

HOVNANIAN ENTERPRISES INC  
Form 10-Q  
September 04, 2009  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

For quarterly period ended JULY 31, 2009

OR

Transition report pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

Commission file number 1-8551

Hovnanian Enterprises, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	22-1851059
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

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

(Address of Principal Executive Offices) (Zip Code)

732-747-7800

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(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 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 the latest practicable date. 62,649,376 shares of Class A Common Stock and 14,574,819 shares of Class B Common Stock were outstanding as of September 1, 2009.

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

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  (Do not check if smaller reporting company) Smaller Reporting Company

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HOVNIANIAN ENTERPRISES, INC.

FORM 10-Q

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share Amounts)

	July 31, 2009 (unaudited)	October 31, 2008 (1)
<b>ASSETS</b>		
Homebuilding:		
Cash and cash equivalents	\$545,591	\$838,207
Restricted cash and cash equivalents	19,688	4,324
Inventories - at the lower of cost or fair value:		
Sold and unsold homes and lots under development	760,781	1,342,584
Land and land options held for future development or sale	464,980	644,067
Consolidated inventory not owned:		
Specific performance options	31,554	10,610
Variable interest entities	43,141	77,022
Other options	46,465	84,799
Total consolidated inventory not owned	121,160	172,431
Total inventories	1,346,921	2,159,082
Investments in and advances to unconsolidated joint ventures	35,622	71,097
Receivables, deposits, and notes	62,994	78,766
Property, plant, and equipment - net	79,595	92,817
Prepaid expenses and other assets	123,915	156,595
Total homebuilding	2,214,326	3,400,888
Financial services:		
Cash and cash equivalents	5,538	9,849
Restricted cash	2,627	4,005
Mortgage loans held for sale or investment	60,287	90,729
Other assets	2,672	5,025
Total financial services	71,124	109,608
Income taxes receivable - including net deferred tax benefits	-	126,826
Total assets	\$2,285,450	\$3,637,322

(1) Derived from the audited balance sheet as of October 31, 2008.

See notes to condensed consolidated financial statements (unaudited).

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share Amounts)

	July 31, 2009 (unaudited)	October 31, 2008 (1)
<b>LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY</b>		
Homebuilding:		
Nonrecourse land mortgages	\$ -	\$820
Accounts payable and other liabilities	313,883	420,695
Customers deposits	25,669	28,676
Nonrecourse mortgages secured by operating properties	21,711	22,302
Liabilities from inventory not owned	80,882	135,077
Total homebuilding	442,145	607,570
Financial services:		
Accounts payable and other liabilities	8,887	10,559
Mortgage warehouse line of credit	49,820	84,791
Total financial services	58,707	95,350
Notes payable:		
Senior secured notes	624,705	594,734
Senior notes	970,605	1,511,071
Senior subordinated notes	173,495	400,000
Accrued interest	28,977	72,477
Total notes payable	1,797,782	2,578,282
Income tax payable	60,428	-
Total liabilities	2,359,062	3,281,202
Minority interest related to inventory not owned	30,183	24,880
Minority interest in consolidated joint ventures	732	976
Stockholders (deficit) equity:		
Preferred stock, \$.01 par value - authorized 100,000 shares; issued 5,600 shares at July 31, 2009 and at October 31, 2008 with a liquidation preference of \$140,000	135,299	135,299
Common stock, Class A, \$.01 par value authorized 200,000,000 shares; issued 74,344,096 shares at July 31, 2009 and 73,803,879 shares at October 31, 2008 (including 11,694,720 shares at July 31, 2009 and October 31, 2008 held in Treasury)	743	738
Common stock, Class B, \$.01 par value (convertible to Class A at time of sale) authorized 30,000,000 shares; issued 15,266,567 shares at July 31, 2009 and 15,331,494 shares at October 31, 2008 (including 691,748 shares at July 31, 2009 and October 31, 2008 held in Treasury)	153	153
Paid in capital - common stock	449,773	418,626

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Accumulated deficit	(575,238)	(109,295)
Treasury stock - at cost	(115,257)	(115,257)
Total stockholders (deficit) equity	(104,527)	330,264
Total liabilities and stockholders (deficit) equity	\$2,285,450	\$3,637,322

(1) Derived from the audited balance sheet as of October 31, 2008.

