

Forestar Group Inc.
Form 10-K
March 06, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

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

For the Fiscal Year Ended December 31, 2014

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 26-1336998
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

6300 Bee Cave Road
Building Two, Suite 500
Austin, Texas 78746-5149

(Address of Principal Executive Offices, including Zip Code)
Registrant's telephone number, including area code: (512) 433-5200

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

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, par value \$1.00 per share	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

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

Indicate by check mark whether the registrant has submitted electronically 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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.

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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

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the closing sales price of the Common Stock on the New York Stock Exchange on June 30, 2014, was approximately \$457 million. For purposes of this computation, all officers, directors, and ten percent beneficial owners of the registrant (as indicated in Item 12) are deemed to be affiliates. Such determination should not be deemed an admission that such directors, officers, or ten percent beneficial owners are, in fact, affiliates of the registrant.

As of March 2, 2015, there were 33,618,526 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Selected portions of the Company's definitive proxy statement for the 2015 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

TABLE OF CONTENTS

	Page
<u>PART I.</u>	
Item 1.	<u>3</u>
Item 1A.	<u>22</u>
Item 1B.	<u>31</u>
Item 2.	<u>31</u>
Item 3.	<u>31</u>
Item 4.	<u>31</u>
<u>PART II.</u>	
Item 5.	<u>31</u>
Item 6.	<u>33</u>
Item 7.	<u>34</u>
Item 7A.	<u>58</u>
Item 8.	<u>59</u>
Item 9.	<u>99</u>
Item 9A.	<u>99</u>
Item 9B.	<u>99</u>
<u>PART III.</u>	
Item 10.	<u>100</u>
Item 11.	<u>100</u>
Item 12.	<u>100</u>
Item 13.	<u>101</u>
Item 14.	<u>101</u>
<u>PART IV.</u>	
Item 15.	<u>101</u>
<u>SIGNATURES</u>	<u>104</u>

PART I

Item 1. Business

Overview

Forestar Group Inc. is a real estate and oil and gas company. We own directly or through ventures 113,000 acres of real estate located in ten states and 13 markets, including about 102,000 acres with timber, primarily in Georgia. We also have 960,000 net acres of oil and gas mineral interests, consisting of fee ownership and leasehold interests located in 16 states in the continental U.S. In 2014, we had revenues of \$307 million and net income of \$17 million. Unless the context otherwise requires, references to “we,” “us,” “our” and “Forestar” mean Forestar Group Inc. and its consolidated subsidiaries. Unless otherwise indicated, information is presented as of December 31, 2014, and references to acreage owned include approximate acres owned by us and ventures regardless of our ownership interest in a venture.

Business Segments

We manage our operations through three business segments:

Real estate,

Oil and gas, and

Other natural resources.

A summary of significant business segment assets at year-end 2014 follows:

Our real estate segment provided approximately 70% percent of our 2014 consolidated revenues. We secure entitlements and develop infrastructure, primarily for single-family residential and mixed-use communities. We own 92,000 acres in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. We invest in projects 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 also develop and own directly or through ventures, multifamily communities as income producing properties, principally in our target markets.

Our oil and gas segment provided 27% percent of our 2014 consolidated revenues. We promote the exploration, development and production of oil and gas on our 960,000 owned and leasehold mineral interests. This includes 590,000 owned mineral acres and 370,000 net mineral acres leased from others.

Our other natural resources segment provided 3% percent of our 2014 consolidated revenues. We sell wood fiber from our land, primarily in Georgia, and lease land for recreational uses. We have about 102,000 real estate acres with timber we own directly or through ventures. In addition, we have water interests in about 1.5 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 and about 20,000 acres of groundwater leases in central Texas.

Our real estate origins date back to the 1955 incorporation of Lumbermen's Investment Corporation, which in 2006 changed its name to Forestar (USA) Real Estate Group Inc. We have decades long legacy of residential and commercial real estate development operations, primarily in Texas. Our oil and gas origins date back to the mid-1940s when we started leasing our oil and gas mineral interests to third-party exploration and production companies. In 2007, Temple-Inland distributed all of the issued and outstanding shares of our common stock to its stockholders, which we will refer to as the "spin-off".

Our results of operations, including information regarding our business segments, are discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and in Item 8, Financial Statements and Supplementary Data.

