NOT FILED WITH THE SEC

THIS ANNUAL REPORT IS BEING PREPARED PURSUANT TO REQUIREMENTS CONTAINED IN THE INDENTURE DATED AS OF JANUARY 23, 2020 GOVERNING THE 6.625% SENIOR NOTES DUE 2028 ISSUED BY ASHTON WOODS USA L.L.C., IN THE INDENTURE DATED AS OF MARCH 27, 2019 GOVERNING THE 9.875% SENIOR NOTES DUE 2027 ISSUED BY ASHTON WOODS USA L.L.C., AND IN THE INDENTURE DATED AS OF AUGUST 8, 2017 GOVERNING THE 6.750% SENIOR NOTES DUE 2025 ISSUED BY ASHTON WOODS USA L.L.C.

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

For the fiscal year ended May 31, 2020

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: **N/A**

Ashton Woods USA L.L.C.

(Exact Name of Registrant as Specified in Its Charter)

Nevada	**37-1590746**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3820 Mansell Road, Suite 400 Alpharetta, GA	**30022**
(Address of Principal Executive Offices)	(Zip Code)

(770) 998-9663

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:	Securities registered pursuant to Section 12(g) of the Act:
Title of Each Class	Title of Each Class
NONE	**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 [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [X] 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 [ ] N/A [X]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 [ ] N/A [X]

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company
[ ]	[ ]	[X]	[ ]	[ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

ASHTON WOODS USA L.L.C.
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PART I.

Item 1. *Business*

Our company

Headquartered in Atlanta, Georgia, Ashton Woods USA L.L.C., together with its subsidiaries (collectively, the "Company" or "Ashton Woods"), is one of the largest private homebuilders in the United States. Based on home closings for calendar 2019, we ranked second among private homebuilders and 18th among all homebuilders (private and public) in the U.S. according to Builder Magazine. We design, build, and market high-quality attached and detached single-family homes under the Ashton Woods Homes and Starlight Homes brand names. We serve a broad customer base and focus on achieving the highest standards in design, quality, and customer satisfaction.

Our homebuilding operations started in Dallas, Texas in 1989. We have delivered over 49,000 homes in the 31 years that we have been in business, and we have grown organically through the formation of homebuilding and land development operations in select strategic markets that we believe we possess strong long-term housing and employment growth characteristics. Our geographic footprint is diversified across the Southeast and Southwest U.S., with operations in Atlanta, Georgia; Dallas, Houston, Austin, and San Antonio, Texas; Orlando, Naples, Sarasota, and Tampa, Florida; Phoenix, Arizona; Charleston, South Carolina; and Raleigh, North Carolina.

Impact of COVID-19 Pandemic

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus ("COVID-19") a global pandemic and recommended containment and mitigation measures worldwide. The worldwide spread of the COVID-19 virus has caused broad business and social disruption across many industries and locations, both domestically and abroad. Further, the spread of COVID-19 has also caused significant volatility in U.S. and international debt and equity markets. To date, COVID-19 has caused significant negative impacts across our industry, from trade availability, suspension of services in local municipalities, delays in homes closings, increased cancellations, various and differing shelter in place orders by state, county, and other local municipalities, and disruptions to normal operating procedures, to volatile economic conditions and a decline in consumer confidence. We have taken measures to enhance our liquidity position and provide additional financial flexibility, including drawing down funds on our revolving credit facility and aligning operating expenses to the current state of the business. We continue to monitor the situation closely, and the health and safety of our employees and customers remains our top priority. We have made process updates such as enhanced cleaning and social distancing measures and have distributed personal protective equipment, including face coverings and gloves, for use by our employees. There is significant uncertainty around the breadth, severity, and duration of COVID-19 and the business disruptions related to COVID-19, as well as its impact on the U.S. and international economies, consumer confidence and, in turn, the impact it will have on our results. Additional discussion of the risks to the Company from COVID-19 are discussed in Item 1A. Risk Factors in this annual report.

Our brands

Ashton Woods markets its homes through its two award-winning brands, Ashton Woods and Starlight Homes. The Ashton Woods brand is known for its design leadership and the ability to personalize one's home through the Design Studio experience. The Starlight Homes brand is focused on the first-time and move-down buyer segments, offering affordable homes with thoughtful designs and quality finishes. Both Ashton Woods and Starlight Homes offer communities in attractive locations and are committed to reliable customer service.

The Ashton Woods brand focuses on buyers with a preference for and willingness to pay a premium for design and personalization. Our reputation as a design leader and our ability to offer personalization in a production model has allowed us to deliver a highly differentiated value proposition that is relevant and meaningful to a clearly-defined core target consumer. As a result, we attract buyers who seek out unique design and are willing to spend more to get what they want.

Ashton Woods' brand pillars are a combination of what we deliver (design and personalization) and how we deliver it (through collaboration and expertise). These brand pillars come to life in our award-winning Design Studios, which are staffed by design professionals with significant expertise, extensive training, and the ability to translate buyers' visions into homes that reflect their sense of style. Our focus on comprehensive research of local homebuyer preferences provides Ashton Woods homebuyers with the opportunity to select from a variety of floor plans designed for and tailored to address the local market. Our sales and marketing strategy leverages our national brand while allowing our operating divisions to customize execution to meet the needs and preferences of our local markets.

Where Ashton Woods' value proposition is that of an industry leader in design, Starlight Homes is focused on affordability. With first-time homebuyers entering the market in larger numbers and demand outpacing supply for homes at lower price points, our strategy in approaching the entry-level market is primarily to convert renters into first-time homebuyers by offering affordable homes that include appealing features. Secondarily, we have also seen an increase in move-down buyers purchasing Starlight Homes due to the attractive finishes and high quality they can obtain at this price point.

Starlight Homes' affordability value proposition is driven by operating efficiencies built into the brand. Starlight Homes marketing is driven by a direct data-based model, while sales efficiency is enhanced through a rigorous process to convert leads. Starlight Homes is driven by a highly efficient build process resulting from repeated construction of simplified, yet thoughtful, designs without changes or design options, driving shorter cycle times and higher asset turns. The Starlight Homes offerings further strengthen the Ashton Woods portfolio and position us for efficient growth well into the future.

Our strategy

Integrated operating philosophy

Our strategic decision-making incorporates all aspects of our business, including land acquisition and development, product design and offerings, community design, construction practices, and sales and marketing.

Our integrated operations allow us to identify, research, and execute on market opportunities in an effective and efficient manner. As a result of extensive product research in 2014, we developed a differentiated, personalization-focused value proposition to drive growth in our core Ashton Woods brand. In 2017, we introduced Starlight Homes to appeal to the underserved first-time buyer segment.

In addition, we offer title services to our home buyers in our Dallas, San Antonio, Austin, Houston, Orlando, Southwest Florida, Raleigh, and Atlanta operating divisions through two wholly-owned title agencies. We also offer residential mortgage services to our homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, Charleston, Raleigh, Orlando, Southwest Florida, and Phoenix through an unconsolidated mortgage joint venture. Offering title and mortgage services to our customers provides the opportunity for a more streamlined homebuying experience.

Differentiated product focused on distinct target markets

We are dedicated to providing high-quality, well-designed homes in desirable locations while endeavoring to meet the demands of today's homebuyers. The product lines offered in a particular community depend upon many factors, including the supply of existing housing and the demand for new housing in the general area. In an effort to better meet the demand in the marketplace, we conduct in-depth qualitative and quantitative market research. This research enables us to meet the specific lifestyle demands of our targeted homebuyers and create synergies between the design of our homes and the community development.

We believe our two primary brands, Ashton Woods and Starlight Homes, enable us to provide a differentiated value proposition to meet the needs of distinct customer segments. In 2014, an in-depth analysis of homebuyer segments drove us to attract the target consumers for the core Ashton Woods brand—specifically, buyers who have a preference for and willingness to pay a premium for design and personalization. Our Design Studios provide Ashton Woods homebuyers the ability to make selections from an extensive array of options, including hardwoods, tiles, cabinets, light fixtures, countertops, and other fixtures and finishes, guided by deeply experienced and extensively trained in-house designers.

Starlight Homes addresses the needs of the growing entry-level market, guiding people through the process of achieving the dream of home ownership. Starlight Homes' tagline, Guiding You Home, speaks to the critical role the sales team plays in helping consumers realize that home ownership is attainable and guiding first-time homebuyers through what they may perceive to be an intimidating process. As such, every sales associate goes through a rigorous training program, which prepares them to move potential homebuyers through the marketing and sales process from lead to appointment to sale. Consistent and thorough analysis of these conversion metrics allows us to efficiently deploy resources where needed to optimize the business cost per lead and cost per sale.

Superior customer experience through design, quality, and service

We strive to build and sell homes that combine high-quality craftsmanship with design characteristics that ultimately reflect the various lifestyles and aspirations of our broad customer base.

We differentiate ourselves through a combination of high-style architecture and design, high-quality materials and construction, and a dedication to homeowner satisfaction. Our product offerings are designed to enhance efficiency and livability, and align with modern tastes, and our product offerings continue to evolve as we commit to delivering innovative designs.

We focus on value engineering our products based on our market and customer segmentation studies, without compromising quality or selection of finishes. We also engage in efforts to reduce our construction cycle times, which ultimately generates better capital efficiency.

We instill in our employees the importance of high quality and superior customer service through extensive in-house training, as well as through a compensation structure directly tied in part to our customer satisfaction results. We are committed to achieving the highest level of customer service during the sales process, as well as after a home has closed. We have a variety of programs and services in place that seek to ensure customer satisfaction and seek to improve production efficiency and reduce warranty costs.

Preserve and build on market position and selectively pursue growth opportunities

We maintain a rigorous focus on securing land only in premier locations for our targeted customers. We believe this focus provides us with superior competitive positioning and enhanced operational performance. We target land opportunities in each of our markets largely through the use of an in-depth analysis of supply and demand fundamentals, combined with site-specific financial feasibility studies, which we prepare in conjunction with our local operational managers. We undertake a detailed financial analysis as part of the evaluation of each land acquisition opportunity. This process enables us to enhance our financial returns while mitigating our land and inventory risk.

Through ongoing evaluation and assessment, we focus our operations and community development in those markets in which we operate that we believe exhibit positive demographic trends and offer attractive long-term growth opportunities. Maintaining and growing our share of those markets, through both selective growth and the expansion of our product offerings as we have done with Starlight Homes, enables us to source attractive acquisition opportunities and achieve economies of scale by leveraging our reputation as the preferred builder of choice by developers, land brokers, trade partners, and municipalities.

We pursue growth where we believe it is merited based on existing market demand and economic attributes and where it is consistent with our integrated operating philosophy and land acquisition strategy and our commitment to best-in-class quality and superior customer experience. We have historically accessed new markets through organic growth. Since fiscal year 2010, we have opened new Ashton Woods operations in Raleigh, Austin, San Antonio, Charleston, Sarasota, and Naples to take advantage of market developments we believed offered attractive growth opportunities at the time. While we will continue to evaluate new market opportunities from time to time, and, in the future, may also grow our business through select opportunistic acquisitions, joint ventures, and other strategic transactions, we believe we have ample growth opportunities across our existing geographic footprint and product offerings, and we currently intend to focus primarily on organic growth within our existing markets.

Enhancing our product offerings in our existing markets, as market conditions allow, is central to our growth strategy. We perform extensive research to determine demand for additional product offerings in each of our markets. Our single-family rental business, in which we sell homes and land, and build homes for a fee, has experienced meaningful growth and institutionalization as an asset class. During the year ended May 31, 2020, we entered into contracts to sell 345 homes and closed on sales of 292 homes to single family rental companies. In certain instances, we have built communities or dedicated sections of communities for single family rental companies, either as part of our regular homebuilding operations, or as a contract developer and builder for single family home rental companies.

Operating divisions and products

We currently operate in Raleigh, Charleston, Atlanta, Orlando, Southwest Florida, Houston, Dallas, Austin, San Antonio, and Phoenix. We build and sell detached single-family homes in all of our markets and currently offer attached single-family homes in all of our operating divisions except Austin, Phoenix, and San Antonio. During the year ended May 31, 2020, we closed 5,109 homes. Of those closings, 4,326 (85%) were single-family detached homes, while the remaining 783 (15%) of the homes closed were single-family attached homes.

We generally seek to maintain the flexibility to alter our product mix within a given market and to alter our development focus among markets depending on market conditions and consumer preferences. In determining our product mix in each market and our markets for development and growth, we consider demographic trends, demand for a particular type of product, margins, timing, and the economic strength of the market. We have focused, and intend to continue to focus, on our broad customer base. The base prices of our homes range from the low $100,000s to over $1,000,000.

As of May 31, 2020, we had 139 active communities, comprised of 115 detached single-family home communities and 24 attached single-family home communities. Active communities are defined as communities that have sold at least five homes and have at least five homes left to sell.

Land acquisition and development

We endeavor to achieve a balance between land owned and developed for our own use, and additional lots controlled through option contracts. We believe that our attractive land positions in our markets will enable us to continue to maintain market share in the current homebuilding environment. As of May 31, 2020, and based on the last twelve months' closings, we had land supply for use in our homebuilding operations of approximately 7.0 years, consisting of a 1.8 year supply of owned land and lots and homes available to close, and a 5.2 year supply of land and lots controlled through contracts.

We typically purchase land only after necessary entitlements have been obtained so that development or construction may begin as soon as market conditions dictate. The term "entitlements" refers to development agreements, tentative maps or recorded plats, as applicable, since the types of entitlements will vary depending on the jurisdiction within which the land is located. Even though entitlements are usually obtained before we purchase land, we are often required to secure a variety of other governmental approvals and permits during the land development process. The time required to obtain such approvals and permits can substantially lengthen the development process.

We select land and lots to purchase based upon a variety of factors, including:

- in depth market studies to confirm pricing and pace assumptions;
- competition analysis to establish competitive positioning;
- suitability for development, generally within a one to three-year time period from the beginning of the development process to the delivery of the last home;
- financial review as to the feasibility of the proposed project, including projected profit margins, return on capital employed, and the capital payback period;
- results of environmental and legal due diligence;
- proximity to local traffic corridors and amenities;
- management's judgment on the state of the real estate market and the economic trends; and
- our experience in a particular market.

We acquire land through purchase and option contracts, as well as through joint ventures with other builders or developers. A portion of our land is acquired through option contracts, which allows us to control lots and land without incurring the risks of land ownership or financial commitments other than non-refundable deposits. We generally enter into option contracts with third parties to purchase finished lots as home construction begins. These contracts are generally non-recourse and require non-refundable deposits. At May 31, 2020, we had $168.3 million in non-refundable deposits on real estate under option or contract, of which $23.3 million is related to purchase and option agreements consolidated under ASC 606 or ASC 470-40. We had 37,574 total lots and homes under control for use in our homebuilding operations. Of the 37,574 lots and homes controlled, we owned 25.5% or 9,573 lots and homes, and 74.5% or 28,001 lots were under contract. Once we acquire land, we generally initiate development and construction through contractual agreements with local subcontractors. These activities include site planning, engineering and home construction, as well as development activities to provide roads, sewerage, water supply, other utilities, drainage, recreation facilities, and other amenities.

Land joint ventures

Occasionally, we use partnerships or joint ventures to purchase and develop land. As of May 31, 2020, we controlled 130 lots for future use by our homebuilding operations through one joint venture with a related party. We may form new partnerships or joint ventures in the future where economically advantageous.

Letters of credit and surety bonds

In the normal course of business, the Company provides letters of credit and surety bonds to third parties to secure performance and provide deposits under various contracts and commitments. The amount of such obligations outstanding at any time varies in accordance with our development activities and commitments. In the event any letters of credit or surety bonds are drawn upon, we would be obligated to reimburse the issuer of such letter of credit or surety bond. At May 31, 2020, the Company had letters of credit outstanding of $2.7 million and surety bonds outstanding of $73.6 million. As of May 31, 2020, the Company had $47.3 million of unused letter of credit capacity under its senior secured revolving credit facility.

Marketing and sales

We believe that we have established a reputation for building high quality, well-designed homes, which helps to generate interest in each new community. We drive awareness and consideration of our communities through a variety of marketing vehicles, most notably and increasingly through digital advertising and social media to drive visitors to our website(s). We focus on continually improving upon our brand awareness and maintaining consistency across our various operating divisions by applying standardized sales office designs and national marketing communications guidelines, while customizing by operating division to address the needs and wants of local homebuyers.

We typically build, decorate, furnish, and landscape between one and two model homes for each Ashton Woods community and maintain on-site sales offices in our Ashton Woods and Starlight Homes communities. As of May 31, 2020, we maintained 143 model homes in all stages of construction. We believe that model homes play a particularly important role in the marketing of our Ashton Woods communities, helping homebuyers to imagine the possibilities of an Ashton Woods home. Our Starlight Homes sales offices play an equally important role, as they are housed in a fully completed Starlight Homes home, with features and finishes that will be included in the homebuyer's purchase.

Generally, interior decorations are undertaken by our internal design firm, and vary among our models based upon the lifestyles of targeted Ashton Woods homebuyers. Ashton Woods homebuyers may select various options and personalize their new homes at our award-winning Design Studios. Our Starlight Homes homebuyers do not make any selections through our Design Studios, as we generally maintain and sell speculative inventory that provides homebuyers with available homes to view and purchase.

Our sales counselors are available to assist prospective homebuyers by providing them with floor plans and price information, and tours of model and inventory homes. Sales counselors are trained by us and attend regular meetings to be updated on sales techniques, competitive products in the area, the availability of financing, construction schedules, and marketing and advertising plans, which management believes results in a sales force with extensive knowledge of our operating practices and housing products.

We use various sales incentives in order to attract homebuyers, including sales price reductions, reductions in the prices of certain options or upgrades for our Ashton Woods homebuyers, and the payment of certain closing costs. The decision to offer incentives and the type of incentives offered at any point in time are driven by market forces and vary by location.

Sales of our homes are made pursuant to home sale contracts, the terms of which vary according to market practices and to the legal requirements of the states in which they are used. Typically, each contract requires a deposit from the homebuyer. In addition, the home sale contract typically contains one or more contingencies relating to financing, the sale of an existing home, or other factors that provide homebuyers with the right to cancel in the event they are unable to obtain financing at a prevailing interest rate, are not able to sell their home, or such other contingencies are not met within a specified time period after the execution of the home sales contract.

Other services

The Company also offers title services to its homebuyers in its Austin, Dallas, Houston, San Antonio, Raleigh, Orlando, Southwest Florida, and Atlanta operating divisions through two wholly-owned title agencies.

In addition, Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, Charleston, Raleigh, Orlando, Phoenix, and Southwest Florida through an unconsolidated mortgage joint venture. The Company has an ownership interest of 49% in this mortgage joint venture.

Construction

We act as the general contractor for the construction of our homes. Subcontractors are typically engaged to complete construction of each home at a negotiated price. Agreements with our subcontractors and material suppliers are generally entered into after competitive bidding. Our operating divisions monitor the construction of each project to coordinate the activities of subcontractors and suppliers, and to seek to ensure subcontractor compliance with contract documents, zoning and building codes, and quality and cost controls.

We specify that quality, durable materials be used in the construction of our homes. We have numerous suppliers of raw materials and services, and such materials and services have been and continue to be available. From time to time, we enter into regional and national supply contracts with certain vendors to leverage our purchasing power and our size in order to control our costs. However, we do not have any material long-term contractual commitments with any of our subcontractors or suppliers. We do not maintain inventories of construction materials except for materials being utilized for homes under construction. Prices of materials may fluctuate due to various factors, including demand or supply shortages, which may be beyond the control of our vendors. We believe that our relationships with our suppliers and subcontractors are good.

Construction time for our homes depends on the availability of labor, materials and supplies, the type and size of the home, location, and weather conditions. Our homes are designed to promote efficient use of space and materials, and to minimize construction costs and time. Construction of a home is typically completed within nine months following commencement of construction.

Warranty program

We offer a standard one, two, and ten-year warranty to our homebuyers. The one-year limited warranty covers workmanship and materials. We subcontract our homebuilding work to subcontractors who typically provide us with a two-year warranty for faulty work not in compliance with the plans, specifications, applicable building codes, and standard construction practices, and therefore, claims relating to workmanship and materials are generally the primary responsibility of our subcontractors. In addition, the first and second years of our warranty cover certain defects in plumbing, electrical, heating, cooling, and ventilation systems. The remaining years of protection cover only structural defects. We contract with an independent third party that assists in administering our warranty program.

Warranty liabilities are initially established on a per home basis by charging cost of sales and establishing a warranty liability for each home delivered to cover expected costs of materials and labor during the warranty period. The amounts accrued are based on management's estimate of expected warranty-related costs under all unexpired warranty obligation periods. The Company's warranty liability is based upon historical warranty cost experience in each operating division and is adjusted as appropriate to reflect qualitative risks associated with the types of homes built and the geographic areas in which they are built. The Company's warranty liability is included in other liabilities in the consolidated balance sheets.

Corporate operations

We perform the following functions at a centralized level:

- the evaluation and selection of geographic markets;
- the allocation of capital resources to particular markets, including final approval of all land acquisitions;
- the consolidation of operating division and segment financial information;
- the capitalization of the Company;

- the maintenance of centralized information systems; and
- the monitoring of the decentralized operations of our subsidiaries and operating divisions.

We allocate the capital resources necessary for new projects in a manner consistent with our overall operating strategy. We utilize gross margins, net income margins, and inventory turnover as the primary criteria for our allocation of capital resources. We will vary the capital allocation based on market conditions, results of operations, and other factors. Capital commitments are determined through consultation among certain corporate and operational management, who play an important role in ensuring that new communities are consistent with our strategy. Centralized financial controls are also maintained through the standardization of accounting and financial policies and procedures.