See notes to condensed consolidated financial statements (unaudited).

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## HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands Except Per Share Data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	July 31, 2009	2008	July 31, 2009	2008
Revenues:				
Homebuilding:				
Sale of homes	\$367,141	\$692,690	\$1,107,891	\$2,500,192
Land sales and other revenues	11,044	9,750	24,731	45,863
Total homebuilding	378,185	702,440	1,132,622	2,546,055
Financial services	8,929	14,101	26,275	40,626
Total revenues	387,114	716,541	1,158,897	2,586,681
Expenses:				
Homebuilding:				
Cost of sales, excluding interest	337,869	635,533	1,029,693	2,345,942
Cost of sales interest	24,621	35,473	73,790	98,633
Inventory impairment loss and land option write-offs	101,130	110,933	521,505	446,961
Total cost of sales	463,620	781,939	1,624,988	2,891,536
Selling, general and administrative	55,264	90,004	187,130	287,819
Total homebuilding	518,884	871,943	1,812,118	3,179,355
Financial services	6,345	8,234	19,568	27,554
Corporate general and administrative	15,494	20,481	64,763	62,166
Other interest	23,942	10,655	66,696	11,657
Other operations	1,957	3,368	8,550	6,658
Intangible amortization	-	293	-	1,520
Total expenses	566,622	914,974	1,971,695	3,288,910
Gain on extinguishment of debt	37,016	-	427,804	-
Loss from unconsolidated joint ventures	(5,537)	(920)	(38,220)	(9,356)
Loss before income taxes	(148,029)	(199,353)	(423,214)	(711,585)
State and federal income tax provision (benefit):				
State	1,542	1,476	23,318	15,700
Federal	19,341	1,648	19,411	(53,154)
Total taxes	20,883	3,124	42,729	(37,454)
Net loss	\$(168,912)	\$(202,477)	\$(465,943)	\$(674,131)
Per share data:				



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Basic and assuming dilution:				
Loss per common share	\$(2.16)	\$(2.67)	\$(5.96)	\$(9.98)
Weighted average number of common shares outstanding	78,065	75,723	78,208	67,574

See notes to condensed consolidated financial statements (unaudited).

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HOVNIANIAN ENTERPRISES, INC. AND  
SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF  
STOCKHOLDERS (DEFICIT) EQUITY

(In Thousands Except Share Amounts)

(unaudited)

	A Common Stock		B Common Stock		Preferred Stock		Paid-In Capital	Accumulated Deficit	Treasury Stock	Total
	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount				
Balance, November 1, 2008	62,109,159	\$738	14,639,746	\$153	5,600	\$135,299	\$418,626	\$(109,295)	\$(115,257)	\$330,264
Stock options amortization and issuances, net of tax							3,851			3,851
Stock option cancellations							12,269			12,269
Restricted stock amortization, issuances and forfeitures, net of tax	475,290	5					15,027			15,032
Conversion of Class B to Class A Common Stock	64,927		(64,927)							-
Net loss								(465,943)		(465,943)
Balance, July 31, 2009	62,649,376	\$743	14,574,819	\$153	5,600	\$135,299	\$449,773	\$(575,238)	\$(115,257)	\$(104,527)

See notes to condensed consolidated financial statements (unaudited).

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HOVNIANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(unaudited)

