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HOVNANIAN ENTERPRISES INC

Form 10-Q/A

December 20, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

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

For quarterly period ended APRIL 30, 2006 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

(State or Other Jurisdiction of Incorporation or Organization)

22-1851059

(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

(Registrant's Telephone Number, Including Area Code)

10 Highway 35, P. O. Box 500, Red Bank, NJ 07701

(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 large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer

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. 47,052,034 shares of Class A Common Stock and 14,670,716 shares of Class B Common Stock were outstanding as of May 26, 2006.

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## Explanatory Paragraph

This Form 10-Q/A for the quarterly period ended April 30, 2006 is being filed for the purpose of restating Note 3 in our Notes to Condensed Consolidated Financial Statements, which includes expanded reportable segment footnote disclosure related to our homebuilding operations. We have restated the accompanying Consolidated Financial Statements to revise our segment disclosures for all periods presented to show six reportable homebuilding segments. The restatement has no impact on our condensed consolidated balance sheets as of April 30, 2006 and October 31, 2005, or condensed consolidated statements of income and related income per common share amounts for the three and six months ended April 30, 2006 and 2005, or condensed consolidated statements of cash flows for the six months ended April 30, 2006 and 2005. Conforming and other changes that are responsive to certain disclosure comments, primarily relating to segment reporting received from the Division of Corporation Finance of the Securities and Exchange Commission, have been made to Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 and our Controls and Procedures Discussion in Item 4 of this Form 10-Q/A. See Note 3 in the Notes to Condensed Consolidated Financial Statements for further information relating to the restatement. Each amendment noted is solely. This Form 10-Q/A has not been updated for events or information subsequent to the date of filing of the original Form 10-Q, except in connection with the foregoing.

HOVNANIAN ENTERPRISES, INC.

FORM 10-Q/A

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In Thousands Except Share Amounts)

| ASSETS   | April 30,<br>2006 | October 31,<br>2005 |
|--|-------------------|---------------------|
|  | -----             | -----               |
|  | (unaudited)       |                     |
| Homebuilding:  |                   |                     |
| Cash and cash equivalents.....                                       | \$ 47,525         | \$ 201,641          |
|  | -----             | -----               |
| Restricted cash.....   | 8,766             | 17,189              |
|  | -----             | -----               |
| Inventories - At the lower of cost or fair<br>value:                 |                   |                     |
| Sold and unsold homes and lots under<br>development.....             | 3,306,101         | 2,459,431           |
|  | -----             | -----               |
| Land and land options held for future<br>development or sale.....    | 561,220           | 595,806             |
|  | -----             | -----               |
| Consolidated Inventory Not Owned:                                    |                   |                     |
| Specific performance options.....                                    | 10,696            | 9,289               |
| Variable interest entities.....                                      | 381,178           | 242,825             |
| Other options.....   | 136,530           | 129,269             |
|  | -----             | -----               |
| Total Consolidated Inventory Not Owned..                             | 528,404           | 381,383             |
|  | -----             | -----               |
| Total Inventories.....   | 4,395,725         | 3,436,620           |
|  | -----             | -----               |
| Investments in and advances to unconsolidated<br>joint ventures..... | 211,556           | 187,205             |
|  | -----             | -----               |
| Receivables, deposits, and notes .....                               | 82,206            | 125,388             |
|  | -----             | -----               |
| Property, plant, and equipment - net.....                            | 110,509           | 96,891              |
|  | -----             | -----               |
| Prepaid expenses and other assets.....                               | 165,642           | 125,662             |

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|  |              |              |
|--|--------------|--------------|
|  | -----        | -----        |
| Goodwill.....                                | 32,658       | 32,658       |
|  | -----        | -----        |
| Definite life intangibles.....               | 204,875      | 249,506      |
|  | -----        | -----        |
| Total Homebuilding.....                      | 5,259,462    | 4,472,760    |
|  | -----        | -----        |
| Financial Services:                          |              |              |
| Cash and cash equivalents.....               | 5,153        | 9,632        |
| Restricted cash.....                         | 1,351        | 1,037        |
| Mortgage loans held for sale.....            | 214,190      | 211,248      |
| Other assets.....                            | 6,482        | 15,375       |
|  | -----        | -----        |
| Total Financial Services.....                | 227,176      | 237,292      |
|  | -----        | -----        |
| Income Taxes Receivable - Including Deferred |              |              |
| Tax Benefits.....                            | 96,650       | 9,903        |
|  | -----        | -----        |
| Total Assets.....                            | \$ 5,583,288 | \$ 4,719,955 |
|  | =====        | =====        |

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In Thousands Except Share Amounts)

| LIABILITIES AND STOCKHOLDERS' EQUITY                          | April 30,<br>2006 | October 31,<br>2005 |
|---|-------------------|---------------------|
|   | -----             | -----               |
|   | (unaudited)       |                     |
| Homebuilding:   |                   |                     |
| Nonrecourse land mortgages.....                               | \$ 38,117         | \$ 48,673           |
| Accounts payable and other liabilities.....                   | 500,286           | 510,529             |
| Customers' deposits.....                                      | 238,709           | 259,930             |
| Nonrecourse mortgages secured by operating<br>properties..... | 24,017            | 24,339              |
| Liabilities from inventory not owned.....                     | 254,691           | 177,014             |
|   | -----             | -----               |
| Total Homebuilding.....                                       | 1,055,820         | 1,020,485           |
|   | -----             | -----               |
| Financial Services:   |                   |                     |
| Accounts payable and other liabilities.....                   | 8,887             | 8,461               |
| Mortgage warehouse line of credit.....                        | 195,189           | 198,856             |
|   | -----             | -----               |
| Total Financial Services.....                                 | 204,076           | 207,317             |
|   | -----             | -----               |
| Notes Payable:  |                   |                     |
| Revolving credit agreement.....                               | 275,000           | -                   |
| Senior notes.....   | 1,399,247         | 1,098,739           |
| Senior subordinated notes.....                                | 400,000           | 400,000             |
| Accrued interest.....   | 25,375            | 20,808              |
|   | -----             | -----               |
| Total Notes Payable.....                                      | 2,099,622         | 1,519,547           |
|   | -----             | -----               |

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|  |              |              |
|--|--------------|--------------|
| Total Liabilities.....   | 3,359,518    | 2,747,349    |
| Minority interest from inventory not owned.....  | 243,339      | 180,170      |
| Minority interest from consolidated joint ventures.....  | 3,241        | 1,079        |
| Stockholders' Equity:  |              |              |
| Preferred Stock,\$.01 par value-authorized 100,000 shares; issued 5,600 shares at April 30, 2006 and at October 31, 2005 with a liquidation preference of \$140,000.....   | 135,299      | 135,389      |
| Common Stock,Class A,\$.01 par value-authorized 200,000,000 shares; issued 58,378,455 shares at April 30, 2006 and 57,976,455 shares at October 31, 2005 (including 11,295,656 shares at April 30, 2006 and 10,995,656 shares at October 31, 2005 held in Treasury).....                 | 584          | 580          |
| Common Stock,Class B,\$.01 par value (convertible to Class A at time of sale) authorized 30,000,000 shares; issued 15,363,534 shares at April 30, 2006 and 15,370,250 shares at October 31, 2005 (including 691,748 shares at April 30, 2006 and October 31, 2005 held in Treasury)..... | 154          | 154          |
| Paid in Capital.....   | 234,018      | 236,001      |
| Retained Earnings.....   | 1,705,359    | 1,522,952    |
| Deferred Compensation.....   |              | (19,648)     |
| Treasury Stock - at cost.....  | (98,224)     | (84,071)     |
| Total Stockholders' Equity.....  | 1,977,190    | 1,791,357    |
| Total Liabilities and Stockholders' Equity.....  | \$ 5,583,288 | \$ 4,719,955 |

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(In Thousands Except Per Share Data)  
(Unaudited)

|                                    | Three Months Ended<br>April 30, |             | Six Months Ended<br>April 30, |             |
|------------------------------------|---------------------------------|-------------|-------------------------------|-------------|
|                                    | 2006                            | 2005        | 2006                          | 2005        |
| Revenues:                          |                                 |             |                               |             |
| Homebuilding:                      |                                 |             |                               |             |
| Sale of homes.....                 | \$ 1,479,548                    | \$1,189,672 | \$2,725,745                   | \$2,205,641 |
| Land sales and other revenues..... | 73,382                          | 3,528       | 85,915                        | 27,927      |
| Total Homebuilding.....            | 1,552,930                       | 1,193,200   | 2,811,660                     | 2,233,568   |
| Financial Services.....            | 21,191                          | 16,269      | 40,453                        | 30,462      |
| Total Revenues.....                | 1,574,121                       | 1,209,469   | 2,852,113                     | 2,264,030   |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Expenses:   |            |            |            |            |
| Homebuilding:   |            |            |            |            |
| Cost of sales, excluding interest..                       | 1,180,299  | 876,827    | 2,114,986  | 1,648,083  |
| Cost of sales interest.....                               | 20,283     | 18,464     | 36,852     | 36,231     |
| Total Cost of Sales.....                                  | 1,200,582  | 895,291    | 2,151,838  | 1,684,314  |
| Selling, general and administrative                       | 151,853    | 106,704    | 287,087    | 203,292    |
| Inventory impairment loss.....                            | 5,595      | 1,500      | 8,704      | 1,998      |
| Total Homebuilding.....                                   | 1,358,030  | 1,003,495  | 2,447,629  | 1,889,604  |
| Financial Services.....                                   | 14,517     | 11,467     | 28,047     | 21,387     |
| Corporate General and Administrative.                     | 25,911     | 14,916     | 53,633     | 30,794     |
| Other Interest.....                                       | 700        | 539        | 1,520      | 694        |
| Other Operations.....                                     | 8,521      | 1,279      | 15,522     | 3,219      |
| Intangible Amortization.....                              | 13,391     | 10,386     | 25,060     | 20,474     |
| Total Expenses.....                                       | 1,421,070  | 1,042,082  | 2,571,411  | 1,966,172  |
| Income from unconsolidated joint ventures.....            | 9,497      | 7,140      | 17,072     | 8,575      |
| Income Before Income Taxes.....                           | 162,548    | 174,527    | 297,774    | 306,433    |
| State and Federal Income Taxes:                           |            |            |            |            |
| State.....  | 6,235      | 10,318     | 11,109     | 15,764     |
| Federal.....  | 52,664     | 58,073     | 98,920     | 103,051    |
| Total Taxes.....  | 58,899     | 68,391     | 110,029    | 118,815    |
| Net Income.....   | 103,649    | 106,136    | 187,745    | 187,618    |
| Less: Preferred Stock Dividends.....                      | 2,669      |            | 5,338      |            |
| Net Income Available to Common Stockholders.....          | \$ 100,980 | \$ 106,136 | \$ 182,407 | \$ 187,618 |
| Per Share Data:   |            |            |            |            |
| Basic:  |            |            |            |            |
| Income per common share.....                              | \$ 1.60    | \$ 1.71    | \$ 2.90    | \$ 3.01    |
| Weighted average number of common shares outstanding..... | 62,919     | 62,233     | 62,864     | 62,237     |
| Assuming dilution:  |            |            |            |            |
| Income per common share.....                              | \$ 1.55    | \$ 1.62    | \$ 2.80    | \$ 2.87    |
| Weighted average number of common shares outstanding..... | 65,106     | 65,498     | 65,254     | 65,459     |

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 (Dollars In Thousands)

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(Unaudited)

|   | A Common Stock                      |        | B Common Stock                      |        | Preferred Stock                     |            | Paid-In<br>Capital | Retain<br>Earnings |
|---|-------------------------------------|--------|-------------------------------------|--------|-------------------------------------|------------|--------------------|--------------------|
|   | Shares<br>Issued and<br>Outstanding | Amount | Shares<br>Issued and<br>Outstanding | Amount | Shares<br>Issued and<br>Outstanding | Amount     |                    |                    |
| Balance,<br>October 31, 2005.   | 46,980,799                          | \$ 580 | 14,678,502                          | \$ 154 | 5,600                               | \$ 135,389 | \$236,001          | \$1,522,9          |
| Issuance costs....  |                                     |        |                                     |        |                                     |            | (90)               |                    |
| Preferred Dividend<br>Declared<br>(\$476.56 per<br>Share).....                        |                                     |        |                                     |        |                                     |            |                    | (5,3               |
| Stock Options,<br>amortization<br>and issuances,<br>net of tax.....                   | 200,596                             |        | 2                                   |        |                                     |            | 11,296             |                    |
| Restricted Stock<br>amortization,<br>issuances and<br>forfeitures,<br>net of tax..... | 194,688                             |        | 2                                   |        |                                     |            | 6,369              |                    |
| Reclass Due to<br>SFAS 123R<br>Implementation<br>(See Note 2)....                     |                                     |        |                                     |        |                                     |            | (19,648)           |                    |
| Conversion of<br>Class B to<br>Class A<br>common stock....                            | 6,716                               |        | (6,716)                             |        |                                     |            |                    |                    |
| Treasury Stock<br>Purchases.....  | (300,000)                           |        |                                     |        |                                     |            |                    |                    |
| Net Income.....   |                                     |        |                                     |        |                                     |            |                    | 187,7              |
| Balance,<br>April 30, 2006...   | 47,082,799                          | \$ 584 | 14,671,786                          | \$ 154 | 5,600                               | \$ 135,299 | \$234,018          | \$1,705,3          |

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands - unaudited)

Six Months Ended  
April 30,

2006 2005

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|  |            |            |
|--|------------|------------|
|  | -----      | -----      |
| Cash Flows From Operating Activities:  |            |            |
| Net Income.....  | \$ 187,745 | \$ 187,618 |
| Adjustments to reconcile net income to net cash<br>(used in) operating activities: |            |            |
| Depreciation.....  | 6,319      | 3,513      |
| Intangible amortization.....   | 25,060     | 20,474     |
| Compensation from stock options and awards.....                                    | 16,955     | 2,891      |
| Amortization of bond discounts.....  | 508        | 309        |
| Excess tax benefits from share-based payment....                                   | (3,802)    | -          |
| Loss (gain) on sale and retirement of property<br>and assets.....                  | 145        | (663)      |
| Equity earnings in unconsolidated entities.....                                    | (17,072)   | (8,575)    |
| Distributions from unconsolidated entities.....                                    | 9,829      | 5,626      |
| Deferred income taxes.....   | (40,761)   | (6,357)    |
| Impairment losses.....   | 8,704      | 1,998      |
| Decrease (increase) in assets:   |            |            |
| Mortgage notes receivable.....   | (2,940)    | 52,540     |
| Restricted cash, receivables, prepaids and<br>other assets.....                    | 44,128     | (26,091)   |
| Inventories.....   | (805,208)  | (213,974)  |
| (Decrease) increase in liabilities:  |            |            |
| State and Federal income taxes.....  | (45,986)   | (92,197)   |
| Customers' deposits.....   | (20,977)   | 23,067     |
| Interest and other accrued liabilities.....  | 5,349      | (23,234)   |
| Accounts payable.....  | (10,705)   | (15,223)   |
|  | -----      | -----      |
| Net cash (used in) operating activities.....                                       | (642,709)  | (88,278)   |
|  | -----      | -----      |
| Cash Flows From Investing Activities:  |            |            |
| Net proceeds from sale of property and assets.....                                 | 166        | 1,238      |
| Purchase of property, equipment and other fixed<br>Assets and acquisitions.....    | (44,454)   | (119,375)  |
| Investments in and advances to unconsolidated<br>entities.....                     | (17,343)   | (52,730)   |
| Distributions from unconsolidated entities.....                                    | 271        | 625        |
|  | -----      | -----      |
| Net cash (used in) investing activities.....                                       | (61,360)   | (170,242)  |
|  | -----      | -----      |
| Cash Flows From Financing Activities:  |            |            |
| Proceeds from mortgages and notes.....   | 47,736     | 45,028     |
| Net proceeds (payments) related to revolving<br>credit agreement.....              | 275,000    | (9,900)    |
| Net (payments) related to mortgage<br>warehouse line of credit.....                | (3,668)    | (64,091)   |
| Proceeds from senior debt.....   | 300,000    | 200,000    |
| Proceeds from senior subordinated debt.....  | -          | 100,000    |
| Payments of issuance costs.....  | (90)       |            |
| Principal payments on mortgages and notes.....                                     | (58,529)   | (27,795)   |
| Excess tax benefits from share-based payment.....                                  | 3,802      | -          |
| Preferred dividends paid.....  | (5,338)    | -          |
| Purchase of treasury stock.....  | (14,153)   | (15,934)   |
| Proceeds from sale of stock and employee stock plan.                               | 714        | 5,360      |
|  | -----      | -----      |
| Net cash provided by financing activities....                                      | 545,474    | 232,668    |
|  | -----      | -----      |
| Net (Decrease) in Cash.....  | (158,595)  | (25,852)   |
| Cash and Cash Equivalents Balance, Beginning<br>of Period.....                     | 211,273    | 60,959     |
|  | -----      | -----      |
| Cash and Cash Equivalents Balance, End of Period.....                              | \$ 52,678  | \$ 35,107  |



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|   | =====      | =====      |
|---|------------|------------|
| Supplemental Disclosures of Cash Flow                     |            |            |
| Cash paid during the year for:                            |            |            |
| Interest.....   | \$ 37,296  | \$ 33,681  |
|   | =====      | =====      |
| Income taxes.....   | \$ 165,446 | \$ 211,146 |
|   | =====      | =====      |
| Supplemental disclosures of noncash operating activities: |            |            |
| Consolidated Inventory Not Owned:                         |            |            |
| Specific performance options.....                         | \$ 9,385   | \$ 34,309  |
| Variable interest entities.....                           | 363,888    | 113,652    |
| Other options.....  | 134,015    | 115,162    |
|   | -----      | -----      |
| Total Inventory Not Owned.....                            | \$ 507,288 | \$ 263,123 |
|   | =====      | =====      |

See notes to condensed consolidated financial statements (unaudited).

### HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q/A and Article 10 of Regulation S-X. In the opinion of management, all adjustments for interim periods presented have been made, which include only normal recurring accruals and deferrals necessary for a fair presentation of our consolidated financial position, results of operations, and changes in cash flows. The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. Effective November 1, 2005, the Company adopted Statement of Financial Accounting Standards ("SFAS") 123R, "Share-Based Payments", which revises SFAS 123, "Accounting for Stock-Based Compensation". Prior to fiscal year 2006, the Company accounted for stock awards granted to employees under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. As a result, the recognition of stock-based compensation expense was generally limited to the expense attributed to nonvested stock awards, as well as the amortization of certain acquisition-related deferred compensation.

SFAS 123R applies to new awards and to awards modified, repurchased, or cancelled after the required effective date, as well as to the unvested

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portion of awards outstanding as of the required effective date. The Company uses the Black-Scholes model to value its new stock option grants under SFAS 123R, applying the "modified prospective method" for existing grants which requires the Company to value stock options prior to its adoption of SFAS 123R under the fair value method and expense the unvested portion over the remaining vesting period. The fair value for options is established at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for April 30, 2006: risk-free interest rate of 4.13%; dividend yield of zero; volatility factor of the expected market price of our common stock of 0.44; and a weighted average expected life of the option of 5.2 years. SFAS 123R also requires the Company to estimate forfeitures in calculating the expense related to stock-based compensation (estimated at 2% for fiscal 2006 and fiscal 2005, respectively,) and requires the Company to reflect the benefits of tax deductions in excess of recognized compensation cost to be reported as both a financing cash inflow and an operating cash outflow upon adoption.

Compensation cost arising from nonvested stock granted to employees and from non-employee stock awards is recognized as expense using the straight-line method over the vesting period. Unearned compensation is included in deferred compensation in stockholders' equity beginning in the first quarter of fiscal 2004. Upon adoption of SFAS 123R, deferred compensation is no longer recorded for non vested stock awards, therefore deferred compensation was reclassified to Paid-In Capital.

For the three months and six months ended April 30, 2006, the Company's total stock-based compensation expense was \$9.1 million (\$5.8 million net of tax) and \$17.0 million (\$10.7 million net of tax), respectively. Included in this total stock-based compensation expense was incremental expense for stock options of \$4.1 million (\$2.6 million net of tax) and \$7.4 million (\$4.7 million net of tax) for the three and six months ended April 30, 2006, respectively.

The following table illustrates the effect (in thousands, except per share amounts) on net income and earnings per share for the three and six months ended April 30, 2005 as if the Company's stock-based compensation had been determined based on the fair value at the grant dates for awards made prior to fiscal 2006, under those plans and consistent with SFAS 123R:

|   | Three Months Ended<br>April 30, 2005 | Six Months Ended<br>April 30, 2005 |
|---|--------------------------------------|------------------------------------|
|   | -----                                | -----                              |
| Net income as reported.....   | \$106,136                            | \$187,618                          |
| Deduct: total stock-based employee<br>compensation expense determined<br>using Black-Scholes fair value<br>based method for all awards... | 1,490                                | 2,842                              |
|   | -----                                | -----                              |
| Pro forma net income.....   | \$104,646                            | \$184,776                          |
|   | =====                                | =====                              |
| Pro forma basic earnings per share  | \$ 1.68                              | \$ 2.97                            |
|   | =====                                | =====                              |
| Basic earnings per share as<br>reported.....  | \$ 1.71                              | \$ 3.01                            |
|   | =====                                | =====                              |
| Pro forma diluted earnings per<br>share.....  | \$ 1.60                              | \$ 2.82                            |
|   | =====                                | =====                              |
| Diluted earnings per share as<br>reported.....  | \$ 1.62                              | \$ 2.87                            |
|   | =====                                | =====                              |

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Pro forma information regarding net income and earnings per share is calculated as if we had accounted for our stock-based compensation under the fair value method of SFAS 123R. The fair value for options is established at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for April 30, 2005: risk-free interest rate of 4.17% for both periods; dividend yield of zero; volatility factor of the expected market price of our common stock of 0.43; and a weighted average expected life of the option of 4.9 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from traded options, and changes in the subjective input assumptions can materially affect the fair value estimate, management believes the existing models do not necessarily provide a reliable measure of the fair value of its employee stock options.

On November 10, 2005, the FASB issued FASB Staff Position No. SFAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards" (FSP 123R-3). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R. The Company has until November 2006 to make a one-time election to adopt the transition method described in FSP 123R-3. The Company is currently evaluating FSP 123R-3; however, if the Company were to make the one-time election, it is not expected to affect operating income or net income.

### 3. Operating and Reporting Segments (as Restated)

Subsequent to the issuance of the Company's condensed consolidated financial statements for the quarterly period ended April 30, 2006, the Company expanded its disclosure of reportable segments in accordance with the provisions of Financial Accounting Standards No. 131 ("SFAS 131"), ("Disclosures About Segments of an Enterprise and Related Information"). SFAS 131 defines operating segments as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. The Company has identified its chief operating decision-maker as the Chief Executive Officer. The Company had historically aggregated its homebuilding operating segments into a single, national reportable segment, but has restated its segment disclosure to include six homebuilding reportable segments, as identified below, for the three and six months ended April 30, 2006 and 2005. The restatement has no impact on the Company's condensed consolidated balance sheets as of April 30, 2006 and October 31, 2005, condensed consolidated statements of income and related income per common share amounts for the three and six months ended April 30, 2006 and 2005 or condensed consolidated statements of cash flows for the three months ended April 30, 2006 and 2005.

The Company's operating segments are aggregated into reportable segments in accordance with SFAS 131, based primarily upon geographic proximity, similar regulatory environments, land acquisition characteristics and similar methods used to construct and sell homes. The

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Company's reportable segments consist of:

### Homebuilding:

- (1) Northeast (New Jersey, New York, Pennsylvania)
- (2) Mid-Atlantic (Delaware, Maryland, Virginia, West Virginia, Washington D.C.)
- (3) Midwest (Illinois, Michigan, Minnesota, Ohio)
- (4) Southeast (Florida, Georgia, North Carolina, South Carolina)
- (5) Southwest (Arizona, Texas)
- (6) West (California)

### Financial Services

Operations of the Company's Homebuilding segments primarily include the sale and construction of single-family attached and detached homes, attached townhomes and condominiums, mid-rise and high-rise condominiums, urban infill and active adult homes in planned residential developments. Operations of the Company's Financial Services segment include mortgage banking and title services to the homebuilding operations' customers. We do not retain or service mortgages that we originate but rather sell the mortgages and related servicing rights to investors.

Evaluation of segment performance is based primarily on operating earnings from continuing operations before provision for income taxes. Operating earnings for the Homebuilding segments consist of revenues generated from the sales of homes and land, equity in earnings from unconsolidated entities and management fees and other income, net, less the cost of homes and land sold, selling, general and administrative expenses and minority interest expense, net. Operating earnings for the Financial Services segment consist of revenues generated from mortgage banking and title services, less the cost of such services and certain selling, general and administrative expenses incurred by the Financial Services segment.

Each reportable segment follows the same accounting policies described in Note 10 - "Operating and Reporting Segments (as restated)" to the consolidated financial statements in the Company's 2005 Annual Report on Form 10-K/A. Operational results of each segment are not necessarily indicative of the results that would have occurred had the segment been an independent, stand-alone entity during the periods presented.

Financial information relating to the Company's operations was as follows:

| (In thousands)                         | Three Months Ended<br>April 30, |                  | Six Months Ended<br>April 30, |                  |
|--|---------------------------------|------------------|-------------------------------|------------------|
|  | 2006                            | 2005             | 2006                          | 2005             |
| <b>Revenues:</b>                       |                                 |                  |                               |                  |
| Northeast                              | \$ 204,268                      | \$ 250,111       | \$ 411,228                    | \$ 472,547       |
| Mid-Atlantic                           | 251,506                         | 184,060          | 449,788                       | 342,546          |
| Midwest                                | 37,439                          | 17,583           | 64,961                        | 36,121           |
| Southeast                              | 318,243                         | 151,243          | 588,288                       | 256,854          |
| Southwest                              | 234,828                         | 164,708          | 418,692                       | 301,945          |
| West                                   | 505,572                         | 423,731          | 875,437                       | 821,557          |
| <b>Total Homebuilding<br/>Revenues</b> | <b>1,551,856</b>                | <b>1,191,436</b> | <b>2,808,394</b>              | <b>2,231,570</b> |
| <b>Financial Services</b>              | <b>21,191</b>                   | <b>16,269</b>    | <b>40,453</b>                 | <b>30,462</b>    |

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|                           |             |             |             |             |
|---------------------------|-------------|-------------|-------------|-------------|
| Corporate and Unallocated | 1,074       | 1,764       | 3,276       | 1,998       |
|                           | -----       | -----       | -----       | -----       |
| Total Revenues            | \$1,574,121 | \$1,209,469 | \$2,852,113 | \$2,264,030 |
|                           | =====       | =====       | =====       | =====       |

Income Before Income Taxes:

|              |         |         |          |         |
|--------------|---------|---------|----------|---------|
| Northeast    | 29,335  | 54,106  | 64,993   | 88,014  |
| Mid-Atlantic | 39,921  | 33,791  | 76,498   | 50,400  |
| Midwest      | (6,646) | (2,871) | (11,989) | (5,028) |
| Southeast    | 26,013  | 12,745  | 49,044   | 18,315  |
| Southwest    | 22,425  | 11,573  | 35,898   | 15,676  |
| West         | 69,317  | 80,339  | 120,671  | 162,343 |
|              | -----   | -----   | -----    | -----   |

Homebuilding Income

|                     |         |         |         |         |
|---------------------|---------|---------|---------|---------|
| Before Income Taxes | 180,365 | 189,683 | 335,115 | 329,720 |
|                     | -----   | -----   | -----   | -----   |

|                    |       |       |        |       |
|--------------------|-------|-------|--------|-------|
| Financial Services | 6,674 | 4,803 | 12,405 | 9,076 |
|--------------------|-------|-------|--------|-------|

|                           |          |          |          |          |
|---------------------------|----------|----------|----------|----------|
| Corporate and Unallocated | (24,491) | (19,959) | (49,746) | (32,363) |
|                           | -----    | -----    | -----    | -----    |

|                               |            |            |            |            |
|-------------------------------|------------|------------|------------|------------|
| Income before<br>income taxes | \$ 162,548 | \$ 174,527 | \$ 297,774 | \$ 306,433 |
|                               | =====      | =====      | =====      | =====      |

April 30,      October 31,  
2006              2005

(In thousands)

Assets:

|              |             |             |
|--------------|-------------|-------------|
| Northeast    | \$1,195,422 | \$1,058,155 |
| Mid-Atlantic | 719,979     | 621,836     |
| Midwest      | 200,133     | 156,464     |
| Southeast    | 819,088     | 688,880     |
| Southwest    | 533,959     | 377,866     |
| West         | 1,539,632   | 1,143,747   |
|              | -----       | -----       |

Total Homebuilding  
Assets

|           |           |
|-----------|-----------|
| 5,008,213 | 4,046,948 |
| -----     | -----     |

|                    |         |         |
|--------------------|---------|---------|
| Financial Services | 227,176 | 237,292 |
|--------------------|---------|---------|

|                           |         |         |
|---------------------------|---------|---------|
| Corporate and Unallocated | 347,899 | 435,715 |
|                           | -----   | -----   |

|              |             |             |
|--------------|-------------|-------------|
| Total Assets | \$5,583,288 | \$4,719,955 |
|              | =====       | =====       |

4. Interest costs incurred, expensed and capitalized were:

|  |                    |       |                  |       |
|--|--------------------|-------|------------------|-------|
|  | Three Months Ended |       | Six Months Ended |       |
|  | April 30,          |       | April 30,        |       |
|  | -----              | ----- | -----            | ----- |
|  | 2006               | 2005  | 2006             | 2005  |
|  | -----              | ----- | -----            | ----- |

(Dollars in Thousands)

Interest Capitalized at

|                             |           |           |           |           |
|-----------------------------|-----------|-----------|-----------|-----------|
| Beginning of Period(1)..... | \$ 61,781 | \$ 40,587 | \$ 48,366 | \$ 37,465 |
|-----------------------------|-----------|-----------|-----------|-----------|

|                               |        |        |        |        |
|-------------------------------|--------|--------|--------|--------|
| Plus Interest Incurred(2).... | 36,250 | 22,904 | 67,054 | 43,948 |
|-------------------------------|--------|--------|--------|--------|

Less Cost of Sales Interest

|                  |        |        |        |        |
|------------------|--------|--------|--------|--------|
| Expensed(3)..... | 20,283 | 18,464 | 36,852 | 36,231 |
|------------------|--------|--------|--------|--------|

|                               |       |       |       |       |
|-------------------------------|-------|-------|-------|-------|
| Less Other Interest Expensed. | 700   | 539   | 1,520 | 694   |
|                               | ----- | ----- | ----- | ----- |

Interest Capitalized at

|                    |           |           |           |           |
|--------------------|-----------|-----------|-----------|-----------|
| End of Period..... | \$ 77,048 | \$ 44,488 | \$ 77,048 | \$ 44,488 |
|--------------------|-----------|-----------|-----------|-----------|

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- (1) Beginning balance for 2006 does not include interest incurred of \$2.3 million which is capitalized in property, plant, and equipment.
- (2) Data does not include interest incurred by our mortgage and finance subsidiaries.
- (3) Represents interest on borrowings for construction, land and development costs, which are charged to interest expense when homes are delivered.

5. Accumulated depreciation at April 30, 2006 and October 31, 2005 amounted to \$36.5 million and \$30.5 million, respectively, for our homebuilding assets.

6. In accordance with Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment of or Disposal of Long Lived Assets", we record impairment losses on inventories related to communities under 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 carrying amounts. In addition, from time to time, we will write off certain residential land options including approval and engineering costs for land we decided not to purchase. We wrote off such costs in the amount of \$5.6 million and \$1.5 million during the three months ended April 30, 2006 and 2005, respectively, and \$8.7 million and \$2.0 million during the six months ended April 30, 2006 and 2005, respectively. Residential inventory impairment losses and option write-offs are reported in the Condensed Consolidated Statements of Income as "Homebuilding-Inventory impairment loss".

7. We provide a warranty accrual for repair costs over \$1,000 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 warranty costs under our general liability insurance deductible as part of selling, general and administrative costs. For fiscal 2006, our deductible is \$20 million per occurrence with an aggregate \$20 million for construction defect claims. (deductible was \$5 million per occurrence for homes built in fiscal 2005). Additions and charges incurred in the warranty accrual and general liability accrual for the three and six months ended April 30, 2006 and 2005 are as follows:

|  | Three Months Ended<br>April 30, |           | Six Months Ended<br>April 30, |           |
|--|---------------------------------|-----------|-------------------------------|-----------|
|  | 2006                            | 2005      | 2006                          | 2005      |
|  | -----                           |           |                               |           |
|  | (Dollars in Thousands)          |           |                               |           |
| Balance, beginning of period.....          | \$ 87,631                       | \$ 74,116 | \$ 86,706                     | \$ 64,922 |
| Company acquisitions during<br>period..... | 186                             |           | 186                           |           |
| Additions.....                             | 5,066                           | 12,580    | 12,330                        | 25,917    |
| Charges incurred.....                      | (2,650)                         | (5,574)   | (8,989)                       | (9,717)   |
|  | -----                           |           |                               |           |
| Balance, end of period.....                | \$ 90,233                       | \$ 81,122 | \$ 90,233                     | \$ 81,122 |
|  | =====                           |           |                               |           |

Warranty accruals are based upon historical experience. We engage a third party actuary that uses our historical warranty data to estimate our unpaid claims, claim adjustment expenses and incurred but not reported claims reserves for the risks that we are assuming under the general liability and workers compensation programs. The estimates include provisions for inflation, claims handling and legal fees.

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Insurance claims paid by our insurance carriers were \$4.8 million and \$7.0 million for the six months ended April 30, 2006 and 2005, respectively.

8. We are involved in litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on our financial position or results of operations and we are subject to extensive and complex regulations that affect the development and home building, sales and customer financing processes, including zoning, density, building standards and mortgage financing. These regulations often provide broad discretion to the administering governmental authorities. This can delay or increase the cost of development or homebuilding.

We also are subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment. The particular environmental laws which apply to any given community vary greatly according to the community site, the site's environmental conditions and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation, and/or other costs, and can prohibit or severely restrict development and homebuilding activity in certain environmentally sensitive regions or areas.

In March 2005, we received two requests for information pursuant to Section 308 of the Clean Water Act from Region 3 of the Environmental Protection Agency (the "EPA"). These requests sought information concerning storm water discharge practices in connection with completed, ongoing and planned homebuilding projects by subsidiaries in the states and district that comprise EPA Region 3. We also received a notice of violations for one project in Pennsylvania and requests for sampling plan implementation in two projects in Pennsylvania. The amount requested by the EPA to settle the asserted violations at the one project was not material. We provided the EPA with information in response to its requests. We have since been advised by the Department of Justice ("DOJ") that it will be involved in the review of our storm water discharge practices. We cannot predict the outcome of the review of these practices or estimate the costs that may be involved in resolving the matter. To the extent that the EPA or the DOJ asserts violations of regulatory requirements and requests injunctive relief or penalties, we will defend and attempt to resolve such asserted violations.

In addition, in November 2005, we received two notices from the California Regional Water Quality Control Board alleging violations of certain storm water discharge rules and assessing an administrative civil liability of \$0.2 million and \$0.3 million. We do not consider these assessments to be material and are considering our response to the notices.

It can be anticipated that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot predict the effect of these requirements, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules and regulations and their interpretations and application.