We operate through separate operating divisions, which are located near or within the geographic market in which they operate. Each operating division generally is managed by professionals with substantial experience in the operating division's market. In addition, each established operating division is equipped with the skills to complete the functions of land acquisition, land development, construction, marketing, sales, and product service.

Competition and market factors

The development and sale of residential properties is highly competitive and fragmented. We compete with numerous small and large residential builders for sales on the basis of a number of interrelated factors, including location, reputation, amenities, design, quality, and price. We compete with new home sales, re-sales of existing homes, and available rental housing.

We believe that we compare well with other builders in the markets in which we operate due primarily to:

- our experience within our geographic markets and the breadth of our product line, which allows us to vary our product offerings to reflect changing conditions within a market;
- our responsiveness to market conditions, which enables us to capitalize on the opportunities for attractive land acquisitions in desirable locations; and
- our reputation for quality design, construction, and service.

Some of our competitors have significantly greater financial resources or lower cost structures than we do. Because some of our competitors are larger than us, they may possess certain advantages over us, such as the ability to raise money at lower cost and the ability to negotiate better prices on materials and services with subcontractors. Certain of our smaller competitors may have an advantage over us based on length of operation in the market compared to us or better name recognition than us. Furthermore, many custom homebuilders may have an advantage over us because purchasers of custom homes tend to want a level of flexibility in the design and construction of their homes that we do not offer.

The demand for new housing is directly related to consumer confidence levels and general economic conditions, including employment and interest rate levels. Other factors are also believed to affect the housing industry and the demand for new homes. Such other factors include:

- the availability of labor and materials and increases in the costs thereof;
- changes in costs associated with home ownership such as increases in property taxes and energy costs;
- changes in consumer preferences;
- demographic trends;
- the amount of resale housing inventory available in the market; and
- the availability of and changes in mortgage financing programs.

Government regulation and environmental matters

Substantially all of our land is purchased with entitlements, giving us the right to obtain building permits upon compliance with specified conditions, which generally are within our control. Upon compliance with such conditions, we must obtain building permits. The length of time necessary to obtain such permits and approvals affects the carrying costs of unimproved property acquired for the purpose of development and construction. In addition, the continued effectiveness of permits already granted is subject to factors such as changes in policies, rules and regulations, and their interpretation and application. Several governmental authorities have imposed impact fees as a means of defraying the cost of providing certain governmental services to developing areas. To date, the governmental approval processes discussed above have not had a material adverse effect on our development activities and have not had a material effect on our capital expenditures, earnings, and competitive position, and indeed all homebuilders in a given market face the same fees and restrictions. There can be no assurance, however, that these and other restrictions will not adversely affect us in the future.

We may also be subject to periodic delays or may be precluded entirely from developing communities due to building moratoriums or "slow-growth" or "no-growth" initiatives or building permit, water tap or sewer tap allocation ordinances which could be implemented in the future in the states and markets in which we operate. The majority of our land is entitled and, therefore, other than delays in the delivery of land and lots to us caused by such delays, the moratoriums generally would only adversely affect us to the extent land is not entitled or if they arose from health, safety and welfare issues such as insufficient water or sewerage facilities. Local and state governments also have broad discretion regarding the imposition of development fees for projects in their jurisdiction. These fees are normally established, however, when we receive recorded final plats and building permits. We are also subject to a variety of local, state, and federal statutes, ordinances, rules, and regulations concerning the protection of health and the environment. Although in the future these laws may result in delays, cause us to incur substantial compliance and other costs, and prohibit or severely restrict development in certain environmentally sensitive regions or areas, these laws have not had a material effect on our capital expenditures, earnings, and competitive position to date.

Employees and subcontractors

As of May 31, 2020, we employed 808 employees, of whom 290 were sales and marketing personnel, 277 were executive, management and administrative personnel and 241 were construction personnel. Although our employees are not covered by collective bargaining agreements, subcontractors may be represented by labor unions or may be subject to collective bargaining arrangements. We believe that our relations with our employees and subcontractors are good.

Item 1A. *Risk Factors*

You should read the discussion of our business, included elsewhere in this annual report, in conjunction with the risks included below. We are or could become subject to the risks and uncertainties set forth below and/or those alluded to elsewhere in this annual report, and/or additional risks not currently known to us or that we now consider to be immaterial. If we are negatively affected by any or a combination of such risks and uncertainties, our results of operations, cash flows, financial position or business prospects could be severely and negatively impacted.

The impact and consequences of COVID-19 could adversely affect our business or our financial results.

While some current economic fundamentals support the housing industry across most of our markets, such as strong household formations, low mortgage interest rates, and a limited supply of homes, we expect that overall economic conditions in the United States and globally will continue to be negatively impacted by the broad market and economic disruptions caused by COVID-19, although the depth, breadth, and the duration of any such impact is unknown.

A variety of uncontrollable events related to, arising out of, and/or resulting from the COVID-19 pandemic and responses have had an adverse impact on our business and our operations to date and may continue to have a significant adverse effect on our business, financial condition, and the results of operations, especially if the pandemic or its effects persist. In particular, many of the risks described below may be heightened or exacerbated due to the pandemic. For example, in addition to other potential impacts, the pandemic and related responses and resulting economic conditions may increase our cost of capital, reduce availability of capital, reduce demand for our homes, cause an increase in cancellation rates, reduce revenue, reduce the availability of residential mortgage financing, impair our ability to deliver homes on schedule, or increase the cost of delivering homes, any of which could have a material adverse impact on our results of operations and financial condition.

Demand for our homes is dependent on a variety of macroeconomic factors, such as employment levels, interest rates, changes in stock market valuations, consumer confidence, housing demand, availability of financing for home buyers, availability and prices of new homes compared to existing inventory, and demographic trends. These factors, and in particular consumer confidence, have been and may continue to be significantly adversely affected by the COVID-19 pandemic, as well as a variety of additional factors beyond our control, including: catastrophic events or natural disasters (such as adverse weather, hurricanes, floods, wildfires, earthquakes, droughts, excessive heat or rain, epidemics, and terrorist attacks); international, political or military developments; social unrest; and significant volatility in debt and equity markets. Certain of these events, including specifically COVID-19, can also have a serious impact on our ability to develop our residential communities or could cause delays in, prevent the completion of, or increase the cost of, developing one or more of our residential communities, which in turn could negatively impact our sales and results of operations.

On March 11, 2020, the World Health Organization characterized the outbreak of COVID-19 as a global pandemic and recommended containment and mitigation measures. On March 13, 2020, the United States declared a national emergency concerning the outbreak, and since that date states and most municipalities have declared public health emergencies. As a result, there have been extraordinary and wide-ranging actions taken by federal, state, and local public health and governmental authorities to contain and combat the outbreak and spread of COVID-19 across the United States, including quarantines and “shelter-in-place” orders which substantially restrict daily activities. While states and local municipalities began to loosen certain of these restrictions to varying degrees as conditions appeared to begin to improve, certain new restrictions have been ordered in certain jurisdictions as the reported cases of COVID-19 have increased, and new or additional restrictions may be imposed, and daily activities may continue to be significantly impacted, as increases in COVID-19 cases occur or continue to occur. In all of the markets in which we build homes, construction operations have been deemed “essential”, and we have largely been able to maintain our operations through the date of this report, although in an altered and potentially more limited capacity due to various health, safety, and operational precautions required by local municipalities and/or that we adopted in response to COVID-19.

Through the present, the global spread of COVID-19 has caused significant and broad business, economic, and social disruption across many industries and locations, both domestically and abroad. Further, the spread of COVID-19 has also caused significant volatility in U.S. and international debt and equity markets, all of which can negatively impact the business environment, including our access to capital, the availability of residential mortgages, and consumer confidence. The spread of COVID-19 has also caused significant and broad public health concerns and resulting restrictions, including without limitation, in how businesses currently operate, social distancing, limitation on the number of people in a gathering, including in sales offices, model homes, specs, and construction trailers, and remote working, where possible, which can cause, among other things, lags in communication, and which requires reliance on the proper and secure functioning of telephonic and electronic communication methods. COVID-19 and its broad impact has also caused significant concerns for consumers and changes in consumer behavior, whether homebuying or otherwise.

There is significant uncertainty around the breadth, severity, and duration of COVID-19 and the business, economic, and social disruptions and impact related to COVID-19, as well as its impact on the U.S. and global economies and consumer confidence. The extent to which COVID-19 impacts our results over the long term will depend on future developments, which are highly uncertain and cannot be predicted, including, without limitation, new information that may emerge concerning the severity and duration of COVID-19 and the actions that will be necessary to contain it or treat its impact, including, without limitation state or local shelter-in-place orders; the ability to continue to build, sell, and close homes; consumer demand; the availability of, disruption to and cost of supplies and/or labor; the continuation of necessary government services such as zoning, permitting, and related government approvals; the continuation of services by third parties necessary for home inspections and closings; the continued ability to obtain and issue title insurance; the availability of residential mortgage financing and rates attractive and available to homebuyers; and the ability of employees and subcontractors to continue to perform, whether because of health issues caused by COVID-19 or otherwise. To date, COVID-19 has caused significant negative impacts across our industry, which have affected our operations, from trade availability, suspension of necessary services in local municipalities, closing of courthouses and other government buildings and services, a reduction in foot traffic in neighborhoods, delays in home closings, increases in cancellations, various and differing shelter in place orders by state, county, and other local municipalities, and disruption to normal operating procedures, including, without limitation, remote working and reduced physical presence of employees in communities, to volatile economic conditions and a decline in consumer confidence, all of which could materially and adversely impact our results of operations and financial condition, including, without limitation, because of a decline in demand for new homes, cancellation of homes in backlog, inability of buyers to obtain residential mortgages, inability to construct and complete new homes, and potential increases in impairments across our markets. Further, as the spread of COVID-19 continues, even as the spread may come in waves, and as it is still early in the United States' response to COVID-19, it is not currently possible to assess the ultimate impact COVID-19 and its consequences will have on the Company’s operations, results of operations, and financial condition, which are highly uncertain, cannot be predicted, and will depend upon future developments, including, without limitation, the severity and the duration of the COVID-19 pandemic, the duration and extent of existing social distancing and shelter-in-place orders, further mitigation strategies taken by applicable government authorities, the availability of a vaccine, adequate testing and treatments, and the prevalence of widespread immunity to COVID-19.

Adverse changes in general economic, real estate construction, or other business conditions could adversely affect our business or our financial results.

As in prior years, we expect future home sales activity and selling price appreciation (or depreciation) to vary in strength between markets and within submarkets based to a substantial degree on their specific economic and housing environments, which may also reflect international, national, state, and/or regional factors. These variations may be significant and unfavorable, and could be more pronounced and/or prolonged in our current and future markets due to changes in conditions that are outside of our control, including, but not limited to:

- Employment levels, and job and wage growth. Prior to the COVID-19 outbreak, the U.S. had experienced recent upward trends in employment and income levels. Unemployment rates in the U.S. increased significantly as a result of the spread of COVID-19 in March and April 2020 and, while unemployment rates have recently declined, the level of unemployment in the U.S. remains above the rates experienced prior to the pandemic. If unemployment rates continue at elevated rates for a significant period of time or worsen, particularly for buyers of entry-level and first-time move-up homes, a corresponding reduction in demand for homes or cancellation of contracts could negatively impact our business.
- Negative population growth, household formations, or other demographic changes that can impair demand for housing.
- Diminished consumer confidence in general or specifically with respect to purchasing homes, or lack of consumer interest in purchasing a home compared to other housing alternatives due to location preferences, perceived affordability constraints, economic concerns related to COVID-19, or otherwise.
- Inflation, which could result in our production costs increasing at a rate or to a level that we cannot recover through the selling prices of our homes. Inflation may also cause increases in mortgage loan interest rates, and in the interest rates we may need to accept to obtain external financing for our business.
- Shortages or rising prices of building materials and construction services, including independent contractor or outside supplier capacity constraints. These conditions could increase our costs and/or extend our construction and home delivery schedules, and we may be unable to raise the selling prices of our homes to cover the impact of such cost increases and/or delays.
- Civil unrest, including a continuation of widespread protests and civil unrest related to efforts to institute law enforcement and other social and political reforms, and the impacts of implementing or failing to implement any such reforms; acts of terrorism, and government responses to such acts.
- An epidemic or pandemic (such as the outbreak and worldwide spread of COVID-19), and the control response measures that international, federal, state and local governments, agencies, law enforcement and/or health authorities implement to address it, which may (as with COVID-19) precipitate or exacerbate one or more of the above-mentioned and/or other risks, and significantly disrupt or prevent us from operating our business in the ordinary course for an extended period; as well as inclement weather, natural disasters, and other environmental conditions can delay the delivery of our homes and/or increase our costs.

Since the homebuilding industry downturn between 2006 to 2012, the housing market generally has continued to recover; however, we cannot predict the overall trajectory of the market, including, without limitation, because of the COVID-19 pandemic. Some housing markets and submarkets have been stronger than others and there continues to be variability in operating trends. If economic or housing conditions become more challenging generally or in our current or future markets, including, but not limited to, due to the factors listed above, whether individually or collectively, or otherwise, or home sales or selling prices do not continue to advance at the same pace as in recent years or decline, there would likely be a corresponding adverse effect on our business and our consolidated financial position, including, but not limited to, our net orders, the number of homes we deliver, our active community count, our average selling prices, the revenues we generate, our housing gross profit margins and our ability to operate profitably, and the effect may be material. In addition, adjustments to federal government economic, taxation and spending laws, policies or programs by the current administration and U.S. Congress may negatively impact the financial markets, consumer spending and/or the housing market, and, in turn, materially and adversely affect our operating results and consolidated financial position.

Fluctuations and declines in the market value of land may have an adverse effect on the value of our inventory resulting in impairment charges, which could adversely affect our business and results of operations.

We regularly acquire land for replacement and expansion of land inventory within our existing and new markets. The market value of land, building lots and housing inventories can fluctuate significantly as a result of changing market conditions and the measures we employ to manage inventory risk may not be adequate to insulate our operations from a severe drop in inventory values. Further, as a result of these fluctuations, the book value of our real estate assets may not reflect current or future market value of these assets. When market conditions are such that land values are not appreciating, previously entered into option agreements may become less desirable, at which time we may elect to forgo deposits and pre-acquisition costs and terminate the agreements. At times in past years, as a result of the negative impact of economic conditions in our markets on land values, we have had to recognize inventory impairment charges and have also, at times, chosen to write-off deposits on land. If these conditions recur or worsen, we may have to incur additional and larger inventory impairment charges which would adversely affect our financial condition and results of operations and our ability to comply with certain covenants in our debt instruments linked to tangible net worth.

Undue or unforeseen delays in our business activities could have material adverse effects on our operating results.

The timing of land acquisitions, zoning, and other regulatory approvals impacts our ability to pursue the development of new communities and procure permits in existing communities in accordance with our business plans. If the timing of land acquisitions, zonings, or regulatory approvals is delayed, including because of the COVID-19 pandemic or otherwise, or if moratoria are imposed, we will be delayed in our ability to develop communities and/or deliver homes, which would likely decrease our backlog. Furthermore, a delay could result in a decrease in our revenues and earnings for the period or periods in which the delay occurs and possibly subsequent periods until the planned communities can be completed. A delay in the development of one or more communities or in a significant number of home closings or land sales due to acts of God, adverse weather, subcontractor unavailability, strikes, or other unforeseen factors could also result in a decrease in our revenues and earnings for the periods in which the delays occur and, possibly, subsequent periods. Further, our development of communities is also dependent on continued demand for our homes and can be impacted by the changes in economic and market conditions discussed above, as well as by delays in approvals, permits, and other requirements for developments also as discussed in these Risk Factors, and the pace at which we develop communities may change as economic and market conditions change. There can be no assurance that our estimates of target active communities in future periods will actually be achieved within the time frame initially expected or at all.

A substantial increase in mortgage interest rates or the unavailability of mortgage financing may reduce consumer demand for our homes.

A substantial number of purchasers of our homes finance their home purchase with mortgage financing. Housing demand is adversely affected by reduced availability of mortgage financing and factors that increase the upfront or monthly costs of financing a home such as increases in interest rates, property taxes, or insurance premiums. Any substantial increase, cumulatively or individually, in mortgage interest rates or unavailability of mortgage financing may adversely affect the ability of prospective homebuyers to obtain financing for our homes, as well as adversely affect the ability of prospective homebuyers to sell their current homes.

As a result of the turbulence in the credit markets and mortgage finance industry, the federal government has taken on a significant role in supporting mortgage lending through its conservatorship of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), both of which purchase home mortgages and mortgage-backed securities originated by mortgage lenders, and its insurance of mortgages originated by lenders through the Federal Housing Administration ("FHA") and the United States Department of Veterans Affairs ("VA"). The availability and affordability of mortgage loans, including consumer interest rates for such loans, could be adversely affected by a curtailment or cessation of the federal government's mortgage-related programs or policies. The FHA may continue to impose stricter loan qualification standards, raise minimum down payment requirements, impose higher mortgage insurance premiums and other costs, and/or limit the number of mortgages it insures. Due to federal budget deficits, the U.S. Treasury may not be able to continue supporting the mortgage-related activities of Fannie Mae, Freddie Mac, the FHA, and the VA at present levels, or it may revise significantly the federal government's participation in and support of the residential mortgage market. Because the availability of Fannie Mae, Freddie Mac, FHA, and VA-backed mortgage financing is an important factor in marketing and selling many of our homes, any limitations, restrictions, or changes in the availability of such government-backed financing could reduce our home sales, which could have a material adverse effect on the Company's business and results of operations.

Even if potential new homebuyers do not need financing, changes in interest rates could make it harder for them to sell their existing homes to potential buyers who need financing. Where potential homebuyers must sell their existing homes in order to buy a home, increases in mortgage costs, lack of availability of mortgages, and/ or regulatory changes could prevent the buyers of potential homebuyers' existing homes from obtaining mortgage financing, which would result in our potential homebuyers' inability to buy a new home. All these factors could prevent or limit our ability to attract new buyers as well as our ability to fully realize our backlog because our sales contracts frequently include a financing contingency. Financing contingencies permit the buyer to cancel the sales contract in the event that mortgage financing at prevailing interest rates is unobtainable within the period specified in the contract. Our homebuyers' need for mortgage financing and our exposure to such financing contingencies render us vulnerable to changes in prevailing interest rates and lending standards.

In March 2020 the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed in to law. The CARES Act included two protections for homeowners with federally or GSE-backed (Fannie Mae or Freddie Mac) or funded mortgages. First, the CARES Act and the recent guidance from the GSEs, the FHA, the VA, and the USDA, prohibit lenders and servicers from beginning a judicial or non-judicial foreclosure against a borrower, or from finalizing a foreclosure judgment or sale. This protection began on March 18, 2020, and extends through at least August 31, 2020. Second, if a borrower experiences financial hardship due to the coronavirus pandemic, they have a right to request and obtain a forbearance for up to 180 days. The borrower may also have the right to request and obtain an extension for up to another 180 days. There will be no additional fees, penalties, or additional interest (beyond scheduled amounts) added to the borrower's account. No additional documentation must be submitted to qualify other than the claim of a pandemic-related financial hardship. Once these provisions expire either at August 31, 2020 or following an extension, if any, the number of mortgage defaults and foreclosures may increase materially. If these increases occur, it may become more difficult for future homebuyers to obtain home mortgages on the same terms as are presently available.

Increases in the after-tax costs of owning a home could prevent potential homebuyers from buying our homes and adversely affect our business or financial results.

Certain expenses of owning a home, including mortgage interest expenses and real estate taxes, generally have been deductible expenses for an individual's federal, and in some cases state, income taxes, subject to various limitations. The "Tax Cuts and Jobs Act", which was signed into law at the end of calendar year 2017 and became effective January 1, 2018, includes provisions which impose significant limitations with respect to these income tax deductions. For instance, under the "Tax Cuts and Jobs Act", the annual deduction for real estate taxes and state and local income or sales taxes would generally be limited to $10,000. Furthermore, through the end of 2025, the deduction for mortgage interest would generally only be available with respect to acquisition indebtedness that does not exceed $750,000. These changes and limitations on homeowner tax deductions could adversely impact demand for and sales prices of new homes particularly in areas with relatively high housing prices and/or high state and local income and real estate taxes. In addition, if the federal government further changes or any state government changes its income tax laws to eliminate or substantially limit these income tax deductions, the after-tax cost of owning a new home would increase for many of our potential customers. Also, increases in property tax rates or fees on developers by local governmental authorities, including those imposed in response to reduced federal and state funding or to fund local initiatives, such as funding schools or road improvements, can adversely affect the ability of potential homebuyers to obtain financing or their desire to purchase new homes, and can have an adverse impact on our business and financial results.

An increase in unemployment or underemployment may lead to a decrease in sales pace or an increase in the number of loan delinquencies and property repossessions and may have an adverse impact on us.

In the United States, the unemployment rate was 3.5% in December 2019 and increased significantly to 11.1% in June 2020, according to the U.S. Bureau of Labor Statistics, in large part driven by the impact of and response to the COVID-19 pandemic. In response to the COVID-19 pandemic and the consequences therefrom, the federal government enacted various stimulus packages, including the Paycheck Protection Program (PPP) Flexibility Act and the CARES Act, in an effort to mitigate the impact of COVID-19 on businesses and their workforces, and to provide additional financial support to employees who have lost their jobs during the COVID-19 pandemic. If such stimulus and other support is reduced or not extended, unemployment or underemployment may continue to increase, concerns about job loss may be exacerbated, and unemployed or underemployed individuals may become delinquent in their mortgage payments and other obligations, all of which may have an adverse impact on our business and financial results. People who are not employed or are underemployed or are concerned about the loss, or potential loss, of their jobs are less likely to purchase new homes, may be forced to try to sell the homes they own and may face difficulties in making required mortgage payments. Therefore, continued high levels of unemployment or any further increase in unemployment or underemployment may lead to a decrease in sales pace or an increase in the number of loan delinquencies and property repossessions, which may have an adverse impact on us both by reducing demand for the homes we build and by increasing the supply of homes for sale.

