

Forestar Group Inc.
Form 10-Q
November 04, 2010

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

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from _____ to _____

**Commission File Number: 001-33662
FORESTAR GROUP INC.**

(Exact Name of Registrant as Specified in Its Charter)

Delaware

*(State or Other Jurisdiction of
Incorporation or Organization)*

26-1336998

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

6300 Bee Cave Road, Building Two, Suite 500, Austin, Texas 78746

(Address of Principal Executive Offices, Including Zip Code)

(512) 433-5200

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller reporting company)

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.

Title of Each Class	Number of Shares Outstanding as of November 1, 2010
Common Stock, par value \$1.00 per share	35,429,150

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Consolidated Balance Sheets**

	(Unaudited)	
	Third	
	Quarter-End	Year-End
	2010	2009
	(In thousands)	
ASSETS		
Cash and cash equivalents	\$ 4,483	\$ 21,051
Real estate	526,044	542,812
Assets held for sale	21,365	31,226
Investment in unconsolidated ventures	105,954	109,597
Timber	18,364	19,845
Receivables, net	33,884	1,841
Prepaid expenses	2,074	2,587
Income taxes receivable	5,411	
Property and equipment, net	5,300	5,234
Deferred tax asset	42,084	40,751
Other assets	12,060	9,790
TOTAL ASSETS	\$ 777,023	\$ 784,734
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable	\$ 2,953	\$ 4,573
Accrued employee compensation and benefits	847	4,025
Accrued property taxes	7,025	4,302
Accrued interest	1,011	871
Income taxes payable		2,809
Other accrued expenses	8,183	8,269
Other liabilities	28,218	24,924
Debt	217,566	216,626
TOTAL LIABILITIES	265,803	266,399
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Forestar Group Inc. shareholders equity:		
Preferred stock, par value \$0.01 per share, 25,000,000 authorized shares, none issued		
Common stock, par value \$1.00 per share, 200,000,000 authorized shares, 36,639,885 issued at September 30, 2010 and 36,255,336 issued at December 31, 2009	36,640	36,255
Additional paid-in capital	389,763	384,795
Retained earnings	98,553	95,876

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Accumulated other comprehensive loss		(256)
Treasury stock, at cost, 1,216,001 shares at September 30, 2010 and 209,544 shares at December 31, 2009	(19,444)	(4,214)
Total Forestar Group Inc. shareholders' equity	505,512	512,456
Noncontrolling interests	5,708	5,879
TOTAL EQUITY	511,220	518,335
TOTAL LIABILITIES AND EQUITY	\$ 777,023	\$ 784,734

Please read the notes to the consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Income
(Unaudited)

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands, except per share amounts)			
REVENUES				
Real estate sales	\$ 10,000	\$ 18,259	\$ 36,895	\$ 55,387
Commercial operating properties and other	5,139	4,662	17,041	14,768
Real estate	15,139	22,921	53,936	70,155
Mineral resources	6,654	18,828	18,387	31,767
Fiber resources and other	2,220	3,558	6,185	12,928
	24,013	45,307	78,508	114,850
COSTS AND EXPENSES				
Cost of real estate sales	(4,183)	(8,356)	(17,312)	(20,934)
Cost of commercial operating properties and other	(4,091)	(4,007)	(13,237)	(11,814)
Cost of mineral resources	(223)	(221)	(852)	(499)
Cost of fiber resources and other	(466)	(880)	(1,208)	(2,816)
Other operating	(10,163)	(9,923)	(29,203)	(29,717)
General and administrative	(4,797)	(8,000)	(16,493)	(22,758)
Gain on sale of assets	15,441	24,833	15,441	104,047
	(8,482)	(6,554)	(62,864)	15,509
OPERATING INCOME	15,531	38,753	15,644	130,359
Equity in earnings (loss) of unconsolidated ventures	82	(2,443)	740	(7,063)
Interest expense	(3,913)	(5,440)	(12,562)	(15,653)
Other non-operating income	246	287	690	382
INCOME BEFORE TAXES	11,946	31,157	4,512	108,025
Income tax expense	(2,860)	(10,956)	(1,507)	(39,761)
CONSOLIDATED NET INCOME	9,086	20,201	3,005	68,264
Less: Net income attributable to noncontrolling interests	(164)	(725)	(328)	(1,763)
NET INCOME ATTRIBUTABLE TO FORESTAR GROUP INC.	\$ 8,922	\$ 19,476	\$ 2,677	\$ 66,501
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	35,858	35,817	36,030	35,769

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Diluted	36,379	36,173	36,596	35,975
NET INCOME PER COMMON SHARE				
Basic	\$ 0.25	\$ 0.54	\$ 0.07	\$ 1.86
Diluted	\$ 0.25	\$ 0.54	\$ 0.07	\$ 1.85

Please read the notes to the consolidated financial statements.

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Table of Contents**FORESTAR GROUP INC.****Consolidated Statements of Cash Flows
(Unaudited)**

	First Nine Months	
	2010	2009
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income	\$ 3,005	\$ 68,264
Adjustments:		
Depreciation and amortization	7,231	7,390
Deferred income taxes	(1,470)	(21,153)
Tax benefits not recognized for book purposes	91	6,066
Equity in (earnings) loss of unconsolidated ventures	(740)	7,063
Distributions of earnings of unconsolidated ventures	1,184	259
Distributions of earnings to noncontrolling interests	(569)	(1,992)
Share-based compensation	7,370	7,717
Non-cash real estate cost of sales	15,387	19,040
Non-cash cost of assets sold	6,604	49,804
Real estate development and acquisition expenditures	(11,499)	(29,710)
Reimbursements from utility and improvement districts	495	22,299
Other changes in real estate	133	(637)
Gain on termination of timber lease	(617)	(195)
Cost of timber cut	1,141	2,577
Deferred income	1,655	(944)
Asset impairments	900	5,044
Loss on sale of assets held for sale	277	
Other	(51)	90
Changes in:		
Receivables	(32,359)	295
Prepaid expenses and other	570	307
Accounts payable and other accrued liabilities	(4,220)	(8,864)
Income taxes	(8,219)	23,389
Net cash (used for) provided by operating activities	(13,701)	156,109
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software and reforestation	(2,282)	(6,317)
Investment in unconsolidated ventures	(1,538)	(1,916)
Return of investment in unconsolidated ventures	4,790	2,671
Proceeds from sale of assets held for sale	2,602	
Net cash provided by (used for) investing activities	3,572	(5,562)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt	(22,551)	(155,948)
Additions to debt	36,698	43,512
Deferred financing fees	(5,969)	(3,127)
Return of investment to noncontrolling interest	(706)	(171)
Exercise of stock options	881	576

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Repurchases of common stock	(15,178)	
Payroll taxes on restricted stock and stock options	(49)	(44)
Tax benefit from share-based compensation	121	
Other	314	70
Net cash used for financing activities	(6,439)	(115,132)
Net (decrease) increase in cash and cash equivalents	(16,568)	35,415
Cash and cash equivalents at beginning of period	21,051	8,127
Cash and cash equivalents at end of period	\$ 4,483	\$ 43,542

Please read the notes to the consolidated financial statements.

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FORESTAR GROUP INC.

**Notes to the Consolidated Financial Statements
(Unaudited)**

Note 1 Basis of Presentation

Our consolidated financial statements include the accounts of Forestar Group Inc., all subsidiaries, ventures and other entities in which we have a controlling interest and variable interest entities of which we are the primary beneficiary. We eliminate all material intercompany accounts and transactions. Noncontrolling interests in consolidated pass-through entities are recognized before income taxes. We account for our investment in other entities in which we have significant influence over operations and financial policies using the equity method (we recognize our share of the entities' income or loss and any preferential returns and treat distributions as a reduction of our investment). We account for our investment in other entities in which we do not have significant influence over operations and financial policies using the cost method (we recognize as income distributions of accumulated earnings).

We prepare our unaudited interim financial statements in accordance with U.S. generally accepted accounting principles and Securities and Exchange Commission requirements for interim financial statements. As a result, they do not include all the information and disclosures required for complete financial statements. However, in our opinion, all adjustments considered necessary for a fair presentation have been included. Such adjustments consist only of normal recurring items unless otherwise noted. We make estimates and assumptions about future events. Actual results can, and probably will, differ from those we currently estimate including those related to allocating cost of sales to real estate, minerals and fiber and measuring assets for impairment. These interim operating results are not necessarily indicative of the results that may be expected for the entire year. For further information, please read the financial statements included in our 2009 Annual Report on Form 10-K.

Note 2 New and Pending Accounting Pronouncements

In first quarter 2010, we adopted Accounting Standards Update (ASU) 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, ASU 2010-06, *Improving Disclosures about Fair Value Measurements* and ASU 2010-09, *Amendments to Certain Recognition and Disclosure Requirements*. Adoption of these pronouncements did not have a significant effect on our earnings or financial position but did result in certain additional disclosures.

ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* will be effective fourth quarter 2010. We do not anticipate that adoption will have a significant impact on our earnings or financial position but may result in additional disclosures.

Note 3 Strategic Initiatives and Assets Held for Sale

In 2009, we announced our near-term strategic initiatives to enhance shareholder value by: generating significant cash flow, principally from the sale of about 175,000 acres of higher and better use (HBU) timberland; reducing debt by approximately \$150,000,000; and repurchasing up to 20 percent of our common stock.

In 2009, we sold about 95,000 acres of timber and timberland in Georgia and Alabama in two transactions generating net cash proceeds of \$153,851,000, which were principally used to reduce debt and pay taxes.

In third quarter 2010, we sold about 14,100 acres of timber and timberland in Georgia and Alabama for \$22,621,000 to East Coast Trading Co., Inc. in two separate transactions. These transactions generated net proceeds of \$22,030,000, resulting in recognition of a \$15,441,000 gain and \$5,200,000 of deferred income tax expense. At third quarter-end 2010, the net proceeds from these transactions are held by a qualified intermediary as we plan to reinvest these proceeds in qualifying real estate, thereby deferring the gain for tax purposes under Internal Revenue Code Section 1031. As a result, the net proceeds are classified as a receivable pending reinvestment. We have until November 13, 2010 to identify qualified replacement properties, and until March 28, 2011 to acquire the identified properties. If we are unable to identify and close on the replacement properties within the required time periods, we will not be able to defer the gain for tax purposes and all deferred taxes related to these transactions will become currently payable.

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At third quarter-end 2010, assets held for sale includes over 59,000 acres of undeveloped land with a carrying value of \$13,517,000 and related timber with a carrying value of \$7,848,000. These assets are actively being marketed.

In addition, we repurchased 1,000,987 shares of our common stock at a cost of \$15,178,000 in third quarter 2010. The repurchased shares are classified as treasury stock.

In first quarter 2010, we sold our undivided interest in corporate aircraft resulting in net cash proceeds of \$2,602,000 and loss on sale of assets of \$277,000.

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Real estate consists of:

	Third Quarter-End 2010	Year-End 2009
	(In thousands)	
Entitled, developed and under development projects	\$ 412,309	\$ 427,047
Undeveloped land	90,404	91,011
Commercial operating properties	46,156	49,171
	548,869	567,229
Accumulated depreciation	(22,825)	(24,417)
	\$ 526,044	\$ 542,812

Included in entitled, developed and under development projects are the estimated costs of assets we expect to convey to and be reimbursed by utility and improvement districts of \$60,953,000 at third quarter-end 2010 and \$60,863,000 at year-end 2009. Our Cibolo Canyons project located near San Antonio, Texas represents \$37,052,000 of this amount at third quarter-end 2010 and \$37,062,000 at year-end 2009. These costs relate to water, sewer and other infrastructure assets we have submitted to utility or improvement districts for review, approval and reimbursement. We submitted for reimbursement to these districts \$3,316,000 in first nine months 2010 and \$3,109,000 in first nine months 2009. We collected \$495,000 from these districts in first nine months 2010 and \$22,299,000 in first nine months 2009, of which \$20,270,000 related to our Cibolo Canyons project and was accounted for as a reduction of our investment in the mixed-use development. We expect to collect the amounts submitted when these districts achieve adequate tax bases to support payment.