Strategy

Our strategy is:

Recognizing and responsibly delivering the greatest value from every acre; and

Growing through strategic and disciplined investments.

We are focused on delivering the greatest real estate value from every acre through the entitlement and development of strategically-located residential and mixed-use communities. We secure entitlements by delivering thoughtful plans and balanced solutions that meet the needs of the communities where we operate. Moving land through the entitlement and development process creates significant real estate value. Residential development activities target lot sales to local, regional and national home builders who build quality products and have strong and effective marketing and sales programs. The lots we deliver in the majority of our communities are for mid-priced homes, predominantly in the first and second move-up categories. We also actively market and sell undeveloped land through our retail sales program. We develop multifamily commercial tracts ourselves as a merchant builder or we may venture with partners for the construction, operation, and sale of income producing properties.

We also seek to maximize value from our owned oil and gas mineral interests through promoting exploration, development and production activities by increasing the acreage leased, lease rates, royalty interests, negotiating additional interests in production and by entering into seismic exploration agreements and joint ventures. In addition, we lease mineral interests for oil and gas exploration and production and participate in working interests or may drill as an operator on both our owned and leased mineral interests.

We realize value from our undeveloped land by selling fiber and by managing it for future real estate development and conservation uses. We also generate cash flow and earnings through recreational leases. We are focused on creating value from our water interests by securing reservation and production supply agreements with various municipalities and water providers in our target markets.

We are committed to disciplined investment in our business. A majority of our real estate projects were acquired in the open market, with the remainder coming from entitlement efforts associated with our low basis lands principally located in and around Atlanta, Georgia. Our mineral interest investments are typically in conventional and unconventional oil and liquid-rich formations.

Our portfolio of assets in combination with our strategy, management expertise, stewardship and reinvestment in our business, position Forestar to maximize and grow long-term value for shareholders.

2014 Strategic Initiatives

On February 13, 2014, we announced Growing FORward, new strategic initiatives designed to further enhance shareholder value by:

Growing segment earnings through strategic and disciplined investments,

Increasing returns, and

Repositioning non-core assets.

On December 8, 2014, we announced that our Board of Directors, working together with our management team and financial advisor, is exploring strategic alternatives to enhance shareholder value. This analysis includes a review of alternatives with respect to our oil and gas business. There is no assurance that exploration of strategic alternatives will result in any transaction being pursued or consummated.

2014 Significant Highlights (including ventures)

Real Estate

• Sold 2,343 developed residential lots, with the highest average annual gross profit per lot reported since 2006

• Sold 22,137 acres of undeveloped land for almost \$2,200 per acre

• Sold 32 commercial acres for over \$258,600 per acre

• Sold 944 acres of residential tracts for over \$8,500 per acre

• Exchanged over 10,000 acres of timber leases into ownership of 5,400 acres of undeveloped land, generating a \$10.5 million gain

• Acquired partner's interest in Eleven multifamily venture for \$21.5 million, generating a gain of \$7.6 million

• Received over \$60 million from Cibolo Canyons Special Improvement District, generating a gain of \$6.6 million

Oil and Gas

• Increased proved reserves almost 20% to 10.1 MMBOE, with oil and liquids accounting for 76% of total reserves

• Increased working interest oil and liquids production nearly 53% compared with 2013, principally due to working investments in the Bakken/Three Forks and Lansing-Kansas City formations

• Production volumes related to royalty interests declined over 20% to approximately 310,300 BOE in 2014 which, in combination with lower lease bonus and delay rental revenues and higher operating costs, negatively impacted segment earnings by \$6.1 million

• Incurred non-cash impairment charges of \$32.6 million associated with unproved leasehold interests and proved properties principally due to the significant decline in oil prices

• Sold oil and gas properties primarily in Oklahoma and North Dakota for \$17.7 million, generating gains of \$8.5 million

• Leased over 3,900 net mineral acres to third parties in Texas and Louisiana for over \$1.2 million

Other Natural Resources

• Generated \$3.4 million gain related to termination of a timber lease in connection with the sale of the remaining 2,700 acres from the Ironstob venture

• Sold nearly 330,000 tons of fiber for \$14.93 per ton

• Generated \$1.1 million of revenue related to groundwater reservation agreement and almost \$0.2 million gain associated with the sale of water rights related to a real estate community near Denver

Real Estate

In our real estate segment, we conduct a wide array of project planning and management activities related to the acquisition, entitlement, development and sale of real estate, primarily residential and mixed-use communities, which we refer to as community development. We own and manage our projects either directly or through ventures, which we use to achieve a variety of business objectives, including more effective capital deployment, risk management, and leveraging a partner's local market contacts and expertise.