Increases in our cancellation rates could have a negative impact on our home sales revenue and homebuilding gross margins.

Cancellations negatively impact the number of home closings, net new home orders, home sales revenue, and results of operations, as well as the number of homes in backlog. Home order cancellations can result from a number of factors, including, but not limited to, declines or slow appreciation in the market value of homes, increases in the supply of homes available to be purchased, increased competition, higher mortgage interest rates, homebuyers' inability to sell their existing homes, homebuyers' inability to obtain suitable financing, including providing sufficient down payments, and adverse changes in economic conditions. Many of our contracts with homebuyers have one or more contingencies relating to financing, the sale of an existing home, or other factors allowing cancellation if the contingency is not met within a specified period. Our entry-level product offerings are generally subject to higher cancellation rates than our move-up, multi-move-up, and luxury product offerings. As we experience a shift in the mix of active communities toward more that we consider to be entry-level, we anticipate that our consolidated cancellation rate will increase. We have experienced an increase in cancellation rates since the beginning of the COVID-19 pandemic and cannot predict whether cancellation rates will stabilize as new homebuyers adjust to current conditions or if they will continue to increase as the effects of COVID-19 continue to worsen or become prolonged. These higher cancellation rates and any unexpected increases in home order cancellations in any of our markets could have a negative impact on our home sales revenue and financial and operating results.

In cases of cancellation after construction of the home has started, we remarket the home and may retain any deposits we are holding, depending upon the circumstances. Nevertheless, the deposits retained, if any, may not cover the additional costs involved in remarketing the home, any difference in the sales price at which the home ultimately closes and the cost of carrying higher inventory. Significant numbers of cancellations could adversely affect our business, financial condition, and results of operations.

Our business is seasonal and our operating results can fluctuate.

We have historically experienced, and in the future expect to continue to experience, variability in our operating results on a quarterly and an annual basis. Factors expected to contribute to this variability include, among other things:

- the timing of land acquisitions, completion of development, and zoning and other regulatory approvals;
- the timing of home closings, land sales, and level of home sales;
- our product mix;
- our ability to continue to acquire additional land and lots or options thereon on acceptable terms;
- the condition of the real estate market and the general economy;
- delays in construction due to acts of God, adverse weather, reduced subcontractor availability, and strikes;
- changes in prevailing interest rates and the availability of mortgage financing; and
- employment levels.

Adverse changes in these conditions may affect our business or may be more prevalent or concentrated in particular regions or localities in which we operate. In the past several years, unfavorable changes in many of these factors negatively affected all of the markets we serve. Economic conditions in certain of our markets continue to be characterized by levels of uncertainty. Any deterioration in economic conditions or continuation of uncertain economic conditions could have a material adverse effect on our business.

Adverse changes in economic conditions can cause demand and prices for our homes to decrease or cause us to take longer to build our homes and make it costlier for us to do so. We may not be able to recover these increased costs by raising prices because of weak market conditions and because the price of each home we sell is usually set several months before the home is delivered, as many homebuyers sign their home purchase contracts before construction begins. The potential difficulties described above could impact our homebuyers' ability to obtain suitable financing and cause some homebuyers to cancel or refuse to honor their home purchase contracts altogether.

As market conditions permit, we intend to continue to consider growth or expansion of our operations, which could have a material adverse effect on our cash flows or profitability and our ability to service our debt and meet our working capital requirements.

We intend to continue to consider growth or expansion of our operations in our current operating divisions or in other markets, which will require substantial capital expenditures. The magnitude, timing, and nature of any future expansion will depend on a number of factors, including the identification of suitable markets, our financial capabilities, the availability of qualified personnel in the target market, and general economic and business conditions. Our expansion into new markets or existing operating divisions could have a material adverse effect on our cash flows and profitability.

Before a new community generates revenues, we invest significant time and material expenditures to acquire the land, obtain approvals, construct large portions of the community's infrastructure, put certain amenities in place, build model homes, and arrange sales facilities.

Historically, our strategy has been to enter new markets through the start-up of company-developed operating divisions, rather than the acquisition of existing homebuilding companies. Because we typically do not acquire existing homebuilders when entering a new market, we do not have the advantage of the experience and goodwill of an established local homebuilding company. As a result, we incur substantial start-up costs in establishing our presence and operations in new markets, and we may not be successful in such new markets. If we are unsuccessful in developing profitable operations in new markets or are unsuccessful in generating positive cash flows in a timely manner, we may not be able to recover our investment, our financial results could suffer and we may not be able to service our debt and meet our working capital requirements.

Furthermore, in the future, we may choose to enter new markets or expand operations in existing operating divisions through acquisitions, and these acquisitions may result in the incurrence of additional debt, some of which could be secured or unsecured senior debt. Acquisitions also involve numerous risks, including difficulties in the assimilation of the acquired company's operations, the incurrence of unanticipated liabilities or expenses, the diversion of management's attention from other business concerns, risks of entering markets in which we have limited or no direct experience, and the potential loss of key employees of the acquired company.

Our future success is highly dependent on the availability of undeveloped land and improved lots at prices acceptable to us, as well as adequate liquidity to acquire such properties.

Our success in land development and in the building and sale of homes depends in large part upon the continued availability of undeveloped land and improved lots at prices acceptable to us and with terms that meet our underwriting criteria. The availability of undeveloped land and improved lots at favorable prices depends on a number of factors that are beyond our control. Such factors include the risks of competitive over-bidding on land sites, restrictive governmental regulations that limit housing density, deterioration in market conditions, availability of financing to acquire land, and other market conditions. If the availability of suitable land opportunities is negatively affected, the number of homes we may be able to build and sell could decline. Further, increased demand for such land could cause prices to rise and we may not be able to pass the increased costs on to homebuyers. Such factors would negatively affect our revenues and profits. In addition, our ability to purchase land will depend upon us having satisfactory liquidity to fund these purchases and available financing sources, including through joint ventures or other purchase arrangements that give the Company access to land and lots over time, often referred to as "land banking" arrangements. Because such land purchases involve significant cash investments, we may be at a competitive disadvantage for these land purchases due to differences in levels of debt between us and other homebuilders and due to differing access to capital between us and other homebuilders. We may further be at a competitive disadvantage if land banking arrangements are not readily available on terms satisfactory to us, forcing us to finance the purchase of larger parcels of land and lots within a shorter time period or to forgo certain purchases.

To the extent that we are unable to purchase land timely or enter into new contracts for the purchase of land at reasonable prices, our home sales revenue and results of operations could be negatively impacted and/or we could be required to scale back our operations.

Lack of greater geographic diversification could expose our business to increased risks if there are economic downturns in our markets.

As of May 31, 2020, we have homebuilding operations in the following markets:

East:	Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota, and Naples)
Central:	Houston, Dallas, Austin, San Antonio, and Phoenix

Some or all of these markets could be affected by:

- severe weather;
- natural disasters;
- the duration and severity of the COVID-19 pandemic or other pandemic or public health emergencies;
- industry product failures or construction related defects;
- shortages in the availability or increased costs in obtaining land, equipment, labor, or building supplies;
- political or social unrest;
- changes to the population growth rates and the demand for homes in these regions; or
- changes in the regulatory and fiscal environment.

Four of the ten markets in which we have homebuilding operations are in the State of Texas. Failure to be more geographically diversified could impact us severely if the homebuilding business in one or more of our current markets should decline, including by causing us to limit, reduce, or phase out our presence in any market or sub-market.

We could experience a reduction in the number of homes sold, reduced revenues, or reduced cash flows if we are unable to obtain reasonably priced financing to support our homebuilding and land development activities.

The homebuilding industry is capital intensive, and homebuilding operations require significant up-front expenditures to acquire land and begin development. Accordingly, we use significant amounts of capital to finance our homebuilding and land development activities. If, in the future, internally generated funds and other funds available to us are not sufficient to finance our capital needs (including capital required to fund land acquisition, development and construction activities), we would seek additional capital in the form of debt or equity financing from a variety of potential sources, including additional bank financing and/or securities offerings. The amount and types of indebtedness that we may incur are limited by the terms of our senior secured credit facility and the indentures governing our 6.625% Senior Notes due 2028 (the “6.625% Notes”), 9.875% Senior Notes due 2027 (the “9.875% Notes”), and 6.750% Senior Notes due 2025 (the “6.750% Notes”). In addition, the availability of borrowed funds to be utilized for land acquisition, development, and construction may be greatly reduced and the lending community may require increased amounts of equity to be invested in a project by borrowers in connection with both new loans and the extension of existing loans, and the availability of funding may be further affected by the COVID-19 pandemic and the resulting impact on the economy and capital markets. Any shortage of financing, increased cost of such financing, unwillingness of third parties to engage in joint ventures and land banking transactions, failure to obtain capital to fund our planned capital investments, and other expenditures, and/or delays in obtaining such capital could have a material adverse effect on our business, cause project delays and result in increased costs.

Any downgrade of our credit ratings could adversely affect our access to capital and the cost of obtaining such capital and have other adverse effects on us.

Our credit ratings, ratings on our outstanding indebtedness and our current credit condition, among other factors, can impact our ability to access capital and any negative changes in these ratings may also result in more stringent covenants and higher interest rates. Our credit ratings could be downgraded in the future or credit agencies could issue negative commentaries about us in the future, any of which could adversely impact our business, financial condition, results of operations or liquidity. Any weakening of our financial condition, increase in leverage and/or decrease in profitability or cash flows could adversely affect our ability to access capital, cause a credit downgrade or result in a change in outlook or increase our cost of borrowing.

Governmental regulations and environmental matters could increase the cost, limit the availability of our development and homebuilding projects, and adversely affect our business or financial results.

We are subject to extensive and complex regulations that affect land development and home construction, including zoning, density restrictions, building design and building standards. These regulations often provide broad discretion to the administering governmental authorities as to the conditions we must meet prior to development or construction being approved, if approved at all. We are subject to determinations by these authorities as to the adequacy of water or sewage facilities, roads, or other local services. New housing developments may also be subject to various assessments for schools, parks, streets, and other public improvements. In addition, in many markets government authorities have implemented no growth or growth control initiatives, and have also imposed various moratoria. Any of these and changes in any of these regulations can limit, delay, or increase the costs of development or home construction.

We are subject to a variety of local, state, and federal laws and regulations concerning protection of health, safety and the environment, including those regulating the emission or discharge of materials into the environment; the handling, use, storage, and disposal of hazardous substances; impacts to wetlands and other sensitive environments; safety on job sites; those that seek to protect individuals from COVID-19; and the remediation of contamination at properties that we have owned. Noncompliance with these laws and regulations could result in fines or penalties, claims for personal injury or property damage, obligations to remediate, permit revocations, or other sanctions. The impact of environmental laws varies depending upon the prior uses of the building site or adjoining properties and may be greater in areas with less supply where undeveloped land or desirable alternatives are less available. These matters may result in delays, may cause us to incur substantial compliance, remediation, mitigation, and other costs, and can prohibit or severely restrict development and homebuilding activity in environmentally sensitive regions or areas.

We are also subject to other local, state, and federal laws and regulations in other aspects of our business, which are subject to evolving interpretation. Failure to comply with such laws and regulations could increase our costs or adversely affect our business or financial results.

A major health and safety incident relating to our business could be costly in terms of potential liabilities and reputational damage.

Building sites are inherently dangerous, and operating in the homebuilding industry poses certain inherent health and safety risks. Due to health and safety regulatory requirements and the number of projects we work on, health and safety performance is critical to the success of all areas of our business. Any failure in health and safety performance may result in penalties for non-compliance with relevant regulatory requirements, and a failure that results in a major or significant health and safety incident is likely to be costly in terms of potential liabilities incurred as a result. Such a failure could generate significant negative publicity and have a corresponding impact on our reputation, our relationships with relevant regulatory agencies or governmental authorities, and our ability to develop land and build homes, which in turn could have a material adverse effect on our business, financial condition and operating results.

Homebuilding is subject to home warranty and construction defect claims and litigation and other litigation in the ordinary course of business that can be significant. Our operating expenses could increase if we are required to pay higher insurance premiums or incur substantial litigation expense with respect to such claims, risks, and exposure. Additionally, our insurance policies may not offset our entire exposure due to limitations in coverage, deductible amounts, and exclusions under the policies or other related restrictions.

As a homebuilder, we are subject to home warranty and construction defect claims and litigation, including litigation brought by individual homeowners, homeowner's associations, and class action litigation, and other types of claims and litigation arising in the ordinary course of business. Such claims can relate to a variety of alleged engineering, architectural, product, or construction defects and increasingly include claims alleging defects in the application of exterior cladding systems including stucco and brick. In recent periods, the occurrence of these types of claims and litigation has increased and the amounts demanded by claimants may vary widely, with large demands made in some cases. In addition, claimants also from time to time allege claims for damages resulting from causes outside of communities in which they live. There can be no assurance that any developments we undertake will be free from defects or product failures once completed or that they will generate the expected levels of return. Construction defects or product failures may occur on projects and communities, and may arise a significant period of time after completion. Contracts entered into in the ordinary course of business and alleged or actual defects or product failures arising in a community attributable to us may lead to significant contractual or other liabilities.

We seek to mitigate this exposure by maintaining products and completed operations general liability insurance and by generally obtaining indemnities and evidence of insurance naming us as additional insured from subcontractors generally covering claims related to damages resulting from faulty workmanship and materials. Additionally, we create warranty and other reserves for the homes we sell based on historical experience in our markets and our judgment of the risks associated with the types of homes built. Although we actively monitor our reserves and coverage, because of the uncertainties inherent in these matters, including the size, nature, and frequency of current and future potential demands and litigation, we cannot provide assurance that our insurance coverage, our subcontractor arrangements and our reserves will be adequate to address all of our warranty and construction defect claims in the future. While we generally confirm evidence of subcontractor insurance coverage, it is possible and at times we have determined that the limits evidenced have been or will likely be reduced or exhausted by other claims or losses, which increases our potential exposure. It is also possible that exclusionary endorsements will preclude or limit coverage, or that existing coverage will be canceled or not renewed. In addition, additional insured endorsement language varies and may change, making it more difficult to trigger or enforce additional insured coverage. Further, contractual indemnities may be difficult to enforce. Enforcement of contractual obligations can be impacted by the unforeseeable insolvency of a vendor or subcontractor, as well as compliance with evolving state anti-indemnity legislation. We may also be responsible for applicable deductibles or self-insured retentions, and some types of claims may not be covered by insurance or may exceed applicable coverage limits. Additionally, the availability of products and completed operations general liability insurance for construction defects is currently limited and costly. This coverage may be further restricted or become unavailable or costlier in the future, or may be canceled, denied or rescinded.

Unexpected expenditures attributable to defects, product failures, or previously unknown sub-surface or other conditions arising in a community may have a material adverse effect on the levels of return generated from a particular community. In addition, severe or widespread incidence of actual or alleged defects giving rise to unexpected levels of expenditure, to the extent not covered by insurance or redress against subcontractors and other insurance carriers, may adversely affect our business, financial condition, and operating results.

A builder's ability to recover against any available insurance policy depends upon the continued solvency and financial strength of the insurance carrier that issued the policy. Many of the states in which we build homes have lengthy statutes of limitations and statutes of repose applicable to claims for construction defects, and some states may amend or have amended those statutes providing for further extended time periods of exposure. To the extent that any carrier providing insurance coverage to us or our subcontractors becomes insolvent or experiences financial difficulty in the future, we may be unable to recover on those policies, which may have a material adverse effect on our financial condition and results of operations.

Increasingly in recent years, individual and class action lawsuits and claims under respective state right to repair acts and similar statues have been filed and asserted against homebuilders, asserting claims of personal injury and property damage, allegedly caused by a variety of issues, including, but not limited to, construction defects relating to foundation, exterior cladding including stucco and brick, building envelope, flashing installation, water intrusion, mold, or the use of faulty or hazardous materials in such dwellings. Claimants in home warranty and construction defect litigation may also include other claims, such as claims for false and deceptive trade practices, in their suits seeking additional damages and penalties beyond the cost of repairs. Furthermore, decreases in home values as a result of general economic conditions may result in an increase in both non-meritorious and meritorious claims, including those relating to construction defects and marketing and sales practices or other theories of liability. Our insurance may not cover all of the types of claims arising from such issues, or such coverage may become prohibitively expensive, and insurance may not be available for other types of claims and litigation. If we are not able to obtain or retain insurance against these claims or if our insurance does not cover all the types of claims made against us, we may experience litigation costs and losses that could reduce our net income. Even if we are successful in defending such claims, we may incur significant costs. In addition, we may be subject to disparaging or defamatory comments and postings on social media or otherwise relating to alleged construction defects or other issues with homeowners, partners or former employees, exposing the Company to reputational and other harm, which may be significant.

Our results of operations could be adversely affected if legal claims against us are not resolved in our favor.

In the ordinary course of our business, we are subject to legal claims by homebuyers, persons with whom we have land purchase contracts or other business relationships, and a variety of other persons or entities. We establish reserves when appropriate with respect to legal claims, and we believe that, in general, legal claims will not have a material adverse effect on our business or financial condition. However, if the amounts we are required to pay as a result of claims against us substantially exceed the sums anticipated by our reserves, the need to pay those amounts could have a material adverse effect on our results of operations.

We are dependent on the services of certain key employees, and the loss of their services could hurt our business.

Our future success depends upon our ability to attract, train, assimilate, and retain skilled personnel. If we are unable to retain our key employees, attract, train, assimilate, or retain other skilled personnel in the future; or if one or more of our key employees contract COVID-19 and become unable to perform their services for the Company for an extended period of time, it could hinder the execution of our business strategy. Competition for qualified personnel in all of our operating markets is intense, and it could be difficult for us to find experienced personnel to replace our current employees, many of whom have significant homebuilding experience. Furthermore, a significant increase in the number of our active communities would necessitate the hiring of a significant number of additional skilled personnel, who are in short supply in our markets.

The supply of skilled labor may be adversely affected by changes in immigration laws and policies.

The timing and quality of our development and construction activities depend upon the availability, cost and skill of contractors and subcontractors and their employees. The supply of labor in the markets in which we operate could be adversely affected by changes in immigration laws and policies as well as changes in immigration trends, including, without limitation, as a result of the COVID-19 pandemic. Accordingly, a sufficient supply of skilled labor may not be available to us in the future. In addition, changes in federal and state immigration laws and policies, or in the enforcement of current laws and policies may have the effect of increasing our labor costs. The lack of adequate supply of skilled labor or a significant increase in labor costs could materially and adversely affect our financial performance.

We are dependent on the continued availability and satisfactory performance of our subcontractors and our business could be materially and adversely impacted if qualified subcontractors are not available.

We conduct our construction and development operations only as a general contractor. Our construction work is performed by unaffiliated third-party subcontractors. Consequently, we depend on the continued availability of and satisfactory performance by these subcontractors for the development of our communities and the construction of our homes. There may be insufficient availability of and unsatisfactory performance by these unaffiliated third-party subcontractors. In addition, inadequate subcontractor resources could have a material adverse effect on our business.

We can be injured by failures of persons who act on our behalf to comply with applicable regulations and guidelines.

Although we expect all of our employees, officers, and directors to comply at all times with all applicable laws, rules and regulations, there may be instances in which employees, subcontractors or others with whom we conduct business engage in practices that do not comply with applicable laws, rules, or regulations. When we learn of practices that do not comply with applicable laws, rules, or regulations, we promptly move actively to stop the non-complying practices and will take appropriate disciplinary action with regard to employees of ours who were aware of the practices and did not take steps to address them, through and including termination of their employment. However, regardless of the steps we take after we learn of practices that do not comply with applicable laws, rules, or regulations, we can in some instances be subject to fines or other governmental penalties, and our reputation can be injured.

Products supplied to us and work done by subcontractors can expose us to risks that could adversely affect our business.

We rely on subcontractors to perform the actual development of our communities and the construction of our homes, and in some cases, to select and obtain building materials. Despite our detailed specifications and quality control procedures, in some cases, subcontractors may use improper construction processes or defective products or materials. Defective products or materials widely used by the homebuilding industry can result in the need to perform extensive repairs to large numbers of homes. The cost of complying with our warranty obligations may be significant if we are unable to recover the cost of repairs from subcontractors, materials suppliers and insurers.

We also can suffer damage to our reputation, and may be exposed to possible liability, if subcontractors fail to comply with applicable laws, including laws involving things that are not within our control. When we learn about possibly improper practices by subcontractors, we try to cause the subcontractors to discontinue them. However, we are not always able to do that, and even when we can, it may not avoid claims against us relating to prior improper practices of the subcontractors.

Efforts to impose liabilities or obligations on us with regard to labor law violations by subcontractors and other parties whose employees perform contracted services could have an adverse effect on our financial condition.

The homes we sell are built by employees of subcontractors and other independent contract parties. We do not have the ability to control what these contract parties pay their employees or the work rules they impose on their employees. However, various governmental agencies have recently tried to hold contract parties like us responsible for violations of wage and hour laws and other work-related laws by companies whose employees are performing contracted services. Governmental rulings that make us responsible for labor practices by our subcontractors could create substantial exposures for us in situations that are not within our control, which could have an adverse impact on our financial condition.

Supply risks and shortages relating to labor and materials can harm our business by delaying construction and increasing costs.

The homebuilding industry has, from time to time, experienced significant difficulties with respect to:

- shortages of qualified trades people and other labor;
- shortages of materials;
- volatile increases in the cost of certain materials, including lumber, framing, and cement, which are significant components of home construction costs;
- work stoppages;
- labor disputes;
- changes in laws related to unionizing activity;
- increases in subcontractor and professional service costs; and
- lack of availability of adequate utility infrastructure and services.