In first quarter 2010, entitled, developed and under development projects decreased by \$11,865,000 due to lender foreclosure of a lien on a condominium property in Austin, Texas, owned by a consolidated variable interest entity. Please read Note 18 for additional information.

We recognized asset impairment charges in second quarter 2010 of \$900,000 related to a residential real estate project located near Salt Lake City, Utah and \$3,050,000 in first nine months 2009 related to the condominium project discussed above.

Depreciation expense, primarily related to commercial operating properties, was \$2,067,000 in first nine months 2010 and \$1,367,000 in first nine months 2009 and is included in other operating expenses.

Note 5 Timber

We have over 205,000 acres of timber, primarily in Georgia. The cost of timber cut and sold was \$1,141,000 in first nine months 2010 and \$2,577,000 in first nine months 2009.

Note 6 Noncontrolling Interests

A reconciliation of changes in shareholders' equity at third quarter-end 2010 follows:

	Forestar Group Inc.	Noncontrolling Interests (In thousands)	Total
Balance at year-end 2009	\$ 512,456	\$ 5,879	\$ 518,335
Net income	2,677	328	3,005
Unrealized gain	256		256
Distributions to noncontrolling interests		(1,275)	(1,275)

Contributions from noncontrolling interests			776	776
Repurchases of common stock	(15,178)			(15,178)
Other (primarily share-based compensation)	5,301			5,301
Balance third quarter-end 2010	\$ 505,512	\$	5,708	\$ 511,220

Note 7 Investment in Unconsolidated Ventures

At third quarter-end 2010, we had ownership interests ranging from 25 to 50 percent in 10 ventures that we account for using the equity method. We have no real estate ventures that are accounted for using the cost method. Our three largest ventures at third quarter-end 2010 are CL Realty, Temco and Palisades West. We own a 50 percent interest in both CL Realty and Temco, and Cousins Real Estate Corporation owns the other 50 percent interest. We own a 25 percent interest in Palisades West, Cousins Properties Incorporated owns a 50 percent interest and Dimensional Fund Advisors LP owns the remaining 25 percent interest. Information regarding these ventures follows:

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CL Realty, L.L.C. was formed in 2002 for the purpose of developing residential and mixed-use communities in Texas and across the southeastern United States. At third quarter-end 2010, the venture had 14 residential and mixed-use communities, of which 10 are in Texas, 3 are in Florida and 1 is in Georgia, representing about 7,010 planned residential lots and 550 commercial acres.

Temco Associates, LLC was formed in 1991 for the purpose of acquiring and developing residential real estate sites in Georgia. At third quarter-end 2010, the venture has 5 residential and mixed-use communities, representing about 1,560 planned residential lots, all of which are located in Paulding County, Georgia. The venture also owns approximately 5,500 acres of undeveloped land in Paulding County, Georgia.

Palisades West LLC was formed in 2006 for the purpose of constructing a commercial office park in Austin, Texas. The project includes two office buildings totaling approximately 375,000 square feet and an accompanying parking garage. At third quarter-end 2010, the buildings are approximately 97 percent leased. Our remaining commitment for investment in this venture as of third quarter-end 2010 is \$3,067,000. Effective fourth quarter 2008, we entered into a 10-year operating lease for approximately 32,000 square feet that we occupy as our corporate headquarters. In first nine months 2010, rents paid under this operating lease were \$889,000 and are included in general and administrative expenses.

Combined summarized balance sheet information for our ventures accounted for using the equity method follows:

	Third Quarter-End 2010					Year-End 2009				
	CL Realty	Temco	Palisades West	Other Ventures	Total	CL Realty	Temco	Palisades West	Other Ventures	Total
	(In thousands)									
Real estate	\$ 108,301	\$ 60,411	\$ 122,624	\$ 70,458	\$ 361,794	\$ 113,169	\$ 60,402	\$ 122,566	\$ 89,507	\$ 385,644
Total assets	109,383	60,540	125,277	76,828	372,028	114,598	60,751	125,396	96,711	397,456
Borrowings										
(a)	2,911	2,963		73,711	79,585	3,568	3,061		77,113	83,742
Total liabilities	4,901	3,650	50,705 ^(b)	84,593	143,849	5,414	3,268	51,158 ^(b)	88,273	148,113
Equity	104,482	56,890	74,572	(7,765)	228,179	109,184	57,483	74,238	8,438	249,343
Our investment in real estate ventures:										
Our share of their equity ^(c)	52,241	28,445	18,643	14,594	113,923	54,592	28,742	18,559	15,673	117,566
Unrecognized deferred gain ^(d)	(7,059)			(910)	(7,969)	(7,059)			(910)	(7,969)
Investment in real estate ventures	\$ 45,182	\$ 28,445	\$ 18,643	\$ 13,684	\$ 105,954	\$ 47,533	\$ 28,742	\$ 18,559	\$ 14,763	\$ 109,597

Combined summarized income statement information for our ventures accounted for using the equity method follows:

	Third Quarter 2010	2009	First Nine Months 2010	2009
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(In thousands)

Revenues:				
CL Realty	\$ 1,120	\$ 273	\$ 5,332	\$ 2,030
Temco	233	151	2,110	1,349
Palisades West	3,414	3,179	10,145	9,236
Other ventures	1,549	1,988	9,769	6,059
Total	\$ 6,316	\$ 5,591	\$ 27,356	\$ 18,674
Earnings (Loss):				
CL Realty ^(e)	\$ 964	\$ (3,479)	\$ 2,184	\$ (8,453)
Temco ^(f)	(382)	(1,457)	430	(2,400)
Palisades West	1,124	1,387	3,406	3,424
Other ventures	(524)	(1,344)	(16,807)	(1,668)
Total	\$ 1,182	\$ (4,893)	\$ (10,787)	\$ (9,097)
Our equity in their earnings (loss):				
CL Realty	\$ 482	\$ (1,739)	\$ 1,092	\$ (4,226)
Temco	(191)	(729)	215	(1,200)
Palisades West	281	347	850	856
Other ventures ^(c)	(490)	(322)	(1,417)	(2,493)
Total	\$ 82	\$ (2,443)	\$ 740	\$ (7,063)

(a) Total includes current maturities of \$74,808,000 at third quarter-end 2010, of which \$42,447,000 is non-recourse to us, and \$80,625,000 at year-end 2009, of which \$46,936,000 is non-recourse to us.

(b) Principally includes deferred income from leasehold improvements funded by

tenants in excess of leasehold improvement allowances. These amounts are recognized as rental income over the lease term and are offset by depreciation expense related to these tenant improvements. There is no effect on venture net income.

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- (c) Our share of the equity in other ventures reflects our ownership interests ranging from 25 to 50 percent, excluding venture losses that exceed our investment where we are not obligated to fund those losses.

- (d) Represents deferred gains on real estate contributed by us to ventures. We are recognizing income as real estate is sold to third parties. The deferred gains are reflected as a reduction to our investment in unconsolidated ventures.

- (e) CL Realty's loss includes impairment charges of \$3,300,000 related to two residential real estate projects located in Tampa, Florida in third quarter 2009 and an impairment charge of \$5,238,000

related to an equity investment in an unconsolidated venture in first nine months 2009.

- (f) In third quarter 2009, Temco Associates loss includes an impairment charge of \$1,263,000 related to a residential real estate project located in Atlanta, Georgia.

In first nine months 2010, we invested \$1,538,000 in these ventures and received \$5,974,000 in distributions; in first nine months 2009, we invested \$1,916,000 in these ventures and received \$2,930,000 in distributions. Distributions include both return of investments and distributions of earnings.

At third quarter-end 2010, other ventures include three partnerships we participate in that have \$72,414,000 of borrowings classified as current maturities. These partnerships have total assets of \$54,753,000 and other liabilities of \$10,792,000. These partnerships are managed by third parties who intend to extend or refinance these borrowings; however, there is no assurance that this can be done. Although some of these borrowings are guaranteed by third parties, we may under certain circumstances elect or be required to provide additional equity to these partnerships. We do not believe that the ultimate resolution of these matters will have a significant effect on our earnings or financial position. Our investment in these partnerships is \$3,183,000 at third quarter-end 2010. These three partnerships are variable interest entities. Please read Note 18 for additional information.

In first nine months 2010, other ventures loss includes a \$13,061,000 loss on sale of a golf course and country club property in Denton, Texas. This loss did not impact our equity in the earnings (loss) of this venture as we exclude losses that exceed our investment where we are not obligated to provide additional equity.

We have provided performance bonds and letters of credit on behalf of certain ventures totaling \$2,351,000 at third quarter-end 2010. Generally these performance bonds and letters of credit would be drawn on due to lack of performance by us or the ventures, such as failure to timely deliver streets and utilities in accordance with local codes and ordinances.

Note 8 Receivables

Receivables consist of:

	Third Quarter-End 2010	Year-End 2009
	(In thousands)	
Seller financing notes receivable, average interest rate of 6.49% at third quarter-end 2010 and 5.76% at year-end 2009	\$ 949	\$ 1,112
Note receivable, interest rate of 9.00% at third quarter-end 2010	10,000	
Due from qualified intermediary (see Note 3 for additional information)	22,630	
Accrued interest and other	449	873

	34,028	1,985
Allowance for bad debts	(144)	(144)
	\$ 33,884	\$ 1,841

Seller financing notes receivable generally are secured by a deed of trust with a minimum 10 percent down payment and are generally due within three years.

Note receivable represents our loan to a third-party equity investor in the JW Marriott® San Antonio Hill Country Resort & Spa. The loan bears interest at 9 percent, increasing to 12 percent after July 2012, and is repayable at the earliest of refinancing or sale of the resort hotel or July 31, 2013. Borrowings are collateralized by pledges of funding commitments from the borrower, including our right to direct capital calls and to enforce rights under the fund operating agreement in the event of nonpayment.

Accrued interest and other receivables principally include miscellaneous operating receivables arising in the normal course of business.

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Debt consists of:

	Third Quarter-End 2010	Year-End 2009
	(In thousands)	
Term loan facility average interest rate of 6.50% at third quarter-end 2010 and 5.54% at year-end 2009	\$ 125,000	\$ 125,000
Revolving loan facility average interest rate of 6.50% at third quarter-end 2010	19,000	
Secured promissory note interest rate of 3.76% at third quarter-end 2010 and 2.73% at year-end 2009	15,216	16,716
Other indebtedness due through 2011 at variable interest rates based on prime (3.75% at third quarter-end 2010 and 3.25% at year-end 2009) and fixed interest rates of 8.00%	58,350	74,910
	\$ 217,566	\$ 216,626

Our senior credit facility and other debt agreements contain terms, conditions and financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At third quarter-end 2010, we were in compliance with the terms, conditions and financial covenants of these agreements.

