

HOVNANIAN ENTERPRISES INC
Form 10-K
December 20, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

OF 1934

For the fiscal year ended OCTOBER 31, 2018

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

Commission file number: 1-8551

Hovnanian Enterprises, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

22-1851059

(I.R.S. Employer Identification No.)

90 Matawan Road, Fifth Floor, Matawan, NJ

(Address of Principal Executive Offices)

07747

(Zip Code)

732-747-7800

(Registrant's Telephone Number, Including Area Code)

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

Title of Each Class

Name of Each Exchange on Which Registered

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

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

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

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

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

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

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

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

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

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

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

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

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HOVNANIAN ENTERPRISES, INC.

DOCUMENTS INCORPORATED BY REFERENCE:

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

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Part I

ITEM 1

BUSINESS

Business Overview

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

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

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

The following is a summary of our growth history:

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

1983 - Completed initial public offering.

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

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

1994 - Entered the Coastal Southern California market.

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

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

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

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

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

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

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

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

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

Geographic Breakdown of Markets by Segment

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

Northeast: New Jersey and Pennsylvania

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

Midwest: Illinois and Ohio

Southeast: Florida, Georgia and South Carolina

Southwest: Arizona and Texas

West: California

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

Employees

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

Corporate Offices and Available Information

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

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Business Strategies

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

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

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

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

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

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

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

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

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

Operating Policies and Procedures

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Residential Development Activities

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

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

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

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

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

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

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

(Value of net sales contracts in thousands)	2018	2017	Percentage of	
			Change	
Northeast	\$74,730	\$119,018	(37.2	%)
Mid-Atlantic	340,963	399,420	(14.6	%)
Midwest	204,487	193,451	5.7	%
Southeast				