A number of these difficulties may be triggered or worsened by the COVID-19 pandemic and its resulting economic effects. These difficulties can, and often do, cause unexpected short-term increases in construction costs and cause construction delays. We are generally unable to pass on any unexpected increases in construction costs to those homebuyers who have already entered into sales contracts, as those contracts generally fix the price of the home at the time the contract is signed, which may be up to one year in advance of the delivery of the home. Furthermore, sustained increases in construction costs may, over time, erode our profit margins. In the future, pricing competition may restrict our ability to pass on any additional costs, and we may not be able to achieve sufficient operating efficiencies to maintain our current profit margins.

Our business and operating results could be adversely affected by adverse weather conditions and natural disasters.

Adverse weather conditions, such as extended periods of rain, snow or cold temperatures, and natural disasters, such as hurricanes, tornadoes, floods, and fires, can reduce the availability of materials, delay land development and community openings, delay completion and sale of homes, damage partially complete or other unsold homes in our inventory, and/or decrease the demand for homes or increase the cost of building homes. To the extent that natural disasters or adverse weather events occur, our business and results may be adversely affected. To the extent that insurance does not cover business interruption losses or repair costs resulting from these events, our revenues, earnings, liquidity, and capital resources could be adversely affected.

If we are unsuccessful in competing against our competitors, our market share could decline or our growth could be impaired and, as a result, our financial results could be adversely affected.

The homebuilding industry is highly competitive. Homebuilders compete for, among other things, desirable land, financing, raw materials, employees, skilled labor, and purchasers. We compete for residential sales on the basis of a number of interrelated factors, including location, reputation, community amenities, design, quality, and price. We compete with numerous large and small homebuilders, including some homebuilders with nationwide operations and greater financial resources and/or lower costs than us. Any consolidation of homebuilding companies may create competitors that have greater financial, marketing, and sales resources than we do and may also create competitors that are able to compete more effectively against us. In addition, there may be new entrants into the markets in which we currently conduct business. We also compete for sales with the resale market for existing and foreclosed homes, with real estate speculators, and with available rental housing. If we are unable to successfully compete, our financial results could be adversely affected and the value of, or our ability to service, our debt could be adversely affected.

Reduced numbers of homes sold may extend the time it takes us to recover land purchase and property development costs and force us to absorb additional costs, which could have an adverse impact on our operating results and financial condition.

We incur many costs even before we begin to build homes in a community. These include costs related to preparing and developing land and installing roads, sewage, and other utilities, as well as taxes and other costs related to ownership of the land on which we plan to build homes. Reducing the rate at which we build homes, which is related to the number of home sales and closings, or delays in the opening of new home communities or phases in existing communities, extends the length of time it takes us to recover these costs, which could have an adverse impact on our operating results and financial condition.

We enter into unconsolidated joint ventures in which we do not have a controlling interest and we could be adversely impacted if our joint venture partners fail to fulfill their obligations.

We enter into land development joint ventures from time to time as a means of accessing larger parcels of land and lot positions, while managing our risk profile and leveraging our capital base. At May 31, 2020, we had an equity investment of less than 50% in one land development joint venture and did not have a controlling interest in the unconsolidated entity. Our partners in our land development joint ventures are both related parties and unrelated homebuilders, land developers, or other real estate entities. Our joint venture partners generally share profits and losses in accordance with their respective ownership interests.

The land development joint ventures from time to time obtain secured acquisition and development financing. We or our joint venture partners, may, from time to time, provide varying levels of guarantees associated with the debt of these unconsolidated entities. These guarantees may require the partners to repay their share of the debt of the unconsolidated joint venture entity in the event the entity defaults on its obligations under the borrowings, or may require the completion of development of the land owned by the joint venture.

In addition, we are currently party to a joint venture that offers residential mortgage financing to homebuyers and the public at large. At May 31, 2020, we had an equity investment of less than 50% and did not have a controlling interest in this entity. Our partner in the mortgage joint venture is an unrelated party, and the parties to the joint venture generally share profits and losses in accordance with their respective ownership interests. The debt of the mortgage joint venture is non-recourse to us.

Our investments in joint ventures are considered illiquid since we do not have a controlling interest and therefore are limited in buy/sell decisions of joint venture assets. In addition, we may not necessarily agree with decisions made by our joint venture partners or our joint venture partners may fail to take actions that we would take if we had a controlling interest. Further, our financial condition and results of operations could be negatively impacted if any debt guarantees that we provide are drawn upon.

We are a community-based homebuilding company and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

Our business as a homebuilding company depends on our relationship to the communities we build and serve, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring, and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior homes to our homebuyers and caring about our homebuyers and employees. Further, residents of communities we develop or in which we build rely on us to resolve issues or disputes that may arise in connection with the operation or development of their communities. Efforts made by us to resolve these issues or disputes could be deemed unsatisfactory by the affected residents and have a negative impact on our reputation. If our reputation is negatively affected by the actions of our subcontractors, employees or otherwise, our business and, therefore, our operating results may be materially adversely affected.

Failure in our financial and operational controls could result in significant cost overruns or errors in valuing sites.

We own and purchase a large number of sites each year and are therefore dependent on our ability to process a very large number of transactions (which include, among other things, evaluating the site purchase, designing the layout of the community, sourcing materials and subcontractors, and managing contractual commitments) efficiently and accurately. Errors by employees, failure to comply with regulatory requirements and conduct of business rules, failings or inadequacies in internal control processes, equipment failures, natural disasters, or the failure of external systems, including those of our suppliers, subcontractors, or counterparties, could result in operational losses that could adversely affect our business, financial condition, and operating results and our relationships with our homebuyers.

We may be unable to obtain adequate surety bonding for the development of our communities.

We provide surety bonds to governmental authorities and others to ensure the completion of our projects. If we are unable to provide required surety bonds for our projects, our business operations and revenues could be adversely affected. If we are unable to obtain required surety bonds in the future or are required to provide credit enhancements with respect to our current or future surety bonds, our liquidity could be negatively impacted.

Future terrorist attacks against the United States or increased domestic or international social, political, or economic unrest or instability could have an adverse effect on our operations.

Adverse developments in the war on terrorism, future terrorist attacks against the United States, any outbreak or escalation of hostilities between the United States and any foreign power, or social, economic, or political instability domestically or internationally may cause disruption to the economy, consumer confidence, the U.S. housing market, our Company, our employees, and our homebuyers. Historically, perceived threats to national security and other actual or potential conflicts or wars and related geopolitical risks have also created significant social, economic, and political uncertainties. In addition, the economy, consumer confidence, the Company, our employees, and our homebuyers may be impacted by protests and civil unrest, including in relation to efforts to institute social, political, and law enforcement reform, as well as the impacts of implementing or failing to implement reforms. If any such events were to occur, or there was a perception that they were about to occur, they could adversely affect our revenues, operating expenses, and financial condition.

Inflation could cause our costs to rise and we may not be able to recover such costs if there is a decline in demand for our homes.

Inflation could have a long-term negative effect on our business due to gradual or not so gradual increases in land, labor, and materials costs, which we may or may not be able to pass on to our home buyers in the form of higher home prices. Further, inflation is generally accompanied by higher interest rates, which may prove to be a disincentive to home ownership, thereby affecting demand for homes and our ability to pass on increased costs in the form of higher home prices and/or lower incentives. As a result, inflation could cause our margins to decline.

Information technology failures and data security breaches could harm our business and subject us to adverse publicity, costly government enforcement actions, or private litigation, and expenses.

We use information technology and other computer resources to carry out important operational activities and to maintain our financial and business records, including information provided by our customers. Many of these resources are provided to us and/or maintained on our behalf by third-party service providers. Our computer systems, including our back-up systems, or those of the third-parties on whose systems we rely, are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches (including through data-theft and cyber-attack), compromises, catastrophic events such as fires, tornadoes and hurricanes, and usage errors by our employees or independent contractors. If our computer systems and our back-up systems, or those of the third-parties on whose systems we rely, are damaged, or cease to function properly, we could suffer interruptions in our operations or unintentionally allow misappropriation of proprietary or confidential information (including information about our homebuyers, employees and business partners), which could require us to incur significant costs to remediate or otherwise resolve these issues. Our failure to maintain the security of the data we are required to protect could result in damage to our reputation, financial obligations to third parties, fines, penalties, regulatory proceedings and private litigation with potentially large costs, and also in deterioration in our customers' confidence in us and other competitive disadvantages. While we endeavor to protect our systems and information from such threats, such measures, which require ongoing monitoring and updating as technologies change and efforts to overcome security measures become increasingly sophisticated, are costly and may not be effective in preventing or mitigating significant negative occurrences or irregularities in our systems or those of third parties on whose systems we rely. Further, work from home and other remote access efforts in response to COVID-19 could increase our risk of such threats as a result of the use of less secure internet connections, increased difficulty in monitoring our employees and responding to third party threats, and increased hacking, phishing, and other fraudulent activity. In addition, the costs of maintaining adequate protection against such threats, as they develop in the future or as legal requirements related to data security change, could be material.

Further, as part of our business, we maintain proprietary information electronically and electronically receive, process, store, and transmit confidential and sensitive business information, including that of our homebuyers, employees, and business partners. We rely on the security of our networks, databases, systems and processes and those of third parties, such as vendors, to protect our confidential and proprietary information and information about our homebuyers, employees, and business partners. Criminals and other wrongdoers are constantly devising schemes to circumvent information technology security safeguards and other companies have suffered serious data security breaches. If unauthorized parties gain access to our networks or databases, or those of our vendors or third-party service providers, they may be able to steal, publish, delete, release or modify our sensitive proprietary information and sensitive third-party information, including confidential and personally identifiable information. In addition, employees may intentionally or inadvertently cause data or security breaches that result in unauthorized release of such personal or confidential information. A significant and/or extended disruption or breach of security related to our computer systems, back-up systems, and/or systems of our third party service providers may cause our business to suffer, may result in business disruption, damage to our reputation, and loss of consumer confidence in our company, and cause us to lose customers, sales and revenue, and result in unintended misappropriation of proprietary, personal and confidential information. In any such event we could be required to incur significant expense to remediate or otherwise resolve and respond to these issues, including financial obligations to third parties, fines, penalties, regulatory investigations or proceedings, and private litigation with potentially large costs and other competitive disadvantages, any or all of which could adversely affect our financial condition, results of operations, and reputation. Furthermore, Congress or individual states could enact new laws regulating electronic commerce that could adversely affect us and our results of operations.

If we were subjected to a material amount of additional entity-level taxation by individual states and localities, it would negatively impact our operating results.

Because of widespread state budget deficits and other reasons, several states are evaluating ways to subject partnerships and limited liability companies to entity-level taxation through the imposition of state income, franchise and other forms of taxation. Changes in current state law may subject us to additional entity-level taxation by individual states and localities, reducing our available cash.

We are not subject to the requirements of the Securities Act of 1933, the Securities Exchange Act of 1934, or the Sarbanes-Oxley Act of 2002.

We are not subject to the requirements of the Securities Act of 1933, the Securities Exchange Act of 1934, the rules and regulations of the Securities and Exchange Commission or the Sarbanes-Oxley Act of 2002, which requires, among other things, public companies to have and maintain effective disclosure controls and procedures to ensure timely disclosure of material information, and have management review the effectiveness of those controls on a quarterly basis. The Sarbanes-Oxley Act of 2002 also requires public companies to have and maintain effective internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements, and have management review the effectiveness of those controls on an annual basis (and have the independent auditor attest to the effectiveness of such internal controls). If we were to become publicly traded, we would also be subject to the requirements of Section 404 of the Sarbanes-Oxley Act. Currently, we are not required to comply with these requirements.

Risks associated with our indebtedness

Our indebtedness could adversely affect our financial condition, limit our growth and make it more difficult for us to satisfy our debt obligations.

As of May 31, 2020, we had $755.0 million of aggregate indebtedness outstanding (excluding accrued interest) and $207.9 million available for borrowing under our senior secured credit facility, after applying a borrowing base formula and based on the value of collateral pledged to secure the facility. Our indebtedness could have important consequences for us. Such indebtedness could, among other things:

- cause us to be unable to satisfy our obligations under our existing or new debt agreements, including the notes;
- make us more vulnerable to adverse general economic and industry conditions;
- make it difficult to fund future working capital, land acquisition and development, home construction, acquisitions, and general corporate needs;
- cause us to be limited in our flexibility in planning for, or reacting to, changes in our business; and
- cause us to be less competitive than other companies with less indebtedness.

In addition, subject to restrictions in our existing debt instruments, we may incur additional indebtedness. If new debt is added to our current debt levels, the related risks that we now face could intensify.

Despite current indebtedness levels, we may still be able to incur substantially more debt. This could further exacerbate the risks associated with our substantial leverage.

We may be able to incur substantial additional indebtedness, including additional secured indebtedness and other senior unsecured indebtedness, in the future. Although the indentures governing our 6.625% Notes, 9.875% Notes, and 6.750% Notes, and the agreement governing our senior secured revolving credit facility contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of significant qualifications and exceptions and, under certain circumstances, the amount of indebtedness that could be incurred in compliance with these restrictions could be substantial. Any secured indebtedness, including draws under our senior secured revolving credit facility, would be effectively senior to the notes to the extent of the value of the assets securing such indebtedness. As of May 31, 2020, we had $207.9 million of availability under our senior secured credit facility, based on a borrowing base formula and based on the value of collateral pledged to secure the facility, and $2.7 million of outstanding letters of credit, all of which would be effectively senior to the notes. If we incur additional indebtedness, the related risks that we now face would intensify and could future exacerbate the risks associated with our substantial leverage.

We may be unable to generate sufficient cash to service our debt obligations.

Our ability to pay our expenses and to pay the principal and interest on the notes and our other debt depends on our ability to generate positive cash flows in the future. Our operations may not generate cash flows in an amount sufficient to enable us to pay the principal and interest on our debt or to fund our other liquidity needs.

If we do not have sufficient cash flows from operations, we may be required to incur additional indebtedness, refinance all or part of our existing debt or sell assets. Our ability to borrow funds under our senior credit facility in the future will depend on our meeting the financial covenants of such senior credit facility, and sufficient borrowings may not be available to us. In addition, the terms of existing or future debt agreements may restrict us from effecting any of these alternatives. Any inability to generate sufficient cash flows or refinance our debt on favorable terms could significantly and adversely affect our financial condition, the value of the notes and our ability to pay the principal and interest on our debt.

The families and family trusts that own the majority of our equity interests have the right to select our board members, can influence our business operations, including all matters subject to membership approval, and may have interests that conflict with the interests of our note holders.

Little Shots Nevada L.L.C. ("Little Shots"), which is directly or indirectly controlled by five families or family trusts, beneficially owns 87.82% of our equity interests. Except as may be limited by our debt agreements, Little Shots, by virtue of this equity ownership, has the ability to:

- elect the entire membership of our board of directors;
- control all of our management policies, including decisions regarding payments to our members or other affiliates, whether by way of dividend, compensation or otherwise or entering into other transactions with entities affiliated with the families and trusts controlling Little Shots; and
- determine the outcome of corporate matters or transactions, including mergers, joint ventures, consolidations, asset sales, equity issuances, or debt incurrences.

Of our five directors, three are affiliated with Little Shots and the families and trusts that control it.

Other affiliates of Little Shots and these families and trusts operate businesses that derive revenue from homebuilding and land development. Some of such affiliated entities have engaged, and will in the future continue to engage, in transactions with us. In particular, we are party to a service and software license agreement with an affiliate of this group pursuant to which we are provided with a license to use software critical to our business. The initial term of the services and software license agreement was two years and it automatically renews for successive one-year terms unless either party gives notice that the agreement will not be renewed. We are also party to agreements whereby we purchase finished lots from affiliates of Little Shots and the controlling families and trusts. See "Certain relationships and related-party transactions" for a description of such transactions. In addition, we may enter into other agreements for the purchase of finished lots or undeveloped land with affiliates of this group in the future. The families and family trusts controlling Little Shots are not restricted from engaging in homebuilding or land development activities in the United States through entities unrelated to us.

Any guarantees of the notes by our subsidiaries may be voidable, subordinated or limited in scope under laws governing fraudulent transfers and insolvency.

Under federal bankruptcy laws and comparable provisions of state fraudulent transfer laws, a guarantee of the notes by any subsidiary guarantor could be voided, subordinated, or limited in scope if, among other things, at the time the guarantor issued its guarantee, the applicable guarantor:

- intended to hinder, delay, or defraud any present or future creditor; or
- received less than reasonably equivalent value or fair consideration for the incurrence of such guarantee; and
- was insolvent or rendered insolvent by reason of such incurrence; or
- was engaged in a business or transaction for which such guarantor's remaining assets constituted unreasonably small capital; or
- intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature.

The measures of insolvency for purposes of the foregoing considerations will vary depending upon the law applied in any proceeding with respect to the foregoing. Generally, however, a guarantor in the United States would be considered insolvent if:

- the sum of its debts, including contingent liabilities, was greater than the saleable value of all of its assets;
- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liabilities on its existing debts, including contingent liabilities, as they become absolute and mature; or
- it could not pay its debts as they become due.

We cannot be sure what standard a court would use to determine whether or not a guarantor was solvent at the relevant time, or, regardless of the standard that the court uses, that the issuance of the guarantee would not be avoided or the guarantee would not be subordinated to the guarantors' other debt. If such a case were to occur, the guarantee could also be subject to the claim that, since the guarantee was incurred for the benefit of the issuer of the notes, and only indirectly for the benefit of the guarantor, the obligations of the applicable guarantor were incurred for less than fair consideration.

The indentures governing the 6.625% Notes, 9.875% Notes, and the 6.750% Notes contain provisions intended to limit each guarantor's liability to the maximum amount that it could incur without causing the incurrence of obligations under its guarantee to be a fraudulent transfer. This provision may not be effective to protect the guarantees from being voided under fraudulent transfer law, or may eliminate the guarantor's obligations or reduce the guarantor's obligations to an amount that effectively makes the guarantee worthless. In a recent case, this kind of provision was found to be ineffective to protect the guarantees.

Our senior secured revolving credit facility and the indenture governing the 6.625% Notes, 9.875% Notes, and 6.750% Notes contain a variety of covenants imposing significant operating and financial restrictions, which may limit our ability to operate our business. Our failure to comply with these covenants could result in an event of default under the senior secured revolving credit facility or the indentures governing the 6.625% Notes, 9.875% Notes, and 6.750% Notes.

Our senior secured revolving credit facility requires us to maintain specified financial ratios and tests, among other obligations, including a minimum tangible net worth test and a maximum leverage ratio. In addition, our senior secured credit facility and the indentures governing the 6.625% Notes, 9.875% Notes, and the 6.750% Notes have affirmative and negative covenants customary for financings of those types, which limit our ability to, among other things, borrow money, make investments and extend credit, engage in transactions with our affiliates, consummate certain asset sales, consolidate or merge with another entity or sell, transfer, lease or otherwise dispose of all or substantially all of our assets, and create liens on our assets. It is possible that these covenants could adversely impact our ability to finance our future operations or capital needs or to pursue available business opportunities. Additionally, a failure to comply with any of these covenants could lead to an event of default under our senior secured credit facility and/or the indentures, which could result in an acceleration of the indebtedness under the senior secured credit facility and/or the indentures, depending on the covenant default. Acceleration of any such indebtedness or other senior indebtedness would constitute an event of default under the senior secured revolving credit facility or the indenture governing the 6.625% Notes, 9.875% Notes, and the 6.750% Notes.

Item 1B. *Unresolved Staff Comments*

Not applicable

Item 2. *Properties*

The Company leases 27,642 square feet of office space in Alpharetta, Georgia for our corporate offices. In addition, we lease a total of approximately 123,000 square feet of space for our operating divisions under leases expiring at various times through September 2027. Periods under lease range from 12 months to 88 months, with various commencement dates and renewal options.

The Company is a party to a lease as a lessee with an affiliate of certain of the beneficial owners of the Company's equity or their affiliates (individually and collectively, the "Investors") to rent approximately 8,500 square feet of commercial space in Dallas, Texas. The Company has 31 months remaining as of May 31, 2020. Total minimum lease payments due under the lease were $0.3 million and $0.2 million as of May 31, 2020 and 2019, respectively.

Item 3. *Legal Proceedings*

We are involved in lawsuits and other contingencies in the ordinary course of business. The amounts demanded by the claimants in these lawsuits and claims may vary widely, with large demands made in certain cases, which are disputed and aggressively defended by the Company. Management believes that, while the ultimate outcome of these ordinary course contingencies cannot be predicted with certainty, the ultimate liability, if any, net of anticipated recoveries including from any insurance, will not have a material adverse effect on our financial condition, results of operations or cash flows.

Item 4. *Mine Safety Disclosures*

Not applicable.

PART II.

Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchase of Equity Securities*

We are a limited liability company, and the majority of our membership interests are owned indirectly through Little Shots Nevada, L.L.C. by five families or family trusts related to the following individuals: Elly Reisman, Norman Reisman, Bruce Freeman, Seymour Joffe, and Harry Rosenbaum. See Item 12 "*Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*" for additional information about the ownership of our membership interests. There is no established public trading market for our membership interests.

We periodically make distributions to our Members for the payment of federal and state income taxes. We made distributions of $12.5 million, $21.4 million, and $17.8 million during the years ended May 31, 2020, 2019, and 2018, respectively. We are restricted in our ability to pay distributions under various covenants of our debt agreements.

Item 6. *Select Financial Data*

	Year ended May 31,		
	2020	**2019**	**2018**
Revenues:		(in thousands)	
Home sales	$ 1,767,058	$ 1,665,997	$ 1,474,683
Land sales	8,753	20,805	3,353
Financial services and other revenues	40,291	8,744	—
	$ 1,816,102	$ 1,695,546	$ 1,478,036
Gross profit (loss):			
Home sales	$ 317,436	$ 279,568	$ 253,086
Land sales	1,517	1,242	702
Financial services and other revenues	11,390	6,728	—
	$ 330,343	$ 287,538	$ 253,788
Selling, general and administrative	$ 234,806	$ 211,164	$ 183,318
Net income [1]	$ 75,816	$ 60,593	$ 52,470

(1) Because we are structured as a limited liability company, income tax obligations are paid by our Members and are not borne by us. As a limited liability company, we periodically make tax distributions to our Members. The Company made tax distributions of $12.5 million, $21.4 million, and $17.8 million during the year ended May 31, 2020, 2019, and 2018, respectively.