Our sales and customer financing processes are subject to the jurisdiction of the U. S. Department of Housing and Urban Development ("HUD"). In connection with the Real Estate Settlement Procedures Act, HUD

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recently inquired about our process of referring business to our affiliated mortgage company and has separately requested documents related to customer financing. We have responded to HUD's inquiries. In connection with these inquiries, the Inspector General of HUD has recommended to the Secretary of HUD that we indemnify HUD for any losses that it may sustain in connection with nine loans that it alleges were improperly underwritten. We cannot predict the outcome of HUD's inquiry or estimate the costs that may be involved in resolving the matter. We do not expect the ultimate cost to be material.

9. As of April 30, 2006 and October 31, 2005, respectively, we are obligated under various performance letters of credit amounting to \$432.8 million and \$330.8 million.

10. As of April 30, 2006, our amended and restated unsecured Revolving Credit Agreement ("Agreement") with a group of banks provided a revolving credit line of \$1.2 billion through July 2009. The facility contained an accordion feature under which the aggregate commitment could be increased to \$1.3 billion subject to the availability of additional commitments. Interest was payable monthly at various rates at our option, based on either (1) a LIBOR-based rate for a one, two, three, or six month interest period as selected by us plus a margin ranging from 1.00% to 1.95% per annum, depending on our Consolidated Leverage Ratio, as defined in the Agreement or (2) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus 1/2%. In addition, we paid a fee ranging from 0.20% to 0.30% per annum on the unused portion of the revolving credit line depending on our Consolidated Leverage Ratio and the average percentage unused portion of the revolving credit line. As of April 30, 2006 and October 31, 2005, the outstanding balance under the Agreement was \$275.0 million and zero, respectively.

On May 31, 2006, we entered into an amended and restated unsecured Revolving Credit Agreement ("May 2006 Agreement") with a group of lenders. The May 2006 Agreement replaced the Agreement and increased the revolving credit line from \$1.2 billion to \$1.5 billion and extended the maturity through May 2011. The facility contains an accordion feature under which the aggregate commitment can be increased to \$2.0 billion subject to the availability of additional commitments. Loans under the May 2006 Agreement will bear interest at various rates based on (1) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus 1/2% or (2) a margin ranging from 0.65% to 1.50% per annum, depending on our Leverage Ratio, as defined in the May 2006 Agreement, and our debt ratings plus a LIBOR-based rate for a one, two, three, or six month interest period as selected by us. In addition, we pay a fee ranging from 0.15% to 0.25% per annum on the unused portion of the revolving credit line depending on our Leverage Ratio and our debt ratings and the average percentage unused portion of the revolving credit line.

We and each of our significant subsidiaries, except for K. Hovnanian Enterprises, Inc., the borrower, and various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, a subsidiary formerly engaged in homebuilding activity in Poland, our financial services subsidiaries, joint ventures, and certain other subsidiaries, is a guarantor under the May 2006 Agreement and was a guarantor under the prior Agreement.

Our amended secured mortgage loan warehouse agreement with a group of banks, which is a short-term borrowing facility, provides up to \$250 million through October 30, 2006. Interest is payable monthly at the Eurodollar Rate plus 1.0%. The loan is repaid when we sell the underlying



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mortgage loans to permanent investors. On May 19, 2006, we amended our secured mortgage loan warehouse agreement. Pursuant to the new agreement, we may borrow up to \$250 million through May 18, 2007. Interest is payable monthly at the LIBOR Rate plus 1.0%.

We also have a \$100 million commercial paper facility. On April 21, 2006, we amended our \$100 million commercial paper facility. Pursuant to the new agreement, the facility will expire on April 20, 2007 and interest is payable monthly at the LIBOR Rate plus 0.65%. As of April 30, 2006 and October 31, 2005, borrowings under both agreements were \$195.2 million and \$198.9 million, respectively.

11. On November 30, 2004, we issued \$200 million of 6 1/4% Senior Notes due 2015 and \$100 million of 6% Senior Subordinated Notes due 2010. The net proceeds of the issuance were used to repay the outstanding balance on our revolving credit facility as of November 30, 2004 and for general corporate purposes.

On August 8, 2005, we issued \$300 million 6 1/4% Senior Notes due 2016. The notes were issued at a discount to yield 6.46% and have been reflected net of the unamortized discount in the Condensed Consolidated Balance Sheets. The notes are redeemable in whole or in part at our option at 100% of their principal amount plus the payment of a make-whole amount. The net proceeds of the issuance were used to repay the outstanding balance under our revolving credit facility as of August 8, 2005, and for general corporate purposes, including acquisitions.

On February 27, 2006, we issued \$300 million of 7 1/2% Senior Notes due 2016. The notes are redeemable in whole or in part at our option at 100% of their principal amount plus the payment of a make-whole amount. The net proceeds of the issuance were used to repay a portion of the outstanding balance under our revolving credit facility as of February 27, 2006.

At April 30, 2006, we had \$1,405.3 million of outstanding senior notes (\$1,399.2 million, net of discount), comprised of \$140.3 million 10 1/2% Senior Notes due 2007, \$100 million 8% Senior Notes due 2012, \$215 million 6 1/2% Senior Notes due 2014, \$150 million 6 3/8% Senior Notes due 2014, \$200 million 6 1/4% Senior Notes due 2015, \$300 million 6 1/4% Senior Notes due 2016, and \$300 million 7 1/2% Senior Notes due 2016. At April 30, 2006, we had \$400.0 million of outstanding senior subordinated notes, comprised of \$150 million 8 7/8% Senior Subordinated Notes due 2012, \$150 million 7 3/4% Senior Subordinated Notes due 2013, and \$100 million 6% Senior Subordinated Notes due 2010.

On June 5, 2006, we entered into an underwriting agreement to sell \$250 million 8 5/8% Senior Notes due 2017. The estimated net proceeds of \$247.7 million, after giving effect to discounts and commissions but without giving effect to our estimated expenses of the offering, will be used to repay amounts outstanding under the May 2006 Agreement. Subject to customary closing conditions contained in the underwriting agreement, we expect to settle this transaction on June 12, 2006.

Under the terms of the indentures governing our debt securities, we have the right to make certain redemptions and depending on market conditions, may do so from time to time.

12. Per Share Calculations - Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to non-vested stock and outstanding options to purchase common stock, of 2.2

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million and 3.3 million for the three months ended April 30, 2006 and 2005, respectively, and approximately 2.4 million and 3.2 million for the six months ended April 30, 2006 and 2005, respectively.

13. On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of \$25,000 per share for net proceeds of \$135 million. Dividends on the Series A Preferred Stock are not cumulative and are paid at an annual rate of 7.625%. The Series A Preferred Stock is not convertible into the Company's common stock and is redeemable in whole or in part at our option at the liquidation preference of the shares beginning on the fifth anniversary of their issuance. The Series A Preferred Stock is traded as depositary shares, with each depositary share representing 1/1000th of a share of Series A Preferred Stock. The depositary shares are listed on the Nasdaq National Market under the symbol "HOVNP". The net proceeds from the offering, reflected in Preferred Stock in the Condensed Consolidated Balance Sheet, were used for the partial repayment of the outstanding balance under our revolving credit facility as of July 12, 2005. On both January 17, 2006 and April 17, 2006, we paid \$2.7 million of dividends on the Series A Preferred Stock.

14. Variable Interest Entities - In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). A Variable Interest Entity ("VIE") is created when (i) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties or (ii) equity holders either (a) lack direct or indirect ability to make decisions about the entity, (b) are not obligated to absorb expected losses of the entity or (c) do not have the right to receive expected residual returns of the entity if they occur. If an entity is deemed to be a VIE pursuant to FIN 46, an enterprise that absorbs a majority of the expected losses of the VIE is considered the primary beneficiary and must consolidate the VIE.

Based on the provisions of FIN 46, we have concluded that whenever we option land or lots from an entity and pay a non-refundable deposit, a VIE is created under condition (ii) (b) and (c) of the previous paragraph. We are deemed to have provided subordinated financial support, which refers to variable interests that will absorb some or all of an entity's expected theoretical losses if they occur. For each VIE created with a significant nonrefundable option fee (we currently define significant as greater than \$100,000 because we have determined that in the aggregate the VIEs related to deposits of this size or less are not material), we compute expected losses and residual returns based on the probability of future cash flows as outlined in FIN 46. If we are deemed to be the primary beneficiary of the VIE we consolidate it on our balance sheet. The fair value of the VIE's inventory is reported as "Consolidated Inventory Not Owned - Variable interest entities".

Typically, the determining factor in whether or not we are the primary beneficiary is the deposit amount as a percentage of the total purchase price, because it determines the amount of the first risk of loss we take on the contract. The higher this percentage deposit, the more likely we are to be the primary beneficiary. Other important criteria that impact the outcome of the analysis, are the probability of getting the property through the approval process for residential homes, because this impacts the ultimate value of the property, as well as who is the responsible party (seller or buyer) for funding the approval process and development work that will take place prior to the decision to exercise the option.

Management believes FIN 46 was not clearly thought out for application in the homebuilding industry for land and lot options. Under

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FIN 46, we can have an option and put down a small deposit as a percentage of the purchase price and still have to consolidate the entity. Our exposure to loss as a result of our involvement with the VIE is only the deposit, not its total assets consolidated on the balance sheet. In certain cases, we will have to place inventory the VIE has optioned to other developers on our balance sheet. In addition, if the VIE has creditors, its debt will be placed on our balance sheet even though the creditors have no recourse against us. Based on these observations we believe consolidating VIEs based on land and lot option deposits does not reflect the economic realities or risks of owning and developing land.

At April 30, 2006, all 35 VIEs we were required to consolidate were the result of our options to purchase land or lots from the selling entities. We paid cash or issued letters of credit deposits to these VIEs totaling \$27.3 million. Our option deposits represent our maximum exposure to loss. The fair value of the property owned by these VIEs was \$381.2 million. Since we do not own an equity interest in any of the unaffiliated variable interest entities that we must consolidate pursuant to FIN 46, we generally have little or no control or influence over the operations of these entities or their owners. When our requests for financial information are denied by the land sellers, certain assumptions about the assets and liabilities of such entities are required. In most cases, we determine the fair value of the assets of the consolidated entities based on the remaining contractual purchase price of the land or lots we are purchasing. In these cases, it is assumed that the entities have no debt obligations and the only asset recorded is the land or lots we have the option to buy with a related offset to minority interest for the assumed third party investment in the variable interest equity. At April 30, 2006, the balance reported in minority interest from inventory not owned was \$243.3 million. Creditors of these VIEs have no recourse against us.

We will continue to control land and lots using options. Not all our deposits are with VIEs. Including the deposits with the 35 VIEs above, at April 30, 2006, we have total cash and letters of credit deposits amounting to approximately \$465.7 million to purchase land lots with a total purchase price of \$5.3 billion. The maximum exposure to loss is limited to the deposits, although some deposits are refundable at our request or refundable if certain conditions are not met.

15. Investments in Unconsolidated Homebuilding and Land Development Joint Ventures - We enter into homebuilding and land development joint ventures from time to time as a means of accessing lot positions, expanding our market opportunities, establishing strategic alliances, managing our risk profile, leveraging our capital base, and enhancing returns on capital. Our homebuilding joint ventures are generally entered into with third party investors to develop land and construct homes that are sold directly to third party homebuyers. Our land development joint ventures include those entered into with developers and other homebuilders, as well as financial investors, to develop finished lots for sale to the joint venture's members or other third parties. As of April 30, 2006, we have investments in nine homebuilding joint ventures and nine land development joint ventures. The tables set forth below summarize the combined financial information related to our unconsolidated homebuilding and land development joint ventures that are accounted for under the equity method.

April 30, 2006

| Homebuilding | Land Development | Total |
|--------------|------------------|-------|
|--------------|------------------|-------|

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|  |    |         |    |         |    |           |
|--|----|---------|----|---------|----|-----------|
| Assets:  |    |         |    |         |    |           |
| Cash and cash equivalents.....                   | \$ | 50,487  | \$ | 3,820   | \$ | 54,307    |
| Inventories.....                                 |    | 687,372 |    | 205,055 |    | 892,427   |
| Other assets.....                                |    | 126,973 |    | 3,927   |    | 130,900   |
|  |    | -----   |    | -----   |    | -----     |
| Total assets.....                                | \$ | 864,832 | \$ | 212,802 | \$ | 1,077,634 |
|  |    | =====   |    | =====   |    | =====     |
| Liabilities and Equity:                          |    |         |    |         |    |           |
| Accounts payable and<br>accrued liabilities..... | \$ | 140,945 | \$ | 23,472  | \$ | 164,417   |
| Notes payable.....                               |    | 352,582 |    | 60,818  |    | 413,400   |
| Equity of:                                       |    |         |    |         |    |           |
| Hovnianian Enterprises, Inc....                  |    | 89,838  |    | 90,570  |    | 180,408   |
| Others.....                                      |    | 281,467 |    | 37,942  |    | 319,409   |
|  |    | -----   |    | -----   |    | -----     |
| Total Equity.....                                |    | 371,305 |    | 128,512 |    | 499,817   |
|  |    | -----   |    | -----   |    | -----     |
| Total liabilities and equity....                 | \$ | 864,832 | \$ | 212,802 | \$ | 1,077,634 |
|  |    | =====   |    | =====   |    | =====     |
| Debt to Capitalization Ratio....                 |    | 49%     |    | 32%     |    | 45%       |

October 31, 2005

|  |    |              |    |                  |    |           |
|--|----|--------------|----|------------------|----|-----------|
|  |    | -----        |    | -----            |    | -----     |
|  |    | Homebuilding |    | Land Development |    | Total     |
|  |    | -----        |    | -----            |    | -----     |
| Assets:  |    |              |    |                  |    |           |
| Cash and cash equivalents.....                   | \$ | 46,200       | \$ | 5,012            | \$ | 51,212    |
| Inventories.....                                 |    | 694,408      |    | 198,267          |    | 892,675   |
| Other assets.....                                |    | 166,974      |    | 295              |    | 167,269   |
|  |    | -----        |    | -----            |    | -----     |
| Total assets.....                                | \$ | 907,582      | \$ | 203,574          | \$ | 1,111,156 |
|  |    | =====        |    | =====            |    | =====     |
| Liabilities and Equity:                          |    |              |    |                  |    |           |
| Accounts payable and<br>accrued liabilities..... | \$ | 228,264      | \$ | 21,523           | \$ | 249,787   |
| Notes payable.....                               |    | 316,532      |    | 59,131           |    | 375,663   |
| Equity of:                                       |    |              |    |                  |    |           |
| Hovnianian Enterprises, Inc....                  |    | 75,349       |    | 86,593           |    | 161,942   |
| Others.....                                      |    | 287,437      |    | 36,327           |    | 323,764   |
|  |    | -----        |    | -----            |    | -----     |
| Total Equity.....                                |    | 362,786      |    | 122,920          |    | 485,706   |
|  |    | -----        |    | -----            |    | -----     |
| Total liabilities and equity....                 | \$ | 907,582      | \$ | 203,574          | \$ | 1,111,156 |
|  |    | =====        |    | =====            |    | =====     |
| Debt to Capitalization Ratio....                 |    | 47%          |    | 32%              |    | 44%       |

As of April 30, 2006 and October 31, 2005, we had advances outstanding of approximately \$27.9 million and \$23.7 million, respectively, to these unconsolidated joint ventures, which were included in the accounts payable and accrued liabilities balances in the table above. On our Hovnianian Enterprises, Inc. Condensed Consolidated Balance Sheet our "Investments in and advances to unconsolidated joint ventures" amounted to \$211.6 million and \$187.2 million at April 30, 2006 and October 31, 2005, respectively. The minor difference between the Hovnianian equity balance plus advances to unconsolidated joint ventures balance disclosed here compared to the Hovnianian Enterprises, Inc. Condensed Consolidated Balance Sheet is due to a different inside basis versus outside basis in certain joint ventures.

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For the Three Months Ended April 30, 2006

|                                    | Homebuilding | Land Development | Total      |
|------------------------------------|--------------|------------------|------------|
| Revenues.....                      | \$ 248,120   | \$ 4,030         | \$ 252,150 |
| Cost of sales and expenses.....    | (213,086)    | (4,594)          | (217,680)  |
| Net income (loss).....             | \$ 35,034    | \$ (564)         | \$ 34,470  |
| Our share of net earnings (losses) | \$ 9,959     | \$ (462)         | \$ 9,497   |

For the Three Months Ended April 30, 2005

|                                    | Homebuilding | Land Development | Total      |
|------------------------------------|--------------|------------------|------------|
| Revenues.....                      | \$ 124,007   | \$ 4,973         | \$ 128,980 |
| Cost of sales and expenses.....    | (107,848)    | (5,952)          | (113,800)  |
| Net income (loss).....             | \$ 16,159    | \$ (979)         | \$ 15,180  |
| Our share of net earnings (losses) | \$ 7,319     | \$ (179)         | \$ 7,140   |

For the Six Months Ended April 30, 2006

|                                    | Homebuilding | Land Development | Total      |
|------------------------------------|--------------|------------------|------------|
| Revenues.....                      | \$ 464,168   | \$ 12,431        | \$ 476,599 |
| Cost of sales and expenses.....    | (403,983)    | (12,251)         | (416,234)  |
| Net income.....                    | \$ 60,185    | \$ 180           | \$ 60,365  |
| Our share of net earnings (losses) | \$ 17,258    | \$ (186)         | \$ 17,072  |

For the Six Months Ended April 30, 2005

|                                    | Homebuilding | Land Development | Total      |
|------------------------------------|--------------|------------------|------------|
| Revenues.....                      | \$ 135,189   | \$ 7,701         | \$ 142,890 |
| Cost of sales and expenses.....    | (117,121)    | (8,962)          | (126,083)  |
| Net income (loss).....             | \$ 18,068    | \$ (1,261)       | \$ 16,807  |
| Our share of net earnings (losses) | \$ 8,952     | \$ (377)         | \$ 8,575   |

Income from unconsolidated joint ventures is reflected as a separate

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line in the accompanying Condensed Consolidated Financial Statements and reflects our proportionate share of the income of these unconsolidated homebuilding and land development joint ventures. Our ownership interests in the joint ventures vary but are generally less than or equal to 50 percent. In determining whether or not we must consolidate joint ventures, where we are the manager of the joint venture, we consider the guidance in EITF 04-5 in assessing whether the other partners have specific rights to overcome the presumption of control by us or the manager of the joint venture. In most cases, the presumption is overcome because the joint venture agreements require that both partners agree on establishing the operating and capital decisions of the partnership, including budgets, in the ordinary course of business.