On August 6, 2010, we entered into an amended and restated senior credit facility in order to consolidate previous amendments and to effect the following additional principal amendments to: extend the maturity date of the revolving loan to August 6, 2013 (with a one-year extension option to August 6, 2014) and of the term loan to August 6, 2015; reduce the revolving loan commitment to \$175 million, subject to the ability to increase the aggregate facility by up to \$150 million by securing additional commitments; eliminate any additional required commitment reductions during the term of the facility; reduce the interest coverage ratio from 1.75x to 1.05x; provide that during any period when the minimum interest coverage ratio falls below 1.50x, the interest rate on outstanding loans will increase by 2 percent and no new acquisitions, discretionary capital expenditures or distributions will be permitted; reduce the minimum value to commitment ratio from 1.75:1.00 to 1.60:1.00; and provide that if the interest coverage ratio does not exceed 3.0x, we may not repurchase our common stock. We incurred fees of about \$5,700,000 related to this amendment.

At third quarter-end 2010, our senior credit facility provides for a \$125,000,000 term loan and a \$175,000,000 revolving line of credit. The term loan includes a prepayment penalty for payments in excess of \$25,000,000 prior to February 6, 2012. The revolving line of credit may be prepaid at any time without penalty. The revolving line of credit includes a \$100,000,000 sublimit for letters of credit, of which \$3,071,000 is outstanding at third quarter-end 2010. Total borrowings under our senior credit facility (including the face amount of letters of credit) may not exceed a borrowing base formula. At third quarter-end 2010, we had \$152,929,000 in net unused borrowing capacity under our senior credit facility.

At our option, we can borrow at LIBOR plus 4.5 percent (subject to a 2 percent LIBOR floor) or prime plus 2.5 percent. Borrowings under the senior credit facility are secured by (a) all timberland and minerals, (b) assignments of current and future leases, rents and contracts, including our mineral leases, (c) a security interest in our primary operating account, (d) pledge of the equity interests in current and future material operating subsidiaries or joint venture interests, or if such pledge is not permitted, a pledge of the right to distributions from such entities, and (e) negative pledge (without a mortgage) on all other wholly-owned assets. The senior credit facility provides for releases of real estate to be conveyed provided that borrowing base compliance is maintained.

At third quarter-end 2010, we have \$7,617,000 in unamortized deferred fees which are included in other assets. Amortization of deferred financing fees was \$3,543,000 in first nine months 2010 and \$3,841,000 in first nine months 2009 and is included in interest expense.

At third quarter-end 2010, commercial operating properties having a book value of \$23,157,000 are subject to liens in connection with \$15,216,000 of debt.

At third quarter-end 2010, entitled, developed and under development projects having a book value of \$127,882,000 are subject to liens in connection with \$58,350,000 of principally non-recourse debt.

In first quarter 2010, other indebtedness decreased by \$13,207,000 due to lender foreclosure of a lien on a condominium property in Austin, Texas owned by a consolidated variable interest entity. Please read Note 18 for additional information.

Note 10 Fair Value

Non-financial assets measured at fair value on a non-recurring basis principally include real estate assets and assets held for sale, which are measured for impairment. In second quarter 2010, a real estate asset was remeasured and reported at fair value due to events or circumstances that indicated the carrying value may not be recoverable. We determined estimated fair value based on the present value of future probability weighted cash flows expected from the sale of the long-lived asset. As a result, we recognized asset impairment of \$900,000 in second quarter 2010. The carrying value of this asset may have subsequently increased or decreased from the fair value reflected due to activity that has occurred since the measurement date.

Outstanding	1,267	\$	20.47	4	\$	2,432
Exercisable	1,225	\$	20.12	4	\$	2,432

Note 13 Other Comprehensive Income

Other comprehensive income consists of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Consolidated net income	\$ 9,086	\$ 20,201	\$ 3,005	\$ 68,264
Change in fair value of interest rate swap agreement		400	393	968
Income tax effect of change in fair value		(140)	(137)	(339)
Other comprehensive income	9,086	20,461	3,261	68,893
Less: Comprehensive income attributable to noncontrolling interests	(164)	(725)	(328)	(1,763)
Other comprehensive income attributable to Forestar Group Inc.	\$ 8,922	\$ 19,736	\$ 2,933	\$ 67,130

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Earnings available to common shareholders and weighted average common shares outstanding used to compute earnings per share were:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Earnings available to common shareholders:				
Consolidated net income	\$ 9,086	\$ 20,201	\$ 3,005	\$ 68,264
Less: Net income attributable to noncontrolling interest	(164)	(725)	(328)	(1,763)
Net income attributable to Forestar Group Inc.	\$ 8,922	\$ 19,476	\$ 2,677	\$ 66,501
Weighted average common shares outstanding basic	35,858	35,817	36,030	35,769
Dilutive effect of stock options	154	134	223	50
Dilutive effect of restricted stock and restricted stock units	367	222	343	156
Weighted average common shares outstanding diluted	36,379	36,173	36,596	35,975

At third quarter-end 2010 and 2009, the effect of 1,574,000 and 1,704,000 stock options and unvested shares of restricted stock were not included in the computation of diluted weighted average shares outstanding because they were anti-dilutive.

Note 15 Income Taxes

Our effective tax rate was 24 percent in third quarter 2010 and 33 percent in first nine months 2010 which includes a 4 percent benefit attributable to noncontrolling interests. Our effective tax rate was 35 percent in third quarter 2009 and 37 percent in first nine months 2009 which included less than a 1 percent benefit attributable to noncontrolling interests. Differences between the effective tax rate and the statutory rate are principally due to state income taxes, percentage depletion and nondeductible items. Our 2009 rate included a benefit from a federal income tax rate change for qualified timber gains due to the Food, Conservation and Energy Act of 2008 which expired in 2009.

We have not provided a valuation allowance for our deferred tax asset because we believe it is likely it will be recoverable in future periods.

At third quarter-end 2010, our unrecognized tax benefits totaled \$7,581,000, of which \$6,206,000 would affect our effective tax rate if recognized.

Note 16 Commitments and Contingencies**Litigation**

We are involved in various legal proceedings that arise from time to time in the ordinary course of doing business and believe that adequate reserves have been established for any probable losses. We do not believe that the outcome of any of these proceedings should have a significant adverse effect on our financial position, long-term results of operations or cash flows. It is possible; however, that charges related to these matters could be significant to our results or cash flows in any one accounting period.

Environmental

Environmental remediation liabilities arise from time to time in the ordinary course of doing business, and we believe we have established adequate reserves for any probable losses. We own 288 acres near Antioch, California, portions of which were sites of a former Temple-Inland paper manufacturing operation that are in remediation. We estimate the cost to complete remediation activities will be about \$3,500,000, which is included in other accrued expenses and will principally be paid in 2010 and 2011. Our estimate requires us to make assumptions regarding the scope of required remediation, the effectiveness of planned remediation activities, and approvals by regulatory

authorities. Our estimate is subject to revision as new information becomes available.

Note 17 Segment Information

We manage our operations through three business segments: real estate, mineral resources and fiber resources. Real estate secures entitlements and develops infrastructure on our lands for single-family residential and mixed-use communities and manages our undeveloped land and our commercial operating properties. Mineral resources manages our oil, natural gas and water interests. Fiber resources manages our timber and recreational leases.

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Assets allocated by segment are as follows:

	Third Quarter-End 2010	Year-End 2009
	(In thousands)	
Real estate	\$ 636,359	\$ 654,250
Mineral resources	1,144	1,356
Fiber resources	18,666	20,088
Assets not allocated to segments	120,854	109,040
Total assets	\$ 777,023	\$ 784,734

We evaluate performance based on segment earnings before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures and net income (loss) attributable to noncontrolling interests. Unallocated items consist of general and administrative expense, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense. The accounting policies of the segments are the same as those described in the accounting policy note to the consolidated financial statements. Our revenues are derived from our U.S. operations and all of our assets are located in the U.S. In first nine months 2010, no single customer accounted for more than 10 percent of our total revenues.

Segment revenues and earnings are as follows:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Revenues:				
Real estate	\$ 15,139	\$ 22,921	\$ 53,936	\$ 70,155
Mineral resources	6,654	18,828	18,387	31,767
Fiber resources	2,220	3,558	6,185	12,928
Total revenues	\$ 24,013	\$ 45,307	\$ 78,508	\$ 114,850
Segment earnings (loss):				
Real estate	\$ (1,883)	\$ 92	\$ 883	\$ 5,641
Mineral resources	6,196	17,850	16,640	29,033
Fiber resources	1,372	2,080	3,900	8,279
Total segment earnings	5,685	20,022	21,423	42,953
Items not allocated to segments ^(a)	6,097	10,410	(17,239)	63,309
Income before taxes	\$ 11,782	\$ 30,432	\$ 4,184	\$ 106,262

(a) Items not allocated to segments consist of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
General and administrative expense	\$ (3,860)	\$ (5,874)	\$ (13,438)	\$ (17,750)
Share-based compensation expense	(1,817)	(3,396)	(7,370)	(7,717)
Gain on sale of assets	15,441	24,833	15,441	104,047
Interest expense	(3,913)	(5,440)	(12,562)	(15,653)
Other non-operating income	246	287	690	382
	\$ 6,097	\$ 10,410	\$ (17,239)	\$ 63,309

In third quarter 2010, gain on sale of assets represents the sale of about 14,100 acres of timber and timberland in Georgia and Alabama for \$22,621,000.

In third quarter 2010, share-based compensation expense decreased as a result of a decline in our stock price and its impact on cash-settled awards.

In third quarter and first nine months 2010, interest expense decreased as a result of lower debt levels.

In third quarter 2009, general and administrative expense includes a \$1,753,000 non-cash impairment charge related to our undivided 15 percent interest in corporate aircraft contributed to us by Temple-Inland at spin-off. In first nine months 2009, general and administrative expense includes about \$3,200,000 paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal.

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In third quarter 2009, gain on sale of assets principally represents the sale of about 20,000 acres of timber and timberland in Georgia for \$38,901,000. In first nine months 2009, gain on sale of assets of \$104,047,000 represents the sale of about 95,000 acres of timber and timberland in Georgia and Alabama for \$158,603,000.

Note 18 Variable Interest Entities

We participate in real estate ventures for the purpose of acquiring and developing residential and mixed-use communities in which we may or may not have a controlling financial interest. Generally accepted accounting principles require consolidation of variable interest entities (VIE) in which an enterprise has a controlling financial interest and is the primary beneficiary. A controlling financial interest will have both of the following characteristics: (a) the power to direct the VIE activities that most significantly impact economic performance and (b) the obligation to absorb the VIE losses and right to receive benefits that are significant to the VIE. We examine specific criteria and use judgment when determining whether we are the primary beneficiary and must consolidate a VIE. We perform this review initially at the time we enter into venture agreements and subsequently when reconsideration events occur.

At third quarter-end 2010, we are the primary beneficiary of two VIEs that we consolidate. We have provided the majority of equity to these VIEs, which absent our contributions or advances do not have sufficient equity to fund their operations. We have the authority to approve project budgets and the issuance of additional debt. At third-quarter end 2010, our consolidated balance sheet includes \$15,153,000 in assets, principally real estate, and \$7,993,000 in liabilities, principally debt, related to these two VIEs. In first nine months 2010, we contributed or advanced \$1,311,000 to these VIEs. In first quarter 2010, real estate assets decreased by \$11,865,000, debt decreased by \$13,207,000 and other liabilities increased by \$1,342,000 due to lender foreclosure of a lien on property owned by one of these VIEs. We have a nominal general partner interest in this VIE and could be held responsible for its liabilities.