	Nine Months Ended	
	July 31,	
	2009	2008
<b>Cash flows from operating activities:</b>		
Net loss	\$(465,943)	\$(674,131)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	13,114	13,603
Intangible amortization	-	1,520
Compensation from stock options and awards	10,968	11,729
Stock option cancellations	12,269	-
Amortization of bond discounts and deferred financing costs	915	490
Excess tax payments from share-based payment	-	2,287
Loss (gain) on sale and retirement of property and assets	320	(2,304)
Loss from unconsolidated joint ventures	38,220	9,356
Distributions of earnings from unconsolidated joint ventures	2,418	4,831
Gain on extinguishment of debt	(427,804)	-
Deferred income taxes	-	105,302
Impairment and land option write-offs	521,505	446,961
Decrease (increase) in assets:		
Mortgage notes receivable	30,458	91,562
Restricted cash, receivables, prepaids, deposits and other assets	36,035	61,929
Inventories	272,123	426,761
State and Federal income tax assets	126,826	(46,644)
(Decrease) increase in liabilities:		
State and Federal income tax liability	60,428	-
Customers deposits	(3,007)	(21,873)
Accounts payable, interest and other accrued liabilities	(174,230)	(143,975)
Net cash provided by operating activities	54,615	287,404
<b>Cash flows from investing activities:</b>		
Net proceeds from sale of property and assets	1,009	3,539
Purchase of property, equipment and other fixed assets and acquisitions	(552)	(4,224)
Investments in and advances to unconsolidated joint ventures	(9,637)	(14,793)
Distributions of capital from unconsolidated joint ventures	4,596	13,005
Net cash used in investing activities	(4,584)	(2,473)
<b>Cash flows from financing activities:</b>		
(Payments) proceeds from mortgages and notes	(1,864)	94
Net proceeds from senior secured notes (including deferred financing costs)	-	572,623
Net proceeds related to revolving credit agreement (includes deferred financing costs)	-	(215,780)
Net payments related to mortgage warehouse line of credit	(34,971)	(87,991)
Deferred financing costs from note issuances	(3,987)	-
Principal payments and debt repurchases	(306,136)	(9,237)
Excess tax payments from share-based payment	-	(2,287)
Net proceeds from sale of stock and employee stock plan	-	127,079
Net cash (used in) provided by financing activities	(346,958)	384,501

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Net (decrease) increase in cash and cash equivalents	(296,927)	669,432
Cash and cash equivalents balance, beginning of period	848,056	16,233
Cash and cash equivalents balance, end of period	\$551,129	\$685,665

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands - Unaudited)

(Continued)

	Nine Months Ended July 31, 2009	2008
Supplemental disclosures of cash flow:		
Cash paid (received) during the period for:		
Interest, net of capitalized interest	\$181,136	\$115,363
Income taxes	\$(145,437)	\$(95,976)

Supplemental disclosure of noncash financing activities:

In the first quarter of fiscal 2009, the Company issued \$29.3 million of 18.0% Senior Secured Notes due 2017 in exchange for \$71.4 million of unsecured senior notes.

See notes to condensed consolidated financial statements (unaudited).

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## HOVNIANIAN ENTERPRISES, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

Hovnianian Enterprises, Inc. ( the Company , the Parent , we , us or our ) has reportable segments consisting of six Homebuilding segments (Northeast, Mid-Atlantic, Midwest, Southeast, Southwest and West) and the Financial Services segment (see Note 15).

The accompanying unaudited Condensed Consolidated Financial Statements include our accounts and those of all wholly-owned subsidiaries after elimination of all intercompany balances and transactions. Certain prior year amounts have been reclassified to conform to the current year presentation.

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments for interim periods presented have been made, which include normal recurring accruals and deferrals necessary for a fair presentation of our consolidated financial position, results of operations, and cash flows. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and these differences could have a significant impact on the financial statements. Results for interim periods are not necessarily indicative of the results which might be expected for a full year. The balance sheet at October 31, 2008 has been derived from the audited Consolidated Financial Statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. In preparing these financial statements, the Company has evaluated subsequent events and transactions for potential recognition or disclosure through September 4, 2009, the date the financial statements were filed with the Securities and Exchange Commission.

2. For the three and nine months ended July 31, 2009, the Company s total stock-based compensation expense was \$2.0 million (net of tax) and \$23.2 million (net of tax), respectively. Included in this total stock-based compensation expense was the vesting of stock options of \$0.7 million (net of tax) and \$16.1 million (net of tax) for the three and nine months ended July 31, 2009, respectively. Included in the three and nine months ended July 31, 2009 is a \$0.8 million adjustment for the change in our estimated forfeiture rate. Also, included in the nine months ended July 31, 2009 is \$12.3 million (net of tax) for stock option cancellations that occurred in the first quarter of fiscal 2009. The Chief Executive Officer, Chief Financial Officer and each of the non-executive members of the Board of Directors consented to the cancellation of certain of their options (with the full understanding that the Company made no commitment to provide them with any other form of consideration in respect to the cancelled options) in order to reduce a portion of the equity reserve overhang under the Company s equity compensation plans represented by the number of shares of the Company s common stock remaining available for future issuance under such plans (including shares that may be issued upon the exercise or vesting of outstanding options and other rights).