Supplemental data:	Year ended May 31, 2020	2019	2018
		($ in thousands)	
Active communities at end of period	139	132	130
Net new home orders (in units)	5,309	4,138	3,800
Homes closed (in units) (1)	5,109	4,357	3,643
Average sales price per home closed	$ 346	$ 382	$ 405
Backlog at end of period (in units)	1,508	1,308	1,527
Sales value of backlog at end of period	$ 555,323	$ 528,226	$ 696,524
Home gross margin (2)	18.0%	16.8%	17.2%
Adjusted home gross margin (3)	20.3%	19.1%	19.1%
Ratio of selling, general and administrative expenses to home sales revenue	13.3%	12.7%	12.4%
Interest incurred (4)	$ 57,753	$ 47,667	$ 42,361
Adjusted EBITDA (5)	$ 140,602	$ 116,016	$ 108,443
Adjusted EBITDA margin (5)	7.7%	6.8%	7.3%
Total debt to total capitalization	62.8%	57.5%	58.9%
Total net debt to net capitalization	52.7%	57.5%	57.5%
Cancellation rate (as a percentage of gross sales)(6)	20.5%	23.2%	12.8%

(1) A home is included in "homes closed" when title to and possession of the property is transferred to the buyer. Revenues and cost of sales for a home are recognized at the time of the closing of a sale, when title to and possession of the property are transferred to the buyer.

(2) Home gross margin is defined as the difference between home sales revenues and cost of sales—homes, expressed as a percentage of home sales revenues. Cost of sales—homes includes the land costs, home construction costs, indirect costs of construction, previously capitalized interest, a reserve for warranty expense, architecture fee amortization, impairment charges, closing costs, and pre-acquisition costs related to real estate purchases that are no longer probable.

(3) Adjusted home gross margin is not a financial measure under GAAP and should not be considered an alternative to home gross margin determined in accordance with GAAP as an indicator of operating performance. We use this measure to evaluate our performance against other companies in the homebuilding industry and believe it is also relevant and useful to investors. Adjusted home gross margin is home gross margin that is adjusted for inventory impairments and interest amortized to cost of sales. The following is a reconciliation of home gross margin, which is the most directly comparable GAAP measure, to adjusted home gross margin:

	Year ended May 31, 2020	2019	2018
		(in thousands)	
Home sales revenues	$ 1,767,058	$ 1,665,997	$ 1,474,683
Cost of sales homes	1,449,622	1,386,429	1,221,597
Home gross margin	317,436	279,568	253,086
Add: Inventory impairments - homes	2,741	3,157	331
Interest amortized to cost of sales	39,127	34,860	27,710
Adjusted home gross margin	$ 359,304	$ 317,585	$ 281,127

(4) Interest incurred for any period is the aggregate amount of interest that is capitalized or charged directly to interest expense during such period. The following table summarizes interest costs incurred, amortized to cost of sales, and expensed during the year ended May 31, 2020, 2019, and 2018:

	Year ended May 31,		
	2020	2019	2018
		(in thousands)	
Capitalized interest, beginning of period	$ 19,040	$ 13,824	$ 10,813
Interest incurred	57,753	47,667	42,361
Interest amortized to cost of sales	(39,127)	(34,860)	(27,710)
Interest expensed	(16,020)	(7,591)	(11,640)
Capitalized interest, end of period	$ 21,646	$ 19,040	$ 13,824

(5) Adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization) is a measure commonly used in the homebuilding industry and is presented as a useful adjunct to net income/loss and other measurements under GAAP because it is a meaningful measure of a company's performance, as interest expense, taxes, depreciation, and amortization expense can vary significantly between companies due, in part, to differences in structure, levels of indebtedness, capital purchasing practices, and interest rates. Adjusted EBITDA is not a financial measure under GAAP and should not be considered an alternative to net income/loss determined in accordance with GAAP as an indicator of operating performance, nor an alternative to cash flows from operating activities determined in accordance with GAAP as a measure of liquidity. Because some analysts and companies may not calculate Adjusted EBITDA in the same manner as us, the Adjusted EBITDA information in this report may not be comparable to similar presentations by others. Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by total revenues.

The following is a reconciliation of net income, which is the most directly comparable GAAP measure, to Adjusted EBITDA:

	Year ended May 31,		
	2020	2019	2018
		(in thousands)	
Net income	$ 75,816	$ 60,593	$ 52,470
Depreciation and amortization	9,639	10,483	11,360
Interest amortized to cost of sales	39,127	34,860	27,710
Interest expensed	16,020	7,591	11,640
EBITDA	$ 140,602	$ 113,527	$ 103,180
Loss from early extinguishment of debt	—	2,489	5,263
Adjusted EBITDA	$ 140,602	$ 116,016	$ 108,443

(6) The following table summarizes the cancellation rates (as a percentage of gross sales) by buyer profile for the year ended May 31, 2020, 2019, and 2018:

	Year ended May 31,		
	2020	2019	2018
Entry-Level - Starlight Homes	27.3%	35.9%	35.3%
Entry-Level - Ashton Woods	14.7%	14.6%	9.2%
Move-up - Ashton Woods	15.2%	13.4%	12.1%
Multi-Move-Up - Ashton Woods	13.6%	17.7%	12.1%
Consolidated	20.5%	23.2%	12.8%

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following management's discussion and analysis is intended to assist the reader in understanding the Company's business and is provided as a supplement to, and should be read in conjunction with, the Company's audited consolidated financial statements and accompanying notes included elsewhere in this annual report. The Company's results of operations discussed below are presented in conformity with U.S. GAAP.

The following tables and related discussion set forth key operating and financial data for our homebuilding operations as of and for the fiscal years ended May 31, 2020 and 2019. For similar operating and financial data and discussion of our fiscal 2019 results compared to our fiscal 2018 results, refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under Part II of our annual report on Form 10-K for the fiscal year ended May 31, 2019, which is available on our website (www.ashtonwoods.com).

Forward-Looking Statements

Certain statements included in this report contain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995, which represent our expectations or beliefs concerning future events, and no assurance can be given that the results described in this report will be achieved. These forward-looking statements can generally be identified by the use of statements that include words such as "estimate," "project," "believe," "expect," "anticipate," "intend," "plan," "foresee," "likely," "will," "target," "could," "seek", or other similar words or phrases. All forward-looking statements are based upon information available to us as of the date of this report.

A forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we undertake no obligation to update or revise 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 or new information, even if future events make it clear that any expected results that we have expressed or implied will not be realized. Though we are of the view that such forward-looking statements are reasonable, the results or savings or benefits in the forward-looking statement may not be achieved. New factors emerge from time to time and it is not possible for management to predict all such factors.

These forward-looking statements reflect our best estimates and are subject to risks, uncertainties, and other factors, many of which are outside of our control, which could cause actual results to differ materially from the results discussed in the forward-looking statements. These factors include, but are not limited to, the following:

- The potential negative impact of the COVID-19 pandemic, which, in addition to exacerbating each of the risks listed below, may include a significant decrease in demand for our homes or consumer confidence generally with respect to purchasing a home, an inability to sell and build homes in a typical manner or at all, increased costs or decreased supply of building materials or disruptions in the availability of subcontractors, housing inspectors, and other third-parties we rely on to support our operations, the availability of residential mortgage financing, and the recognition of charges in future periods, which may be material, for inventory impairments and/or land option contract abandonments;
- Reversal of the previous homebuilding recovery or continued or further decline in economic conditions;
- Fluctuations in mortgage interest rates and the availability of mortgage financing;
- The availability of high-quality undeveloped land and improved lots at suitable prices;
- The volatility of the capital markets and the banking industry;
- An ownership change, which could have unfavorable implications for our debt instruments;
- The availability of qualified employees, skilled labor, qualified subcontractors, and raw materials;
- The competitive nature of the homebuilding industry;
- Deterioration of the economic climate either nationally or in the regions in which we operate, which could impact growth and expansion opportunities, impact the price of labor and materials, impact the value of our inventory, impact inflation, consumer confidence, and consumer preferences;
- Government regulatory and other actions, which could affect tax laws, including laws designed to incentivize home ownership, and could result in delays or increased costs in obtaining necessary permits and complying with environmental laws;
- Timing of permits and other regulatory approvals;
- Our substantial indebtedness and our ability to comply with the related financial and other covenants and our ability to obtain replacement financing as these instruments mature;
- The cost and availability of insurance and the level of warranty claims;

- Cybersecurity attacks, breaches, and/or threats, and related exposures;
- Judgments or other costs and exposure with respect to litigation and claims;
- Changes in accounting guidelines or our interpretation of those guidelines;
- Adverse weather conditions, epidemics or pandemics, social or political unrest or uncertainty, and acts of war or terror; and
- Other factors, including those discussed elsewhere in this annual report on Form 10-K for the fiscal year ended May 31, 2020, over which the Company has little or no control.

Overview and Outlook

COVID-19

COVID-19 has had a material impact on the global and United States economies, and has impacted our business operations. There has been continuing business uncertainty surrounding COVID-19, due to rapidly changing governmental orders, public health concerns, the resulting market reactions, a significant increase in the unemployment rate, and the behavior of potential homebuyers. Responses to COVID-19 have included, among other things, varying degrees of quarantines, "stay-at-home" or "shelter-in-place" orders, and similar mandates for many individuals, which in some instances substantially restrict daily activities and have required many businesses to curtail or cease normal operations.

The current environment makes it challenging to predict the impact that the pandemic may have on the future performance of our business. Our primary concern is the health and well-being of our employees, customers, business partners, and the communities we serve. In particular, for several months, we closed our sales centers, model homes, and Design Studios to the general public, and our sales teams shifted to a virtual or appointment-only home sales process and leveraged digital sales tools to connect with our customers online. While we have since re-opened our sales centers, model homes, and Design Studios to the general public, we are currently limiting the number of individuals in any of these venues and are requiring other public health precautions in an effort to protect our employees and customers. The state and local governments in all of the markets in which we operate have designated residential construction as an essential business as part of critical infrastructure and are currently allowing the construction and sales of homes. We are following recommended social distancing and other health and safety protocols when meeting in person with a customer and continue to operate our corporate and division office functions remotely. In the field, we have implemented construction site health and safety guidelines in an effort to adhere to social distancing and other public health-related recommendations and requirements.

Since restrictions on business and normal daily activities began to be put in place March 2020, we have made a number of strategic decisions that focus on cash generation and preservation, including drawing down funds under our revolving credit facility, slowing and delaying construction of homes, delaying openings of new communities, and restructuring and delaying land investments. As we have continued to sell and close homes, we are strategically starting construction on additional homes, making new land investments, and developing lots we own, while continuing to focus on maintaining adequate liquidity through the uncertain times ahead. Although while we saw a slow down in sales through late April with the emergence of COVID-19 in March, sales began to pick back up in April and May, which resulted in homes that we would have expected to close during the year ended May 31, 2020 now being scheduled to close after the fiscal year end.

Business

We design, build, and market detached and attached single-family homes in six states under the Ashton Woods Homes and Starlight Homes brand names. The Company offers entry-level, move-up, and multi-move-up homes under the Ashton Woods Homes brand name, and offers entry-level homes under the Starlight Homes brand name. Our Ashton Woods communities are created to deliver design and personalization for our homebuyers through collaboration and expertise. Our Ashton Woods sales and marketing strategy leverages our national brand while allowing our operating divisions to customize execution to meet the needs and preferences of our local markets. While Ashton Woods' value proposition is grounded in design and personalization, Starlight is focused on delivering more affordable homes. Our strategy in approaching the Starlight market is primarily to convert renters into first-time homebuyers by offering affordable, purely speculative inventory that includes attractive features.

Presented below are certain operating and other data based on buyer profile:

	Year ended May 31,	
	2020	2019
Net new home orders (units):		
Entry-Level - Starlight Homes	2,227	1,419
Entry-Level - Ashton Woods	986	559
Move-up - Ashton Woods	1,671	1,729
Multi-Move-Up - Ashton Woods	425	431
Company Total	5,309	4,138
Homes closed (units):		
Entry-Level - Starlight Homes	2,066	1,369
Entry-Level - Ashton Woods	890	637
Move-up - Ashton Woods	1,675	1,726
Multi-Move-Up - Ashton Woods	478	625
Company Total	5,109	4,357

	As of May 31,	
	2020	2019
Backlog (units) at end of period:		
Entry-Level - Starlight Homes	483	322
Entry-Level - Ashton Woods	317	170
Move-up - Ashton Woods	570	633
Multi-Move-Up - Ashton Woods	138	183
Company Total	1,508	1,308

	As of May 31,	
	2020	2019
Active communities:		
Entry-Level - Starlight Homes	30	26
Entry-Level - Ashton Woods	27	14
Move-up - Ashton Woods	60	70
Multi-Move-Up - Ashton Woods	22	22
Company Total	139	132

	Year ended May 31,	
	2020	2019
Average monthly sales per average active community: (1)		
Entry-Level - Starlight Homes	6.6	5.8
Entry-Level - Ashton Woods	4.0	3.6
Move-up - Ashton Woods	2.1	2.0
Multi-Move-Up - Ashton Woods	1.6	1.4
Company Average	3.3	2.6

(1) Average active community is calculated by averaging the active community counts of the May 31 current year ended and May 31 prior year ended.

Average sales price per home closed (in thousands):	Year ended May 31, 2020	2019
Entry-Level - Starlight Homes	$ 222	$ 216
Entry-Level - Ashton Woods	$ 292	$ 297
Move-up - Ashton Woods	$ 427	$ 413
Multi-Move-Up - Ashton Woods	$ 707	$ 749
Company Average	$ 346	$ 382

During the year ended May 31, 2020, we closed 5,109 homes. Of those closings, 4,326 (85%) were single-family detached homes, while the remaining 783 (15%) of the homes closed were single-family attached homes.

During the year ended May 31, 2020, the Company added 66 new active communities, while closing out 59 communities. Of the 66 active communities added during the year ended May 31, 2020, 18 (27%) are considered to be entry-level Starlight Homes, 11 (17%) are considered to be entry-level Ashton Woods Homes, 27 (41%) are considered to be move-up Ashton Woods Homes, and 10 (15%) are considered to be multi-move-up Ashton Woods Homes.

Wholesale home sales within our Starlight Homes brand are included in consolidated net new home orders, homes closed, and backlog at end of period, as discussed in Note 1(j) to our consolidated financial statements. The wholesale home sales, which are generally sold at a discount to retail, typically have lower average sales prices than retail home sales. Presented below are certain data for our wholesale home sales:

Wholesale (units):	Year ended May 31, 2020	2019
Net new home orders	345	68
Homes closed	292	39
Backlog at end of period	82	29

Results of operations - Segments

We have grouped our homebuilding operating divisions into two reportable segments, east and central. At May 31, 2020, our reportable homebuilding segments consisted of homebuilding operating divisions located in the following areas:

1) East:	Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota, and Naples)
2) Central:	Houston, Dallas, Austin, San Antonio, and Phoenix

Presented below are certain operating and other data for our segments:

Net new home orders (units):

	Year ended May 31,	
	2020	**2019**
East:		
Entry-Level - Starlight Homes	1,171	894
Entry-Level - Ashton Woods	299	218
Move-up - Ashton Woods	475	648
Multi-Move-Up - Ashton Woods	325	287
Total east	2,270	2,047
Central:		
Entry-Level - Starlight Homes	1,056	525
Entry-Level - Ashton Woods	687	341
Move-up - Ashton Woods	1,196	1,081
Multi-Move-Up - Ashton Woods	100	144
Total central	3,039	2,091
Company total	5,309	4,138

Homes closed (units):

	Year ended May 31,	
	2020	**2019**
East:		
Entry-Level - Starlight Homes	1,086	938
Entry-Level - Ashton Woods	270	295
Move-up - Ashton Woods	497	762
Multi-Move-Up - Ashton Woods	360	410
Total east	2,213	2,405
Central:		
Entry-Level - Starlight Homes	980	431
Entry-Level - Ashton Woods	620	342
Move-up - Ashton Woods	1,178	964
Multi-Move-Up - Ashton Woods	118	215
Total central	2,896	1,952
Company total	5,109	4,357

Average sales price per home closed:

	Year ended May 31, 2020	Year ended May 31, 2019
	(in thousands)	
East:		
Entry-Level - Starlight Homes	$ 220	$ 214
Entry-Level - Ashton Woods	$ 302	$ 291
Move-up - Ashton Woods	$ 463	$ 440
Multi-Move-Up - Ashton Woods	$ 704	$ 764
Total east	$ 364	$ 389
Central:		
Entry-Level - Starlight Homes	$ 224	$ 220
Entry-Level - Ashton Woods	$ 288	$ 303
Move-up - Ashton Woods	$ 412	$ 392
Multi-Move-Up - Ashton Woods	$ 719	$ 721
Total central	$ 332	$ 374
Company total	$ 346	$ 382

Backlog (units) at end of period:

	As of May 31, 2020	As of May 31, 2019
East:		
Entry-Level - Starlight Homes	264	179
Entry-Level - Ashton Woods	89	47
Move-up - Ashton Woods	160	203
Multi-Move-Up - Ashton Woods	100	127
Total east	613	556
Central:		
Entry-Level - Starlight Homes	219	143
Entry-Level - Ashton Woods	228	123
Move-up - Ashton Woods	410	430
Multi-Move-Up - Ashton Woods	38	56
Total central	895	752
Company total	1,508	1,308

Active communities:

	As of May 31,	
	2020	2019
East:		
Entry-Level - Starlight Homes	17	14
Entry-Level - Ashton Woods	8	6
Move-up - Ashton Woods	18	24
Multi-Move-Up - Ashton Woods	18	16
Total east	61	60
Central:		
Entry-Level - Starlight Homes	13	12
Entry-Level - Ashton Woods	19	8
Move-up - Ashton Woods	42	46
Multi-Move-Up - Ashton Woods	4	6
Total central	78	72
Company total	139	132

Average monthly sales per average active community: (1)

	As of May 31,	
	2020	2019
East:		
Entry-Level - Starlight Homes	6.3	5.7
Entry-Level - Ashton Woods	3.6	3.0
Move-up - Ashton Woods	1.9	2.0
Multi-Move-Up - Ashton Woods	1.6	1.3
Total east	3.1	2.6
Central:		
Entry-Level - Starlight Homes	7.0	5.8
Entry-Level - Ashton Woods	4.2	4.1
Move-up - Ashton Woods	2.3	2.0
Multi-Move-Up - Ashton Woods	1.7	1.7
Total central	3.4	2.6
Company total	3.3	2.6

(1) Average active community is calculated by averaging the active community counts of the May 31 current year ended and May 31 prior year ended.

The Company presents adjusted home gross margin on a segment basis in the following tables. Adjusted home gross margin is a non-GAAP measure. The following is a reconciliation of home gross margin of our segments, the most directly comparable U.S. GAAP measure, to our segments' adjusted home gross margin:

	Year ended May 31,	
	2020	**2019**
Homebuilding East:	(in thousands)	
Home sales revenues	$ 805,731	$ 935,124
Cost of sales homes	683,551	789,357
Home gross margin	122,180	145,767
Add: Inventory impairments	2,701	2,560
Interest amortized to cost of sales	20,937	21,554
Adjusted home gross margin	$ 145,818	$ 169,881
Ratio of home gross margin to home sales revenues	15.2%	15.6%
Ratio of adjusted home gross margin to home sales revenues	18.1%	18.2%

	Year ended May 31,	
	2020	**2019**
Homebuilding Central:	(in thousands)	
Home sales revenues	$ 961,327	$ 730,873
Cost of sales homes	766,071	597,072
Home gross margin	195,256	133,801
Add: Inventory impairments	41	597
Interest amortized to cost of sales	18,190	13,306
Adjusted home gross margin	$ 213,487	$ 147,704
Ratio of home gross margin to home sales revenues	20.3%	18.3%
Ratio of adjusted home gross margin to home sales revenues	22.2%	20.2%

Results of operations - Discussion

Year Ended May 31, 2020 Compared to Year Ended May 31, 2019

Home sales revenues - Consolidated

Home sales revenues increased 6.1% ($101.1 million) for the year ended May 31, 2020, to $1,767.1 million from $1,666.0 million for the year ended May 31, 2019. The increase in revenues for the year ended May 31, 2020, as compared to the year ended May 31, 2019, was due to an increase in the number of homes closed, partially offset by a decrease in the average sales price of homes closed.

The number of homes closed increased 17.3% (752 homes) for the year ended May 31, 2020 to 5,109 from 4,357 for the year ended May 31, 2019. The increase in closings was primarily due to an increase in the number of active communities, particularly the number of entry-level active communities, which typically have higher sales paces, as well as an increase in the average monthly sales per active communities across all of our buyer profiles. The number of active communities increased from 132 at May 31, 2019 to 139 at May 31, 2020, which included 40 entry-level active communities at May 31, 2019 and 57 entry-level active communities at May 31, 2020. The average monthly sales per average active community increased across all of our buyer profiles from the year ended May 31, 2019 to the year ended May 31, 2020, with the largest increases in our entry-level communities. Net sales in the Starlight entry-level communities increased from 5.8 average monthly sales per average active community for the year ended May 31, 2019 to 6.6 average monthly sales per average active community for the year ended May 31, 2020. Net sales in the Ashton Woods entry-level communities increased from 3.6 average monthly sales per average active community for the year ended May 31, 2019 to 4.0 average monthly sales per average active community for the year ended May 31, 2020.