Typically, our unconsolidated joint ventures obtain separate project specific mortgage financing for each venture. Generally, the amount of such financing is limited to no more than 50% of the joint venture's total assets, and such financing is obtained on a non-recourse basis, with guarantees from us limited only to performance and completion guarantees and limited environmental indemnifications.

16. Recent Accounting Pronouncements - In May 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections". This statement, which replaces APB Opinion No. 20, "Accounting Changes", and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements", changes the requirements for the accounting for and reporting of a change in accounting principle. The statement requires retrospective application of changes in accounting principle to prior periods' financial statements unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In June 2005, the Emerging Issues Task Force ("EITF") released Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" ("EITF 04-5"). EITF 04-5 creates a framework for evaluating whether a general partner or a group of general partners controls a limited partnership and therefore should consolidate the partnership. EITF 04-5 states that the presumption of general partner control would be overcome only when the limited partners have certain specific rights as outlined in EITF 04-5. EITF 04-5 is effective immediately for all newly formed limited partnerships and for existing limited partnership agreements that are modified. For general partners in all other limited partnerships, EITF 04-5 is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. Implementation of EITF 04-5 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

17. Intangible Assets - The intangible assets recorded on our balance sheet are goodwill, which has an indefinite life, and definite life intangibles, including tradenames, architectural designs, distribution processes, and contractual agreements resulting from our acquisitions. We no longer amortize goodwill, but instead assess it periodically for impairment. We are amortizing the definite life intangibles over their expected useful lives, ranging from three to seven years.

18. On March 1, 2005, we acquired for cash the assets of Cambridge Homes, a privately held Orlando homebuilder and provider of related financial services, headquartered in Altamonte Springs, Florida. Cambridge

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Homes also provides mortgage financing, as well as title and settlement services to its homebuyers. In connection with the acquisition, based on an appraisal of acquisition intangibles, we have definite life intangible assets equal to the excess of purchase price over the fair value of the net tangible assets of \$22 million. We are amortizing the various definite life intangibles over their estimated lives.

On March 2, 2005, we acquired the operations of Town & Country Homes, a privately held homebuilder and land developer headquartered in Lombard, Illinois, which occurred concurrently with our entering into a joint venture agreement with affiliates of Blackstone Real Estate Advisors in New York to own and develop Town & Country's existing residential communities. The joint venture is being accounted for under the equity method. Town & Country Homes' operations beyond the existing owned and optioned communities, as of the acquisition date, are wholly-owned and included in our consolidated financial statements.

On August 3, 2005, we acquired substantially all of the homebuilding assets of Oster Homes, a privately held Ohio homebuilder, headquartered in Lorain, Ohio.

On August 8, 2005, we acquired substantially all of the assets of First Home Builders of Florida, a privately held homebuilder and provider of related financial services headquartered in Cape Coral, Florida.

In connection with the First Home Builders of Florida and Oster Homes acquisitions, we have definite life intangible assets equal to the excess purchase price over the fair value of net tangible assets of \$121 million in the aggregate. We are awaiting the appraisal from these acquisitions. Until the appraisals are received, we estimated the intangible value for amortization calculations. We expect to have final appraisals by the third quarter ended July 31, 2006. We expect to amortize the definite life intangibles over their estimated lives.

On April 17, 2006, we acquired for cash the assets of CraftBuilt Homes, a privately held homebuilder headquartered in Bluffton, South Carolina. In connection with the acquisition, we have definite life intangible assets equal to the excess purchase price over the fair value of net tangible assets of \$4.5 million in the aggregate. We are awaiting the appraisal from this acquisition. Until the appraisal is received, we estimated the intangible value for amortization calculations. We expect to have the final appraisal by the end of the second quarter of fiscal 2007. We expect to amortize the definite life intangibles over their estimated lives.

19. Hovnanian Enterprises, Inc., the parent company (the "Parent"), is the issuer of publicly traded common stock and preferred stock. One of its wholly owned subsidiaries, K. Hovnanian Enterprises, Inc. (the "Subsidiary Issuer"), acts as a finance entity that as of April 30, 2006 had issued and outstanding \$400 million of Senior Subordinated Notes, \$1,405.3 million face value of Senior Notes, and \$275 million drawn on a Revolving Credit Agreement. The Senior Subordinated Notes, Senior Notes and the Revolving Credit Agreement are fully and unconditionally guaranteed by the Parent.

In addition to the Parent, each of the wholly owned subsidiaries of the Parent other than the Subsidiary Issuer (collectively, the "Guarantor Subsidiaries"), with the exception of various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, our mortgage lending subsidiaries, a subsidiary formerly engaged in homebuilding activity in Poland, our title insurance subsidiaries, joint ventures, and certain other subsidiaries (collectively, the "Non-guarantor

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Subsidiaries"), have guaranteed fully and unconditionally, on a joint and several basis, the obligations of the Subsidiary Issuer to pay principal and interest under the Senior Notes, Senior Subordinated Notes, and the Revolving Credit Agreement.

In lieu of providing separate audited financial statements for the Guarantor Subsidiaries we have included the accompanying condensed consolidating financial statements. Management does not believe that separate financial statements of the Guarantor Subsidiaries are material to investors. Therefore, separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented.

The following condensed consolidating financial information presents the results of operations, financial position, and cash flows of (i) the Parent, (ii) the Subsidiary Issuer, (iii) the Guarantor Subsidiaries, (iv) the Non-guarantor Subsidiaries, and (v) the eliminations to arrive at the information for Hovnanian Enterprises, Inc. on a consolidated basis.

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
 CONDENSED CONSOLIDATING BALANCE SHEET  
 APRIL 30, 2006  
 (Dollars in Thousands)

|   | Parent             | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations    |
|---|--------------------|----------------------|--------------------------------|-----------------------------------|----------------------|
| <b>ASSETS</b>   |                    |                      |                                |                                   |                      |
| Homebuilding.....   | \$ 1,238           | \$ 130,096           | \$ 4,844,120                   | \$ 284,008                        | \$ 5                 |
| Financial Services.....   |                    |                      | 99                             | 227,077                           |                      |
| Income Taxes (Payable) Receivable..   | 35,799             |                      | 60,565                         | 286                               |                      |
| Investments in and amounts due to<br>and from consolidated<br>subsidiaries..... | 1,940,153          | 2,281,543            | (2,374,684)                    | (241,662)                         | (1,605,350)          |
| <b>Total Assets.....</b>  | <b>\$1,977,190</b> | <b>\$2,411,639</b>   | <b>\$ 2,530,100</b>            | <b>\$ 269,709</b>                 | <b>\$(1,605,350)</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                     |                    |                      |                                |                                   |                      |
| Homebuilding.....   | \$                 | \$                   | \$ 1,025,003                   | \$ 30,817                         | \$ 1                 |
| Financial Services.....   |                    |                      | 58                             | 204,018                           |                      |
| Notes Payable.....  |                    | 2,098,584            | 1,038                          |                                   | 2                    |
| Minority Interest.....  |                    |                      | 243,339                        | 3,241                             |                      |
| Stockholders' Equity.....   | 1,977,190          | 313,055              | 1,260,662                      | 31,633                            | (1,605,350)          |
| <b>Total Liabilities and Stockholders'<br/>Equity.....</b>                      | <b>\$1,977,190</b> | <b>\$2,411,639</b>   | <b>\$ 2,530,100</b>            | <b>\$ 269,709</b>                 | <b>\$(1,605,350)</b> |

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 CONDENSED CONSOLIDATING BALANCE SHEET  
 OCTOBER 31, 2005  
 (Dollars in Thousands)



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|   | Parent             | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations    | Con-<br>solidated |
|---|--------------------|----------------------|--------------------------------|-----------------------------------|----------------------|-------------------|
| <b>Assets</b>   |                    |                      |                                |                                   |                      |                   |
| Homebuilding.....   | \$ 1,192           | \$ 325,997           | \$ 3,931,333                   | \$ 214,238                        | \$                   | \$4               |
| Financial Services.....   |                    |                      | 200                            | 237,092                           |                      |                   |
| Income Taxes (Payable) Receivable.  | (22,704)           |                      | 32,970                         | (363)                             |                      |                   |
| Investments in and Amounts Due to<br>And From Consolidated<br>Subsidiaries..... | 1,812,869          | 1,413,666            | (1,617,271)                    | (189,626)                         | (1,419,638)          |                   |
| <b>Total Assets.....</b>  | <b>\$1,791,357</b> | <b>\$1,739,663</b>   | <b>\$ 2,347,232</b>            | <b>\$ 261,341</b>                 | <b>\$(1,419,638)</b> | <b>\$4</b>        |
| <b>Liabilities</b>  |                    |                      |                                |                                   |                      |                   |
| Homebuilding.....   |                    | \$ 20,431            | \$ 996,428                     | \$ 3,626                          | \$                   | \$1               |
| Financial Services.....   |                    |                      | 81                             | 207,236                           |                      |                   |
| Notes Payable.....  |                    | 1,498,739            | (3,531)                        | 24,339                            |                      | 1                 |
| Minority Interest.....  |                    |                      | 180,170                        | 1,079                             |                      |                   |
| Stockholders' Equity.....   | 1,791,357          | 220,493              | 1,174,084                      | 25,061                            | (1,419,638)          | 1                 |
| <b>Total Liabilities and Stockholders'<br/>Equity.....</b>                      | <b>\$1,791,357</b> | <b>\$1,739,663</b>   | <b>\$ 2,347,232</b>            | <b>\$ 261,341</b>                 | <b>\$(1,419,638)</b> | <b>\$4</b>        |

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
THREE MONTHS ENDED APRIL 30, 2006  
(Dollars in Thousands)

|  | Parent         | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations | Conso-<br>lidated |
|--|----------------|----------------------|--------------------------------|-----------------------------------|-------------------|-------------------|
| <b>Revenues:</b>   |                |                      |                                |                                   |                   |                   |
| Homebuilding.....  | \$             | \$ 98                | \$1,541,591                    | \$ 11,241                         | \$                | \$1,552,          |
| Financial Services.....                                      |                |                      | 2,021                          | 19,170                            |                   | 21,               |
| Intercompany Charges.....                                    |                | 76,084               | 75,685                         |                                   | (151,769)         |                   |
| Equity In Pretax Income of<br>Consolidated Subsidiaries..... | 162,548        |                      |                                |                                   | (162,548)         |                   |
| <b>Total Revenues.....</b>                                   | <b>162,548</b> | <b>76,182</b>        | <b>1,619,297</b>               | <b>30,411</b>                     | <b>(314,317)</b>  | <b>1,574,</b>     |
| <b>Expenses:</b>   |                |                      |                                |                                   |                   |                   |
| Homebuilding.....  |                | 497                  | 1,436,417                      | 5,686                             | (36,047)          | 1,406,            |
| Financial Services.....                                      |                |                      | 1,296                          | 13,221                            |                   | 14,               |
| <b>Total Expenses.....</b>                                   |                | <b>497</b>           | <b>1,437,713</b>               | <b>18,907</b>                     | <b>(36,047)</b>   | <b>1,421,</b>     |
| Income from Unconsolidated<br>Joint Ventures.....            |                |                      | 9,497                          |                                   |                   | 9,                |
| <b>Income (Loss) Before Income Taxes.</b>                    | <b>162,548</b> | <b>75,685</b>        | <b>191,081</b>                 | <b>11,504</b>                     | <b>(278,270)</b>  | <b>162,</b>       |
| State and Federal Income Taxes.....                          | 58,899         | 24,637               | 69,886                         | 4,879                             | (99,402)          | 58,               |

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|                        |           |           |            |          |              |         |
|------------------------|-----------|-----------|------------|----------|--------------|---------|
| Net Income (Loss)..... | \$103,649 | \$ 51,048 | \$ 121,195 | \$ 6,625 | \$ (178,868) | \$ 103, |
|                        | =====     | =====     | =====      | =====    | =====        | =====   |

HOVNIANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
 CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
 THREE MONTHS ENDED APRIL 30, 2005  
 (Dollars in Thousands)

|  | Parent            | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations   | Conso<br>idate |
|--|-------------------|----------------------|--------------------------------|-----------------------------------|---------------------|----------------|
| <b>Revenues:</b>   |                   |                      |                                |                                   |                     |                |
| Homebuilding.....  | \$                | \$ 59                | \$1,192,973                    | \$ 168                            | \$                  | \$1,193,       |
| Financial Services.....                                      |                   |                      | 1,945                          | 14,324                            |                     | 16,            |
| Intercompany Charges.....                                    |                   | 52,263               | 52,864                         |                                   | (105,127)           |                |
| Equity In Pretax Income of<br>Consolidated Subsidiaries..... | 174,527           |                      |                                |                                   | (174,527)           |                |
| <b>Total Revenues.....</b>                                   | <b>174,527</b>    | <b>52,322</b>        | <b>1,247,782</b>               | <b>14,492</b>                     | <b>(279,654)</b>    | <b>1,209,</b>  |
| <b>Expenses:</b>   |                   |                      |                                |                                   |                     |                |
| Homebuilding.....  |                   | (543)                | 1,060,303                      | 857                               | (30,002)            | 1,030,         |
| Financial Services.....                                      |                   |                      | 1,042                          | 11,418                            | (993)               | 11,            |
| <b>Total Expenses.....</b>                                   |                   | <b>(543)</b>         | <b>1,061,345</b>               | <b>12,275</b>                     | <b>(30,995)</b>     | <b>1,042,</b>  |
| Income from Unconsolidated<br>Joint Ventures.....            |                   |                      | 7,140                          |                                   |                     | 7,             |
| <b>Income (Loss) Before Income Taxes.</b>                    | <b>174,527</b>    | <b>52,865</b>        | <b>193,577</b>                 | <b>2,217</b>                      | <b>(248,659)</b>    | <b>174,</b>    |
| State and Federal Income Taxes.....                          | 68,391            | 6,074                | 37,704                         | (2,852)                           | (40,926)            | 68,            |
| <b>Net Income (Loss).....</b>                                | <b>\$ 106,136</b> | <b>\$ 46,791</b>     | <b>\$ 155,873</b>              | <b>\$ 5,069</b>                   | <b>\$ (207,733)</b> | <b>\$ 106,</b> |

HOVNIANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
 CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
 SIX MONTHS ENDED APRIL 30, 2006  
 (Dollars in Thousands)

|  | Parent  | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations | Conso<br>idate |
|--|---------|----------------------|--------------------------------|-----------------------------------|-------------------|----------------|
| <b>Revenues:</b>   |         |                      |                                |                                   |                   |                |
| Homebuilding.....  | \$      | \$ 251               | \$2,798,018                    | \$ 13,391                         | \$                | \$2,811,       |
| Financial Services.....                                      |         |                      | 4,276                          | 36,177                            |                   | 40,            |
| Intercompany Charges.....                                    |         | 142,842              | 142,388                        |                                   | (285,230)         |                |
| Equity In Pretax Income of<br>Consolidated Subsidiaries..... | 297,774 |                      |                                |                                   | (297,774)         |                |

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|                                     |           |           |            |          |              |         |
|-------------------------------------|-----------|-----------|------------|----------|--------------|---------|
| Total Revenues.....                 | 297,774   | 143,093   | 2,944,682  | 49,568   | (583,004)    | 2,852,  |
| <b>Expenses:</b>                    |           |           |            |          |              |         |
| Homebuilding.....                   |           | 705       | 2,601,758  | 7,141    | (66,240)     | 2,543,  |
| Financial Services.....             |           |           | 2,179      | 26,113   | (245)        | 28,     |
| Total Expenses.....                 |           | 705       | 2,603,937  | 33,254   | (66,485)     | 2,571,  |
| Income from Unconsolidated          |           |           |            |          |              |         |
| Joint Ventures.....                 |           |           | 17,072     |          |              | 17,     |
| Income (Loss) Before Income Taxes.  | 297,774   | 142,388   | 357,817    | 16,314   | (516,519)    | 297,    |
| State and Federal Income Taxes..... | 110,029   | 48,048    | 131,750    | 6,791    | (186,589)    | 110,    |
| Net Income (Loss).....              | \$187,745 | \$ 94,340 | \$ 226,067 | \$ 9,523 | \$ (329,930) | \$ 187, |

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
 CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
 SIX MONTHS ENDED APRIL 30, 2005  
 (Dollars in Thousands)

|   | Parent    | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidate |
|---|-----------|-------------------|------------------------|----------------------------|--------------|-------------|
| <b>Revenues:</b>  |           |                   |                        |                            |              |             |
| Homebuilding.....   | \$        | \$ 101            | \$2,232,571            | \$ 896                     | \$           | \$2,233,    |
| Financial Services.....                                   |           |                   | 2,974                  | 27,488                     |              | 30,         |
| Intercompany Charges.....                                 |           | 100,660           | 101,849                |                            | (202,509)    |             |
| Equity In Pretax Income of Consolidated Subsidiaries..... | 306,433   |                   |                        |                            | (306,433)    |             |
| Total Revenues.....                                       | 306,433   | 100,761           | 2,337,394              | 28,384                     | (508,942)    | 2,264,      |
| <b>Expenses:</b>  |           |                   |                        |                            |              |             |
| Homebuilding.....   |           | (1,088)           | 1,996,758              | 2,028                      | (52,913)     | 1,944,      |
| Financial Services.....                                   |           |                   | 1,772                  | 21,493                     | (1,878)      | 21,         |
| Total Expenses.....                                       |           | (1,088)           | 1,998,530              | 23,521                     | (54,791)     | 1,966,      |
| Income from Unconsolidated                                |           |                   |                        |                            |              |             |
| Joint Ventures.....                                       |           |                   | 8,575                  |                            |              | 8,          |
| Income (Loss) Before Income Taxes.                        | 306,433   | 101,849           | 347,439                | 4,863                      | (454,151)    | 306,        |
| State and Federal Income Taxes.....                       | 118,815   | 23,172            | 92,627                 | 1,306                      | (117,105)    | 118,        |
| Net Income (Loss).....                                    | \$187,618 | \$ 78,677         | \$ 254,812             | \$ 3,557                   | \$ (337,046) | \$ 187,     |