Also at third quarter-end 2010, we are not the primary beneficiary of three VIEs that we account for using the equity method. The unrelated managing partners oversee the day-to-day operations and guarantee some of the debt of the VIEs while we have the authority to approve project budgets and the issuance of additional debt. Although some of the debt is guaranteed by the managing partners, we may under certain circumstances elect or be required to provide additional funds to these VIEs. At third quarter-end 2010, these three VIEs have total assets of \$54,753,000, substantially all of which represent developed and undeveloped real estate and total liabilities of \$83,207,000, which includes \$72,414,000 of borrowings classified as current maturities. These amounts are included in other ventures in the combined summarized balance sheet information for ventures accounted for using the equity method in Note 7. At third quarter-end 2010, our investment in these three VIEs is \$3,183,000 and is included in investment in unconsolidated ventures. We did not make any contributions or advances to these ventures in first nine months 2010. Our maximum exposure to loss related to these VIEs is estimated at \$37,289,000, which exceeds our investment as we have a nominal general partner interest in two of these VIEs and could be held responsible for their liabilities. The maximum exposure to loss represents the maximum loss that we could be required to recognize assuming all the ventures' assets (principally real estate) are worthless, without consideration of the probability of a loss or of any actions we may take to mitigate any such loss.

Note 19 Share-Based Compensation

A summary of the awards granted under our 2007 Stock Incentive Plan follows.

Cash-settled awards

Cash-settled awards granted to our employees in the form of restricted stock units or stock appreciation rights vest over two to four years from the date of grant and generally provide for accelerated vesting upon death, disability or if there is a change in control. Vesting for some restricted stock unit awards is also conditioned upon achievement of a minimum one percent annualized return on assets over a three-year period. Cash-settled stock appreciation rights have a ten-year term, generally become exercisable ratably over three to four years and provide for accelerated or continued vesting upon retirement, death, disability or if there is a change in control. Stock appreciation rights were granted with an exercise price equal to the market value of our stock on the date of grant.

Cash-settled awards granted to our directors in the form of restricted stock units are fully vested at the time of grant and payable upon retirement.

The following table summarizes the activity of cash-settled awards in first nine months 2010:

	Equivalent Units (In thousands)	Weighted Average Grant Date Fair Value (Per unit)
Non-vested at beginning of period	1,005	\$ 5.35
Granted	399	12.68
Vested	(264)	7.18
Forfeited	(15)	6.58
Non-vested at end of period	1,125	\$ 7.51

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The fair value of awards settled in cash was \$731,000 in first nine months 2010 and \$22,000 in first nine months 2009. At third quarter-end 2010, the fair value of vested cash-settled awards is \$10,462,000 and is included in other liabilities. The aggregate current value of non-vested awards is \$10,571,000 at third quarter-end 2010 based on a third quarter-end stock price of \$17.05.

Restricted stock

Restricted stock awards vest either ratably over or after three years, generally if we achieve a minimum one percent annualized return on assets over such three-year period. The following table summarizes the activity of restricted stock awards in first nine months 2010:

	Restricted Shares (In thousands)	Weighted Average Grant Date Fair Value (Per share)
Non-vested at beginning of period	331	\$ 17.43
Granted	308	17.80
Vested		
Forfeited	(3)	28.20
Non-vested at end of period	636	\$ 17.56

The aggregate current value of non-vested awards is \$10,849,000 at third quarter-end 2010 based on a third quarter-end stock price of \$17.05.

Stock options

Stock options have a ten-year term, generally become exercisable ratably over three to four years and provide for accelerated or continued vesting upon retirement, death, disability or if there is a change in control. Options were granted with an exercise price equal to the market value of our stock on the date of grant. The following table summarizes the activity of stock option awards in first nine months 2010:

	Options Outstanding (In thousands)	Weighted Average Exercise Price (Per share)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Current Value Less Exercise Price) (In thousands)
Balance at beginning of period	780	\$ 24.80	8	\$ 2,052
Granted	181	17.80		
Exercised				
Forfeited	(4)	28.85		
Balance at end of period	957	\$ 23.45	8	\$ 1,255
Exercisable at end of period	395	\$ 26.85	7	\$ 314

We estimate the fair value of stock options using the Black-Scholes option pricing model and the following assumptions:

	First Nine Months	
	2010	2009
Expected dividend yield	0.0%	0.0%
Expected stock price volatility	51.0%	41.8%
Risk-free interest rate	2.3%	1.8%
Expected life of options (years)	6	6
Weighted average estimated fair value of options granted	\$ 8.98	\$ 3.94

We have limited historical experience as a stand-alone company so we utilized alternative methods in determining our valuation assumptions. The expected life was based on the simplified method utilizing the midpoint between the vesting period and the contractual life of the awards. The expected stock price volatility was based on historical prices of our peers' common stock for a period corresponding to the expected life of the options. Pre-vesting forfeitures are estimated based upon the pool of participants and their expected activity and historical trends.

Pre-Spin Awards

Certain of our employees participated in Temple-Inland's share-based compensation plans. In conjunction with the 2007 spin-off, these awards were equitably adjusted into separate awards of the common stock of Temple-Inland and the spin-off entities.

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Cash-settled awards generally vest and are paid after three years from the date of grant or the attainment of defined performance goals, generally measured over a three-year period. To settle vested cash awards, we paid \$1,904,000 in first nine months 2010 and \$394,000 in first nine months 2009. At third quarter-end 2010, there are no remaining cash-settled awards.

Stock options have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, disability or if there is a change in control. A summary of stock option awards outstanding at third quarter-end 2010 follows:

	Options Outstanding (In thousands)	Weighted Average Exercise Price (Per share)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Current Value Less Exercise Price) (In thousands)
Outstanding on Forestar stock	81	\$ 21.60	4	\$ 149
Outstanding on Temple-Inland stock	171	20.07	5	286
				\$ 435
Exercisable on Forestar stock	76	\$ 20.98	4	\$ 149
Exercisable on Temple-Inland stock	155	19.65	5	286
				\$ 435

The intrinsic value of options exercised was \$553,000 in first nine months 2010 and \$138,000 in first nine months 2009.

Share-Based Compensation Expense

Share-based compensation expense consists of:

	Third Quarter 2010	2009	First Nine Months 2010	2009
	(In thousands)			
Cash-settled awards	\$ 422	\$ 2,464	\$ 3,187	\$ 4,937
Restricted stock	923	467	2,538	1,266
Stock options	472	465	1,645	1,514
	\$ 1,817	\$ 3,396	\$ 7,370	\$ 7,717

Share-based compensation expense is included in:

	Third Quarter 2010	2009	First Nine Months 2010	2009
	(In thousands)			
General and administrative expense	\$ 937	\$ 2,126	\$ 3,055	\$ 5,008
Other operating expense	880	1,270	4,315	2,709

\$ 1,817 \$ 3,396 \$ 7,370 \$ 7,717

In third quarter 2010, share-based compensation expense decreased as a result of a decline in our stock price and its impact on cash-settled awards.

We did not capitalize any share-based compensation in first nine months 2010 or 2009.

Unrecognized share-based compensation for non-vested restricted stock and stock options is \$7,968,000 at third quarter-end 2010. The weighted average period over which this amount will be recognized is estimated to be 2 years.

In first nine months 2010, we withheld 3,000 shares having a value of \$49,000 in connection with vesting of restricted stock awards and exercises of stock options. These shares are included in treasury stock and are reflected in financing activities in our consolidated statement of cash flows.

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Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2009 Annual Report on Form 10-K. Unless otherwise indicated, information is presented as of third quarter-end 2010, and references to acreage owned includes 59,000 acres classified as assets held for sale in accordance with our near-term strategic initiatives and all acres owned by ventures regardless of our ownership interest in a venture.

Forward-Looking Statements

This Quarterly Report on Form 10-Q and other materials we have filed or may file with the Securities and Exchange Commission contain forward-looking statements within the meaning of the federal securities laws. These forward-looking statements are identified by their use of terms and phrases such as believe, anticipate, could, estimate, likely, intend, may, plan, expect, and similar expressions, including references to assumptions. These statements reflect our current views with respect to future events and are subject to risk and uncertainties. We note that a variety of factors and uncertainties could cause our actual results to differ significantly from the results discussed in the forward-looking statements. Factors and uncertainties that might cause such differences include, but are not limited to:

- general economic, market or business conditions in Texas or Georgia, where our real estate activities are concentrated;

- the opportunities (or lack thereof) that may be presented to us and that we may pursue;

- significant customer concentration

- future residential or commercial entitlements, development approvals and the ability to obtain such approvals;

- accuracy of estimates and other assumptions related to investment in real estate, the expected timing and pricing of land and lot sales and related cost of real estate sales, impairment of long-lived assets, income taxes, share-based compensation and oil and gas reserves;

- the levels of resale housing inventory and potential impact of foreclosures in our development projects and the regions in which they are located;

- the development of relationships with strategic partners;

- fluctuations in costs and expenses;

- demand for new housing, which can be affected by a number of factors including the availability of mortgage credit;

- supply of and demand for oil and gas and fluctuations in oil and gas prices;

- competitive actions by other companies;

- changes in governmental policies, laws or regulations and actions or restrictions of regulatory agencies;

- government regulation of exploration and production technology, including hydraulic fracturing;

- the results of financing efforts, including our ability to obtain financing with favorable terms;

our partners' ability to fund their capital commitments and otherwise fulfill their operating and financial obligations;

water withdrawal or usage may be subject to state and local laws, regulations or permit requirements, and there is no assurance that all our water interests or rights will be available for withdrawal or use; and

the final resolutions or outcomes with respect to our contingent and other liabilities related to our business.

Other factors, including the risk factors described in Item 1A of our 2009 Annual Report on Form 10-K, may also cause actual results to differ materially from those projected by our forward-looking statements. New factors emerge from time to time and it is not possible for us to predict all such factors, nor can we assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

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Our strategy is to maximize and grow long-term shareholder value through:
Entitlement and development of real estate;

Realization of value from minerals, water and fiber resources; and

Strategic and disciplined investment in our business.

In 2009, we announced our near-term strategic initiatives to enhance shareholder value by: generating significant cash flow, principally from the sale of about 175,000 acres of higher and better use (HBU) timberland; reducing debt by approximately \$150,000,000; and repurchasing up to 20 percent of our common stock.

In 2009, we sold about 95,000 acres of timber and timberland in Georgia and Alabama in two transactions generating net cash proceeds of \$153,851,000, which were principally used to reduce debt and pay taxes.

In third quarter 2010, we sold about 14,100 acres of timber and timberland in Georgia and Alabama for \$22,621,000 to East Coast Trading Co., Inc. in two separate transactions. These transactions generated net proceeds of \$22,030,000, resulting in recognition of a \$15,441,000 gain and \$5,200,000 of deferred income tax expense. At third quarter-end 2010, the net proceeds from these transactions are held by a qualified intermediary as we plan to reinvest these proceeds in qualifying real estate, thereby deferring the gain for tax purposes under Internal Revenue Code Section 1031. As a result, the net proceeds are classified as a receivable pending reinvestment. We have until November 13, 2010 to identify qualified replacement properties, and until March 28, 2011 to acquire the identified properties. If we are unable to identify and close on the replacement properties within the required time periods, we will not be able to defer the gain for tax purposes and all deferred taxes related to these transactions will become currently payable.

At third quarter-end 2010, assets held for sale includes over 59,000 acres of undeveloped land with a carrying value of \$13,517,000 and related timber with a carrying value of \$7,848,000. We continue to actively market this land in accordance with these initiatives. Market conditions for timberland have deteriorated since second quarter 2009 due to increase investor return requirements, low consumer confidence and alternative investment options for buyers in the marketplace. As a result of these market conditions, additional time may be required to complete the sale of these assets.