3. Interest costs incurred, expensed and capitalized were:

(In thousands)	Three Months Ended		Nine Months Ended	
	July 31, 2009	2008	July 31, 2009	2008
Interest capitalized at beginning of period	\$179,282	\$177,602	\$170,107	\$155,642
Plus interest incurred (1)	43,944	51,268	145,042	137,390
Less cost of sales interest expensed	(24,621)	(35,473)	(73,790)	(98,633)
Less other interest expensed (2)	(23,942)	(10,655)	(66,696)	(11,657)
Interest capitalized at				

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end of period (3)	\$174,663	\$182,742	\$174,663	\$182,742
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(1) Data does not include interest incurred by our mortgage and finance subsidiaries.

(2) Beginning in the third quarter of fiscal 2008, our assets that qualify for interest capitalization (inventory

under development) no longer exceed our debt, and therefore the portion of interest not covered by qualifying assets must be directly expensed. In addition, interest on completed homes and land in planning, which does not qualify for capitalization is expensed as incurred.

(3) We have incurred significant inventory impairments in recent years, which are determined based on

total inventory including capitalized interest. However, the capitalized interest amounts shown above are gross amounts before allocating any portion of the impairments to capitalized interest.

4. Accumulated depreciation at July 31, 2009 and October 31, 2008 amounted to \$79.7 million and \$70.5 million, respectively, for our homebuilding property, plant and equipment.

5. In accordance with Financial Accounting Standards Board Statement No. 144 ("SFAS 144"), *Accounting for the Impairment or Disposal of Long Lived Assets*, we record impairment losses on inventories related to communities under development and held for future development when events and circumstances indicate that they may be impaired and the undiscounted cash flows estimated to be generated by those assets are less than their related carrying amounts. If the expected undiscounted cash flows are less than the carrying amount, then the community is written down to its fair value. We estimated the fair value of each impaired community by determining the present value of the estimated future cash flows at a discount rate commensurate with the risk of the respective community. For the nine months ended July 31, 2009, our discount rates used for the impairments recorded range from 14.3% to 20.3%. Should the estimates or expectations used in determining cash flows or fair value decrease or differ from current estimates in the future, we may be required to recognize additional impairments. As a result of a continued decline in sales price and general market conditions, we recorded inventory impairments, for the three months ended July 31, 2009 and 2008, of \$94.6 million and \$80.2 million, respectively, and for the nine months ended July 31, 2009 and 2008, of \$491.4 million and \$380.4 million, respectively, each of which are presented in the Condensed Consolidated Statements of Operations as part of Inventory impairment loss and land option write-offs and deducted from inventories as presented in the Condensed Consolidated Balance Sheets.

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The following table represents inventory impairments by homebuilding segment for the three and nine months ended July 31, 2009 and 2008:

(Dollars in millions)	Three Months Ended July 31, 2009			Three Months Ended July 31, 2008		
		Dollar	Pre-		Dollar	Pre-
	Number of Communities	Amount of Impairment	Value(1)	Number of Communities	Amount of Impairment	Value(1)
Northeast	5	\$20.3	\$65.9	-	\$ -	\$ -
Mid-Atlantic	9	14.5	36.5	16	20.4	74.1
Midwest	4	1.4	5.0	-	-	-
Southeast	17	2.8	11.8	17	16.7	34.4
Southwest	7	6.0	21.3	13	21.8	59.6
West	9	49.6	72.7	18	21.3	63.8
<b>Total</b>	<b>51</b>	<b>\$94.6</b>	<b>\$213.2</b>	<b>64</b>	<b>\$80.2</b>	<b>\$231.9</b>