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
 CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
 SIX MONTHS ENDED APRIL 30, 2006

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(Dollars in Thousands)

|   | Parent    | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations | Con<br>ida |
|---|-----------|----------------------|--------------------------------|-----------------------------------|-------------------|------------|
| <b>Cash Flows From Operating Activities:</b>  |           |                      |                                |                                   |                   |            |
| Net Income.....   | \$187,745 | \$ 94,340            | \$ 226,067                     | \$ 9,523                          | \$ (329,930)      | \$187      |
| Adjustments to reconcile net income<br>to net cash provided by<br>(used in) operating activities... | (65,373)  | 60                   | (1,045,498)                    | (49,573)                          | 329,930           | (83        |
| Net Cash Provided By (Used In)<br>Operating Activities.....   | 122,372   | 94,400               | (819,431)                      | (40,050)                          | -                 | (64        |
| Net Cash (Used In)<br>Investing Activities.....   |           |                      | (51,401)                       | (9,959)                           |                   | (6         |
| Net Cash Provided By (Used In)<br>Financing Activities.....   | 4,912     | 575,000              | (28,336)                       | (6,102)                           |                   | 54         |
| Intercompany Investing and Financing<br>Activities - Net.....                                       | (127,284) | (867,877)            | 943,125                        | 52,036                            |                   |            |
| Net Increase (Decrease) In Cash.....  | -         | (198,477)            | 43,957                         | (4,075)                           |                   | (15        |
| Balance, Beginning of Period.....   | 16        | 298,596              | (97,024)                       | 9,685                             |                   | 21         |
| Cash and Cash Equivalents Balance,<br>End of Period.....  | \$ 16     | \$100,119            | \$ (53,067)                    | \$ 5,610                          | \$                | \$ 5       |

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
SIX MONTHS ENDED APRIL 30, 2005  
(Dollars in Thousands)

|   | Parent    | Subsidiary<br>Issuer | Guarantor<br>Subsid-<br>iaries | Non-<br>Guarantor<br>Subsidiaries | Elimin-<br>ations | Con<br>ida |
|---|-----------|----------------------|--------------------------------|-----------------------------------|-------------------|------------|
| <b>Cash Flows From Operating Activities:</b>  |           |                      |                                |                                   |                   |            |
| Net Income.....   | \$187,618 | \$ 78,677            | \$ 254,812                     | \$ 3,557                          | \$ (337,046)      | \$ 18      |
| Adjustments to reconcile net income<br>to net cash provided by<br>(used in) operating activities... | (87,806)  | (11,476)             | (498,303)                      | (15,357)                          | 337,046           | (27        |
| Net Cash Provided By (Used In)<br>Operating Activities.....   | 99,812    | 67,201               | (243,491)                      | (11,800)                          | -                 | (8         |
| Net Cash (Used In)<br>Investing Activities.....   | (5,554)   |                      | (164,649)                      | (39)                              |                   | (17        |
| Net Cash Provided By (Used In)<br>Financing Activities.....   | (18,825)  | 290,100              | 25,585                         | (64,192)                          |                   | 23         |
| Intercompany Investing and Financing<br>Activities - Net.....                                       | (75,432)  | (315,110)            | 316,607                        | 73,935                            |                   |            |

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|  |       |           |             |          |       |
|--|-------|-----------|-------------|----------|-------|
| Net Increase (Decrease) In Cash.....                     | 1     | 42,191    | (65,948)    | (2,096)  | (2)   |
| Balance, Beginning of Period.....                        | 15    | 29,369    | 20,017      | 11,558   | 6     |
| Cash and Cash Equivalents Balance,<br>End of Period..... | \$ 16 | \$ 71,560 | \$ (45,931) | \$ 9,462 | \$ 3  |
|  | ===== | =====     | =====       | =====    | ===== |

### 20. Subsequent Events -

As discussed in Note 9, on May 19, 2006, we amended our secured mortgage loan warehouse agreement. Pursuant to the new agreement, we may borrow up to \$250 million through May 18, 2007. Interest is payable monthly at the LIBOR Rate plus 1.0%.

As discussed in Note 9, on May 31, 2006, we amended and restated our unsecured Revolving Credit Agreement. The amended and restated agreement provides a revolving credit line of \$1.5 billion through May 2011.

On June 5, 2006, we entered into an underwriting agreement to sell \$250 million 8 5/8% Senior Notes due 2017. The estimated net proceeds of \$247.7 million, after giving effect to discounts and commissions but without giving effect to our estimated expenses of the offering, will be used to repay amounts outstanding under the May 2006 Agreement. Subject to customary closing conditions contained in the underwriting agreement, we expect to settle this transaction on June 12, 2006.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Restatement of Notes to Financial Statements

As discussed in Note 3 to the condensed consolidated financial statements, subsequent to the issuance of our condensed consolidated financial statements for the quarterly period ended April 30, 2006, we expanded our disclosures of reportable segments in accordance with the provisions of Statements of Financial Accounting Standards ("SFAS ") 131, Disclosures About Segments of an Enterprise and Related Information. We had historically aggregated our homebuilding operating segments into a single, national reportable segment, but we have restated our segment disclosure to include six reportable homebuilding segments for the three and six months ended April 30, 2006 and 2005 (see Note 3). The restatement has no impact on our condensed consolidated balance sheets as of April 30, 2006, condensed consolidated statement of income and related income per common share amounts for the three and six months ended April 30, 2006 and 2005 or condensed consolidated statements of cash flows for the six months ended April 30, 2006 and 2005. We have amended our Annual Report on Form 10-K for the year ended October 31, 2005 for the related impact of this restatement.

### CRITICAL ACCOUNTING POLICIES

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

**Business Combinations** - When we make an acquisition of another company, we use the purchase method of accounting in accordance with the

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Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations". Under SFAS No. 141, we record as our cost the estimated fair value of the acquired assets less liabilities assumed. Any difference between the cost of an acquired company and the sum of the fair values of tangible and intangible assets less liabilities is recorded as goodwill. The reported income of an acquired company includes the operations of the acquired company from the date of acquisition.

Income Recognition from Home and Land Sales - We are primarily engaged in the development, construction, marketing and sale of residential single-family and multi-family homes where the planned construction cycle is less than 12 months. For these homes, in accordance with SFAS No. 66, "Accounting for Sales of Real Estate" ("SFAS 66"), revenue is recognized when title is conveyed to the buyer, adequate cash payment has been received and there is no continued involvement.

Additionally, in certain markets, we sell lots to customers, transferring title, collecting proceeds, and entering into contracts to build homes on these lots. In these cases, we do not recognize the revenue from the lot sale until we deliver the completed home and have no continued involvement related to that home. The cash received on the lot is recorded as customer deposits until the revenue is recognized.

Income Recognition from High-Rise/Mid-Rise Projects - We are developing several high-rise/mid-rise projects that will take more than 12 months to complete. If these projects qualify, revenues and costs are recognized using the percentage of completion method of accounting in accordance with SFAS 66. Under the percentage of completion method, revenues and costs are to be recognized when construction is beyond the preliminary stage, the buyer is committed to the extent of having a sufficient deposit that the buyer cannot require be refunded except for non-delivery of the home, sufficient units in the project have been sold to ensure that the property will not be converted to rental property, the sales prices are collectible and the aggregate sales proceeds and the total cost of the project can be reasonably estimated. We currently do not have any projects that meet these criteria, therefore the revenues from delivering homes in high-rise/mid-rise projects are recognized when title is conveyed to the buyer, adequate cash payment has been received and there is no continued involvement with respect to that home.

Income Recognition from Mortgage Loans - Profits and losses relating to the sale of mortgage loans are recognized when legal control passes to the buyer of the mortgage and the sales price is collected.

Interest Income Recognition for Mortgage Loans Receivable and Recognition of Related Deferred Fees and Costs - Interest income is recognized as earned for each mortgage loan during the period from the loan closing date to the sale date when legal control passes to the buyer and the sale price is collected. All fees related to the origination of mortgage loans and direct loan origination costs are deferred and recorded as either (a) an adjustment to the related mortgage loans upon the closing of a loan or (b) recognized as a deferred asset or deferred revenue while the loan is in process. These fees and costs include loan origination fees, loan discount, and salaries and wages. Such deferred fees and costs relating to the closed loans are recognized over the life of the loans as an adjustment of yield or taken into operations upon sale of the loan to a permanent investor.

Inventories - Inventories and long-lived assets held for sale are recorded at the lower of cost or fair value less selling costs. Fair value is defined as the amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than in a

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forced or liquidation sale. Construction costs are accumulated during the period of construction and charged to cost of sales under specific identification methods. Land, land development, and common facility costs are allocated based on buildable acres to product types within each community then charged to cost of sales equally based upon the number of homes to be constructed in each product type. For inventories of communities under development, a loss is recorded when events and circumstances indicate impairment and the undiscounted future cash flows generated are less than the related carrying amounts. The impairment loss is based on discounted future cash flows generated from expected revenue, less cost to complete including interest, and selling costs.

Insurance Deductible Reserves - For fiscal 2006, our deductible is \$20 million per occurrence with an aggregate \$20 million for premise liability claims and an aggregate \$20 million for construction defect claims under our general liability insurance. Our worker's compensation insurance deductible is \$1 million per occurrence in fiscal 2006. Reserves have been established based upon actuarial analysis of estimated losses incurred during fiscal 2006 and fiscal 2005. We engage a third party actuary that uses our historical warranty data to estimate our unpaid claims, claim adjustment expenses and incurred but not reported claims reserves for the risks that we are assuming under the general liability and workers compensation programs. The estimates include provisions for inflation, claims handling and legal fees.

Interest - In accordance with SFAS 34 "Capitalization of Interest Cost", interest incurred is first capitalized to properties under development during the land development and home construction period and expensed along with the associated cost of sales as the related inventories are sold. Interest in excess of interest capitalized or interest incurred on borrowings directly related to properties not under development is expensed immediately in "Other Interest".

Land Options - Costs are capitalized when incurred and either included as part of the purchase price when the land is acquired or charged to operations when we determine we will not exercise the option. In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46R ("FIN 46R") "Consolidation of Variable Interest Entities", an interpretation of Accounting Research Bulletin No. 51, SFAS No. 49 "Accounting for Product Financing Arrangements" ("SFAS 49"), SFAS No. 98 "Accounting for Leases" ("SFAS 98"), and Emerging Issues Task Force ("EITF") No. 97-10 "The Effects of Lessee Involvement in Asset Construction" ("EITF 97-10"), we record on the Condensed Consolidated Balance Sheet specific performance options, options with variable interest entities, and other options under "Consolidated Inventory Not Owned" with the offset to "Liabilities from inventory not owned" and "Minority interest from inventory not owned".

Unconsolidated Homebuilding and Land Development Joint Ventures - Investments in unconsolidated homebuilding and land development joint ventures are accounted for under the equity method of accounting. Under the equity method, we recognize our proportionate share of earnings and losses earned by the joint venture upon the delivery of lots or homes to third parties. Our ownership interest in joint ventures varies but is generally less than or equal to 50%. In determining whether or not we must consolidate joint ventures, where we are the managing member of the joint venture, we consider the guidance in EITF 04-5 in assessing whether the other partners have specific rights to overcome the presumption of control by us as the manager of the joint venture. In most cases, the presumption is overcome because the joint venture agreements require that both partners agree on establishing the operating and capital decisions of the partnership, including budgets, in the ordinary course of business.

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Intangible Assets - The intangible assets recorded on our balance sheet are goodwill, which has indefinite life, and definite life intangibles, including tradenames, architectural designs, distribution processes, and contractual agreements resulting from our acquisitions. We no longer amortize goodwill, but instead assess it periodically for impairment. We are amortizing the definite life intangibles over their expected useful lives, ranging from three to eight years.

Post Development Completion and Warranty Costs - In those instances where a development is substantially completed and sold and we have additional construction work to be incurred, an estimated liability is provided to cover the cost of such work. In addition, our warranty accrual includes estimated costs for construction work that is unforeseen, but estimable based on past history, at the time of closing. Both of these liabilities are recorded in "Accounts payable and other liabilities" in the Condensed Consolidated Balance Sheets.

### CAPITAL RESOURCES AND LIQUIDITY

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

Our cash uses during the six months ended April 30, 2006 were for operating expenses, increases in housing inventories, construction, income taxes, interest, preferred stock dividends, the acquisition of CraftBuilt Homes and repayments of our revolving credit facility. We provided for our cash requirements from housing and land sales, the revolving credit facility, Senior Notes issued in February 2006, financial service revenues, and other revenues. We believe that these sources of cash are sufficient to finance our working capital requirements and other needs.

On July 3, 2001, our Board of Directors authorized a stock repurchase program to purchase up to 4 million shares of Class A Common Stock. As of April 30, 2006, 2.8 million shares of Class A Common Stock have been purchased under this program.

On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of \$25,000 per share for net proceeds of \$135 million. Dividends on the Series A Preferred Stock are not cumulative and are paid at an annual rate of 7.625%. The Series A Preferred Stock is not convertible into the Company's common stock and is redeemable in whole or in part at our option at the liquidation preference of the shares beginning on the fifth anniversary of their issuance. The Series A Preferred Stock is traded as depositary shares, with each depositary share representing 1/1000th of a share of Series A Preferred Stock. The depositary shares are listed on the Nasdaq National Market under the symbol "HOVNP". The net proceeds from the offering, reflected in Preferred Stock in the Condensed Consolidated Balance Sheet, were used for the partial repayment of the outstanding balance under our revolving credit facility as of July 12, 2005. On both January 17, 2006 and April 17, 2006, we paid \$2.7 million of dividends on the Series A Preferred Stock.

Our homebuilding bank borrowings were made pursuant to an amended and restated unsecured revolving credit agreement (the "Agreement") effective June 17, 2005, that provided a revolving credit line and letter of credit



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line of \$1.2 billion through July 2009. The facility contained an accordion feature under which the aggregate commitment could be increased to \$1.3 billion subject to the availability of additional commitments. Interest was payable monthly at various rates, at our option, based on either (1) a LIBOR-based rate for a one, two, three or six month interest period as selected by us or (2) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus 1/2% plus a margin ranging from 1.00% to 1.95% per annum, depending on our Consolidated Leverage Ratio, as defined in the Agreement. In addition, we paid a fee ranging from 0.20% to 0.30% per annum on the unused portion of the revolving credit line depending on its Leverage Ratio and the average percentage unused portion of the revolving credit line. At April 30, 2006, there was \$275.0 million drawn under this Agreement and we had approximately \$47.5 million of homebuilding cash. At April 30, 2006, we had issued \$432.8 million of letters of credit which reduced cash available under the Agreement.

On May 31, 2006, we entered into an amended and restated unsecured Revolving Credit Agreement ("May 2006 Agreement") with a group of lenders. The May 2006 Agreement replaced the Agreement and increased the revolving credit line from \$1.2 billion to \$1.5 billion and extended the maturity through May 2011. The facility contains an accordion feature under which the aggregate commitment can be increased to \$2.0 billion subject to the availability of additional commitments. Loans under the May 2006 Agreement will bear interest at various rates based on (1) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus 1/2% or (2) a margin ranging from 0.65% to 1.50% per annum, depending on our Leverage Ratio, as defined in the May 2006 Agreement, and our debt ratings plus a LIBOR-based rate for a one, two, three, or six month interest period as selected by us. In addition, we pay a fee ranging from 0.15% to 0.25% per annum on the unused portion of the revolving credit line depending on our Leverage Ratio and our debt ratings and the average percentage unused portion of the revolving credit line.

We believe that we will be able either to extend the Agreement beyond May 2011 or negotiate a replacement facility, but there can be no assurance of such extension or replacement facility. We currently are in compliance and intend to maintain compliance with the covenants under the Agreement. We and each of our significant subsidiaries, except for K. Hovnanian Enterprises, Inc., the borrower, and various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, a subsidiary formerly engaged in homebuilding activity in Poland, our financial services subsidiaries, joint ventures, and certain other subsidiaries, is a guarantor under the Agreement.

At April 30, 2006, we had \$1,405.3 million of outstanding senior notes (\$1,399.2 million, net of discount), comprised of \$140.3 million 10 1/2% Senior Notes due 2007, \$100 million 8% Senior Notes due 2012, \$215 million 6 1/2% Senior Notes due 2014, \$150 million 6 3/8% Senior Notes due 2014, \$200 million 6 1/4% Senior Notes due 2015, \$300 million 6 1/4% Senior Notes due 2016 and \$300 million 7 1/2% Senior Notes due 2016. At April 30, 2006, we had \$400.0 million of outstanding senior subordinated notes, comprised of \$150 million 8 7/8% Senior Subordinated Notes due 2012, \$150 million 7 3/4% Senior Subordinated Notes due 2013, and \$100 million 6% Senior Subordinated Notes due 2010. We and each of our wholly owned subsidiaries, except for K. Hovnanian Enterprises, Inc., the issuer of the senior and senior subordinated notes, and various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, our mortgage lending subsidiaries, a subsidiary formerly engaged in homebuilding activity in Poland, our title insurance subsidiaries, joint ventures, and certain other subsidiaries is a guarantor of the senior notes

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and senior subordinated notes.

On June 5, 2006, we entered into an underwriting agreement to sell \$250 million 8 5/8% Senior Notes due 2017. The estimated net proceeds of \$247.7 million, after giving effect to discounts and commissions but without giving effect to our estimated expenses of the offering, will be used to repay amounts outstanding under the May 2006 Agreement. Subject to customary closing conditions contained in the underwriting agreement, we expect to settle this transaction on June 12, 2006.