The average sales price of homes closed decreased 9.4% for the year ended May 31, 2020 to an average of $346,000 from an average of $382,000 for the year ended May 31, 2019. The decrease in the average sales price of homes closed on a consolidated basis for the year ended May 31, 2020, compared to the year ended May 31, 2019, primarily reflected our continued, planned shift to an increased focus on communities with lower average sales prices. For the year ended May 31, 2020, 2,956 closings (57.9%) were from entry-level communities, with generally lower average sales prices, compared to 2,006 closings (46.0%) for the year ended May 31, 2019.

Home sales revenues - East segment

Home sales revenues for the east segment decreased by 13.8% ($129.4 million) for the year ended May 31, 2020, to $805.7 million from $935.1 million for the year ended May 31, 2019. The decrease in revenues for the year ended May 31, 2020, as compared to the year ended May 31, 2019, was due to a decrease in the number of homes closed and a decrease in the average sales price of homes closed.

The number of homes closed during the year ended May 31, 2020 decreased 8.0% (192 homes) as compared to the year ended May 31, 2019. The average sales price of homes closed decreased 6.4% in the year ended May 31, 2020 to an average of $364,000 from an average of $389,000 for the year ended May 31, 2019. The decrease in the number of homes closed is primarily due to the timing of new communities opening for sales, offset in part by an increase in the average monthly sales per average active community. While the total number of active communities in the East segment totaled 61 at May 31, 2020, compared to 60 at May 31, 2019, a number of the new communities opened for sales in the second half of the fiscal year, such that throughout much of the fiscal year ended May 31, 2020, there was a lower number of active communities in the East segment compared to the same periods of the fiscal year ended May 31, 2019. Offsetting this, in part, the average monthly sales per average active community increased from 2.6 average monthly sales per community for the year ended May 31, 2019 to 3.1 for the year ended May 31, 2020. The largest increases were in entry-level communities, with the sales paces in move-up and multi-move-up communities remaining relatively flat.

The decrease in the average sales price of homes closed for the year ended May 31, 2020, compared to the year ended May 31, 2019, was primarily due to the continued, planned shift in the mix of communities from which we had closings to a higher percentage of closings in entry-level communities, with generally lower average sales prices. During the year ended May 31, 2020, 1,356 (61%) of the homes closed were considered entry-level, compared to 1,233 (51%) for the year ended May 31, 2019.

Home sales revenues - Central segment

Home sales revenues for the central segment increased by 31.5% ($230.5 million) for the year ended May 31, 2020 to $961.3 million from $730.9 million for the year ended May 31, 2019. The increase in revenues for the year ended May 31, 2020, as compared to the year ended May 31, 2019, was due to an increase in the number of homes closed, partially offset by a decrease in the average sales price of homes closed.

The number of homes closed during the year ended May 31, 2020 increased 48.4% (944 homes) as compared to the year ended May 31, 2019. The average sales price of homes closed decreased 11.2% in the year ended May 31, 2020 to an average of $332,000 from an average of $374,000 for the year ended May 31, 2019. The increase in closings was primarily due to an increase in the number of active communities, particularly the number of entry-level active communities, which typically have higher sales paces, as well as an increase in the average monthly sales per active community in all of our buyer profiles. The number of active communities in the Central segment increased from 72 at May 31, 2019 to 78 at May 31, 2020, which included 20 entry-level active communities at May 31, 2019 and 32 entry-level active communities at May 31, 2020. The average monthly sales per average active community increased from 2.6 for the year ended May 31, 2019 to 3.4 for the year ended May 31, 2020, with the largest increases in our entry-level communities. Net sales in the Starlight entry-level communities increased from 5.8 average monthly sales per average active community for the year ended May 31, 2019 to 7.0 average monthly sales per average active community for the year ended May 31, 2020. Net sales in the Ashton Woods entry-level communities increased from 4.1 average monthly sales per average active community for the year ended May 31, 2019 to 4.2 average monthly sales per average active community for the year ended May 31, 2020.

The decrease in the average sales price of homes closed during the year ended May 31, 2020, compared to the year ended May 31, 2019, was primarily due to the continued, planned shift in the mix of communities from which we had closings to a higher percentage of closings in entry-level communities, with generally lower average sales prices and a higher sales pace. During the year ended May 31, 2020, 1,600 (55%) of the homes closed were considered entry-level, compared to 773 (40%) for the year ended May 31, 2019.

Net new home orders, cancellations, and backlog - Consolidated

Net new home orders and backlog do not have a current effect on our revenues; however, both provide important information about our future revenues and business prospects. New home orders are converted to revenues at the time of the home closing. Net new home orders increased 28.3% (1,171 homes) for the year ended May 31, 2020 compared to the year ended May 31, 2019. The increase in net new home orders was primarily due to an increase in the number of active communities, particularly the number of entry-level active communities, which typically have higher sales paces and lower average sales prices, as well as an increase in the average monthly sales per active community in all of our buyer profiles. The number of active communities increased from 132 at May 31, 2019 to 139 at May 31, 2020, which included 40 entry-level active communities at May 31, 2019 and 57 entry-level active communities at May 31, 2020. The average monthly sales per average active community increased across all of our buyer profiles from 2.6 for the year ended May 31, 2019 to 3.3 for the year ended May 31, 2020, with the largest increases in our entry level communities. Net sales in the Starlight entry-level communities increased from 5.8 average monthly sales per average active community for the year ended May 31, 2019 to 6.6 average monthly sales per average active community for the year ended May 31, 2020. Net sales in the Ashton Woods entry-level communities increased from 3.6 average monthly sales per average active community for the year ended May 31, 2019 to 4.0 average monthly sales per average active community for the year ended May 31, 2020. Included in the net new home orders are 345 and 68 wholesale home sales to real estate investors for the year ended May 31, 2020 and 2019, respectively. These homes were sold under bulk sales agreements (see Note 1(j) to our consolidated financial statements).

The cancellation rates (as a percentage of gross sales) on our entry-level homes have typically been higher than the cancellation rates on our move-up and multi-move-up homes. The most common reason for these cancellations is that the home buyer is not able to obtain financing. The largest improvement in cancellation rates for the year ended May 31, 2020 compared to the year ended May 31, 2019 was in our Starlight Homes business, which was positively impacted by wholesale sales during the year ended May 31, 2020, which did not experience any cancellations. Excluding wholesale sales, the cancellation rate on our Starlight Homes business was 30.8% for the year ended May 31, 2020.

Our backlog consists of homes that are under purchase contracts that have not yet closed. Backlog increased 15.3% from 1,308 homes in backlog at May 31, 2019 to 1,508 homes in backlog at May 31, 2020. The increase in backlog was a result of the Company selling 5,309 homes, which is 200 more homes than were closed (5,109 homes closed) during the twelve months ended May 31, 2020. The sales value of backlog at May 31, 2020 was $555.3 million, a 5.1% increase from the sales value of backlog at May 31, 2019 of $528.2 million. The increase in the sales value of backlog is primarily due to the 15.3% increase in the number of homes in backlog, as discussed above, partially offset by a decrease in the average sales price of homes in backlog from $404,000 at May 31, 2019 to $368,000 at May 31, 2020. As discussed above, our communities have continued to shift to a higher percentage of entry-level communities. At May 31, 2020, 53% of homes (800 homes) in backlog (including 82 wholesale home sales) were homes considered to be entry-level, compared to 38% (492 homes) at May 31, 2019, (including 29 wholesale home sales).

Net new home orders and backlog - East segment

Net new home orders in the east segment increased 10.9% (223 homes) during the year ended May 31, 2020 compared to the year ended May 31, 2019. The increase in net new home orders was largely driven by an increase in the average sales pace per active community for the year ended May 31, 2020, as compared to the year ended May 31, 2019 due to the shift in the mix of communities to a higher percentage of entry-level communities, which generally have a higher sales pace, while the number of active communities remained relatively flat.

	As of May 31,	
	2020	2019
Backlog (units) at end of period:		
Entry-Level - Starlight Homes	264	179
Entry-Level - Ashton Woods	89	47
Move-up	160	203
Multi-Move-Up	100	127
Segment Total	613	556

Backlog consisted of 613 homes at May 31, 2020, which is a 10.3% increase from 556 homes in backlog at May 31, 2019. Included in backlog at May 31, 2020 and May 31, 2019 were 82 and 29 wholesale home sales with real estate investors, respectively. The increase in backlog is a result of selling 57 more homes than we closed during the twelve months ended May 31, 2020, due primarily to the increase in our wholesale business. The east segment sold 2,270 homes, while closing 2,213 homes during the twelve months ended May 31, 2020. The increase in the number of homes in backlog is primarily due to the timing of new communities being opened for sales. While the total number of active communities in the East segment remained relatively flat with 61 at May 31, 2020, compared to 60 at May 31, 2019, a number of the new communities opened for sales in the second half of the fiscal year, such that throughout much of the fiscal year ended May 31, 2020, there was a lower number of active communities for the East segment compared to the same period of the fiscal year ended May 31, 2019.

The sales value of backlog at May 31, 2020 was $234.0 million, a 5.3% decrease compared to the sales value of backlog at May 31, 2019 of $247.0 million, due primarily to a decrease in the average sales price of homes in backlog, partially offset by an increase in the number of homes in backlog. The average sales price of homes in backlog at May 31, 2020 was $382,000 compared to $444,000 at May 31, 2019. The decrease in the average sales price of homes in backlog is a result of the mix of types of communities with homes in backlog. As discussed above, the shift in the mix of active communities has trended more towards those we consider to be entry-level, which typically have a lower average sales price. In addition, the wholesale home sales in backlog, which are generally sold at a discount to retail, typically have lower average sales prices than retail home sales. Of the 613 homes in backlog at May 31, 2020, 353 (58%) of the homes were considered entry-level (including 66 wholesale home sales), compared to 226 (41%) of the 556 homes in backlog at May 31, 2019 (including 29 wholesale home sales).

Net new home orders and backlog - Central segment

Net new home orders in the central segment increased 45.3% (948 homes) during the year ended May 31, 2020 compared to the year ended May 31, 2019. The increase in net new home orders was largely driven by an increase in the average sales pace per active community, as well as an increase in the number of active communities for the year ended May 31, 2020, as compared to the year ended May 31, 2019. As discussed above, our strategy has driven a shift in the mix of active communities at May 31, 2020, as compared to May 31, 2019 to a higher percentage of entry-level communities, which typically have a higher rate of sales. The number of entry-level active communities in the Central segment increased from 20 at May 31, 2019 to 32 at May 31, 2020.

	As of May 31,	
	2020	2019
Backlog (units) at end of period:		
Entry-Level - Starlight Homes	219	143
Entry-Level - Ashton Woods	228	123
Move-up	410	430
Multi-Move-Up	38	56
Segment Total	895	752

Backlog consisted of 895 homes at May 31, 2020, which is a 19.0% increase from 752 homes in backlog at May 31, 2019. The increase in backlog is the result of selling 143 more homes than were closed during the twelve months ended

May 31, 2020. The central segment sold 3,039 homes, while closing 2,896 homes during the twelve months ended May 31, 2020.

The sales value of backlog at May 31, 2020 was $321.3 million, a 14.3% increase over the sales value of backlog at May 31, 2019 of $281.2 million due to the 19.0% increase in the number of homes in backlog as discussed above, offset in part by a decrease in the average sales price of homes in backlog. The average sales price of homes in backlog at May 31, 2020 was $359,000 compared to $374,000 at May 31, 2019. The decrease in the average sales price of homes in backlog is a result of the mix of types of communities with homes in backlog. Of the 895 homes in backlog at May 31, 2020, 447 (50%) of the homes were considered entry-level (including 16 wholesale home sales), compared to 266 (35%) of the 556 homes in backlog at May 31, 2019. There were not any wholesale homes sales in backlog at May 31, 2019.

Home gross margins - Consolidated

The average gross margin from homes closed for the year ended May 31, 2020 increased to 18.0% from 16.8% for the year ended May 31, 2019. The increase in average gross margin for the year ended May 31, 2020 was due primarily to the shift in community mix toward entry-level communities, partially offset by the cost of elevated incentives offered in certain move-up and multi-move-up communities. We have generally seen higher demand for our entry level and lower priced homes, while offering fewer incentives, resulting in higher gross margins in our entry-level communities. During the year ended May 31, 2020, 57.9% of closings were from entry-level communities, compared to 46.0% of closings during the year ended May 31, 2019. However, beginning in the middle of fiscal year 2019 and continuing through the end of fiscal year 2020, softening demand for higher priced homes necessitated increases in the incentives necessary to sell homes. As such, throughout the fiscal year, we continued to offer elevated incentives in higher priced move-up and multi-move-up communities, particularly in the east segment.

Adjusted gross margin from homes closed for the year ended May 31, 2020 increased to 20.3% from 19.1% for the year ended May 31, 2019. This increase in the adjusted gross margin was due to an increase in the interest amortized through cost of sales, offset in part by a decrease in impairment charges.

Home gross margins - East segment

The average gross margin from homes closed in the east segment for the year ended May 31, 2020 decreased to 15.2% from 15.6% for the year ended May 31, 2019. The decrease in average gross margin for the year ended May 31, 2020 as compared to the year ended May 31, 2019 was due primarily to elevated incentives on move-up and multi-move-up closings. Beginning in the middle of fiscal year 2019 and continuing throughout fiscal year 2020, softening demand for higher priced homes necessitated increases in the incentives required to sell homes. As such, throughout the fiscal year, we continued to offer elevated incentives in higher priced move-up and multi-move-up communities, particularly in the east segment. Of the 22 multi-move-up active communities in the Company, 18 are in the east segment. As such, the east segment is particularly impacted by the softening demand in these price points. In addition, several communities in the east segment have previously been impaired. The margins in these communities will continue to be negatively impacted as we work through the life of these communities. This impact was, in part, offset by continued strong demand for our entry-level and lower priced homes.

Home gross margins - Central segment

The average gross margin from homes closed in the central segment for the year ended May 31, 2020 increased to 20.3% from 18.3% for the year ended May 31, 2019. The increase in average gross margin for the year ended May 31, 2020 as compared to the year ended May 31, 2019 was due primarily to the shift in community mix to more entry-level communities, which typically have a higher gross margin. During the year ended May 31, 2020, 55.2% (1,600 homes) of closings were from entry-level communities compared to 39.6% (773 homes) of closings for the year ended May 31, 2019. In addition, with only four multi-move-up active communities at May 31, 2020, the central segment was not as significantly impacted by the softening demand and elevated incentives for higher priced homes as the east segment.

Selling, general and administrative expenses

SG&A totaled $234.8 million for the year ended May 31, 2020 compared to $211.2 million for the year ended May 31, 2019. SG&A as a percentage of home sales revenue increased to 13.3% for the year ended May 31, 2020 from 12.7% for the year ended May 31, 2019. The increase in SG&A as a percentage of home sales revenue for the year ended May 31, 2020 as compared to the year ended May 31, 2019 was primarily related to an increase in sales and marketing costs as a percentage of revenue due to a higher number of Starlight communities, which typically have higher marketing costs than Ashton Woods communities, as well as an increase in legal settlements and fees incurred in the normal course of business (including $7.7 million for the legal matter discussed in Note 15 to our consolidated financial statements).

Land sales

We periodically elect to sell parcels of land or lots. We had $8.8 million in sales of land and lots during the year ended May 31, 2020 and $20.8 million in sales of land and lots during the year ended May 31, 2019. As discussed in Note 1(d) to our consolidated financial statements as of May 31, 2020, the Company recorded impairment charges on land that was held for sale of $0.2 million during the year ended May 31, 2020.

Net income

Net income increased $15.2 million for the year ended May 31, 2020 as compared to the year ended May 31, 2019. The increase in net income for the year ended May 31, 2020 as compared to the year ended May 31, 2019 is primarily attributable to an increase in revenues for the year ended May 31, 2020 as compared to the year ended May 31, 2019 as a result of the 17.3% increase in the number of homes closed during the year ended May 31, 2020 as compared to the year ended May 31, 2019 and an increase in home gross margins for the year ended May 31, 2020 as compared to the year ended May 31, 2019, and was offset in part by an increase in SG&A expense.

Liquidity and capital resources

We currently fund our operations with proceeds from the sales of homes and land, borrowings under our Fifth Amended and Restated Credit Agreement, as amended and restated by the Second Amendment to Fifth Amended and Restated Credit Agreement dated as of August 28, 2019 (the “Restated Revolver”), and long-term financing. Our principal uses of cash are land and lot purchases, land development, home construction, repayments under our Restated Revolver, interest costs, overhead, and tax distributions. As we utilize our capital resources and liquidity to fund the growth of our business, we monitor our balance sheet leverage ratios to ensure that we maintain reasonable levels. We also monitor current and expected operational requirements, as well as financial market conditions, to evaluate accessing other available financing sources. Based on our existing financial condition and credit relationships, we believe that our operations and capital resources are sufficient to provide for our current and foreseeable capital needs. However, we continue to evaluate the impact of market conditions on our liquidity and will consider, as appropriate, additional funding opportunities. During the fourth quarter of fiscal 2020, the Company borrowed $250.0 million under the Restated Revolver as a precautionary measure in order to increase its cash position and preserve financial flexibility in light of uncertainty in the global markets resulting from the COVID-19 outbreak. Prior to May 31, 2020, the Company fully repaid the $250.0 million the Company drew under its Restated Revolver after a review of its cash and liquidity position. The Company had no borrowings outstanding under the Restated Revolver as of May 31, 2020.

Operating cash flows

Net cash provided from operating activities for the year ended May 31, 2020 was $53.4 million compared to $18.0 million of net cash used by operating activities for the year ended May 31, 2019. The primary sources of funds from operations are from the closing of homes. The increase in net cash provided from operations for the year ended May 31, 2020 was primarily due to our strategic decision to focus on cash generation and preservation, including slowing and delaying construction of homes, delaying openings of new communities, and restructuring and delaying land investments. As we continued to sell and close homes, we strategically started construction on additional homes, made new land investments, and developed lots we own, while continuing to focus on maintaining adequate liquidity through the uncertain times ahead.

Investing cash flows

Net cash used in investing activities was $5.8 million for the year ended May 31, 2020 and $6.0 million for the year ended May 31, 2019. Net cash used in investing activities for the year ended May 31, 2020 included $7.6 million to furnish and/or update furnishings in model homes and sales offices. The cash outflows were partially offset by a $1.9 million return of investment in our unconsolidated entities.

Financing cash flows

Net cash provided by financing activities was $210.6 million for the year ended May 31, 2020, compared to $3.5 million of cash used in financing activities for the year ended May 31, 2019. The funds provided by financing activities during the year ended May 31, 2020 consisted of $250.0 million received from the issuance of the 6.625% Notes in January 2020 and were offset by (i) $20.4 million of net repayments on the Restated Revolver, (ii) distributions of $12.5 million to our Members, and (iii) $6.5 million of debt issuance costs paid in connection with the issuance of the 6.625% Notes and the amendment to the Restated Revolver. At May 31, 2020, we had no outstanding borrowings under our Restated Revolver and available additional borrowing capacity of $207.9 million based on outstanding letters of credit and the value of collateral pledged to secure the facility.

The total debt to total capitalization ratio consists of total debt divided by total capitalization (debt plus members' equity). Our ratio of total debt to total capitalization increased to 62.8% at May 31, 2020 from 57.5% at May 31, 2019. The net debt to net capitalization ratio consists of total debt, net of cash and restricted cash, divided by net capitalization (debt plus members' equity), net of cash and restricted cash. Our ratio of net debt to net capitalization decreased to 52.7% at May 31, 2020 from 57.5% at May 31, 2019.

Inventory

As of May 31, 2020, we had the following owned homes in our reportable segments (in units):

	Homes Under Construction			**Completed Homes**			
	Unsold	**Models(1)**	**Sold**	**Unsold**	**Models(2)**	**Sold**	**Total Homes**
East	365	5	286	267	57	224	1,204
Central	267	10	502	109	71	182	1,141
Company total	632	15	788	376	128	406	2,345

(1) Includes 12 models under the Ashton Woods brand name and 3 sales offices under the Starlight Homes brand name.
(2) Includes 93 models under the Ashton Woods brand name and 35 sales offices under the Starlight Homes brand name.

As of May 31, 2020, we controlled the following residential homes and lots (in units):

	Total Homes	Finished Lots	Land Under Development	Residential Land Held for Future Development	Total Owned	Total Under Option	Total Controlled
East	1,204	1,130	1,887	716	4,937	13,872	18,809
Central	1,141	1,373	1,533	589	4,636	14,129	18,765
Total Company	2,345	2,503	3,420	1,305	9,573	28,001	37,574
Percentage of total controlled	6.2%	6.7%	9.1%	3.5%	25.5%	74.5%	100.0%

As of May 31, 2020 and 2019, we had the following unsold homes in inventory (in units):

	As of May 31,	
	2020	**2019**
Entry-Level - Starlight Homes	398	529
Entry-Level - Ashton Woods	129	101
Move-up	327	456
Multi-Move-Up	154	215
Consolidated	1,008	1,301

The total number of unsold homes in inventory decreased from 1,301 at May 31, 2019 to 1,008 at May 31, 2020. As discussed above, the Company made a number of strategic decisions focused on cash generation and preservation in the wake of COVID-19, one of which included a time period during which the Company did not start additional unsold homes. As a result of this, as well as continued strong demand through the later part of the spring selling season, notwithstanding a decline in demand in March and April, the number of unsold homes in inventory decreased at May 31, 2020 compared to May 31, 2019.

