	10.96
Cancelled	(16,208)	15.47
Options outstanding at end of period	8,980,078	$ 17.85
Options exercisable at end of period	8,038,678	$ 18.09

As of February 28, 2018, the weighted average remaining contractual life of stock options outstanding and stock options exercisable was 4.1 years and 3.6 years, respectively. There was $.7 million of total unrecognized compensation expense related to unvested stock option awards as of February 28, 2018 that is expected to be recognized over a weighted average period of 1.1 years. For the three months ended February 28, 2018 and 2017, stock-based compensation expense associated with stock options totaled $.2 million and $.8 million, respectively. The aggregate intrinsic values of stock options outstanding and stock options exercisable were $103.8 million and $92.5 million, respectively, at February 28, 2018. (The intrinsic value of a stock option is the amount by which the market value of a share of the underlying common stock exceeds the exercise price of the stock option.)
Other Stock-Based Awards. From time to time, we grant restricted stock and PSUs to various employees as a compensation benefit. We recognized total compensation expense of $3.7 million and $2.3 million for the three months ended February 28, 2018 and 2017, respectively, related to restricted stock and PSUs.

19. Supplemental Disclosure to Consolidated Statements of Cash Flows

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

	Three Months Ended February 28,	
	2018	2017
Summary of cash and cash equivalents at end of period:		
Homebuilding	$560,255	$351,880
Financial services	551	570
Total	$560,806	$352,450
Supplemental disclosures of cash flow information:		
Interest paid, net of amounts capitalized	$(10,981)	$(9,536)
Income taxes paid	1,639	836

	Three Months Ended February 28,	
	2018	2017
Supplemental disclosures of noncash activities:		
Increase (decrease) in consolidated inventories not owned	$8,466	$(22,554)
Increase in inventories due to distributions of land and land development from an unconsolidated joint venture	2,699	1,986
Inventories acquired through seller financing	36,697	7,814

20. Supplemental Guarantor Information

Our obligations to pay principal, premium, if any, and interest on the senior notes and borrowings, if any, under the Credit Facility are guaranteed on a joint and several basis by certain of our subsidiaries (“Guarantor Subsidiaries”). The guarantees are full and unconditional and the Guarantor Subsidiaries are 100% owned by us. Pursuant to the terms of the indenture governing the senior notes and the terms of the Credit Facility, if any of the Guarantor Subsidiaries ceases to be a “significant subsidiary” as defined by Rule 1-02 of Regulation S-X (as in effect on June 1, 1996) using a 5% rather than a 10% threshold (provided that the assets of our non-guarantor subsidiaries do not in the aggregate exceed 10% of an adjusted measure of our consolidated total assets), it will be automatically and unconditionally released and discharged from its guaranty of the senior notes and the Credit Facility so long as all guarantees by such Guarantor Subsidiary of any other of our or our subsidiaries’ indebtedness are terminated at or prior to the time of such release. We have determined that separate, full financial statements of the Guarantor Subsidiaries would not be material to investors and, accordingly, supplemental financial information for the Guarantor Subsidiaries is presented. The supplemental financial information for all periods presented below reflects the relevant subsidiaries that were Guarantor Subsidiaries as of February 28, 2018.

Condensed Consolidating Statements of Operations (in thousands)

	Three Months Ended February 28, 2018				
	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Total revenues	$—	$775,695	$ 95,928	$ —	$871,623
Homebuilding:					
Revenues	$—	$775,695	$ 93,510	$ —	$869,205
Construction and land costs	—	(648,119)	(81,359)	—	(729,478)
Selling, general and administrative expenses	(22,166)	(65,841)	(7,717)	—	(95,724)
Operating income (loss)	(22,166)	61,735	4,434	—	44,003
Interest income	998	5	—	—	1,003
Interest expense	(37,972)	(689)	(1,283)	39,944	—
Intercompany interest	72,846	(30,499)	(2,403)	(39,944)	—
Equity in loss of unconsolidated joint ventures	—	(845)	—	—	(845)
Homebuilding pretax income	13,706	29,707	748	—	44,161
Financial services pretax income	—	—	1,884	—	1,884
Total pretax income	13,706	29,707	2,632	—	46,045
Income tax expense	(44,700)	(48,100)	(24,500)	—	(117,300)
Equity in net loss of subsidiaries	(40,261)	—	—	40,261	—
Net loss	$(71,255)	$(18,393)	$ (21,868)	$ 40,261	$(71,255)