Our mortgage banking subsidiary's warehouse agreement was amended on May 19, 2006. Pursuant to the agreement, we may borrow up to \$250 million through May 2007. Interest is payable monthly at the LIBOR Rate plus 1.0%. We also have a \$100 million commercial paper facility. The facility was amended on April 21, 2006 and expires in April 2007. Interest of LIBOR plus .65% is payable monthly. As of April 30, 2006, the aggregate principal amount of all borrowings under this agreement was \$195.2 million.

Total inventory increased \$812.1 million during the six months ended April 30, 2006. This increase excluded the increase in consolidated inventory not owned of \$147.0 million consisting of specific performance options, options with variable interest entities, and other options that were added to our balance sheet in accordance with SFAS 49, SFAS 98, and EITF 97-10, and variable interest entities in accordance with FIN 46R. See "Notes to Condensed Consolidated Financial Statements"- Note 14 for additional information on FIN 46R. Excluding the impact from an acquisition of \$23.9 million, the total inventory in the Southeast increased \$111.2 million, the Northeast increased \$170.1 million, the Mid-Atlantic increased \$118.7 million, the Midwest increased \$39.4 million, the Southwest increased \$73.0 million, and the West increased \$275.8 million. The increase in inventory was primarily the result of future planned organic growth in our existing markets as we have increased the number of communities open for sale from 367 at October 31, 2005 to 411 at April 30, 2006. Substantially all homes under construction or completed and included in inventory at April 30, 2006 are expected to be closed during the next twelve months. Most inventory completed or under development is partially financed through our revolving credit agreement and senior and senior subordinated indebtedness.

We usually option property for development prior to acquisition. By optioning property, we are only subject to the loss of the cost of the option and predevelopment costs if we choose not to exercise the option. As a result, our commitment for major land acquisitions is reduced.

The following table summarizes the number of buildable homes included in our total residential real estate. The April 30, 2006 and October 31, 2005 numbers exclude real estate owned and options in locations where we have ceased development.

|                   | Active<br>Communities | Active<br>Communities<br>Homes | Proposed<br>Developable<br>Homes | Grand<br>Total<br>Homes |
|-------------------|-----------------------|--------------------------------|----------------------------------|-------------------------|
|                   | -----                 | -----                          | -----                            | -----                   |
| April 30, 2006:   |                       |                                |                                  |                         |
| Northeast.....    | 44                    | 7,550                          | 17,652                           | 25,202                  |
| Mid-Atlantic..... | 86                    | 9,056                          | 13,343                           | 22,399                  |
| Midwest.....      | 29                    | 3,630                          | 5,068                            | 8,698                   |
| Southeast.....    | 91                    | 14,503                         | 14,016                           | 28,519                  |
| Southwest.....    | 103                   | 13,577                         | 7,019                            | 20,596                  |

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|                     |       |        |        |         |
|---------------------|-------|--------|--------|---------|
| West.....           | 58    | 10,636 | 10,261 | 20,897  |
|                     | ----- | -----  | -----  | -----   |
| Consolidated Total  | 411   | 58,952 | 67,359 | 126,311 |
|                     | ===== |        |        |         |
| Unconsolidated      |       |        |        |         |
| Joint Ventures..    |       | 6,024  | 2,431  | 8,455   |
|                     |       | -----  | -----  | -----   |
| Total Including     |       |        |        |         |
| Unconsolidated      |       |        |        |         |
| Joint Ventures..    |       | 64,976 | 69,790 | 134,766 |
|                     |       | =====  | =====  | =====   |
| Owned.....          |       | 28,147 | 6,553  | 34,700  |
| Optioned.....       |       | 26,323 | 60,806 | 87,129  |
|                     |       | -----  | -----  | -----   |
| Controlled Lots...  |       | 54,470 | 67,359 | 121,829 |
|                     |       |        |        |         |
| Construction to     |       |        |        |         |
| Permanent Financing |       |        |        |         |
| Lots.....           |       | 4,482  | -      | 4,482   |
| Lots Controlled by  |       |        |        |         |
| Unconsolidated      |       |        |        |         |
| Joint ventures..    |       | 6,024  | 2,431  | 8,455   |
|                     |       | -----  | -----  | -----   |
| Total Including     |       |        |        |         |
| Unconsolidated      |       |        |        |         |
| Joint Ventures..    |       | 64,976 | 69,790 | 134,766 |
|                     |       | =====  | =====  | =====   |

|                                | Active<br>Communities | Active<br>Communities<br>Homes | Proposed<br>Developable<br>Homes | Grand<br>Total<br>Homes |
|--------------------------------|-----------------------|--------------------------------|----------------------------------|-------------------------|
|                                | -----                 | -----                          | -----                            | -----                   |
| October 31, 2005:              |                       |                                |                                  |                         |
| Northeast.....                 | 40                    | 7,179                          | 19,465                           | 26,644                  |
| Mid-Atlantic.....              | 70                    | 7,137                          | 16,445                           | 23,582                  |
| Midwest.....                   | 25                    | 3,618                          | 3,463                            | 7,081                   |
| Southeast.....                 | 78                    | 14,576                         | 9,668                            | 24,244                  |
| Southwest.....                 | 102                   | 12,905                         | 7,547                            | 20,452                  |
| West.....                      | 52                    | 9,285                          | 9,718                            | 19,003                  |
|                                |                       | -----                          | -----                            | -----                   |
| Consolidated Total             | 367                   | 54,700                         | 66,306                           | 121,006                 |
|                                | =====                 |                                |                                  |                         |
| Unconsolidated                 |                       |                                |                                  |                         |
| Joint Ventures..               |                       | 6,655                          | 3,396                            | 10,051                  |
|                                |                       | -----                          | -----                            | -----                   |
| Total Including Unconsolidated |                       |                                |                                  |                         |
| Joint Ventures..               |                       | 61,355                         | 69,702                           | 131,057                 |
|                                |                       | =====                          | =====                            | =====                   |
| Owned.....                     |                       | 24,731                         | 5,657                            | 30,388                  |
| Optioned.....                  |                       | 25,046                         | 60,649                           | 85,695                  |
|                                |                       | -----                          | -----                            | -----                   |
| Controlled Lots...             |                       | 49,777                         | 66,306                           | 116,083                 |
|                                |                       |                                |                                  |                         |
| Construction to                |                       |                                |                                  |                         |
| Permanent Financing            |                       |                                |                                  |                         |
| Lots.....                      |                       | 4,923                          | -                                | 4,923                   |
| Lots Controlled by             |                       |                                |                                  |                         |

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|   |        |        |         |
|---|--------|--------|---------|
| Unconsolidated<br>Joint ventures..                    | 6,655  | 3,396  | 10,051  |
|   | -----  | -----  | -----   |
| Total Including<br>Unconsolidated<br>Joint Ventures.. | 61,355 | 69,702 | 131,057 |
|   | =====  | =====  | =====   |

The following table summarizes our started or completed unsold homes and models. The increase in total started or completed unsold homes compared to the prior year is primarily due to the increase in mid-rise and high-rise buildings for which we count all units started when vertical construction begins and the growth in the number of active selling communities.

|                   | April 30,<br>2006 |        |       | October 31,<br>2005 |        |       |
|-------------------|-------------------|--------|-------|---------------------|--------|-------|
|                   | Unsold<br>Homes   | Models | Total | Unsold<br>Homes     | Models | Total |
|                   | -----             | -----  | ----- | -----               | -----  | ----- |
| Northeast.....    | 510               | 24     | 534   | 294                 | 18     | 312   |
| Mid-Atlantic..... | 351               | 22     | 373   | 167                 | 19     | 186   |
| Midwest.....      | 211               | 14     | 225   | 175                 | 17     | 192   |
| Southeast.....    | 380               | 35     | 415   | 250                 | 37     | 287   |
| Southwest.....    | 945               | 80     | 1,025 | 901                 | 70     | 971   |
| West.....         | 582               | 144    | 726   | 275                 | 157    | 432   |
|                   | -----             | -----  | ----- | -----               | -----  | ----- |
| Total             | 2,979             | 319    | 3,298 | 2,062               | 318    | 2,380 |
|                   | =====             | =====  | ===== | =====               | =====  | ===== |

Investments in and advances to unconsolidated joint ventures increased \$24.4 million during the six months ended April 30, 2006. This increase is due to income from joint ventures not distributed and additional investment in joint ventures. As of April 30, 2006, we have investments in nine homebuilding joint ventures and nine land development joint ventures. Other than performance and completion guarantees and limited environmental indemnifications, no other guarantees associated with unconsolidated joint ventures have been given.

Receivables, deposits, and notes decreased \$43.2 million to \$82.2 million at April 30, 2006. The decrease was primarily due to a decrease in miscellaneous receivables for a payment received in the first quarter of 2006 from an unconsolidated joint venture. It was also due to the reduction in the receivables from home sales, which were in transit from various title companies, amounting to \$27.2 million and \$39.4 million at April 30, 2006 and October 31, 2005, respectively.

Prepaid expenses and other assets are as follows:

|                                       | April 30,<br>2006 | October 31,<br>2005 | Dollar<br>Change |
|---------------------------------------|-------------------|---------------------|------------------|
|                                       | -----             | -----               | -----            |
| Prepaid insurance.....                | \$ 13,036         | \$ -                | \$ 13,036        |
| Prepaid project costs.....            | 79,004            | 61,773              | 17,231           |
| Senior residential rental properties. | 8,554             | 8,754               | (200)            |
| Other prepaids.....                   | 30,098            | 24,547              | 5,551            |
| Other assets.....                     | 34,950            | 30,588              | 4,362            |
|                                       | -----             | -----               | -----            |

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\$ 165,642    \$ 125,662    \$ 39,980  
 =====    =====    =====

Prepaid insurance increased due to a payment of a full year of liability insurance premium costs during the first quarter of every year. These costs are amortized on a straight line basis. Prepaid project costs and other prepaids increased due to the growth in the number of communities. Prepaid project costs consist of community specific expenditures that are used over the life of the community. Such prepaids are expensed as homes are delivered. The increase in other prepaids is due to advertising materials purchased for new start-up communities, which are amortized as homes are delivered. The increase in other assets is primarily attributable to the executive deferred compensation plan, due to increased profit sharing contributions for senior management.

At April 30, 2006, we had \$32.7 million of goodwill. This amount resulted from Company acquisitions prior to fiscal 2000.

Definite life intangibles decreased \$44.6 million to \$204.9 million at April 30, 2006. The decrease was the result of amortization during the six months of \$25.1 million, and an adjustment to the First Home Builders of Florida acquisition accounting offset by our Cambridge Homes acquisition earnout and contingent payments related to past acquisitions. As we finalize our valuation of the assets acquired from First Home Builders of Florida, we established a deferred tax asset as part of the purchase price allocation, which reduced the recorded intangibles. For any acquisition, professionals are hired to appraise all acquired intangibles. See "- Critical Accounting Policies - Intangible Assets" above for additional information on intangibles. For tax purposes all our intangibles, except those resulting from an acquisition classified as a tax free exchange, are being amortized over 15 years.

Accounts payable and other liabilities are as follows:

|                           | April 30,<br>2006 | October 31,<br>2005 | Dollar<br>Change |
|---------------------------|-------------------|---------------------|------------------|
|                           | -----             | -----               | -----            |
| Accounts payable.....     | \$182,827         | \$ 191,469          | \$ (8,642)       |
| Reserves.....             | 100,362           | 95,310              | 5,052            |
| Accrued expenses.....     | 41,305            | 48,647              | (7,342)          |
| Accrued compensation..... | 67,296            | 75,655              | (8,359)          |
| Other liabilities.....    | 108,496           | 99,448              | 9,048            |
|                           | -----             | -----               | -----            |
|                           | \$500,286         | \$ 510,529          | \$(10,243)       |
|                           | =====             | =====               | =====            |

The decrease in accounts payable was primarily due to decreased deliveries in the second quarter of 2006 compared to the fourth quarter of 2005 throughout our markets, which resulted in less activity and lower payables. Reserves increased for our general liability insurance deductible and bonding. The decrease in accrued expenses is due to timing of property tax payments and acquisition earnout obligations. The decrease in accrued compensation was primarily due to the payout of our fiscal year 2005 bonuses during the first quarter of 2006. The increase in other liabilities is mainly due to increased contributions to our executive deferred compensation plan and an increase in deferred income from an advance related to a lot option in the Southwest.

Financial Services - Mortgage loans held for sale consist of residential mortgages receivable of which \$214.2 million and \$211.2 million at April 30, 2006 and October 31, 2005, respectively, are being temporarily warehoused and awaiting sale in the secondary mortgage market. We may

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incur risk with respect to mortgages that are delinquent, but only to the extent the losses are not covered by mortgage insurance or resale value of the house. Historically, we have incurred minimal credit losses.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED APRIL 30, 2006 COMPARED TO THE SIX MONTHS ENDED APRIL 30, 2005

Total Revenues:

Compared to the same prior period, revenues increased as follows:

|                                       | Three Months Ended     |                   |                  |                      |
|---------------------------------------|------------------------|-------------------|------------------|----------------------|
|                                       | April 30,<br>2006      | April 30,<br>2005 | Dollar<br>Change | Percentage<br>Change |
|                                       | (Dollars In Thousands) |                   |                  |                      |
| Homebuilding:                         |                        |                   |                  |                      |
| Sale of homes.....                    | \$1,479,548            | \$1,189,672       | \$289,876        | 24.4%                |
| Land sales and other<br>revenues..... | 73,382                 | 3,528             | 69,854           | 1,980.0%             |
| Financial Services.....               | 21,191                 | 16,269            | 4,922            | 30.3%                |
| Total Revenues...                     | \$1,574,121            | \$1,209,469       | \$364,652        | 30.1%                |

|                                       | Six Months Ended       |                   |                  |                      |
|---------------------------------------|------------------------|-------------------|------------------|----------------------|
|                                       | April 30,<br>2006      | April 30,<br>2005 | Dollar<br>Change | Percentage<br>Change |
|                                       | (Dollars In Thousands) |                   |                  |                      |
| Homebuilding:                         |                        |                   |                  |                      |
| Sale of homes.....                    | \$2,725,745            | \$2,205,641       | \$520,104        | 23.6%                |
| Land sales and other<br>revenues..... | 85,915                 | 27,927            | 57,988           | 207.6%               |
| Financial Services.....               | 40,453                 | 30,462            | 9,991            | 32.8%                |
| Total Revenues...                     | \$2,852,113            | \$2,264,030       | \$588,083        | 26.0%                |

Homebuilding:

Compared to the same prior period, housing revenues increased \$289.9 million or 24.4% during the three months ended April 30, 2006 and increased \$520.1 million or 23.6% during the six months ended April 30, 2006. Land sales are incidental to our residential housing operations and are expected to continue in the future but may significantly fluctuate up or down. For further details on land sales and other revenues, see paragraph titled "Land Sales and Other Revenues" later in this document.

Information on homes delivered by market area is set forth below:

|                    |                  |
|--------------------|------------------|
| Three Months Ended | Six Months Ended |
| April 30,          | April 30,        |

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|                                    | 2006         | 2005        | 2006        | 2005        |
|------------------------------------|--------------|-------------|-------------|-------------|
| (Dollars in Thousands)             |              |             |             |             |
| Northeast:                         |              |             |             |             |
| Dollars.....                       | \$ 203,828   | \$ 248,843  | \$ 400,127  | \$ 468,734  |
| Homes.....                         | 437          | 589         | 879         | 1,142       |
| Mid-Atlantic:                      |              |             |             |             |
| Dollars.....                       | \$ 251,012   | \$ 183,782  | \$ 448,890  | \$ 342,111  |
| Homes.....                         | 491          | 404         | 870         | 752         |
| Midwest (1):                       |              |             |             |             |
| Dollars.....                       | \$ 29,124    | \$ 18,402   | \$ 58,327   | \$ 36,972   |
| Homes.....                         | 209          | 136         | 379         | 270         |
| Southeast (2):                     |              |             |             |             |
| Dollars.....                       | \$ 311,202   | \$ 151,118  | \$ 580,980  | \$ 256,623  |
| Homes.....                         | 1,316        | 714         | 2,464       | 1,268       |
| Southwest:                         |              |             |             |             |
| Dollars.....                       | \$ 232,289   | \$ 164,133  | \$ 415,548  | \$ 300,044  |
| Homes.....                         | 1,054        | 900         | 1,926       | 1,615       |
| West:                              |              |             |             |             |
| Dollars.....                       | \$ 452,093   | \$ 423,394  | \$ 821,873  | \$ 801,157  |
| Homes.....                         | 1,048        | 1,005       | 1,882       | 1,967       |
| Consolidated Total:                |              |             |             |             |
| Dollars.....                       | \$ 1,479,548 | \$1,189,672 | \$2,725,745 | \$2,205,641 |
| Homes.....                         | 4,555        | 3,748       | 8,400       | 7,014       |
| Unconsolidated Joint Ventures (3): |              |             |             |             |
| Dollars.....                       | \$ 244,402   | \$ 123,732  | \$ 459,014  | \$ 135,317  |
| Homes.....                         | 612          | 351         | 1,197       | 373         |
| Totals:                            |              |             |             |             |
| Housing Revenues...                | \$ 1,723,950 | \$1,313,404 | \$3,184,759 | \$2,340,958 |
| Homes Delivered....                | 5,167        | 4,099       | 9,597       | 7,387       |

- (1) Midwest includes deliveries from our Ohio acquisition of Oster Homes on August 3, 2005.
- (2) Southeast includes deliveries from our Florida acquisitions of Cambridge Homes and First Home Builders of Florida on March 1, 2005 and August 8, 2005, respectively, and our acquisition of CraftBuilt Homes on April 1, 2006 with deliveries in South Carolina and Georgia.
- (3) Unconsolidated Joint Ventures includes deliveries from our joint venture with affiliates of Blackstone Real Estate Advisors that acquired Town & Country Homes existing residential communities on March 2, 2005.