(Dollars in millions)	Nine Months Ended July 31, 2009			Nine Months Ended July 31, 2008		
		Dollar	Pre-		Dollar	Pre-
	Number of Communities	Amount of Impairment	Value(1)	Number of Communities	Amount of Impairment	Value(1)
Northeast	24	\$181.9	\$392.7	6	\$14.7	\$105.8
Mid-Atlantic	46	40.8	131.8	22	32.0	125.6
Midwest	8	5.4	17.0	4	5.6	20.2
Southeast	73	28.3	94.1	29	34.5	106.2
Southwest	41	32.4	84.4	24	44.0	117.4
West	49	202.6	372.2	55	249.6	744.0
<b>Total</b>	<b>241</b>	<b>\$491.4</b>	<b>\$1,092.2</b>	<b>140</b>	<b>\$380.4</b>	<b>\$1,219.2</b>

(1) Represents carrying value, net of prior period impairments, if any, at the time of recording

the applicable period's impairments.

The Condensed Consolidated Statements of Operations line entitled "Inventory impairment loss and land option write-offs" also includes write-offs of capitalized approval, engineering and interest costs that we record when we redesign communities and/or abandon certain engineering costs or the write-off of the deposit when we do not intend to exercise options ( walk-away ) in various locations because the communities' projected profitability will not produce adequate returns on investment commensurate with the risk. The total aggregate write-offs were \$6.5 million and \$30.8 million for the three months ended July 31, 2009 and 2008, respectively, and \$30.1 million and \$66.6 million for the nine months ended July 31, 2009 and 2008, respectively.

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The following table represents write-offs of such costs and the related number of lots by homebuilding segment for the three and nine months ended July 31, 2009 and 2008:

(Dollars in millions)	Three Months Ended				Nine Months Ended			
	July 31, 2009		2008		July 31, 2009		2008	
	Number of Walk-Away Lots	Dollar Amount of Write-Offs	Number of Walk-Away Lots	Dollar Amount of Write-Offs	Number of Walk-Away Lots	Dollar Amount of Write-Offs	Number of Walk-Away Lots	Dollar Amount of Write-Offs
Northeast	78	\$3.2	121	\$4.4	684	\$9.7	574	\$9.2
Mid-Atlantic	4	(0.3)	1,703	19.8	1,906	8.2	4,231	35.6
Midwest	64	-	257	0.7	222	1.4	257	0.7
Southeast	-	-	1,299	5.1	153	(0.1)	3,053	12.1
Southwest	121	3.6	173	0.4	879	10.3	603	4.9
West	158	-	180	0.4	158	0.6	419	4.1
Total	425	\$6.5	3,733	\$30.8	4,002	\$30.1	9,137	\$66.6

As a result of the declining homebuilding market, we have decided to mothball (or stop development on) certain communities in some of our segments where we have determined the current performance does not justify further investment at this time. When we decide to mothball a community, the inventory is reclassified from Sold and unsold homes and lots under development to Land and land options held for future development or sale. During the third quarter of fiscal 2009, we mothballed nine communities with a net book value of \$43.0 million, net of an impairment reserve balance of \$15.8 million. Also during the third quarter of fiscal 2009, we sold four previously mothballed communities and re-activated four previously mothballed communities, which combined had a net book value of \$11.8 million, net of an impairment reserve balance of \$23.3 million. As of July 31, 2009, the net book value associated with our 77 total mothballed communities was \$376.3 million, net of an impairment reserve balance of \$509.1 million.

6. We establish a warranty accrual for repair costs under \$5,000 per occurrence to homes, community amenities and land development infrastructure. We accrue for warranty costs as part of cost of sales at the time each home is closed and title and possession have been transferred to the homebuyer. In addition, we accrue for warranty costs over \$5,000 per occurrence as part of our general liability insurance deductible, which is expensed as selling, general and administrative costs. For homes delivered in fiscal 2009 and 2008, our deductible under our general liability insurance is \$20 million per occurrence with an aggregate \$20 million for liability claims and an aggregate \$21.5 million for construction defect claims. Additions and charges in the warranty reserve and general liability accrual for the three and nine months ended July 31, 2009 and 2008 were as follows:

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(In thousands)	Three Months Ended		Nine Months Ended	
	July 31, 2009	2008	July 31, 2009	2008
Balance, beginning of period	\$118,887	\$123,566	\$125,738	\$120,653
Additions	21,610	15,504	42,657	50,311
Charges incurred	(10,839)	(12,741)	(38,737)	(44,635)
Balance, end of period	\$129,658			