We have real estate in ten states and 13 markets encompassing 113,000 acres, including 92,000 acres located in a broad area around Atlanta, Georgia, with the balance located principally in Texas. Our development projects are principally located in the major markets of Texas.

Our strategy for creating value in our real estate segment is to move acres up the value chain by moving land located in growth corridors but not yet entitled, through the entitlement process, and into development. The chart below depicts our real estate value chain at year-end 2014:

We have approximately 77,000 undeveloped acres located in the path of population growth. As markets grow and mature, we intend to secure the necessary entitlements, the timing for which varies depending upon the size, location, use and complexity of a project, focusing first on those tracts that are more desirable for near-term development. We have 11 real estate projects representing 24,000 acres in the entitlement process, which includes obtaining zoning and access to water, sewer and roads. Additional entitlements, such as flexible land use provisions, annexation, and the creation of local financing districts generate additional value for our business and may provide us the right to reimbursement of major infrastructure costs. We have 75 entitled, developed or under development projects in eight states and 13 markets encompassing 12,000 entitled, developed and under development acres, planned for residential and commercial uses. We use return criteria, which include return on cost, internal rate of return, and cash multiples, when determining whether to invest initially or make additional investment in a project. When investment in development meets our return criteria, we will initiate the development process with subsequent sale of lots to home builders or for commercial tracts, internal development, sale to or venture with third parties. We may sell land at any point within the value chain when additional time required for entitlement or investment in development will not meet our return criteria. In 2014, we sold over 22,000 acres of undeveloped land at an average price of almost \$2,200 per acre.

A summary of our real estate projects in the entitlement process^(a) at year-end 2014 follows:

Project	County	Project Acres ^(b)
California		
Hidden Creek Estates	Los Angeles	700
Terrace at Hidden Hills	Los Angeles	30
Georgia		
Ball Ground	Cherokee	500
Crossing	Coweta	230
Fincher Road	Cherokee	3,890
Garland Mountain	Cherokee/Bartow	350
Martin's Bridge	Banks	970
Mill Creek	Coweta	770
Wolf Creek	Carroll/Douglas	12,230
Yellow Creek	Cherokee	1,060
Texas		
Lake Houston	Harris/Liberty	3,700
Total		24,430

^(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.

Products

The majority of our projects are single-family residential and mixed-use communities. In some cases, commercial land uses within a project enhance the desirability of the community by providing convenient locations for resident support services. We sometimes undertake projects consisting exclusively of commercial tracts and, on occasion, we invest in a venture to develop a single commercial project.

We develop lots for single-family homes and develop multifamily properties on our commercial tracts or other developed sites we may purchase. We sell residential lots primarily to local, regional and national home builders. We have 10,000 acres, principally in the major markets of Texas, comprised of land planned for over 18,000 residential lots. We generally focus our lot sales on the first and second move-up primary housing categories. First and second move-up segments are homes priced above entry-level products yet below the high-end and custom home segments. We also develop and own directly, or through ventures, multifamily communities as income producing properties, primarily in our target markets. Once these multifamily communities reach stabilization, we generally expect to market the properties for sale. We also actively market and sell undeveloped land through our retail sales program. Commercial tracts are developed internally or ventured with commercial developers that specialize in the construction and operation of income producing properties, such as apartments, retail centers, or office buildings. We also sell land designated for commercial use to regional and local commercial developers. We have 2,000 acres of entitled land designated for commercial use.