In addition to the 9,573 lots we owned, we controlled, through the use of purchase and option agreements, 28,001 lots at May 31, 2020. Purchase and option agreements that did not require consolidation under ASC 810, ASC 606, or ASC 470-40 at May 31, 2020 had an aggregate remaining purchase price of $1.2 billion. In connection with these agreements, we had cash deposits of $145.2 million at May 31, 2020. In addition, we had purchase and option agreements consolidated under ASC 606 or ASC 470-40 with an aggregate remaining purchase price of $100.4 million and cash deposits of $23.3 million (See Note 6 to our consolidated financial statements as of May 31, 2020).

During the year ended May 31, 2020, we acquired 6,943 lots for a total purchase price of $349.2 million. We spent $115.0 million on land development during the year ended May 31, 2020. We spent $7.6 million during the year ended May 31, 2020 to furnish and/or update furnishings in model homes and sales offices.

Aggregate contractual commitments and off-balance sheet arrangements

Our contractual obligations under our debt agreements and lease payments under operating leases as of May 31, 2020 are presented below (in thousands):

	Due in Fiscal Year				
	2021	2022-2023	2024-2025	2026 and after	Total
6.625% senior notes [(1)]	$ —	$ —	$ —	$ 250,000	$ 250,000
9.875% senior notes [(1)]	—	—	—	255,000	255,000
6.750% senior notes [(1)]	—	—	—	250,000	250,000
Notes payable	—	4,700	—	—	4,700
Operating leases	4,216	7,580	5,028	2,201	19,025
	$ 4,216	$ 12,280	$ 5,028	$ 757,201	$ 778,725

(1) Excludes interest obligations.

Other than the amendment to the Company's Restated Revolver and sale and issuance of $250 million principal amount of 6.625% Notes discussed in Note 8 to our consolidated financial statements as of May 31, 2020, there have been no significant changes outside the ordinary course of business to our contractual obligations under our debt agreements and lease payments as of May 31, 2020, compared to those contained in our audited consolidated financial statements for the year ended May 31, 2019. Our debt obligations are fully discussed in Note 8 to our consolidated financial statements as of May 31, 2020.

In the ordinary course of business, we provide letters of credit and surety bonds to third parties to secure performance and provide deposits under various contracts and commitments. At May 31, 2020, we had letters of credit and surety bonds outstanding of $2.7 million and $73.6 million, respectively. As of May 31, 2020, we had $47.3 million of unused letter of credit capacity under the Restated Revolver.

On December 13, 2019, the Company issued a $4.7 million note payable to an unaffiliated third party, related to a purchase of land, which matures on July 13, 2022. The note payable has an interest rate of 10.00%. The note is collateralized by the land to which it relates and has no recourse to any other assets or to the Company. As of May 31, 2020, the outstanding note payable balance, including accrued interest, totaled $4.7 million.

At May 31, 2020, we controlled 37,574 lots and homes available to close. Of the 37,574 lots and homes controlled, we owned 25.5%, or 9,573 lots and homes, and 74.5%, or 28,001 lots, were under contract. In the ordinary course of business, we enter into purchase and option agreements in order to procure land for the construction of homes in the future. At May 31, 2020, these agreements had an aggregate remaining purchase price of $1.2 billion, net of deposits of $145.2 million. In addition, we had purchase and option agreements recorded under ASC 606 or ASC 470-40 with an aggregate remaining purchase price of $100.4 million and cash deposits of $23.3 million. Pursuant to these land purchase and land option agreements, we generally provide a deposit to the seller as consideration for the right, but not the obligation, to purchase land at different times in the future, usually at predetermined prices. In certain instances, we are required to record the land under option as if we own it.

As of May 31, 2020, real estate not owned totaled $79.7 million related to ten lot purchase agreements with $24.5 million of non-refundable deposits. Refer to our discussion in Note 6 to our consolidated financial statements as of May 31, 2020.

As of May 31, 2020, we participated in one land development joint venture in which we have less than a controlling interest. We account for our interest in this joint venture under the equity method. Our share of profits from lots we purchase from the joint venture is deferred until we close on the home.

As of May 31, 2020, we participated in a mortgage joint venture in which the Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, Charleston, Raleigh, Orlando, Phoenix, and Southwest Florida. The Company does not have a controlling interest in the joint venture. We account for our interest in the mortgage joint venture under the equity method. Our share of profits is included within equity in earnings in unconsolidated entities in the consolidated statements of income.

Seasonality and inflation

Our historical quarterly results of operations have tended to be impacted by the seasonal nature of the homebuilding industry. We have historically experienced increases in revenues and cash flow from operations during the calendar second quarter of each year based on the timing of home closings. Any period of high inflation is likely to have an adverse effect on us and the homebuilding industry in general since it may contribute to higher land, financing, labor, and construction costs. We attempt to pass on at least a portion of the cost increases to our homebuyers via increased sales prices; however, we may be limited in our ability to increase our prices. Further, higher mortgage interest rates may accompany inflation and affect the affordability of mortgage financing for homebuyers. If we are unable to increase our sales prices to compensate for any increased costs, or if mortgage interest rates increase significantly, thereby affecting the ability of potential homebuyers to obtain financing for their home purchases, our results of operations will likely be adversely affected.

Our operations are also affected by seasonality in cash use. Our cash needs are generally higher from January to April each year as we complete the spring building cycle.

Critical accounting policies and estimates

General

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. ("GAAP") requires us to make decisions based upon estimates, assumptions, and factors we consider relevant to the circumstances. Such decisions include the selection of applicable accounting principles and the use of judgment in their application, the results of which impact reported amounts and disclosures. Some of our critical accounting policies require the use of judgment in their application or require estimates of inherently uncertain matters. Changes in future economic conditions or other business circumstances may affect the outcomes of our estimates and assumptions. Accordingly, actual results could differ materially from those anticipated. In instances where alternative methods of accounting are permissible under GAAP, we have chosen the method that most appropriately reflects the nature of our business, the results of our operations and our financial condition, and have consistently applied those methods over each of the periods presented in the financial statements.

A summary of the significant accounting policies followed in the preparation of the financial statements is contained in our audited Consolidated Financial Statements for the three year period ended May 31, 2020. Other footnotes in those financial statements describe various elements of the financial statements and the assumptions on which specific amounts were determined. Listed below are those accounting policies and underlying estimates and judgments that we believe are critical and require the use of complex judgment in their application.

Revenue recognition

On June 1, 2018, the Company adopted Financial Accounting Standards Board ("FASB") ASC 606, *Revenue from Contracts with Customers* ("ASC 606") applying the modified retrospective method to contracts that were not completed as of June 1, 2018. As a result of our adoption of ASC 606, our accounting policies for revenue recognition are as follows:

With respect to home sale revenues, revenue from a home sale is recognized when we have satisfied the performance obligation in the home sales contract, which is generally at the time of the closing of each sale, when title to and possession of the property are transferred to the buyer. The revenue recognized for each home sale includes the base sales price of the home, as well as any purchased options and upgrades and is reduced for any sales price incentives. Our performance obligation to deliver the agreed-upon home is generally satisfied in less than one year from the original contract date. Home sale contract assets consist of cash from home closings in transit or held in escrow for our benefit, which is typically received within two days of the home closing. Home sale contract assets totaled \$6.4 million and \$4.8 million at May 31, 2020 and 2019, respectively, and are classified as receivables in the consolidated balance sheets. Home sale contract liabilities include customer deposit liabilities related to sold but undelivered homes, which totaled \$17.6 million and \$20.8 million at May 31, 2020 and 2019, respectively. Of the customer deposit liabilities at May 31, 2019, \$19.2 million was recognized in revenues in the year ended May 31, 2020 upon the closing of the related homes. The Company's adoption of ASC 606 did not result in a change in the classification of home sale revenues on the consolidated statements of income. See Note 1(l) to our consolidated financial statements included elsewhere in this annual report for additional discussion of warranties and obligations associated with home sales revenue.

With respect to land sale revenues, we periodically elect to sell parcels of land or lots. These land and lot sales are generally outright sales of specified land parcels with cash consideration due on the closing date, which is generally when performance obligations are satisfied. Land sale contract assets consist of cash from closed land sales in transit or held in escrow for our benefit, which is typically received within two days of closing on the land sale. Land sale contract assets are classified as receivables in the consolidated balance sheets. Land sale contract liabilities consist of customer deposit liabilities related to land parcels under contract for sale. Land sale contract assets and liabilities were immaterial at May 31, 2020 and 2019. The Company's adoption of ASC 606 did not result in a change in the classification of land sale revenues on the consolidated statements of income.

Finally, with respect to financial services and other revenues, financial services revenues, which are not within the scope of ASC 606, primarily consist of title premium income earned from the provision of title services for homebuyers. Other revenues consists of revenue from forfeited customer deposits that is recognized upon cancellation of the home sales contract when the Company is contractually entitled to retain the deposit and other miscellaneous customer revenue that is recognized when the related performance obligation is satisfied. Other revenues also include revenue from fee development, development oversight, and/or construction agreements entered into by the Company with third-party property owners. For these types of contracts, the Company recognizes revenue based on the actual total costs it has incurred plus the applicable fee. In accordance with ASC 606, the Company applies the percentage-of-completion method, using the cost-to-cost approach, as it most accurately measures the progress of our efforts in satisfying our obligations within the fee building agreements. Under this approach, revenue is earned in proportion to total costs incurred divided by total costs expected to be incurred. In the course of providing fee development, development oversight, and/or construction services, the Company routinely subcontracts for services and incurs other direct costs. These costs are typically passed through to the property owners and, in accordance with GAAP, are included in the Company's financial services and other revenues and cost of sales financial services and other revenues on the consolidated statements of income. Financial services and other revenues were previously classified as other expense/(income) on the consolidated statements of income, but are classified as revenue effective June 1, 2018. Financial services and other revenues recognized prior to June 1, 2018 have not been reclassified to revenue on the consolidated statements of income due to the immateriality of those revenues.

ASC 606 provides certain practical expedients that limit some accounting treatments and disclosure requirements. Accordingly, we do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less. In addition, the expected revenue to be recognized in any future year relating to unsatisfied performance obligations with an original expected length greater than one year is not material.

Inventories and cost of sales

In addition to the costs of direct land acquisition, land development and home construction, inventory costs include interest, real estate taxes, and indirect overhead costs incurred during development and home construction. The Company uses the specific identification method for the purpose of accumulating home construction costs. Cost of sales for homes closed includes the specific construction costs of each home (both incurred and estimated to be incurred) and all applicable land acquisition, land development, and related costs based upon the total number of homes expected to be closed in each community. Any changes to the estimated total development costs subsequent to the initial home closings in a community are allocated to the remaining homes in the community.

When a home is closed, the Company generally has not yet recorded all incurred costs necessary to complete the home. Each month, the Company records as a liability and a charge to cost of sales the amount it estimates will ultimately be paid related to completed homes that have been closed as of the end of that month. The Company compares its updated home construction budgets to actual recorded costs to estimate the additional costs remaining to be paid on each closed home. The Company monitors the accuracy of each month's accrual by comparing actual costs paid on closed homes in subsequent months to the amount accrued. Actual costs to be paid on closed homes in the future could differ from the current estimate.

Inventory is stated at cost, unless the carrying amount is determined not to be recoverable, in which case the inventory is written down to fair value in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Subtopic 360-10, *Property, Plant and Equipment* ("ASC 360-10"). The Company reviews its inventory in accordance with ASC Subtopic 360-10, which requires long-lived assets to be assessed for impairment when facts and circumstances indicate an impairment may exist. The Company utilizes an undiscounted future cash flow model in this assessment. When the results of the undiscounted future cash flows are less than the carrying value of the community (asset group), an asset impairment must be recognized in the consolidated financial statements as a component of cost of sales. The amount of the impairment is calculated by subtracting the estimated fair value of the community, less cost to sell, from the carrying value. ASC Subtopic 360-10 also requires that assets held for sale be stated at the lower of cost or fair value, as determined based on active negotiations with market participants, less costs to sell. Accordingly, land held for sale is stated at the lower of accumulated cost or fair value less costs to sell.

Based on the Company's review of its inventory for impairment during the year ended May 31, 2020, inventory impairment charges totaling $2.9 million were recognized. The inventory impairment charges of $2.9 million consisted of $2.7 million of impairments on homes in inventory, which is included as a component of cost of sales – homes in the consolidated statements of income, and $0.2 million of impairments on land that was held for sale, which is included as a component of cost of sales – land in the consolidated statements of income. The Company recorded inventory impairment charges of $4.3 million during the year ended May 31, 2019, which consisted of $3.2 million of impairments on homes in inventory, which is included as a component of cost of sales – homes in the consolidated statements of income, and $1.1 million of impairments of land that was held for sale, which is included as a component of cost of sales – land in the consolidated statements of income.

In order for management to assess the fair value of its real estate assets, certain assumptions must be made that are highly subjective and susceptible to change. Management evaluates, among other things, the actual gross margins for homes closed and the gross margins for homes sold in backlog (representing the number or value of sales that have not yet closed, net of cancellations). This evaluation also includes assumptions with respect to future home sales prices, cost of sales, including levels of sales incentives, the monthly rate of sales, discount rates, profit margins, and potential buyers, which are critical in determining the fair value of the Company's real estate assets. Given the historical variability in the homebuilding industry cycle and the current impacts of COVID-19, the Company is of the view that the valuation of homebuilding inventories is sensitive to changes in economic conditions, such as interest rates, the availability of credit, and unemployment levels. Changes in these economic conditions could materially affect the projected home sales prices, the level of sales incentives, the costs to develop land and construct homes, and the monthly rate of sales. Because of these potential changes in economic and market conditions, in conjunction with the assumptions and estimates required of management in valuing homebuilding inventory, actual results could differ materially from management's assumptions and may require material inventory impairments to be recorded in the future.

Deposits and pre-acquisition costs

Deposits and pre-acquisition costs related to purchase agreements are capitalized when paid and classified in the consolidated balance sheets as deposits on real estate under option contract (for deposits) and other assets (for pre-acquisition costs) until the related land is acquired. These costs are transferred to inventory at the time the land or lots are acquired. Nonrefundable deposits and pre-acquisition costs are charged to expense when the real estate purchase is no longer considered probable. If the Company intends to terminate a purchase agreement, it records a charge to earnings for the costs associated with the purchase agreement in the period such a decision is made. This expense is included as a component of cost of sales – homes in the consolidated statements of income and was $3.1 million, $2.4 million, and $1.1 million for the year ended May 31, 2020, 2019, and 2018, respectively.

Warranty liabilities

Warranty liabilities are initially established on a per home basis by charging cost of sales and establishing a warranty liability for each home delivered to cover expected costs of materials and labor during the warranty period. The amounts accrued are based on management's estimate of expected warranty-related costs under all unexpired warranty obligation periods. The Company's warranty liability is based upon historical warranty cost experience in each operating division and is adjusted as appropriate to reflect qualitative risks associated with the types of homes built and the geographic areas in which they are built. The Company's warranty liability is included in other liabilities in the consolidated balance sheets.

Transactions with related parties

A services agreement with the Investors provides the Company with a license, as well as development and support, for certain of the Company’s computer systems and administrative services. The Company pays fees of $800 per home closing quarterly, in arrears, for these services, which are included in selling, general and administrative expenses in the consolidated statements of income. The Company incurred fees of $4.1 million and $3.5 million during the year ended May 31, 2020 and 2019, respectively, under the services agreement. As of May 31, 2020 and 2019, the balance due to the Investors was $1.4 million and $1.3 million, respectively.

The Company is a party to a lease as a lessee with the Investors to rent approximately 8,500 square feet of commercial space in Dallas, Texas. The Company has 31 months remaining on the lease as of May 31, 2020. Total minimum lease payments due under the lease were $0.3 million and $0.2 million as of May 31, 2020 and 2019, respectively.

At May 31, 2020, the Company was a party to eight lot purchase agreements with the Investors. A deposit ranging from 10% to 20% was required under each of the purchase agreements, and there are no specific performance requirements for the Company. We are required to record one of these lot purchase agreements as real estate not owned in the consolidated balance sheets. As of May 31, 2020, the total purchase price of lots remaining to be purchased under such agreements was approximately $48.2 million.

At May 31, 2020, the Company was a party to a land joint venture with the Investors, which is accounted for under the equity method. The Company has an equity investment of less than 50% in the joint venture and does not have a controlling interest in the unconsolidated entity. Also, the Company is a party to a lot purchase agreement with the joint venture to purchase 130 lots. A 10% deposit was required under the purchase agreement and there are no specific performance requirements for the Company. As of May 31, 2020, the total purchase price of lots remaining to be purchased was $14.5 million. As of May 31, 2020, the joint venture had $3.7 million of debt outstanding, which is non-recourse to the joint venture and to the Company. The loan was obtained to fund land development for one phase of the property. The Company provided the lender with a performance guarantee for the substantial completion of this phase of development. The guarantee of performance may include the payment of money for costs incurred during the completion of the development. In the event the Company pays money or performs any services pursuant to the guarantee, the joint venture has agreed to indemnify and reimburse the Company for any such costs incurred.

Pending accounting pronouncements

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”), which changes the impairment model for most financial assets and certain other instruments from an “incurred loss” approach to a new “expected credit loss” methodology. The effective date of ASU 2016-13 was amended by the release of ASU 2019-10 in November 2019 and was extended to fiscal years beginning after December 15, 2022, and for annual and interim periods thereafter. The standard requires an entity to recognize the effects of adopting the new standard as a cumulative effect adjustment to opening retained earnings in the period of adoption. The Company is currently evaluating the impact that adoption of ASU 2016-13 will have on its consolidated financial statements and related disclosures.

Item 7A. *Quantitative and qualitative disclosures about market risk*

We maintain a mix of variable-rate and fixed-rate debt and our primary market risk exposure for these financial instruments relates to fluctuations in interest rates, which include changes in the U.S. Treasury and LIBOR rates. For our variable-rate debt, our primary exposure is in interest expense.

The borrowings under the Restated Revolver accrue interest at a variable rate. As of May 31, 2020, we had no outstanding borrowings under the Restated Revolver.

Item 8. *Financial Statements*

The financial statements are presented on pages 52 through 76.

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Building a better working world

Report of Independent Auditors

The Members of Ashton Woods USA L.L.C.

We have audited the accompanying consolidated financial statements of Ashton Woods USA L.L.C., which comprise the consolidated balance sheets as of May 31, 2020 and 2019, and the related consolidated statements of income, changes in members' equity, and cash flows for each of the three years in the period ended May 31, 2020, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ashton Woods USA L.L.C. at May 31, 2020 and 2019, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2020, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

July 15, 2020

ASHTON WOODS USA L.L.C.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	May 31, 2020	May 31, 2019
Assets:		
Cash and cash equivalents	$ 255,314	$ —
Restricted cash	3,059	189
Receivables	33,683	25,716
Inventory	882,002	874,240
Property and equipment, net	11,217	14,448
Investments in unconsolidated entities	4,608	5,260
Deposits on real estate under option or contract	143,989	122,329
Other assets	118,373	88,134
Total assets	$ 1,452,245	$ 1,130,316
Liabilities and members' equity:		
Liabilities:		
Accounts payable	$ 70,447	$ 87,543
Other liabilities	167,375	119,992
Customer deposits	17,580	20,816
Debt	746,395	514,868
Total liabilities	1,001,797	743,219
Commitments and contingencies (Note 15)		
Members' equity	450,448	387,097
Total liabilities and members' equity	$ 1,452,245	$ 1,130,316

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands)

	Year ended May 31,		
	2020	**2019**	**2018**
Revenues:			
Home sales	$ 1,767,058	$ 1,665,997	$ 1,474,683
Land sales	8,753	20,805	3,353
Financial services and other revenues	40,291	8,744	—
	1,816,102	1,695,546	1,478,036
Cost of sales:			
Cost of sales homes	1,449,622	1,386,429	1,221,597
Cost of sales land	7,236	19,563	2,651
Cost of sales financial services and other revenues	28,901	2,016	—
	1,485,759	1,408,008	1,224,248
Gross profit	330,343	287,538	253,788
Other expense (income):			
Selling, general and administrative	234,806	211,164	183,318
Interest expense	16,020	7,591	11,640
Depreciation and amortization	9,639	10,483	11,360
Loss from early extinguishment of debt	—	2,489	5,263
Other income	(183)	(884)	(7,328)
	260,282	230,843	204,253
Equity in earnings of unconsolidated entities	5,755	3,898	2,935
Net income	$ 75,816	$ 60,593	$ 52,470

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITY
(In thousands)

	Class A interest	Class B interests	Class C interests	Total members' equity
Members' equity at May 31, 2017	$ 115,700	$ 24,714	$ 172,789	$ 313,203
Net income	20,418	5,018	27,034	52,470
Distributions	(6,912)	(1,699)	(9,153)	(17,764)
Members' equity at May 31, 2018	$ 129,206	$ 28,033	$ 190,670	$ 347,909
Net income	23,578	5,795	31,220	60,593
Distributions	(8,329)	(2,047)	(11,029)	(21,405)
Members' equity at May 31, 2019	$ 144,455	$ 31,781	$ 210,861	$ 387,097
Net income	29,502	7,251	39,063	75,816
Distributions	(4,851)	(1,192)	(6,422)	(12,465)
Members' equity at May 31, 2020	$ 169,106	$ 37,840	$ 243,502	$ 450,448

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year ended May 31,		
	2020	2019	2018
Cash flows from operating activities:			
Net income	$ 75,816	$ 60,593	$ 52,470
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in earnings of unconsolidated entities	(5,755)	(3,898)	(2,935)
Returns on investments in unconsolidated entities	4,503	1,997	1,531
Long-term compensation expense	7,114	4,427	3,805
Loss on early extinguishment of debt	—	2,489	5,263
Inventory impairments	2,914	4,304	331
Depreciation and amortization	9,639	10,483	11,360
Changes in operating assets and liabilities:			
Inventory	(3,031)	(70,630)	(50,387)
Receivables	(7,967)	(7,141)	(7,856)
Deposits on real estate under option or contract	(21,660)	(42,813)	(24,131)
Other assets	(15,079)	20,613	17,156
Accounts payable	(17,096)	22,305	1,768
Other liabilities	27,192	(12,049)	(6,870)
Customer deposits	(3,236)	(8,715)	686
Net cash provided by (used in) operating activities	53,354	(18,035)	2,191
Cash flows from investing activities:			
Returns of investments in unconsolidated entities	1,860	3,749	3,609
Additions to property and equipment	(7,616)	(9,781)	(6,634)
Net cash used in investing activities	(5,756)	(6,032)	(3,025)
Cash flows from financing activities:			
Borrowings from revolving credit facility	1,229,200	1,065,900	1,098,800
Repayments of revolving credit facility	(1,249,627)	(1,045,473)	(1,183,200)
Proceeds from issuance of debt	250,000	253,218	250,000
Payment of debt issuance costs	(6,522)	(5,117)	(7,443)
Repayment of debt	—	(250,000)	(108,219)
Payment of premiums on extinguishment of debt	—	(585)	(3,820)
Members' distributions	(12,465)	(21,405)	(17,764)
Net cash provided by (used in) financing activities	210,586	(3,462)	28,354
Change in cash, cash equivalents, and restricted cash	258,184	(27,529)	27,520
Cash, cash equivalents, and restricted cash, beginning of period	189	27,718	198
Cash, cash equivalents, and restricted cash, end of period	$ 258,373	$ 189	$ 27,718
Supplemental cash flow information:			
Cash paid for interest, net of amounts capitalized	$ 10,835	$ 7,557	$ 11,765

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(In thousands)

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the consolidated balance sheets to the total of the same such amounts shown above:

	As of May 31,		
	2020	2019	2018
Cash and cash equivalents	$ 255,314	$ —	$ 27,496
Restricted cash	3,059	189	222
Total cash, cash equivalents, and restricted cash	$ 258,373	$ 189	$ 27,718

Supplemental disclosures of cash flows information:

	Year ended May 31, 2020
Right-of-use assets obtained in exchange for new operating lease liabilities	$ 99

See accompanying notes to consolidated financial statements.