In addition, we repurchased 1,000,987 shares of our common stock at a cost of \$15,178,000 in third quarter 2010. The repurchased shares are classified as treasury stock.

Results of Operations

A summary of our consolidated results by business segment follows:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Revenues:				
Real estate	\$ 15,139	\$ 22,921	\$ 53,936	\$ 70,155
Mineral resources	6,654	18,828	18,387	31,767
Fiber resources	2,220	3,558	6,185	12,928
Total revenues	\$ 24,013	\$ 45,307	\$ 78,508	\$ 114,850
Segment earnings (loss):				
Real estate	\$ (1,883)	\$ 92	\$ 883	\$ 5,641
Mineral resources	6,196	17,850	16,640	29,033
Fiber resources	1,372	2,080	3,900	8,279

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Total segment earnings	5,685	20,022	21,423	42,953
Items not allocated to segments:				
General and administrative expense	(3,860)	(5,874)	(13,438)	(17,750)
Share-based compensation expense	(1,817)	(3,396)	(7,370)	(7,717)
Gain on sale of assets	15,441	24,833	15,441	104,047
Interest expense	(3,913)	(5,440)	(12,562)	(15,653)
Other non-operating income	246	287	690	382
Income before taxes	11,782	30,432	4,184	106,262
Income tax expense	(2,860)	(10,956)	(1,507)	(39,761)
Net income attributable to Forestar Group Inc.	\$ 8,922	\$ 19,476	\$ 2,677	\$ 66,501

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Significant aspects of our results of operations follow:

Third Quarter and First Nine Months 2010 and 2009

Real estate segment earnings declined principally due to lower undeveloped land sales as a result of current market conditions significantly influenced by low consumer confidence and alternate investment options to buyers in the marketplace.

Mineral resources segment earnings declined principally due to decreased lease bonus revenues as a result of reduced leasing activity by exploration and production companies that are concentrating on drilling activities rather than leasing new mineral interests in our area of operations. This decrease in earnings was partially offset by increased oil production and higher oil prices.

Fiber resources segment earnings decreased principally due to reduction in volume as a result of selling about 130,000 acres of timberland in 2010 and 2009 and postponing harvest plans on acres classified as held for sale.

In third quarter 2010, share-based compensation expense decreased as a result of a decline in our stock price and its impact on cash-settled awards.

In third quarter 2010, gain on sale of assets represents the gain from selling about 14,100 acres of timber and timberland in Georgia and Alabama for \$22,621,000.

Interest expense decreased as a result of lower debt levels.

In third quarter and first nine months 2009, real estate segment earnings were negatively impacted by impairment charges principally associated with a residential condominium project located in Austin, Texas and two joint venture projects located in Tampa, Florida.

In third quarter 2009, mineral resources segment earnings include \$15,820,000 in lease bonus payments from leasing almost 10,800 net mineral acres.

In third quarter 2009, general and administrative expense includes a \$1,753,000 impairment charge related to our undivided 15 percent interest in corporate aircraft contributed to us by Temple-Inland at spin-off. In first nine months 2009, general and administrative expense also includes about \$3,200,000 paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal.

In third quarter 2009, gain on sale of assets principally represents the sale of about 20,000 acres of timber and timberland in Georgia for \$38,901,000. In first nine months 2009, gain on sale of assets of \$104,047,000 represents the sale of about 95,000 acres of timber and timberland in Georgia and Alabama for \$158,603,000.

Current Market Conditions

Current U.S. market conditions in the single-family residential industry continue to be difficult, characterized by product oversupply, depressed sales volumes and prices, high unemployment rates and low consumer confidence. While all markets are being negatively affected by overall poor economic conditions, not all geographic areas and products have been affected to the same extent or with equal severity. These difficult market conditions will likely continue into 2011.

Oil prices have increased partially due to anticipation that future demand will outpace supply growth as economic activity improves. Natural gas prices have remained depressed as production remains strong and demand is lower resulting in increased inventory levels. In our areas of operations, exploration and production companies remained focused on reducing capital expenditures for lease acquisition due to lower natural gas prices and drilling activity to hold existing leases. These conditions may impact the demand for new mineral leases, new exploration activity and the amount of royalty revenues we receive.

Pulpwood demand is relatively stable in our markets. Sawtimber prices remain depressed due to decreased demand for lumber as a result of lower demand for new homes.

Business Segments

We manage our operations through three business segments:

Real estate,

Mineral resources, and

Fiber resources.

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We evaluate performance based on earnings before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures and net income (loss) attributable to noncontrolling interests. Unallocated items consist of general and administrative expense, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense. The accounting policies of the segments are the same as those described in the accounting policy note to the consolidated financial statements.

We operate in cyclical industries. Our operations are affected to varying degrees by supply and demand factors and economic conditions including changes in interest rates, availability of mortgage credit, consumer and home builder sentiment, new housing starts, real estate values, employment levels, changes in the market prices for oil, natural gas, and timber, and the overall strength or weakness of the U.S. economy.

Real Estate

We own directly or through ventures about 232,000 acres of real estate located in nine states and 12 markets. Our real estate segment secures entitlements and develops infrastructure on our lands, primarily for single-family residential and mixed-use communities. We own over 170,000 acres in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. We target investments principally in our strategic growth corridors, regions across the southern half of the United States that possess key demographic and growth characteristics that we believe make them attractive for long-term real estate investment. We own and manage our projects either directly or through ventures. Our real estate segment revenues are principally derived from the sales of residential single-family lots, undeveloped land and commercial real estate and to a lesser degree from the operation of commercial properties, primarily a hotel.

A summary of our real estate results follows:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Revenues	\$ 15,139	\$ 22,921	\$ 53,936	\$ 70,155
Cost of sales	(8,274)	(12,363)	(30,549)	(32,748)
Operating expenses	(8,153)	(7,194)	(21,607)	(22,713)
	(1,288)	3,364	1,780	14,694
Equity in (loss) of unconsolidated ventures	(431)	(2,547)	(569)	(7,290)
Less: Net income attributable to noncontrolling interests	(164)	(725)	(328)	(1,763)
Segment (loss) earnings	\$ (1,883)	\$ 92	\$ 883	\$ 5,641

In first nine months 2010, cost of sales includes a \$900,000 non-cash impairment charge related to a residential real estate project located near Salt Lake City, Utah. In first nine months 2009, cost of sales includes a \$3,050,000 non-cash impairment charge related to a condominium project in Austin, Texas.

In third quarter 2010, operating expenses principally consist of \$1,718,000 in property taxes, \$1,646,000 in professional services, \$1,543,000 in employee compensation and benefits and \$641,000 in depreciation. In third quarter 2009, operating expenses principally consist of \$2,374,000 in property taxes, \$1,312,000 in employee compensation and benefits, \$729,000 in professional services and \$555,000 in depreciation.

In first nine months 2010, operating expenses principally consist of \$5,903,000 in property taxes, \$4,674,000 in employee compensation and benefits, \$3,080,000 in professional services and \$2,089,000 in depreciation. In first nine months 2009, operating expenses principally consist of \$7,881,000 in property taxes, \$4,395,000 in employee compensation and benefits, \$2,109,000 in professional services and \$1,593,000 in depreciation. Property taxes decreased \$1,978,000 principally due to selling about 130,000 acres of timberland in 2010 and 2009, professional services increased \$971,000 primarily as a result of resourcing our multifamily business, and depreciation increased \$496,000 principally due to improvements related to commercial operating properties.

Revenues in our owned and consolidated ventures consist of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Residential real estate	\$ 5,615	\$ 6,348	\$ 19,443	\$ 18,189
Commercial real estate		650	157	793
Undeveloped land	4,385	11,261	17,295	36,405
Commercial operating properties	4,987	4,428	16,220	13,718
Other	152	234	821	1,050
Total revenues	\$ 15,139	\$ 22,921	\$ 53,936	\$ 70,155

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Units sold in our owned and consolidated ventures consist of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
Residential real estate:				
Lots sold	105	131	356	314
Revenue per lot sold	\$ 52,342	\$ 48,285	\$ 54,091	\$ 57,851
Commercial real estate:				
Acres sold		1.5	1.3	1.8
Revenue per acre sold	\$	\$ 435,365	\$ 121,705	\$ 433,406
Undeveloped land:				
Acres sold	1,153	5,313	4,713	14,965
Revenue per acre sold	\$ 3,803	\$ 2,120	\$ 3,669	\$ 2,433

Residential real estate revenues principally consist of the sale of single-family lots to national, regional and local homebuilders. In first nine months 2010, residential lots sold increased principally due to demand from home builders to replace low levels of finished lot inventory and increased demand from consumers as a result of the federal housing tax credit program which expired on April 30, 2010; however, consumer confidence remains low. In first nine months 2010, average residential lot prices were negatively impacted by the higher mix of smaller lots principally due to the increased demand for lower priced homes as a result of the federal housing tax credit program.

In third quarter and first nine months 2010, undeveloped land sales decreased due to current market conditions significantly influenced by low consumer confidence and alternate investment options to buyers in the marketplace. In first nine months 2010, revenue per acre sold increased principally as a result of selling 703 acres of land in the entitlement process in Georgia for about \$8,200 per acre.

Information about our real estate projects and our real estate ventures follows:

	Third Quarter-End	
	2010	2009
Owned and consolidated ventures:		
Entitled, developed and under development projects		
Number of projects	54	54
Residential lots remaining	17,811	20,467
Commercial acres remaining	1,775	1,702
Undeveloped land and land in the entitlement process		
Number of projects	18	19
Acres in entitlement process	29,670	30,430
Acres undeveloped ^(a)	179,736	201,384
Ventures accounted for using the equity method:		
Ventures lot sales (for first nine months)		
Lots sold	261	126
Average price per lot sold	\$ 43,402	\$ 65,165
Ventures entitled, developed and under development projects		
Number of projects	22	21
Residential lots remaining	11,369	9,166
Commercial acres sold (for first nine months)	15	4
Average price per acre sold	\$ 81,318	\$ 196,996
Commercial acres remaining	829	645
Ventures undeveloped land and land in the entitlement process		
Number of projects		2
Acres in entitlement process		1,080

Acres sold (for first nine months)		1
Average price per acre sold	\$	\$ 10,000
Acres undeveloped	5,517	5,517

(a) Includes 59,000 acres classified as assets held for sale.

We underwrite development projects based on a variety of assumptions incorporated into our development plans, including the timing and pricing of lot sales and commercial parcels, and costs to complete development. Our development plans are periodically reviewed in comparison to our return projections and expectations, and we may revise our plans as business conditions warrant. If as a result of changes to our development plans the anticipated future net cash flows are reduced such that our basis in a project is not fully recoverable, we may be required to recognize a non-cash impairment charge for such project.

Table of Contents**Mineral Resources**

We own directly or through ventures about 607,000 net acres of oil and natural gas mineral interests. Our mineral resources segment revenues are principally derived from royalties and other lease revenues from our oil and natural gas mineral interests located principally in Texas, Louisiana, Georgia and Alabama. At third quarter-end 2010, we have about 88,000 net acres under lease and about 29,000 net acres held by production.