	Three Months Ended February 28, 2017				
	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Total revenues	$—	$ 729,927	$ 88,669	$ —	$ 818,596
Homebuilding:					
Revenues	$—	$ 729,927	$ 86,319	$ —	$ 816,246
Construction and land costs	—	(618,452)	(79,628)	—	(698,080)
Selling, general and administrative expenses	(22,267)	(62,898)	(7,724)	—	(92,889)
Operating income (loss)	(22,267)	48,577	(1,033)	—	25,277
Interest income	197	1	—	—	198
Interest expense	(48,349)	(568)	(1,162)	43,772	(6,307)
Intercompany interest	73,493	(26,603)	(3,118)	(43,772)	—
Equity in income of unconsolidated joint ventures	—	731	—	—	731
Homebuilding pretax income (loss)	3,074	22,138	(5,313)	—	19,899
Financial services pretax income	—	—	1,560	—	1,560
Total pretax income (loss)	3,074	22,138	(3,753)	—	21,459
Income tax benefit (expense)	1,300	(8,800)	300	—	(7,200)
Equity in net income of subsidiaries	9,885	—	—	(9,885)	—
Net income (loss)	$ 14,259	$ 13,338	$ (3,453)	$ (9,885)	$ 14,259

Condensed Consolidating Balance Sheets (in thousands)

	February 28, 2018				
	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Assets					
Homebuilding:					
Cash and cash equivalents	$455,629	$72,731	$ 31,895	$—	$560,255
Receivables	4,309	170,217	75,946	—	250,472
Inventories	—	3,100,304	341,270	—	3,441,574
Investments in unconsolidated joint ventures	—	65,672	2,504	—	68,176
Deferred tax assets, net	206,206	195,606	114,757	—	516,569
Other assets	97,950	8,109	2,439	—	108,498
	764,094	3,612,639	568,811	—	4,945,544
Financial services	—	—	11,557	—	11,557
Intercompany receivables	3,461,046	—	120,795	(3,581,841)	—
Investments in subsidiaries	84,467	—	—	(84,467)	—
Total assets	$4,309,607	$3,612,639	$ 701,163	$(3,666,308)	$4,957,101
Liabilities and stockholders' equity					
Homebuilding:					
Accounts payable, accrued expenses and other liabilities	$136,816	$364,322	$ 242,774	$—	$743,912
Notes payable	2,290,922	43,541	25,107	—	2,359,570
	2,427,738	407,863	267,881	—	3,103,482
Financial services	—	—	897	—	897
Intercompany payables	29,147	3,175,070	377,624	(3,581,841)	—
Stockholders' equity	1,852,722	29,706	54,761	(84,467)	1,852,722
Total liabilities and stockholders' equity	$4,309,607	$3,612,639	$ 701,163	$(3,666,308)	$4,957,101

	November 30, 2017				
	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Assets					
Homebuilding:					
Cash and cash equivalents	$575,193	$102,661	$ 42,776	$—	$720,630
Receivables	24,815	144,076	75,322	—	244,213
Inventories	—	2,929,466	333,920	—	3,263,386
Investments in unconsolidated joint ventures	—	62,290	2,504	—	64,794
Deferred tax assets, net	250,747	243,523	139,367	—	633,637
Other assets	91,592	8,424	2,482	—	102,498
	942,347	3,490,440	596,371	—	5,029,158
Financial services	—	—	12,357	—	12,357
Intercompany receivables	3,414,237	—	107,992	(3,522,229)	—
Investments in subsidiaries	49,776	—	—	(49,776)	—
Total assets	$4,406,360	$3,490,440	$ 716,720	$(3,572,005)	$5,041,515
Liabilities and stockholders' equity					
Homebuilding:					
Accounts payable, accrued expenses and other liabilities	$163,984	$371,909	$ 253,500	$—	$789,393
Notes payable	2,289,532	9,283	26,030	—	2,324,845
	2,453,516	381,192	279,530	—	3,114,238
Financial services	—	—	966	—	966
Intercompany payables	26,533	3,109,248	386,448	(3,522,229)	—
Stockholders' equity	1,926,311	—	49,776	(49,776)	1,926,311
Total liabilities and stockholders' equity	$4,406,360	$3,490,440	$ 716,720	$(3,572,005)	$5,041,515

Condensed Consolidating Statements of Cash Flows (in thousands)

	Three Months Ended February 28, 2018				
	KB Home Corporate	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Total
Net cash provided by (used in) operating activities	$3,066	$(134,364)	$ (10,382)	$ —	