An important indicator of our future results are recently signed contracts and home contract backlog for future deliveries. Our sales contracts and homes in contract backlog using base sales prices by market area are set forth below:

|   |                                     |
|---|-------------------------------------|
| Net Contracts(1) for the<br>Six Months Ended<br>April 30, | Contract Backlog<br>as of April 30, |
|---|-------------------------------------|

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|                                    | 2006         | 2005         | 2006         | 2005         |
|------------------------------------|--------------|--------------|--------------|--------------|
| (Dollars in Thousands)             |              |              |              |              |
| Northeast:                         |              |              |              |              |
| Dollars.....                       | \$ 420,376   | \$ 416,882   | \$ 758,960   | \$ 681,208   |
| Homes.....                         | 961          | 1,029        | 1,665        | 1,646        |
| Mid-Atlantic:                      |              |              |              |              |
| Dollars.....                       | \$ 497,147   | \$ 511,983   | \$ 761,279   | \$ 706,815   |
| Homes.....                         | 967          | 1,034        | 1,478        | 1,451        |
| Midwest (1):                       |              |              |              |              |
| Dollars.....                       | \$ 81,606    | \$ 26,459    | \$ 110,774   | \$ 50,831    |
| Homes.....                         | 408          | 227          | 610          | 454          |
| Southeast (3):                     |              |              |              |              |
| Dollars.....                       | \$ 503,789   | \$ 311,184   | \$ 1,438,488 | \$ 437,550   |
| Homes.....                         | 1,648        | 1,333        | 5,265        | 1,785        |
| Southwest:                         |              |              |              |              |
| Dollars.....                       | \$ 436,494   | \$ 400,535   | \$ 315,309   | \$ 272,554   |
| Homes.....                         | 2,036        | 2,119        | 1,406        | 1,428        |
| West:                              |              |              |              |              |
| Dollars.....                       | \$ 600,454   | \$ 860,487   | \$ 587,465   | \$ 862,048   |
| Homes.....                         | 1,292        | 2,122        | 1,163        | 2,072        |
| Consolidated Total:                |              |              |              |              |
| Dollars.....                       | \$ 2,539,866 | \$ 2,527,530 | \$ 3,972,275 | \$ 3,011,006 |
| Homes.....                         | 7,312        | 7,864        | 11,587       | 8,836        |
| Unconsolidated Joint Ventures (4): |              |              |              |              |
| Dollars.....                       | \$ 238,329   | \$ 361,784   | \$ 810,115   | \$ 879,482   |
| Homes.....                         | 654          | 704          | 1,797        | 2,150        |
| Totals:                            |              |              |              |              |
| Dollars.....                       | \$ 2,778,195 | \$ 2,889,314 | \$ 4,782,390 | \$ 3,890,488 |
| Homes.....                         | 7,966        | 8,568        | 13,384       | 10,986       |

- (1) Net contracts are defined as new contracts during the period for the purchase of homes, less cancellations of prior contracts.
- (2) The number and the dollar amount of net contracts and contract backlog in the Midwest in 2006 include the effect of the Oster Homes acquisition, which closed in August 2005.
- (3) The number and the dollar amount of net contracts and contract backlog in the Southeast in 2006 include the effects of the Cambridge Homes, First Home Builders of Florida and CraftBuilt Homes acquisitions, which closed in March 2005, August 2005 and April 2006, respectively.
- (4) The number and the dollar amount of net contracts and contract backlog in Unconsolidated Joint Ventures in 2006 include our joint venture with affiliates of Blackstone Real Estate Advisors that acquired Town & Country Homes existing residential communities on March 2, 2005.

Our reported level of net contracts has been impacted by an increase in our cancellation rates over the past few quarters. The cancellation rate represents the number of cancelled contracts in the quarter divided by the number of gross sales contracts executed in the quarter. For comparison, the following are historical cancellation rates:



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| Quarter | 2003 | 2004 | 2005 | 2006 |
|---------|------|------|------|------|
| -----   | ---- | ---- | ---- | ---- |
| First   | 23%  | 23%  | 27%  | 30%  |
| Second  | 18%  | 19%  | 21%  | 32%  |
| Third   | 21%  | 20%  | 24%  |      |
| Fourth  | 25%  | 24%  | 25%  |      |

Most cancellations occur within the legal rescission period, which varies by state but is generally less than two weeks. Cancellations also occur as a result of buyer failure to qualify for a mortgage, which generally occurs during the first few weeks after signing. Cancellation rates can be higher in markets where buyers sign contracts so as to tie up a house they like and then cancel within the rescission period once they reach a final decision on the house they want. This situation is more common in certain markets, particularly California.

Cost of sales includes expenses for homebuilding and land sales. A breakout of such expenses for homebuilding sales and homebuilding gross margin is set forth below:

|   | Three Months Ended<br>April 30, |             | Six Months Ended<br>April 30, |             |
|---|---------------------------------|-------------|-------------------------------|-------------|
|   | 2006                            | 2005        | 2006                          | 2005        |
|   | -----                           |             |                               |             |
|   | (Dollars in Thousands)          |             |                               |             |
| Sale of Homes.....                                      | \$1,479,548                     | \$1,189,672 | \$2,725,745                   | \$2,205,641 |
| Cost of Sales, excluding<br>interest.....               | 1,128,530                       | 875,016     | 2,055,352                     | 1,632,101   |
| Homebuilding Gross Margin,<br>before interest expense.. | 351,018                         | 314,656     | 670,393                       | 573,540     |
| Homebuilding Cost of<br>Sales Interest.....             | 19,861                          | 18,441      | 35,972                        | 36,020      |
| Homebuilding Gross Margin,<br>after interest expense... | \$ 331,157                      | \$ 296,215  | \$ 634,421                    | \$ 537,520  |
|   | =====                           | =====       | =====                         | =====       |
| Gross Margin Percentage,<br>before interest expense..   | 23.7%                           | 26.4%       | 24.6%                         | 26.0%       |
| Gross Margin Percentage,<br>after interest expense...   | 22.4%                           | 24.9%       | 23.3%                         | 24.4%       |
|   | =====                           | =====       | =====                         | =====       |

Cost of Sales expenses as a percentage of home sales revenues are presented below:

|                          | Three Months Ended<br>April 30, |        | Six Months Ended<br>April 30, |        |
|--------------------------|---------------------------------|--------|-------------------------------|--------|
|                          | 2006                            | 2005   | 2006                          | 2005   |
|                          | -----                           |        |                               |        |
| Sale of Homes.....       | 100.0%                          | 100.0% | 100.0%                        | 100.0% |
| Cost of Sales, excluding |                                 |        |                               |        |

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|  |       |       |       |       |
|--|-------|-------|-------|-------|
| interest:  |       |       |       |       |
| Homebuilding, land & development costs....           | 68.4% | 65.7% | 67.2% | 65.8% |
| Commissions.....                                     | 2.4%  | 2.1%  | 2.3%  | 2.1%  |
| Financing concessions..                              | .9%   | .9%   | .9%   | .9%   |
| Overheads.....                                       | 4.6%  | 4.9%  | 5.0%  | 5.2%  |
|  | ----- | ----- | ----- | ----- |
| Total Cost of Sales, before interest expense.....    | 76.3% | 73.6% | 75.4% | 74.0% |
|  | ----- | ----- | ----- | ----- |
| Gross Margin Percentage, before interest expense.... | 23.7% | 26.4% | 24.6% | 26.0% |
|  | ----- | ----- | ----- | ----- |
| Cost of sales interest.....                          | 1.3%  | 1.5%  | 1.3%  | 1.6%  |
|  | ----- | ----- | ----- | ----- |
| Gross Margin Percentage, after interest expense..... | 22.4% | 24.9% | 23.3% | 24.4% |
|  | ===== | ===== | ===== | ===== |

We sell a variety of home types in various local communities, each yielding a different gross margin. As a result, depending on the geographic mix of deliveries and the mix of both communities and of home types delivered, consolidated quarterly gross margin will fluctuate up or down and may not be representative of the consolidated gross margin for the year. The consolidated gross margin before interest expense for the three and six months ended April 30, 2006 was 270 and 140 basis points lower than the same period in 2005, respectively. Our gross margin after interest expense for the three and six months ended April 30, 2006 was 250 and 110 basis points less than the same period last year, respectively. These decreases are attributed to more prevalent use of incentives and increases in land development and other costs.

Homebuilding selling, general, and administrative expenses as a percentage of homebuilding revenues increased to 10.3% for the three months ended April 30, 2006, compared to 9.0% for the three months ended April 30, 2005 and increased to 10.5% for the six months ended April 30, 2006, compared to 9.2% for the six months ended April 30, 2006. Such expenses increased \$45.1 million for the three months ended April 30, 2006 and increased \$83.8 million for the six months ended April 30, 2006 compared to the same period last year. Included in these expenses are increased advertising costs associated with new community openings and more active selling communities in total, a reaction to slower market conditions, and higher costs due to the acquisitions of Cambridge Homes, First Home Builders of Florida, Oster Homes and to a lesser extent CraftBuilt Homes in the last 13 months. The dollar and percentage increases were in line with our growth goals as we increase selling, general and administrative costs associated with the expected increase in the number of active selling communities in all of our regions.

### Land Sales and Other Revenues:

Land sales and other revenues consist primarily of land and lot sales. A breakout of land and lot sales is set forth below:

|                 | Three Months Ended<br>April 30, |          | Six Months Ended<br>April 30, |           |
|-----------------|---------------------------------|----------|-------------------------------|-----------|
|                 | -----                           | -----    | -----                         | -----     |
|                 | 2006                            | 2005     | 2006                          | 2005      |
|                 | -----                           | -----    | -----                         | -----     |
| Land Sales..... | \$ 70,238                       | \$ 1,173 | \$ 80,793                     | \$ 24,177 |

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|   |           |          |           |          |
|---|-----------|----------|-----------|----------|
| Cost of Sales, Excluding Interest.                  | 51,769    | 1,811    | 59,634    | 15,981   |
|   | -----     | -----    | -----     | -----    |
| Land Sales Gross Margin,<br>Excluding Interest..... | 18,469    | (638)    | 21,159    | 8,196    |
|   | -----     | -----    | -----     | -----    |
| Interest Expense.....                               | 422       | 23       | 880       | 211      |
|   | -----     | -----    | -----     | -----    |
| Land Sales Gross Margin,<br>Including Interest..... | \$ 18,047 | \$ (661) | \$ 20,279 | \$ 7,985 |
|   | =====     | =====    | =====     | =====    |

Land sales are incidental to our residential homebuilding operations and are expected to continue in the future but may significantly fluctuate up or down. Profits from land sales in the first half of the year were significantly more than the first half of 2005, and for the full fiscal year 2006, we expect pre-tax profit from land sales to be higher than they were in fiscal 2005. The increase in land sale profits has to do with a few larger developments that we have undertaken, where we have strategically decided at the outset to sell some portion of the community to one or more other builders. These are typically locations with higher land costs so the sales proceeds are becoming slightly more significant. Although we budget land sales, they are often dependent upon receiving approvals and entitlements, the timing of which can be uncertain. As a result, projecting the amount and timing of land sales is difficult.

### Financial Services

Financial services consist primarily of originating mortgages from our homebuyers and selling such mortgages in the secondary market, and title insurance activities. For the three and six months ended April 30, 2006, financial services provided a \$6.7 million and \$12.4 million profit before income taxes, compared to a profit of \$4.8 million and \$9.1 million for the same period in 2005, respectively. The increase in pretax profit for the three and six months ended April 30, 2006 is primarily due to increased mortgage settlements and the addition of mortgage operations as a result of our 2005 acquisitions.

### Corporate General and Administrative

Corporate general and administrative expenses represent the operations at our headquarters in Red Bank, New Jersey. Such expenses include our executive offices, information services, human resources, corporate accounting, training, treasury, process redesign, internal audit, construction services, and administration of insurance, quality, and safety. As a percentage of total revenues, such expenses increased to 1.7% for the three months ended April 30, 2006 from 1.2% for the prior year's three months and increased to 1.9% from the six months ended April 30, 2006 from 1.4% for the prior year's six months. Corporate general and administrative expenses increased \$11.0 and \$22.8 million during the three and six months ended April 30, 2006 respectively, compared to the same period last year. The increase in corporate general and administrative expenses is primarily attributed to increased depreciation expense for new software systems, increased consulting services related to the new software implementation, Sarbanes-Oxley compliance costs, increased compensation with more headcount and higher profit based bonuses, as well as the adoption of SFAS 123R resulting in the expensing of stock options.

While the sum of homebuilding, selling, general and administrative expenses and corporate general and administrative expenses as a percentage of total revenues for the second quarter is higher than the prior year's

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second quarter percentage, we expect these expenses as a percentage of revenues for the full fiscal year to be just slightly higher than to the prior year.

### Other Interest

Other interest increased \$0.2 million and \$0.8 million for the three and six months ended April 30, 2006, compared to three and six months ended April 30, 2005. This slight increase is primarily due to an increase in interest incurred and expensed on nonrecourse land mortgages directly related to property not yet under development.

### Other Operations

Other operations consist primarily of miscellaneous residential housing operations expenses, senior rental residential property operations, earnout payments from homebuilding company acquisitions, minority interest relating to consolidated joint ventures, and corporate owned life insurance. The increase in other operations to \$8.5 and \$15.5 million for the three and six months ended April 30, 2006 respectively, compared to \$1.3 and \$3.2 million for the three and six months ended April 30, 2005, respectively, is primarily due to increased earnout expenses related to several recent acquisitions.

### Intangible Amortization

We are amortizing our definite life intangibles over their expected useful life, ranging from three to seven years. Intangible amortization increased \$3.0 million and \$4.6 million for the three and six months ended April 30, 2006, when compared to the same period last year. This increase was the result of the amortization expense related to the acquisition of Cambridge Homes in March 2005, Oster Homes in August 2005, First Home Builders of Florida in August 2005 and CraftBuilt Homes in April 2006, offset by reduced amortization on older acquisitions.

### Recent Accounting Pronouncements

In May 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections". This statement, which replaces APB Opinion No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements", changes the requirements for the accounting for and reporting of a change in accounting principle. The statement requires retrospective application of changes in accounting principle to prior periods' financial statements unless it is impracticable to determine the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In June 2005, the Emerging Issues Task Force ("EITF") released Issue No. 04-5 "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" ("EITF 04-5"). EITF 04-5 creates a framework for evaluating whether a general partner or a group of general partners controls a limited partnership and therefore should consolidate the partnership. EITF 04-5 states that the presumption of general partner control would be overcome only when the limited partners have certain

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specific rights as outlined in EITF 04-5. EITF 04-5 is effective immediately for all newly formed limited partnerships and for existing limited partnership agreements that are modified. For general partners in all other limited partnerships, EITF 04-5 is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005. Implementation of EITF 04-5 is not expected to have a material impact on the Company's results of operations or financial position.

### Total Taxes

Total taxes as a percentage of income before taxes decreased for the three months ended April 30, 2006 to 36.2% from 39.2% for the three months ended April 30, 2005, and for the six months ended April 30, 2006 to 37.0% from 38.8% for the six months ended April 30, 2005. This decrease is primarily due to the benefit of the tax deduction on qualified production activities provided by the American Jobs Creation Act of 2004 and the settlement of a prior year item that allowed the release of a reserve.

Deferred federal and state income tax assets primarily represent the deferred tax benefits arising from temporary differences between book and tax income which will be recognized in future years as an offset against future taxable income. If, for some reason, the combination of future years income (or loss) combined with the reversal of the timing differences results in a loss, such losses can be carried back to prior years to recover the deferred tax assets. As a result, management is confident such deferred tax assets are recoverable regardless of future income.

### Inflation

Inflation has a long-term effect, because increasing costs of land, materials, and labor result in increasing sale prices of our homes. In general, these price increases have been commensurate with the general rate of inflation in our housing markets and have not had a significant adverse effect on the sale of our homes. A significant risk faced by the housing industry generally is that rising house construction costs, including land and interest costs, will substantially outpace increases in the income of potential purchasers. Recently in the more highly regulated markets that have seen significant home price appreciation, customer affordability has become a concern. Our broad product array insulates us to some extent, but customer affordability of our homes is something we monitor closely.

Inflation has a lesser short-term effect, because we generally negotiate fixed price contracts with many, but not all, of our subcontractors and material suppliers for the construction of our homes. These prices usually are applicable for a specified number of residential buildings or for a time period of between three to twelve months. Construction costs for residential buildings represent approximately 60% of our homebuilding cost of sales.

### Mergers and Acquisitions

On March 1, 2005, we acquired for cash the assets of Cambridge Homes, a privately held Orlando homebuilder and provider of related financial services, headquartered in Altamonte Springs, Florida. The acquisition provides us with a presence in the greater Orlando market. Cambridge Homes designs, markets and sells both single family homes and attached townhomes and focuses on first-time, move-up and luxury homebuyers. Cambridge Homes also provides mortgage financing, as well as title and settlement services

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to its homebuyers. The Cambridge Homes acquisition was accounted for as a purchase, with the results of its operations included in our consolidated financial statements as of the date of the acquisition.

On March 2, 2005, we acquired the operations of Town & Country Homes, a privately held homebuilder and land developer headquartered in Lombard, Illinois, which occurred concurrently with our entering into a joint venture agreement with affiliates of Blackstone Real Estate Advisors in New York to own and develop Town & Country's existing residential communities. The joint venture is being accounted for under the equity method. Town & Country Homes' operations beyond the existing owned and optioned communities, as of the acquisition date, are wholly owned and included in our consolidated financial statements.

The Town & Country acquisition provides us with a strong initial position in the greater Chicago market, and expands our operations into the Florida markets of West Palm Beach, Boca Raton and Fort Lauderdale and bolsters our current presence in Minneapolis/St. Paul. Town & Country designs, markets and sells a diversified product portfolio in each of its markets, including single family homes and attached townhomes, as well as mid-rise condominiums in Florida. Town & Country serves a broad customer base including first-time, move-up and luxury homebuyers.