A summary of our mineral resources results follows:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Revenues	\$ 6,654	\$ 18,828	\$ 18,387	\$ 31,767
Cost of sales	(223)	(221)	(852)	(499)
Operating expenses	(748)	(861)	(2,204)	(2,462)
	5,683	17,746	15,331	28,806
Equity in earnings of unconsolidated ventures	513	104	1,309	227
Segment earnings	\$ 6,196	\$ 17,850	\$ 16,640	\$ 29,033

Cost of sales represents our share of oil and natural gas production severance taxes, which are calculated based on a percentage of oil and natural gas produced and costs related to our non-operating working interests. These costs were offset by a refund of \$255,000 in first nine months 2009 related to well status changes approved by the Texas Railroad Commission.

In third quarter 2010, operating expenses principally consist of \$307,000 in employee compensation and benefits, \$115,000 in professional services and \$78,000 in property taxes. In third quarter 2009, operating expenses principally consist of \$292,000 in employee compensation and benefits, \$191,000 in professional services and \$66,000 in property taxes.

In first nine months 2010, operating expenses principally consist of \$888,000 in employee compensation and benefits, \$351,000 in professional services and \$225,000 in property taxes. In first nine months 2009, operating expenses principally consist of \$990,000 in employee compensation and benefits, \$609,000 in professional services and \$197,000 in property taxes. Professional services decreased \$258,000 principally due to permanent staffing of our minerals organization.

In third quarter and first nine months 2010, equity in earnings of unconsolidated ventures includes our share of royalty revenue from new wells that began producing from the Barnett Shale natural gas formation.

Revenues from our owned and consolidated mineral interests consist of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Royalties	\$ 3,217	\$ 2,575	\$ 10,542	\$ 8,454
Other lease revenues	3,437	16,253	7,845	23,313
Total revenues	\$ 6,654	\$ 18,828	\$ 18,387	\$ 31,767

In first nine months 2010, royalty revenues from our owned and consolidated mineral interests increased as a result of higher oil prices and oil production partially offset by decreases in natural gas prices. Increased oil prices contributed \$1,780,000 while production increases contributed \$437,000. The production increase primarily relates to new oil wells commencing production in late 2009 and first nine months 2010.

In third quarter 2010, other lease revenues include \$2,549,000 in lease bonus payments as a result of leasing about 9,600 net mineral acres for an average of \$266 per acre and \$890,000 related to delay rental payments. In third quarter 2009, other lease revenues include \$15,820,000 in lease bonus payments as a result of leasing almost 10,800 net mineral acres for an average of \$1,465 per acre and \$403,000 related to delay rental payments.

In first nine months 2010, other lease revenues include \$5,733,000 in lease bonus payments as a result of leasing over 11,700 net mineral acres for an average of \$490 per acre and \$2,084,000 related to delay rental payments. In first nine months 2009, other lease revenues include \$20,857,000 in lease bonus payments as a result of leasing about 25,000 net mineral acres for an average of \$831 per acre and \$2,320,000 related to delay rental payments.

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Oil and natural gas produced and average unit prices related to our royalty interests follows:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
<i>Consolidated entities:</i>				
Oil production (barrels)	27,700	26,000	87,600	79,200
Average price per barrel	\$ 71.41	\$ 62.78	\$ 72.53	\$ 52.20
Natural gas production (millions of cubic feet)	298.5	281.4	946.0	947.4
Average price per thousand cubic feet	\$ 4.15	\$ 3.36	\$ 4.43	\$ 4.56
<i>Our share of ventures accounted for using the equity method:</i>				
Natural gas production (millions of cubic feet)	138.1	1.7	345.6	21.0
Average price per thousand cubic feet	\$ 4.02	\$ 2.64	\$ 4.25	\$ 6.49

Our share of ventures natural gas production increased as a result of additional wells that began producing from the Barnett Shale natural gas formation in late 2009 and first nine months 2010.

In addition, we have water interests in about 1.6 million acres, including a 45 percent nonparticipating royalty interest in groundwater produced or withdrawn for commercial purposes or sold from approximately 1.4 million acres in Texas, Louisiana, Georgia and Alabama. We have not received any income from these interests.

Fiber Resources

Our fiber resources segment focuses principally on the management of our timber holdings and recreational leases. We have over 205,000 acres of timber, primarily in Georgia, and about 18,000 acres of timber under lease. Our fiber resources segment revenues are principally derived from the sales of wood fiber from our land and leases of land for hunting and other recreational uses. We sold about 19,000 acres of undeveloped land in first nine months 2010 and over 110,000 acres in 2009 through our retail land sales program and our strategic initiatives. We are actively marketing an additional 59,000 acres classified as held for sale. As a result of the reduced acreage from executing these land sales, future segment revenues and earnings are anticipated to be lower.

A summary of our fiber resources results follows:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Revenues	\$ 2,220	\$ 3,558	\$ 6,185	\$ 12,928
Cost of sales	(466)	(880)	(1,208)	(2,816)
Operating expenses	(502)	(600)	(1,694)	(2,020)
	1,252	2,078	3,283	8,092
Other operating income	120	2	617	187
Segment earnings	\$ 1,372	\$ 2,080	\$ 3,900	\$ 8,279

In third quarter 2010, operating expenses principally consist of \$224,000 in employee compensation and benefits and \$116,000 in facility and long-term timber lease costs. In third quarter 2009, operating expenses principally consist of \$297,000 in employee compensation and benefits and \$120,000 in facility and long-term timber lease costs.

In first nine months 2010, operating expenses principally consist of \$909,000 in employee compensation and benefits, of which \$197,000 related to employee severance costs, and \$306,000 in facility and long-term timber lease costs. In first nine months 2009, operating expenses principally consist of \$956,000 in employee compensation and benefits and \$412,000 in facility and long-term timber lease costs.

In first nine months 2010 and 2009, other operating income represents a gain from partial termination of a timber lease.

Revenues consist of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
	(In thousands)			
Fiber	\$ 1,767	\$ 3,140	\$ 4,797	\$ 11,301
Recreational leases and other	453	418	1,388	1,627
Total revenues	\$ 2,220	\$ 3,558	\$ 6,185	\$ 12,928

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Fiber sold consists of:

	Third Quarter		First Nine Months	
	2010	2009	2010	2009
Pulpwood tons sold	116,900	216,200	295,600	666,800
Average pulpwood price per ton	\$ 9.41	\$ 8.85	\$ 10.31	\$ 8.27
Sawtimber tons sold	37,500	63,400	90,900	290,300
Average sawtimber price per ton	\$ 17.79	\$ 19.38	\$ 19.23	\$ 19.95
Total tons sold	154,400	279,600	386,500	957,100
Average price per ton	\$ 11.45	\$ 11.24	\$ 12.41	\$ 11.81

In third quarter and first nine months 2010, total tons sold decreased due to reduction in volume as a result of selling about 130,000 acres of timberland in 2010 and 2009 and postponing harvest plans on acres classified as held for sale. The majority of our fiber sales were to Temple-Inland at market prices.

Items Not Allocated to Segments

Unallocated items represent income and expenses managed on a company-wide basis and include general and administrative expenses, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense.

General and administrative expense principally consists of accounting and finance, tax, legal, human resources, internal audit, information technology and our Board of Directors. These functions support all of our business segments and are not allocated.

In third quarter 2010, general and administrative expenses principally consist of \$1,410,000 in employee compensation and benefits, \$583,000 in professional services, \$371,000 in depreciation expense, \$301,000 in facility costs and \$295,000 related to insurance costs. In third quarter 2009, general and administrative expenses principally consist of a \$1,753,000 impairment charge related to our undivided 15 percent interest in corporate aircraft contributed to us by Temple-Inland at spin-off, \$1,344,000 in employee compensation and benefits, \$773,000 in professional services, \$467,000 in depreciation expense, \$346,000 related to insurance costs and \$283,000 in facility costs.

In first nine months 2010, general and administrative expenses principally consist of \$4,145,000 in employee compensation and benefits, \$2,665,000 in professional services, \$1,113,000 in depreciation expense, \$912,000 in facility costs and \$936,000 related to insurance costs. In first nine months 2009, general and administrative expenses principally consist of \$5,341,000 in professional services, of which about \$3,200,000 was paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal, \$4,291,000 in employee compensation and benefits, \$1,994,000 in impairment charges related to our undivided 15 percent interest in corporate aircraft contributed to us by Temple-Inland at spin-off, \$1,348,000 in depreciation expense, \$996,000 related to insurance costs and \$854,000 in facility costs.

Income Taxes

Our effective tax rate was 24 percent in third quarter 2010 and 33 percent in first nine months 2010 which includes a 4 percent benefit attributable to noncontrolling interests. Our effective tax rate was 35 percent in third quarter 2009 and 37 percent in first nine months 2009 which included less than a 1 percent benefit attributable to noncontrolling interests. Differences between the effective tax rate and the statutory rate are principally due to state income taxes, percentage depletion and nondeductible items. Our 2009 rate included a benefit from a federal income tax rate change for qualified timber gains due to the Food, Conservation and Energy Act of 2008 which expired in 2009.

Capital Resources and Liquidity**Sources and Uses of Cash**

We operate in cyclical industries and our cash flows fluctuate accordingly. Our principal operating cash requirements are for the acquisition and development of real estate, either directly or indirectly through ventures, taxes, interest and compensation. Our principal sources of cash are proceeds from the sale of real estate and timber, the cash flow from minerals and commercial operating properties, borrowings, and reimbursements from utility and improvement districts. Operating cash flows are affected by the timing of the payment of real estate development

expenditures and the collection of proceeds from the eventual sale of the real estate, the timing of which can vary substantially depending on many factors including the size of the project, state and local permitting requirements and availability of utilities, and by the timing of oil and natural gas leasing and production activities. Working capital is subject to operating needs, the timing of sales of real estate and timber, the timing of collection of mineral royalties or mineral lease payments, collection of receivables, reimbursement from utility and improvement districts and the payment of payables and expenses.

Table of Contents***Cash Flows from Operating Activities***

Cash flows from our real estate development activities, undeveloped land sales, timber sales, mineral and recreational leases and reimbursements from utility and improvement districts are classified as operating cash flows.

In first nine months 2010, net cash (used for) operating activities was (\$13,701,000) as we funded a \$10,000,000 loan to a third-party equity investor in the JW Marriott® San Antonio Hill Country Resort & Spa and paid income taxes of \$11,031,000. In first nine months 2009, net cash provided by operating activities was \$156,109,000 as proceeds from the sale of about 95,000 acres of timber and timberland in Georgia and Alabama generated net cash proceeds of \$153,851,000 and gain on sale of assets of \$104,047,000. Expenditures for real estate development exceeded non-cash cost of sales due to our development of existing real estate projects, principally in the major markets of Texas. In first nine months 2009, we invested \$18,593,000 in Cibolo Canyons, of which \$16,202,000 was invested in the resort development. In first nine months 2009, we received \$22,299,000 in reimbursements from utility and improvement districts, of which \$20,270,000 was related to our Cibolo Canyons mixed-use development and was accounted for as a reduction of our investment. We paid estimated income taxes of \$31,000,000 in first nine months 2009.

Cash Flows from Investing Activities

Capital contributions to and capital distributions from unconsolidated ventures are classified as investing activities. In addition, proceeds from the sale of property and equipment, software costs and expenditures related to reforestation activities are also classified as investing activities.

In first nine months 2010, net cash provided by investing activities was \$3,572,000 principally due to net distributions from unconsolidated ventures of \$3,252,000. We invested \$2,282,000 in property, equipment, software and reforestation offset by \$2,602,000 in proceeds related to the sale of our undivided interest in corporate aircraft. In first nine months 2009, net cash used for investing activities was (\$5,562,000) and is principally related to investment in property, equipment and software. Net cash returned from our unconsolidated ventures provided \$755,000.