Cibolo Canyons is a significant mixed-use project in the San Antonio market area. Cibolo Canyons includes 2,100 acres planned to include 1,769 residential lots, of which 911 have been sold as of year-end 2014 at an average price of \$71,000 per lot. The residential component includes not only traditional single-family homes but also an active adult section, and is planned to include condominiums. The commercial component includes over 150 acres principally designated for multifamily and retail uses, of which 130 acres have been sold as of year-end 2014. Located at Cibolo Canyons is the JW Marriott[®] San Antonio Hill Country Resort & Spa, a 1,002 room destination resort and two PGA Tour[®] Tournament Players Club[®] (TPC) golf courses designed by Pete Dye and Greg Norman. We have the right to receive from a legislatively created Cibolo Canyons special improvement district (CCSID) nine percent of

hotel occupancy revenues and 1.5 percent of other resort sales revenues collected as taxes by CCSID through 2034 and reimbursement of certain infrastructure costs related to the mixed-use development.

In October 2014, we received \$46,500,000 from CCSID under 2007 economic development agreements (EDA) in connection with development of the JW Marriott® Hill Country Resort & Spa. CCSID funded payment to us from its issuance

7

of \$48,900,000 Hotel Occupancy Tax (HOT) and Sales and Use Tax Revenue Bonds. These bonds are obligations solely of CCSID and are payable from HOT and sales and use taxes levied by CCSID. To facilitate the issuance of the bonds, we provided a \$6,846,000 letter of credit to the bond trustee as security for certain debt service fund obligations in the event CCSID tax collections are not sufficient to support payment of the bonds in accordance with their terms. The letter of credit must be maintained until the earlier of redemption of the bonds or scheduled bond maturity in 2034. We also entered into an agreement with San Antonio Real Estate (SARE), owner of the Resort, to assign SARE's senior rights under the EDA to us in exchange for consideration provided by us, including a surety bond to be drawn if CCSID tax collections are not sufficient to support ad valorem tax rebates payable to SARE. The surety bond has a balance of \$9,010,000 at year-end 2014. The surety bond will decrease as CCSID makes annual ad valorem tax rebate payments to SARE, which obligation is scheduled to be retired in full by 2020.

A summary of activity within our projects in the development process, which includes entitled^(a), developed and under development single-family and mixed-use projects, at year-end 2014 follows:

Project	County	Interest Owned ^(b)	Residential Lots ^(c)		Commercial Acres ^(d)		
			Lots Sold Since Inception	Lots Remaining	Acres Sold Since Inception	Acres Remaining ^(e)	
Projects we own							
California							
San Joaquin River	Contra Costa/Sacramento	100	% —	—	—	288	
Colorado							
Buffalo Highlands	Weld	100	% —	164	—	—	
Johnstown Farms	Weld	100	% 281	313	2	3	
Pinery West	Douglas	100	% 45	41	20	106	
Stonebraker	Weld	100	% —	603	—	—	
Tennessee							
Beckwith Crossing	Wilson	100	% —	99	—	—	
Morgan Farms	Williamson	100	% 61	112	—	—	
Weatherford Estates	Williamson	100	% —	17	—	—	
Texas							
Arrowhead Ranch	Hays	100	% —	381	—	11	
Bar C Ranch	Tarrant	100	% 331	774	—	—	
Barrington Kingwood	Harris	100	% 148	32	—	—	
Cibolo Canyons	Bexar	100	% 911	858	130	56	
Harbor Lakes	Hood	100	% 221	228	13	8	
Hunter's Crossing	Bastrop	100	% 510	—	41	62	
Imperial Forest	Harris	100	% —	428	—	—	
La Conterra	Williamson	100	% 202	—	3	55	
Lakes of Prosper	Collin	100	% 97	190	4	—	
Lantana	Denton	100	% 1,131	650	9	3	
Maxwell Creek	Collin	100	% 935	66	10	—	
Oak Creek Estates	Comal	100	% 226	328	13	—	
Parkside	Collin	100	% —	200	—	—	
Stoney Creek	Dallas	100	% 221	487	—	—	
Summer Creek Ranch	Tarrant	100	% 974	277	35	44	
Summer Lakes	Fort Bend	100	% 614	455	56	—	
Summer Park	Fort Bend	100	% 69	130	28	68	
The Colony	Bastrop	100	% 451	1,434	22	31	
The Preserve at Pecan Creek	Denton	100	% 534	248	—	7	

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Village Park	Collin	100	% 756	—	3	2
Westside at Buttercup Creek	Williamson	100	% 1,496	1	66	—
Other projects (9)	Various	100	% 1,776	228	133	7