On August 3, 2005, we acquired substantially all of the homebuilding assets of Oster Homes, a privately held Ohio homebuilder, headquartered in Lorain, Ohio. The acquisition provides Hovnanian with a complementary presence to its Ohio "build-on-your-own-lot" homebuilding operations. Oster Homes builds in Lorain County in Northeast Ohio, just west of Cleveland. Oster Homes designs, markets and sells single family homes, with a focus on first-time and move-up homebuyers. Additionally, Oster Homes utilizes a design center to market extensive pre-prices, options and upgrades.

On August 8, 2005, we acquired substantially all of the assets of First Home Builders of Florida, a privately held homebuilder and provider of related financial services headquartered in Cape Coral, Florida. First Home Builders is a leading builder in Western Florida and ranked first in the greater Fort Myers-Cape Coral market. First Home Builders of Florida designs, markets and sells single family homes, with a focus on the first-time home buying segment. The company also provides mortgage financing, title and settlement services to its homebuyers.

Both the First Home Builders of Florida and the Oster Homes acquisitions were accounted for as purchases with the results of their operations included in our consolidated financial statements as of the dates of the acquisitions.

On April 17, 2006, we acquired for cash the assets of CraftBuilt Homes, a privately held homebuilder headquartered in Bluffton, South Carolina. The acquisition expands our operations into the coastal markets of South Carolina and Georgia. CraftBuilt Homes designs, markets and sells single family detached homes. Due to its close proximity to Hilton Head, CraftBuilt Homes focuses on first-time, move-up, empty-nester and retiree homebuyers. This acquisition is being accounted for as a purchase with the results of its operations included in our consolidated financial statements as of the date of the acquisition.

All fiscal 2006 and 2005 acquisitions provide for other payments to be made, generally dependant upon achievement of certain future operating and return objectives.

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### Transactions with Related Parties

In December 2005, we entered into an agreement to purchase land in New Jersey from an entity that is owned by family relatives of our Chairman of the Board and our Chief Executive Officer at a base price of \$25 million. The land will be acquired in four phases over a period of 30 months from the date of acquisition of the first phase. The purchase prices for phases two through four are subject to an increase in the purchase price for the phase of not less than 6% per annum and not more than 8% per annum from the date of the closing of the first phase based on an identified prime rate. As of the end of the second quarter of 2006, no land has been acquired. A deposit in the amount of \$500,000, however, has been made by the Company. Neither the Company nor the Chairman of the Board or the Chief Executive Officer has a financial interest in the relatives' company from whom the land will be purchased.

During the second quarter of 2006, an existing lease on a building occupied by one of our companies in the Southeast Region was amended. The lessor is a company, whom at the time of the transaction, was owned partly by Geaton A. Decesaris, Jr., formerly a member of the Company's Board of Directors. The amendment provided for an increase in the square footage of the lease space, an increased security deposit related to the square footage increase and an increase in the lease term. In total the lease is for 39,637 square feet at \$18.86 per square foot per year, with a total security deposit of \$34,511.

Pursuant to the Board of Director requirements, prior to these agreements being finalized, an independent appraisal of the transaction was performed. Upon review of the appraisal by the independent members of the Board of Directors the transactions were approved.

### Safe Harbor Statement

All statements in this Form 10-Q/A that are not historical facts should be considered as "Forward-Looking Statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Although we believe that our plans, intentions and expectations reflected in, or suggested by such forward-looking statements are reasonable, we can give no assurance that such plans, intentions, or expectations will be achieved. Such risks, uncertainties and other factors include, but are not limited to:

- . Changes in general and local economic and business conditions;
- . Adverse weather conditions and natural disasters;
- . Changes in market conditions;
- . Changes in home prices and sales activity in the markets where the Company builds homes;
- . Government regulation, including regulations concerning development of land, the home building, sales and customer financing processes, and the environment;
- . Fluctuations in interest rates and the availability of mortgage financing;
- . Shortages in, and price fluctuations of, raw materials and labor;
- . The availability and cost of suitable land and improved lots;
- . Levels of competition;
- . Availability of financing to the Company;
- . Utility shortages and outages or rate fluctuations; and

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. Geopolitical risks, terrorist acts and other acts of war.

Certain risks, uncertainties, and other factors are described in detail in Item 1 and 2 "Business and Properties" in our Form 10-K/A for the year ended October 31, 2005.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The primary market risk facing us is interest rate risk on our long-term debt. In connection with our mortgage operations, mortgage loans held for sale and the associated mortgage warehouse line of credit are subject to interest rate risk; however, such obligations reprice frequently and are short-term in duration. In addition, we hedge the interest rate risk on mortgage loans by obtaining forward commitments from private investors. Accordingly, the risk from mortgage loans is not material. We do not hedge interest rate risk other than on mortgage loans using financial instruments. We are also subject to foreign currency risk but this risk is not material. The following table sets forth as of April 30, 2006, our long term debt obligations, principal cash flows by scheduled maturity, weighted average interest rates and estimated fair market value ("FMV").

| As of April 30, 2006   |          |           |        |        |            |             |                  |             |
|------------------------|----------|-----------|--------|--------|------------|-------------|------------------|-------------|
| -----                  |          |           |        |        |            |             |                  |             |
| Expected Maturity Date |          |           |        |        |            |             |                  |             |
| 2006                   | 2007     | 2008      | 2009   | 2010   | Thereafter | Total       | FMV @<br>4/30/06 |             |
| -----                  | -----    | -----     | -----  | -----  | -----      | -----       | -----            | -----       |
| (Dollars in Thousands) |          |           |        |        |            |             |                  |             |
| Long Term Debt (1):    |          |           |        |        |            |             |                  |             |
| Fixed Rate....         | \$38,117 | \$140,927 | \$ 722 | \$ 773 | \$100,827  | \$1,586,018 | \$1,867,384      | \$1,803,680 |
| Average                |          |           |        |        |            |             |                  |             |
| interest rate          | 6.17%    | 10.48%    | 6.70%  | 6.72%  | 6.01%      | 7.04%       | 7.23%            | -           |

(1) Does not include bonds collateralized by mortgages receivable or the warehouse line of credit.

In addition, we have reassessed the market risk for our variable rate debt, which is based on either (1) a LIBOR-based rate for a one, two, three, or six month interest period as selected by us plus a margin or (2) a base rate determined by reference to the higher of (a) a PNC Bank, National Association's prime rate and (b) the federal funds rate plus 1/2%. We believe that a one percent increase in this rate would have an approximate \$0.7 million increase in interest expense for the six months ended April 30, 2006, assuming an average of \$137.5 million of variable rate debt outstanding from November 1, 2005 to April 30, 2006.

### Item 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such



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information is accumulated and communicated to the Company's management, including its chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. The Company's management, with the participation of the Company's chief executive officer and chief financial officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of April 30, 2006. Based upon that evaluation and subject to the foregoing, the Company's chief executive officer and chief financial officer concluded that the design and operation of the Company's disclosure controls and procedures are effective to accomplish their objectives.

In addition, there was no change in the Company's internal control over financial reporting that occurred during the quarter ended April 30, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

As described in Note 3 to our condensed consolidated financial statements, we have restated Note 3 to the condensed consolidated financial statements included in the Report to revise our segment disclosures to show six reportable homebuilding segments, rather than treating our homebuilding business as a single national, reportable segment. The treatment of our homebuilding business as a single, national reportable segment was in accordance with the practice followed by substantially all the large, geographically diverse homebuilders that file reports with the SEC. The restatement represents a change in judgment as to the application of Statement of Financial Accounting Standards No. 131 ("SFAS 131"). The restatement has no impact on our previously reported consolidated financial position, results of operations or cash flows for any of the periods presented. Our Company management, with the participation of the Company's chief executive officer and chief financial officer, has re-evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of April 30, 2006, to determine whether the restatement changes their prior conclusion. Subject to the foregoing, and based upon that re-evaluation, the Company's chief executive officer and chief financial officer have determined that it does not change their conclusion that, as of April 30, 2006, the design and operation of the Company's disclosure controls and procedures were effective to accomplish their objectives.

We had previously included in the description of our business and in our Management's Discussion and Analysis of Financial Condition and Results of Operations some information, which is not subject to SFAS 131, on the basis of purely geographic regions, without taking account of other factors that affect what are appropriate reportable segments under SFAS 131. We are now presenting that information on the basis of the same regions we are using to report segment information, so that all regional information in our reports will be presented on the basis of the same regions. However, we are doing that for the purpose of consistency, not because our management has concluded that presenting information on the prior basis was not appropriate. Therefore, our management does not believe the fact that we have changed the basis on which we are presenting information that is not subject to SFAS 131 indicates that our disclosure controls and procedures were not effective to ensure that the information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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### PART II. Other Information

#### Item 1. Legal Proceedings

We are involved in litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on our financial position or results of operations and we are subject to extensive and complex regulations that affect the development and home building, sales and customer financing processes, including zoning, density, building standards and mortgage financing. These regulations often provide broad discretion to the administering governmental authorities. This can delay or increase the cost of development or homebuilding.

We also are subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment. The particular environmental laws which apply to any given community vary greatly according to the community site, the site's environmental conditions and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation, and/or other costs, and can prohibit or severely restrict development and homebuilding activity in certain environmentally sensitive regions or areas.

In March 2005, we received two requests for information pursuant to Section 308 of the Clean Water Act from Region 3 of the Environmental Protection Agency (the "EPA"). These requests sought information concerning storm water discharge practices in connection with completed, ongoing and planned homebuilding projects by subsidiaries in the states and district that comprise EPA Region 3. We also received a notice of violations for one project in Pennsylvania and requests for sampling plan implementation in two projects in Pennsylvania. The amount requested by the EPA to settle the asserted violations at the one project was not material. We provided the EPA with information in response to its requests. We have since been advised by the Department of Justice ("DOJ") that it will be involved in the review of our storm water discharge practices. We cannot predict the outcome of the review of these practices or estimate the costs that may be involved in resolving the matter. To the extent that the EPA or the DOJ asserts violations of regulatory requirements and request injunctive relief or penalties, we will defend and attempt to resolve such asserted violations.

In addition, in November 2005, we received two notices from the California Regional Water Quality Control Board alleging violations of certain storm water discharge rules and assessing an administrative civil liability of \$0.2 million and \$0.3 million. We do not consider these assessments to be material and are considering our response to the notices.

It can be anticipated that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot predict the effect of these requirements, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules and regulations and their interpretations and application.

Our sales and customer financing processes are subject to the jurisdiction of the U. S. Department of Housing and Urban Development ("HUD"). In connection with the Real Estate Settlement Procedures Act,

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HUD recently inquired about our process of referring business to our affiliated mortgage company and has separately requested documents related to customer financing. We have responded to HUD's inquiries. In connection with these inquiries, the Inspector General of HUD has recommended to the Secretary of HUD that we indemnify HUD for any losses that it may sustain in connection with nine loans that it alleges were improperly underwritten. We cannot predict the outcome of HUD's inquiry or estimate the costs that may be involved in resolving the matter. We do not expect the ultimate cost to be material.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

This table provides information with respect to purchases of shares of our Class A Common Stock made by or on behalf of Hovnanian Enterprises or any affiliated purchaser during the second fiscal quarter of 2006.

#### Issuer Purchases of Equity Securities (1)

| Period   | Total Number of<br>Shares Purchased | Average Price<br>Paid Per Share | Total Number<br>Of Shares<br>Purchased as<br>Part of Publicly<br>Announced Plans<br>or Programs | Maximum Number of<br>Shares That May<br>Yet Be Purchased<br>Under The Plans<br>or Programs |
|--|-------------------------------------|---------------------------------|---|--|
| February 1, 2006<br>Through<br>February 28, 2006 | 150,000                             | \$45.60                         | 150,000   | 1,187,668  |
| March 1, 2006<br>Through<br>March 31, 2006       | -                                   | -                               | -   | 1,187,668  |
| April 1, 2006<br>Through<br>April 30, 2006       | -                                   | -                               | -   | 1,187,668  |
| <b>Total</b>                                     | <b>150,000</b>                      | <b>\$45.60</b>                  | <b>150,000</b>  |  |

(1) In July 2001, our Board of Directors authorized a stock repurchase program to purchase up to 4 million shares of Class A Common Stock.

No shares of our Class B Common Stock or of our 7.625% Series A Preferred Stock were purchased by or on behalf of Hovnanian Enterprises or any affiliated purchaser during the second fiscal quarter of 2006.

### Item 4. Submission of Matters to a Vote of Security Holders.

We held our annual stockholders meeting on March 8, 2006 at 10:30 a.m. at Chelsea Meeting Room of the Millenium Hilton Hotel, 55 Church Street, New York, New York. The following matters were voted at the meeting:

(1) Election of all Directors to hold office until the next Annual

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Meeting of Stockholders. There were no broker non-votes. The elected Directors were:

|                          | Class A    |                | Class B     |                |
|--------------------------|------------|----------------|-------------|----------------|
|                          | Votes For  | Votes Withheld | Votes For   | Votes Withheld |
|                          | -----      | -----          | -----       | -----          |
| Kevork S. Hovnanian      | 27,745,399 | 16,530,111     | 141,491,192 | 24,750         |
| Ara K. Hovnanian         | 27,701,823 | 16,573,687     | 141,491,192 | 24,750         |
| Robert B. Coutts         | 40,012,069 | 4,263,441      | 141,512,392 | 3,550          |
| Geaton A. DeCesaris, Jr. | 27,704,267 | 16,571,243     | 141,491,192 | 24,750         |
| Edward A. Kangas         | 39,933,293 | 4,342,217      | 141,514,992 | 950            |
| Joseph A. Marengi        | 40,012,680 | 4,262,830      | 141,512,392 | 3,550          |
| John J. Robbins          | 39,943,218 | 4,332,292      | 141,514,992 | 950            |
| J. Larry Sorsby          | 25,847,371 | 18,428,139     | 141,491,192 | 24,750         |
| Stephen D. Weinroth      | 35,792,288 | 8,483,222      | 141,514,992 | 950            |

- (2) Ratification of selection of Ernst & Young, LLP as independent registered public accountants for fiscal year ending October 31, 2006. There were no broker non-votes.

|                  | Class A    | Class B     |
|------------------|------------|-------------|
|                  | -----      | -----       |
| .. Votes For     | 43,864,854 | 141,513,742 |
| .. Votes Against | 381,096    | 2,200       |
| .. Abstain       | 29,559     | 0           |

### Item 6. Exhibits

Exhibit 3(a) Certificate of Incorporation of the Registrant. (1)

Exhibit 3(b) Certificate of Amendment of Certificate of Incorporation of the Registrant. (2)

Exhibit 3(c) Certificate of Amendment of Certificate of Incorporation of the Registrant. (3)

Exhibit 3(d) Restated Bylaws of the Registrant. (4)

Exhibit 4(a) Indenture, dated as of November 3, 2003, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc. and Wachovia Bank, National Association, as Trustee. (5)

Exhibit 4(b) First Supplemental Indenture, dated as of November 3, 2003, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc., the other Guarantors named therein and Wachovia Bank, National Association, as Trustee. (6)

Exhibit 4(c) Second Supplemental Indenture, dated as of March 18, 2004, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc., the

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other Guarantors named therein and Wachovia Bank, National Association, as Trustee. (7)

Exhibit 4(d) Third Supplemental Indenture, dated as of July 15, 2004, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc., the other Guarantors named therein and Wachovia Bank, National Association, as Trustee. (7)

Exhibit 4(e) Fourth Supplemental Indenture, dated as of April 19, 2005, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc., the other Guarantors named therein and Wachovia Bank, National Association, as Trustee. (7)

Exhibit 4(f) Fifth Supplemental Indenture, dated as of September 6, 2005, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc., the other Guarantors named therein and Wachovia Bank, National Association, as Trustee. (7)

Exhibit 4(g) Sixth Supplemental Indenture, dated as of February 27, 2006, among K. Hovnanian Enterprises, Inc., Hovnanian Enterprises, Inc., the other Guarantors named therein and Wachovia Bank, National Association, as Trustee, relating to the 7 1/2% Senior Notes due 2016 (including form of 7 1/2% Senior Notes due 2016). (8)

Exhibit 4(h) Certificate of Designations, Powers, Preferences and Rights of the 7.625% Series A Preferred Stock of Hovnanian Enterprises, Inc., dated July 12, 2005. (9)

Exhibit 10(a) Sixth Amended and Restated Credit Agreement dated May 31, 2006. (10)

Exhibit 10(b) Amended and Restated Guaranty and Suretyship Agreement, dated May 31, 2006. (10)

Exhibit 31(a) Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.

Exhibit 31(b) Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

Exhibit 32(a) Section 1350 Certification of Chief Executive Officer.

Exhibit 32(b) Section 1350 Certification of Chief Financial Officer.

- (1) Incorporated by reference to Exhibits to Registration Statement (No. 2-85198) on Form S-1 of the Registrant.
- (2) Incorporated by reference to Exhibit 4.2 to Registration Statement (No. 333-106761) on Form S-3 of the Registrant.
- (3) Incorporated by reference to Exhibits to Quarterly Report on Form 10-Q of the Registrant for

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the quarter ended January 31, 2004.

- (4) Incorporated by reference to Exhibit 3.2 to Registration Statement (No. 1-08551) on Form 8-A of the Registrant.
- (5) Incorporated by reference to Exhibits to Registration Statement (No. 333-125738) on Form S-3 of the Registrant.
- (6) Incorporated by reference to Exhibits to Current Report of the Registrant on Form 8-K on November 7, 2003.
- (7) Incorporated by reference to Exhibits to Registration Statement (No. 333-131982) on Form S-3 of the Registrant.
- (8) Incorporated by reference to Exhibits to Current Report of the Registrant on Form 8-K filed on February 27, 2006.
- (9) Incorporated by reference to Exhibits to Current Report on Form 8-K of the Registrant, filed on July 13, 2005.
- (10) Incorporated by reference to Exhibits to Current Report on Form 8-K of the Registrant, filed on June 6, 2006.

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HOVNIANIAN ENTERPRISES, INC.  
(Registrant)

DATE: December 20, 2006

/S/J. LARRY SORSBY  
J. Larry Sorsby,  
Executive Vice President and  
Chief Financial Officer