Cash Flows from Financing Activities

In first nine months 2010, net cash (used for) financing activities was (\$6,439,000) as we repurchased 1,000,987 shares of our common stock for \$15,178,000 and incurred \$5,969,000 in bank fees primarily related to our amendment and extension of our senior credit facility, which was partially offset by a net increase in our debt of \$14,147,000. In first nine months 2009, net cash used for financing activities was (\$115,132,000) as we reduced our outstanding debt by \$112,436,000 principally from the net proceeds generated from the sale of about 95,000 acres of timber and timberland in Georgia and Alabama in accordance with our near-term strategic initiatives.

Non-Cash Financial Information

In first quarter 2010, our real estate assets decreased by \$11,865,000, debt decreased by \$13,207,000 and other liabilities increased by \$1,342,000 due to lender foreclosure of a lien on a condominium property in Austin, Texas owned by a consolidated variable interest entity. The limited partnership has no other significant assets. The lien secured debt guaranteed by the unrelated general partner who managed day to day operations of the partnership. At third quarter-end 2010, the limited partnership has total assets of \$12,000 and total liabilities of \$3,089,000. The partnership liabilities will be settled as the partnership is liquidated.

In third quarter 2010, we sold about 14,100 acres of timber and timberland in Georgia and Alabama for \$22,621,000 to East Coast Trading Co., Inc. in two separate transactions. These transactions generated net proceeds of \$22,030,000, resulting in recognition of a \$15,441,000 gain and \$5,200,000 of deferred income tax expense. At third quarter-end 2010, the net proceeds from these transactions are held by a qualified intermediary as we plan to reinvest these proceeds in qualifying real estate, thereby deferring the gain for tax purposes under Internal Revenue Code Section 1031. As a result, the net proceeds are classified as a receivable pending reinvestment. We have until November 13, 2010 to identify qualified replacement properties, and until March 28, 2011 to acquire the identified properties. If we are unable to identify and close on the replacement properties within the required time periods, we will not be able to defer the gain for tax purposes and all deferred taxes related to these transactions will become currently payable.

Liquidity, Contractual Obligations and Off-Balance Sheet Arrangements

There have been no significant changes in our liquidity, contractual obligations or off-balance sheet arrangements since year-end 2009, except that in third quarter 2010, we entered into an amended and restated senior credit facility in order to consolidate previous amendments and to effect the following additional principal amendments to: extend the maturity date of the revolving loan to August 6, 2013 (with a one-year extension option to August 6, 2014) and of the term loan to August 6, 2015; reduce the revolving loan commitment to \$175 million, subject to the ability to increase the aggregate facility by up to \$150 million by securing additional commitments; eliminate any additional required commitment reductions during the term of the facility; reduce the interest coverage ratio from 1.75x to 1.05x; provide that during any period when the minimum interest coverage ratio falls below 1.50x, the interest rate on outstanding loans will increase by 2 percent and no new acquisitions, discretionary capital expenditures or distributions will be permitted; reduce the minimum value to commitment ratio from 1.75:1.00 to 1.60:1.00; and provide that if the interest coverage ratio does not exceed 3.0x, we may not repurchase our common stock. We incurred fees of about \$5,700,000 related to this amendment.

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At third quarter-end 2010, our senior credit facility provides for a \$125,000,000 term loan and a \$175,000,000 revolving line of credit. The term loan includes a prepayment penalty for payments in excess of \$25,000,000 prior to February 6, 2012. The revolving line of credit may be prepaid at any time without penalty. At third quarter-end 2010, we had \$152,929,000 in net unused borrowing capacity under our senior credit facility.

Our senior credit facility and other debt agreements contain terms, conditions and financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At third quarter-end 2010, we were in compliance with the terms, conditions and financial covenants of these agreements. Based on our current operating projections, we believe that we will remain in compliance with our senior credit facility covenants in the future.

The following table details our compliance with the financial covenants calculated as provided in the senior credit facility:

Financial Covenant	Requirement	Third Quarter-End 2010
Interest Coverage Ratio ^(a)	≥ 1.05:1.0	2.43:1.0
Revenues/Capital Expenditures Ratio ^(b)	≥ 1.00:1.0	7.13:1.0
Total Leverage Ratio ^(c)	≤ 40%	20.7%
Net Worth ^(d)	> \$409 million	\$506 million
Collateral Value to Loan Commitment Ratio ^(e)	≥ 1.60:1.0	2.42:1.0

^(a) Calculated as EBITDA (earnings before interest, taxes, depreciation and amortization), plus non-cash compensation expense, plus other non-cash expenses, divided by interest expense excluding loan fees. This covenant is applied at the end of each quarter on a rolling four quarter basis.

^(b) Calculated as total gross revenues, plus our pro rata share of the

operating revenues from unconsolidated ventures, divided by capital expenditures. Capital expenditures are defined as consolidated development and acquisition expenditures plus our pro rata share of unconsolidated development and acquisition expenditures. This covenant is applied at the end of each quarter on a rolling four quarter basis.

- (c) Calculated as total funded debt divided by adjusted asset value. Total funded debt includes indebtedness for borrowed funds, secured liabilities and reimbursement obligations with respect to letters of credit or similar instruments. Adjusted asset value is defined as the sum of unrestricted cash and cash equivalents,

timberlands,
high value
timberlands,
raw entitled
lands, entitled
land under
development,
minerals
business, other
real estate
owned at book
value without
regard to any
indebtedness
and our pro rata
share of joint
ventures book
value without
regard to any
indebtedness.
This covenant is
applied at the
end of each
quarter.

- (d) Calculated as the amount by which consolidated total assets exceeds consolidated total liabilities. At third quarter-end 2010, the requirement is \$409,000,000, computed as: \$402,800,000, plus 85 percent of the aggregate net proceeds received by us from any equity offering, plus 75 percent of all positive net income, on a cumulative basis. This

covenant is applied at the end of each quarter.

- (e) Calculated as the total collateral value of timberland, high value timberland and our minerals business, divided by total aggregate loan commitment. This covenant is applied at the end of each quarter.

To make additional investments, acquisitions, or distributions, we must maintain available liquidity equal to the lesser of \$35,000,000 or 10% of the aggregate commitments in place. At third quarter-end 2010, this requirement was \$30,000,000 resulting in approximately \$156,702,000 in available liquidity, which represents our unused borrowing capacity under our senior credit facility plus unrestricted cash and cash equivalents. The failure to maintain such minimum liquidity does not constitute a default or event of default of our senior credit facility.

At third quarter-end 2010, we participate in three partnerships that have \$72,414,000 of borrowings classified as current maturities. These partnerships have total assets of \$54,753,000 and other liabilities of \$10,792,000. These partnerships are managed by third parties who intend to extend or refinance these borrowings; however, there is no assurance that this can be done. Although these borrowings are guaranteed by third parties, we may under certain circumstances elect or be required to provide additional equity to these partnerships. We do not believe that the ultimate resolution of these matters will have a significant effect on our earnings or financial position. Our investment in these partnerships is \$3,183,000 at third quarter-end 2010. These three partnerships are variable interest entities.

Table of Contents**Cibolo Canyons San Antonio, Texas**

Cibolo Canyons consists of the JW Marriott® San Antonio Hill Country Resort & Spa development owned by third parties and a mixed-use development we own. We have about \$88,539,000 invested in Cibolo Canyons at third quarter-end 2010.

Resort Hotel, Spa and Golf Development

In 2007, we entered into agreements to facilitate third-party construction and ownership of the JW Marriott® San Antonio Hill Country Resort & Spa, which includes a 1,002 room destination resort and two PGA Tour® Tournament Players Club® (TPC) golf courses. Under these agreements, we agreed to transfer to third-party owners about 700 acres of undeveloped land, to provide about \$30,000,000 cash and to provide approximately \$12,700,000 of other consideration principally consisting of golf course construction materials, substantially all of which has been provided.

In exchange for our commitment to the resort, the third-party owners assigned to us certain rights under an agreement between the third-party owners and a legislatively created Special Purpose Improvement District (SPID). This agreement includes the right to receive from the SPID 9 percent of hotel occupancy revenues and 1.5 percent of other resort sales revenues collected as taxes by the SPID through 2034. The amount we receive will be net of annual ad valorem tax reimbursements by the SPID to the third-party owners of the resort through 2020. In addition, these payments will be net of debt service, if any, on bonds issued by the SPID collateralized by hotel occupancy tax and other resort sales tax through 2034.

The amounts we collect under this agreement are dependent on several factors including the amount of revenues generated by and ad valorem taxes imposed on the resort and the amount of any applicable debt service incurred by the SPID. As a result, there is significant uncertainty as to the amount and timing of collections under this agreement. Until these uncertainties are clarified, amounts collected under the agreement will be accounted for as a reduction of our investment in the resort development. The resort began operations on January 22, 2010, and we expect to begin receiving collections by fourth quarter 2010.

At third quarter-end 2010, we have \$42,869,000 invested in the resort development.

In addition, in January 2010, pursuant to a 2009 commitment, we loaned \$10,000,000 to a third-party equity investor in the resort development. The loan bears interest at 9 percent, increasing to 12 percent after July 2012, and is repayable at the earliest of refinancing or sale of the resort hotel or July 31, 2013. Borrowings are collateralized by pledges of funding commitments from the borrower, including our right to direct capital calls and to enforce rights under the fund operating agreement in the event of nonpayment.

Mixed-Use Development

The mixed-use development we own consists of 2,100 acres planned to include about 1,400 residential lots and about 220 commercial acres designated for multifamily and retail uses, of which 625 lots and 64 commercial acres have been sold through third quarter-end 2010.

In 2007, we entered into an agreement with the SPID providing for reimbursement of certain infrastructure costs related to the mixed-use development. Reimbursements are subject to review and approval by the SPID and unreimbursed amounts accrue interest at 9.75 percent. The SPID's funding for reimbursements is principally derived from its ad valorem tax collections and bond proceeds collateralized by ad valorem taxes, less debt service on these bonds and annual administrative and public service expenses. Through third quarter-end 2010, we have submitted and received approval for reimbursement of about \$57,322,000 of infrastructure costs and have received reimbursements totaling \$20,270,000. At third quarter-end 2010, we have \$37,052,000 in approved and pending reimbursements, excluding interest.

Since the amount of each reimbursement is dependent on several factors, including timing of SPID approval and the SPID having an adequate tax base to generate funds that can be used to reimburse us, there is uncertainty as to the amount and timing of reimbursements under this agreement. We expect to recover our investment from lot and tract sales and reimbursement of approved infrastructure costs from the SPID. We have not recognized income from interest due, but not collected. As these uncertainties are clarified, we will modify our accounting accordingly.

At third quarter-end 2010, we have \$45,670,000 invested in the mixed-use development.

Critical Accounting Policies and Estimates

There have been no significant changes in our critical accounting policies or estimates in first nine months 2010 from those disclosed in our 2009 Annual Report on Form 10-K.

Recent Accounting Standards

Please read Note 2 to the Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q.

Table of Contents**Statistical and Other Data**

A summary of our real estate projects in the entitlement process ^(a) at third quarter-end 2010 follows:

Project	County	Market	Project Acres ^(b)
California			
Hidden Creek Estates	Los Angeles	Los Angeles	700
Terrace at Hidden Hills	Los Angeles	Los Angeles	30
Georgia			
Ball Ground	Cherokee	Atlanta	500
Burt Creek	Dawson	Atlanta	970
Crossing	Coweta	Atlanta	230
Dallas Highway	Haralson	Atlanta	1,060
Fincher Road	Cherokee	Atlanta	3,890
Fox Hall	Coweta	Atlanta	960
Garland Mountain	Cherokee/Bartow	Atlanta	350
Home Place	Coweta	Atlanta	1,510
Martin s Bridge	Banks	Atlanta	970
Mill Creek	Coweta	Atlanta	770
Serenity	Carroll	Atlanta	440
Waleska	Cherokee	Atlanta	150
Wolf Creek	Carroll/Douglas	Atlanta	12,230
Yellow Creek	Cherokee	Atlanta	1,060
Texas			
Lake Houston	Harris/Liberty	Houston	3,700
San Jacinto	Montgomery	Houston	150
Total			29,670

(a) A project is deemed to be in the entitlement process when customary steps necessary for the preparation of an application for governmental land-use approvals, like conducting pre-application meetings or similar discussions with governmental officials, have

commenced, or an application has been filed. Projects listed may have significant steps remaining, and there is no assurance that entitlements ultimately will be received.

- (b) Project acres, which are the total for the project regardless of our ownership interest, are approximate. The actual number of acres entitled may vary.

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A summary of activity within our projects in the development process, which includes entitled^(a), developed and under development real estate projects, at third quarter-end 2010 follows:

Project	County	Market	Interest Owned (b)	Residential Lots ^(c)		Commercial Acres ^(d)	
				Lots Sold Since Inception	Lots Remaining	Acres Sold Since Inception	Acres Remaining
Projects we own							
California							
San Joaquin River	Contra Costa/ Sacramento	Oakland	100%				288
Colorado							
Buffalo Highlands	Weld	Denver	100%		164		
Johnstown Farms	Weld	Denver	100%	115	494	2	8
Pinery West	Douglas	Denver	100%				115
Stonebraker	Weld	Denver	100%		603		13
Westlake Highlands	Jefferson	Denver	100%	21			
Texas							
Arrowhead Ranch	Hays	Austin	100%		259		6
Caruth Lakes	Rockwall	Dallas/Fort Worth	100%	307	342		
Cibolo Canyons	Bexar	San Antonio	100%	625	790	64	157
Harbor Lakes	Hood	Dallas/Fort Worth	100%	201	248	1	13
Hunter's Crossing	Bastrop	Austin	100%	336	155	38	71
La Conterra	Williamson	Austin	100%	76	424		58
Maxwell Creek	Collin	Dallas/Fort Worth	100%	696	315	10	
Oak Creek Estates	Comal	San Antonio	100%	68	579	13	
The Colony	Bastrop	Austin	100%	412	734	22	31
The Gables at North Hill	Collin	Dallas/Fort Worth	100%	199	84		
The Preserve at Pecan Creek	Denton	Dallas/Fort Worth	100%	306	512		9
The Ridge at Ribelin Ranch	Travis	Austin	100%			179	16
Westside at Buttercup Creek	Williamson	Austin	100%	1,313	201	66	
Other projects (9)	Various	Various	100%	1,554	15	197	24
Georgia							
Towne West	Bartow	Atlanta	100%		2,674		121
Other projects (13)	Various	Atlanta	100%		2,934		705

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Other projects (2)	Various	Various	100%	456	98		
				6,685	11,625	592	1,635

Projects in entities we consolidate

Texas

City Park	Harris	Houston	75%	1,116	195	50	115
Lantana	Denton	Dallas/Fort Worth	55% (e)	571	1,596		
Light Farms	Collin	Dallas/Fort Worth	65%		2,868		
Stoney Creek	Dallas	Dallas/Fort Worth	90%	95	659		
Timber Creek	Collin	Dallas/Fort Worth	88%		614		
Other projects (5)	Various	Various	Various	953	254	26	25
				2,735	6,186	76	140

Total owned and consolidated

9,420 17,811 668 1,775

Projects in ventures that we account for using the equity method

Georgia

Seven Hills	Paulding	Atlanta	50%	636	445	26	113
The Georgian	Paulding	Atlanta	38%	288	1,097		
Other projects (4)	Various	Atlanta	Various	1,820	77	3	

Texas

Bar C Ranch	Tarrant	Dallas/Fort Worth	50%	223	976		
Entrada	Travis	Austin	50%		821		3
Fannin Farms West	Tarrant	Dallas/Fort Worth	50%	300	81		15
Harper s Preserve	Montgomery	Houston	50%		1,722		72
Lantana	Denton	Dallas/Fort Worth	Various (e)	1,436	176	14	76
Long Meadow Farms	Fort Bend	Houston	19%	658	1,425	87	133
Southern Trails	Brazoria	Houston	40%	434	593		
Stonewall Estates	Bexar	San Antonio	25%	254	125		
Summer Creek Ranch	Tarrant	Dallas/Fort Worth	50%	796	1,772		363
Summer Lakes	Fort Bend	Houston	50%	332	791	56	
Village Park	Collin	Dallas/Fort Worth	50%	356	211	3	2
Waterford Park	Fort Bend	Houston	50%		493		37

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Other projects (2)	Various	Various	Various	296	228		15
Florida							
Other projects (3)	Various	Tampa	Various	509	336		
Total in ventures				8,338	11,369	189	829
Combined total				17,758	29,180	857	2,604

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- (a) A project is deemed entitled when all major discretionary governmental land-use approvals have been received. Some projects may require additional permits and/or non-governmental authorizations for development.

- (b) Interest owned reflects our net equity interest in the project, whether owned directly or indirectly. There are some projects that have multiple ownership structures within them. Accordingly, portions of these projects may appear as owned, consolidated or accounted for using the equity method.

- (c) Lots are for the total project, regardless of our ownership interest. Lots remaining represent vacant developed lots, lots under development and future planned lots and are subject to change based on

business plan revisions.

(d) Commercial acres are for the total project, regardless of our ownership interest, and are net developable acres, which may be fewer than the gross acres available in the project.

(e) The Lantana project consists of a series of 15 partnerships in which our voting interests range from 25 percent to 55 percent. We account for three of these partnerships using the equity method and we consolidate the remaining partnerships.

A summary of our significant commercial and income producing properties at third quarter-end 2010 follows:

Project	County	Market	Interest Owned ^(a)	Type	Description
Radisson Hotel	Travis	Austin	100%	Hotel	413 guest rooms and suites
Palisades West	Travis	Austin	25%	Office	375,000 square feet
Las Brisas	Williamson	Austin	59%	Multifamily	414 unit luxury apartment

(a) Interest owned reflects our net equity interest in the project, whether owned directly or indirectly.

A summary of our oil and gas mineral interests ^(a) at third quarter-end 2010 follows:

State	Unleased	Leased ^(b)	Held By Production ^(c)	Total ^(d)
			(Net acres)	

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Texas	155,000	72,000	24,000	251,000
Louisiana	125,000	14,000	5,000	144,000
Georgia	170,000			170,000
Alabama	38,000	2,000		40,000
California	1,000			1,000
Indiana	1,000			1,000
	490,000	88,000	29,000	607,000

- (a) Includes ventures.
- (b) Includes leases in primary lease term or for which a delayed rental payment has been received.
- (c) Acres being held by production are producing oil or natural gas in paying quantities.
- (d) Texas, Louisiana, California and Indiana net acres are calculated as the gross number of surface acres multiplied by our percentage ownership of the mineral interest. Alabama and Georgia net acres are calculated as the gross number of surface acres multiplied by our estimated percentage

ownership of
the mineral
interest based
on county
sampling.
Excludes 463
net mineral
acres located in
Colorado.

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A summary of our Texas and Louisiana mineral acres ^(a) by county or parish at third quarter-end 2010 follows:

Texas		Louisiana	
County	Net Acres	Parish	Net Acres
Trinity	46,000	Beauregard	79,000
Angelina	42,000	Vernon	39,000
Houston	29,000	Calcasieu	17,000
Anderson	25,000	Allen	7,000
Cherokee	23,000	Rapides	1,000
Sabine	23,000	Other	1,000
Red River	15,000		144,000
Newton	13,000		
San Augustine	13,000		
Jasper	11,000		
Other	11,000		
	251,000		

^(a) Includes ventures.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*
Interest Rate Risk

Our interest rate risk is principally related to our variable-rate debt. Interest rate changes impact earnings due to the resulting increase or decrease in the cost of our variable-rate debt, which is \$214,135,000 at third quarter-end 2010 and \$213,195,000 at year-end 2009. In 2009, our outstanding variable rate debt includes \$100,000,000 notional amount interest rate swap, which matured on March 1, 2010.

The following table illustrates the estimated effect on our pre-tax income of immediate, parallel, and sustained shifts in interest rates for the next 12 months on our variable-rate debt at third quarter-end 2010, with comparative year-end 2009 information. This estimate assumes that debt reductions from contractual payments will be replaced with short-term, variable-rate debt; however, that may not be the financing alternative we choose.

Change in Interest Rates	Third Quarter-End 2010	Year-End 2009
	(In thousands)	
+2%	\$ (4,162)	\$ (4,100)
+1%	(2,141)	(2,132)
-1%	2,141	2,132
-2%	4,283	4,264

Foreign Currency Risk

We have no exposure to foreign currency fluctuations.

Commodity Price Risk

We have no significant exposure to commodity price fluctuations.

Item 4. *Controls and Procedures*

(a) Disclosure Controls and Procedures

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (or the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and are effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Table of Contents**(b) Changes in Internal Control over Financial Reporting**

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION**Item 1. Legal Proceedings**

We are involved directly or through ventures in various legal proceedings that arise from time to time in the ordinary course of doing business. We believe we have established adequate reserves for any probable losses and that the outcome of any of the proceedings should not have a material adverse effect on our financial position, long-term results of operations or cash flows. It is possible, however, that circumstances beyond our control or significant subsequent developments could result in additional charges related to these matters that could be significant to results of operations or cash flow in any single accounting period.

Item 1A. Risk Factors

There are no material changes from the risk factors disclosed in our 2009 Annual Report on Form 10-K.

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

In third quarter 2010, there were no sales of unregistered securities.

On February 11, 2009, we announced that our Board of Directors authorized the repurchase of up to 7,000,000 shares of our common stock. The following table provides information about the repurchase of our common stock in open-market transactions:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
Month 1 (7/1/2010 - 7/31/2010)		\$		7,000,000
Month 2 (8/1/2010 - 8/31/2010)	522,700	\$ 14.50	522,700	6,477,300
Month 3 (9/1/2010 - 9/30/2010)	478,287	\$ 15.89	478,287	5,999,013
Total	1,000,987	\$ 15.16	1,000,987	

We have no repurchase plans or programs that expired during the period covered by the table above and no repurchase plans or programs that we intend to terminate prior to expiration or under which we no longer intend to make further purchases.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)**Item 5. Other Information**

None.

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Item 6. Exhibits

- 10.1 Amended and Restated Revolving and Term Credit Agreement, dated as of August 6, 2010, by and among Forestar Group Inc., Forestar (USA) Real Estate Group Inc. and its wholly-owned subsidiaries signatory thereto, KeyBank National Association, as administrative agent, and the lenders party thereto (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 6, 2010).
- 31 .1* Certification of Chief Executive Officer pursuant to Exchange Act rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31 .2* Certification of Chief Financial Officer pursuant to Exchange Act rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 .1* Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32 .2* Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

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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.

FORESTAR GROUP INC.

Date: November 4, 2010

By: /s/ Christopher L. Nines
Christopher L. Nines
Chief Financial Officer

By: /s/ Charles D. Jehl
Charles D. Jehl
Chief Accounting Officer

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