Note 1 — Basis of Presentation and Significant Accounting Policies

(a) Operations

Ashton Woods USA L.L.C. (the "Company" or "Ashton Woods"), operating as Ashton Woods Homes, is a limited liability company that designs, builds, and markets detached and attached single-family homes under the Ashton Woods Homes and Starlight Homes brand names. The Company offers entry-level, move-up, and multi-move-up homes under the Ashton Woods Homes brand name and offers entry-level homes under the Starlight Homes brand name. As of May 31, 2020, the Company has Ashton Woods and Starlight Homes operations in the following markets:

East:	Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota, and Naples)
Central:	Houston, Dallas, Austin, San Antonio, and Phoenix

The Company also offers title services to its homebuyers in its Austin, Dallas, Houston, San Antonio, Raleigh, Orlando, Southwest Florida, and Atlanta operating divisions through two wholly-owned title agencies.

In addition, the Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, Charleston, Raleigh, Orlando, Phoenix, and Southwest Florida through an unconsolidated mortgage joint venture. The Company has an ownership interest of 49% in this mortgage joint venture.

(b) Basis of presentation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned, majority-owned and controlled subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

(c) Cash, cash equivalents, and restricted cash

The Company considers all highly liquid investments with an initial maturity of three months or less when purchased to be cash equivalents. Restricted cash consists of amounts held in restricted accounts as collateral for letters of credit issued and outstanding, as permitted by the Company's senior secured revolving credit facility, and other investments.

(d) Inventory

In addition to the costs of direct land acquisition, land development and home construction, inventory costs include interest, real estate taxes, and indirect overhead costs incurred during development and home construction. The Company uses the specific identification method for the purpose of accumulating home construction costs. Cost of sales for homes closed includes the specific construction costs of each home (both incurred and estimated to be incurred) and all applicable land acquisition, land development, and related costs based upon the total number of homes expected to be closed in each community. Any changes to the estimated total development costs subsequent to the initial home closings in a community are allocated to the remaining homes in the community.

When a home is closed, the Company generally has not yet recorded all incurred costs necessary to complete the home. Each month, the Company records as a liability and a charge to cost of sales the amount it estimates will ultimately be paid related to completed homes that have been closed as of the end of that month. The Company compares its updated home construction budgets to actual recorded costs to estimate the additional costs remaining to be paid on each closed home. The Company monitors the accuracy of each month's accrual by comparing actual costs paid on closed homes in subsequent months to the amount accrued. Actual costs to be paid on closed homes in the future could differ from the current estimate.

Inventory is stated at cost, unless the carrying amount is determined not to be recoverable, in which case the inventory is written down to fair value in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Subtopic 360-10, *Property, Plant and Equipment* ("ASC 360-10"). The Company reviews its inventory in accordance with ASC Subtopic 360-10, which requires long-lived assets to be assessed for impairment when facts and circumstances indicate an impairment may exist. The Company utilizes an undiscounted future cash flow model in this assessment. When the results of the undiscounted future cash flows are less than the carrying value of the community (asset group), an asset impairment must be recognized in the consolidated financial statements as a component of cost of sales. The amount of the impairment is calculated by subtracting the estimated fair value of the community, less cost to sell, from the carrying value. ASC Subtopic 360-10 also requires that assets held for sale be stated at the lower of cost or fair value, as determined based on active negotiations with market participants, less costs to sell. Accordingly, land held for sale is stated at the lower of accumulated cost or fair value less costs to sell.

Based on the Company's review of its inventory for impairment during the year ended May 31, 2020, inventory impairment charges totaling $2.9 million were recognized. The inventory impairment charges of $2.9 million consisted of $2.7 million of impairments on homes in inventory, which is included as a component of cost of sales – homes in the consolidated statements of income, and $0.2 million of impairments on land that was held for sale, which is included as a component of cost of sales – land in the consolidated statements of income. The Company recorded inventory impairment charges of $4.3 million during the year ended May 31, 2019, which consisted of $3.2 million of impairments on homes in inventory, which is included as a component of cost of sales – homes in the consolidated statements of income, and $1.1 million of impairments of land that was held for sale, which is included as a component of cost of sales – land in the consolidated statements of income.

In order for management to assess the fair value of its real estate assets, certain assumptions must be made that are highly subjective and susceptible to change. Management evaluates, among other things, the actual gross margins for homes closed and the gross margins for homes sold in backlog (representing the number or value of sales that have not yet closed, net of cancellations). This evaluation also includes assumptions with respect to future home sales prices, cost of sales, including levels of sales incentives, the monthly rate of sales, discount rates, profit margins, and potential buyers, which are critical in determining the fair value of the Company’s real estate assets. Given the historical variability in the homebuilding industry cycle and the current impacts of COVID-19, the Company is of the view that the valuation of homebuilding inventories is sensitive to changes in economic conditions, such as interest rates, the availability of credit, and unemployment levels. Changes in these economic conditions could materially affect the projected home sales prices, the level of sales incentives, the costs to develop land and construct homes, and the monthly rate of sales. Because of these potential changes in economic and market conditions, in conjunction with the assumptions and estimates required of management in valuing homebuilding inventory, actual results could differ materially from management’s assumptions and may require material inventory impairments to be recorded in the future.

(e) Receivables

Receivables at May 31, 2020 and 2019 consisted of the following (in thousands):

	May 31, 2020	May 31, 2019
Closing funds due	$ 6,373	$ 4,849
Land development receivables	13,957	7,770
MUD receivables (1)	10,280	7,349
Other receivables (2)	3,073	5,748
	$ 33,683	$ 25,716

(1) Includes certain land development costs to be reimbursed by four Municipal Utility Districts in Houston, Texas.

(2) Includes amounts due from utility companies, insurance companies, refundable deposits, and drawn amounts due from salespersons.

(f) Real estate not owned

Real estate not owned reflects the future purchase price of lots under option purchase agreements pursuant to ASC 606, *Revenue From Contracts With Customers* (“ASC 606”), ASC Subtopic 470-40 (“ASC 470-40”), *Product Financing Arrangements*, or ASC 810, *Consolidation* (“ASC 810”) (see Note 6).

(g) Investments in unconsolidated entities

The Company participates in one land development joint venture in which it has less than a controlling interest. The Company accounts for its interest in this entity under the equity method. The Company's share of profits from lots it purchases from this joint venture is deferred and treated as a reduction of the cost basis of land purchased from the entity.

The Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, Charleston, Raleigh, Orlando, Phoenix, and Southwest Florida through an unconsolidated mortgage joint venture. The Company has an ownership interest of 49% in this mortgage joint venture. The Company's investment in this mortgage joint venture is accounted for under the equity method.

Investments in unconsolidated entities are evaluated for other-than-temporary impairment during each reporting period pursuant to ASC Subtopic 323-10, *Investments—Equity Method and Joint Ventures*. A series of operating losses or other factors may indicate an other-than-temporary decrease in the value of the Company's investment in the unconsolidated entity. The amount of impairment recognized is the excess of the investment's carrying value over its estimated fair value. The Company did not recognize any other-than-temporary impairments during the year ended May 31, 2020 and 2019 related to its investments in unconsolidated entities.

(h) Deposits and pre-acquisition costs

Deposits and pre-acquisition costs related to purchase agreements are capitalized when paid and classified in the consolidated balance sheets as deposits on real estate under option or contract (for deposits) and other assets (for pre-acquisition costs) until the related land is acquired. These costs are transferred to inventory at the time the land or lots are acquired. Nonrefundable deposits and pre-acquisition costs are charged to expense when the real estate purchase is no longer considered probable. If the Company intends to terminate a purchase agreement, it records a charge to earnings for the costs associated with the purchase agreement in the period such a decision is made. This expense is included as a component of cost of sales – homes in the consolidated statements of income and totaled $3.1 million, $2.4 million, and $1.1 million for the year ended May 31, 2020, 2019, and 2018, respectively.

(i) Property and equipment

Property and equipment is recorded at cost. Depreciation and amortization is generally recorded using the straight-line method over the estimated useful lives of the assets, which range from two to five years. Depreciable lives for leasehold improvements reflect the lesser of the economic life of the asset or the term of the lease. Repairs and maintenance costs are expensed as incurred. The Company's property and equipment at May 31, 2020 and 2019 consisted of the following (in thousands):

	May 31, 2020	May 31, 2019
Office furniture and equipment	$ 3,852	$ 4,109
Sales offices, design studios, and model furnishings	32,863	37,562
Leasehold improvements	2,414	2,117
	39,129	43,788
Accumulated depreciation and amortization[1]	(27,912)	(29,340)
	$ 11,217	$ 14,448

(1) Net of retirements and disposals.

Depreciation and amortization expense approximated $9.6 million, $10.5 million, and $11.4 million for the year ended May 31, 2020, 2019, and 2018, respectively.

(j) Revenue recognition

With respect to home sale revenues, revenue from a home sale is recognized when we have satisfied the performance obligation in the home sales contract, which is generally at the time of the closing of each sale, when title to and possession of the property are transferred to the buyer. The revenue recognized for each home sale includes the base sales price of the home, as well as any purchased options and upgrades and is reduced for any sales price incentives. Our performance obligation to deliver the agreed-upon home is generally satisfied in less than one year from the original contract date. Home sale contract assets consist of cash from home closings in transit or held in escrow for our benefit, which is typically received within two days of the home closing. Home sale contract assets totaled $6.4 million and $4.8 million at May 31, 2020 and May 31, 2019, respectively, and are classified as receivables in the consolidated balance sheets. Home sale contract liabilities include customer deposit liabilities related to sold but undelivered homes, which totaled $17.6 million and $20.8 million at May 31, 2020 and May 31, 2019, respectively. Of the customer deposit liabilities at May 31, 2019, $19.2 million was recognized in revenues in the year ended May 31, 2020 upon the closing of the related homes. Also included in home sale revenues are our wholesale home sales within our Starlight Homes brand. Wholesale home sales primarily consist of completed homes sold under bulk sales agreements to real estate investors who intend to use the homes as rental properties. See Note 1(l) for additional discussion of warranties and obligations associated with home sales revenue.

With respect to land sale revenues, we periodically elect to sell parcels of land or lots. These land and lot sales are generally outright sales of specified land parcels with cash consideration due on the closing date, which is generally when performance obligations are satisfied. Land sale contract assets consist of cash from closed land sales in transit or held in escrow for our benefit, which is typically received within two days of closing on the land sale. Land sale contract assets are classified as receivables in the consolidated balance sheets. Land sale contract liabilities consist of customer deposit liabilities related to land parcels under contract for sale. There were no land sale contract assets or liabilities at May 31, 2020 and 2019.

Finally, with respect to financial services and other revenues, financial services revenues, which are not within the scope of ASC 606, primarily consist of title premium income earned from the provision of title services for homebuyers. Other revenues consists of revenue from forfeited customer deposits that is recognized upon cancellation of the home sales contract when the Company is contractually entitled to retain the deposit and other miscellaneous customer revenue that is recognized when the related performance obligation is satisfied. Other revenues also include revenue from fee development, development oversight, and/or construction agreements entered into by the Company with third-party property owners. For these types of contracts, the Company recognizes revenue based on the actual total costs it has incurred plus the applicable fee. In accordance with ASC 606, the Company applies the percentage-of-completion method, using the cost-to-cost approach, as it most accurately measures the progress of our efforts in satisfying our obligations within the fee building agreements. Under this approach, revenue is earned in proportion to total costs incurred divided by total costs expected to be incurred. In the course of providing fee development, development oversight, and/or construction services, the Company routinely subcontracts for services and incurs other direct costs. These costs are typically passed through to the property owners and, in accordance with GAAP, are included in the Company's financial services and other revenues and cost of sales financial services and other revenues on the consolidated statements of income. Financial services and other revenues were previously classified as other expense/(income) on the consolidated statements of income, but are classified as revenue effective June 1, 2018. Financial services and other revenues recognized prior to June 1, 2018 have not been reclassified to revenue on the consolidated statements of income due to the immateriality of those revenues.

ASC 606 provides certain practical expedients that limit some accounting treatments and disclosure requirements. Accordingly, we do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less. In addition, the expected revenue to be recognized in any future year relating to unsatisfied performance obligations with an original expected length greater than one year is not material.

(k) Prepaid expenses

Included in other assets are prepaid expenses of approximately $8.9 million and $7.9 million as of May 31, 2020 and 2019, respectively, which primarily represent prepaid insurance, fees, permits, and rent.

(l) Warranty costs

The Company provides its homebuyers with limited warranties that generally provide for ten years of structural coverage, two years of coverage for plumbing, electrical and heating, ventilation and air conditioning systems, and one year of coverage for workmanship and materials. Warranty liabilities are initially established on a per home basis by charging cost of sales and establishing a warranty liability for each home delivered to cover expected costs of materials and labor during the warranty period. The amounts accrued are based on management's estimate of expected warranty-related costs under all unexpired warranty obligation periods. The Company's warranty liability is based upon historical warranty cost experience in each operating division and is adjusted as appropriate to reflect qualitative risks associated with the types of homes built and the geographic areas in which they are built. The Company's warranty liability is included in other liabilities in the consolidated balance sheets.

Presented below are summaries of the activity in the Company’s warranty liability account for the year ended May 31, 2020 and 2019 (in thousands):

	Year ended May 31,		
	2020	2019	2018
Warranty liability, beginning of period	$ 11,933	$ 10,342	$ 9,877
Costs accrued during period	11,275	14,037	12,496
Costs incurred during period	(13,086)	(12,446)	(12,031)
Warranty liability, end of period	$ 10,122	$ 11,933	$ 10,342

(m) Advertising costs

The Company expenses advertising costs as they are incurred. Advertising expense, which is included in selling, general and administrative expenses in the consolidated statements of income, was approximately $12.5 million, $11.9 million, and $10.1 million for the year ended May 31, 2020, 2019, and 2018, respectively.

(n) Long-term incentive plan

The Company offers a long-term incentive compensation program designed to align the interests of the Company and its executives by enabling key employees to participate in the Company’s future growth through the issuance of performance shares, which are the equivalent of phantom equity awards. The Company’s performance shares issued prior to June 1, 2016 are accounted for pursuant to ASC Subtopic 718-30, *Compensation – Awards Classified as Liabilities*, as the value of such shares is based, in part, on the price of the shares of a comparable set of public builders. The Company's performance shares issued on or after June 1, 2016 are accounted for pursuant to ASC Subtopic 710-10-25-9 to 25-11, *Deferred Compensation Arrangements*, as the value is not based on the shares of a comparable set of public builders or other equity instruments, but is based on the book value of equity of the Company. The Company measures the value of the performance shares on a quarterly basis using the intrinsic value method. Additional compensation expense may be recognized subsequent to completion of the vesting period for appreciation-only performance shares. See Note 12 for additional discussion regarding the Company’s long-term incentive plan.

(o) Income taxes

The Company operates as a limited liability company and is treated as a partnership for income tax purposes. Accordingly, the Company incurs no liability for federal or state income taxes, since the taxable income or loss is passed through to its Members, but incurs liabilities for certain state taxes payable directly by the Company. The Company calculates its Members’ potential tax liability related to their share of the Company’s taxable income and may make distributions to such Members to allow them to satisfy their tax liability, subject to limitations contained in the Company’s senior secured revolving credit facility and in the indentures governing its 6.625% Senior Notes due 2028 (the “6.625% Notes”), its 9.875% Senior Notes due 2027 (the “9.875% Notes”), and its 6.750% Senior Notes due 2025 (the “6.750% Notes”). Any tax distributions made to the Members are treated as a reduction of equity. The Company made tax distributions to its Members of $12.5 million, $21.4 million, and $17.8 million during the year ended May 31, 2020, 2019, and 2018, respectively.

(p) Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

(q) Segments

ASC Subtopic 280, *Segment Reporting* (“ASC 280”) provides standards for the way in which companies report information about operating segments. In accordance with ASC 280, the Company believes that each of its homebuilding operating markets is an operating segment. In accordance with the aggregation criteria defined in ASC 280, the Company has grouped its homebuilding operations into two reportable segments as follows:

1) East:	Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota, and Naples)
2) Central:	Houston, Dallas, Austin, San Antonio, and Phoenix

The Company has determined that the homebuilding operating markets within its respective reportable segments have similar economic characteristics and product types, and are similar in terms of geography. The Company’s homebuilding operating markets also share all other relevant aggregation characteristics prescribed in ASC 280, such as similar product types, production processes and methods of distribution. See Note 16 for further discussion of the Company’s reportable segments.

(r) Risks and uncertainties

The worldwide spread of COVID-19 virus has caused broad business and social disruption across many industries and locations, both domestically and abroad. Further, the spread of COVID-19 has also caused significant volatility in U.S. and international debt and equity markets. To date, COVID-19 has caused significant negative impacts across our industry, from trade availability, suspension of services in local municipalities, delays in homes closings, increased cancellations, various and differing shelter in place orders by state, county, and other local municipalities, and disruptions to normal operating procedures, to volatile economic conditions and a decline in consumer confidence. There is significant uncertainty around the breadth, severity, and duration of COVID-19 and the business disruptions related to COVID-19, as well as its impact on the U.S. and international economies, consumer confidence and, in turn, the impact it will have on our results. Additional discussion of the risks to the Company from COVID-19 are discussed in Item 1A. Risk Factors in this annual report.

(s) Subsequent events

The Company has evaluated subsequent events through July 15, 2020. This date represents the date on which the consolidated financial statements were available to be issued.

On July 16, 2020, the Board of Directors of the Company approved tax distributions of $4.0 million to its Members based on estimates of its Members' tax liability related to their share of the Company's taxable income.

Note 2 — Debt Transactions

On January 23, 2020, the Company and its wholly owned subsidiary, Ashton Woods Finance Co., issued and sold $250.0 million aggregate principal amount of 6.625% Notes through a private placement to qualified institutional buyers pursuant to Rule 144A and Regulation S, promulgated under the Securities Act of 1933, as amended. The 6.625% Notes were issued at a price of 100.00% of the principal amount to yield 6.625%.

The net proceeds of the 6.625% Notes were used by the Company to pay the amount of indebtedness outstanding under the Company's senior secured revolving credit facility and for working capital and general corporate purposes.

The Company incurred deferred financing fees during the year ended May 31, 2020 of $4.6 million related to the issuance of the 6.625% Notes.

On March 13, 2019, the Company commenced a cash tender offer (the “2019 Tender Offer”) to purchase any and all of its outstanding $250.0 million aggregate principal amount of 6.875% Senior Notes due 2021 (the “6.875% Notes”) at a purchase price in cash of $952.86, plus an early tender premium of $50.00, per $1,000.00 of principal amount of the 6.875% Notes. The 2019 Tender Offer expired at 12:00 midnight, New York City time at the end of the day on April 9, 2019. On March 27, 2019, the Company purchased $204,756,000 principal amount of the 6.875% Notes, at a price of $1,002.86 per $1,000.00 of principal amount plus accrued but unpaid interest to, but not including, the purchase date, which 6.875% Notes were validly tendered and not withdrawn in the 2019 Tender Offer on or prior to the early tender deadline. Also, on March 27, 2019, the Company issued a notice of redemption for the $45,244,000 of remaining outstanding principal amount of 6.875% Notes not purchased in the 2019 Tender Offer in accordance with the redemption, satisfaction and discharge provisions of the indenture under which the 6.875% Notes were issued. The redemption was completed on April 26, 2019, and the remaining outstanding 6.875% Notes were redeemed by the Company.

On March 27, 2019, the Company and Ashton Woods Finance Co., a wholly-owned subsidiary of the Company, issued and sold, at an issue price of 99.301% to yield 9.875%, $255.0 million aggregate principal amount of 9.875% Senior Notes due 2027 (the “9.875% Notes”) through a private placement to qualified institutional buyers pursuant to Rule 144A and in an offshore transaction pursuant to Regulation S, promulgated under the Securities Act of 1933, as amended.

The net proceeds of the 9.875% Notes and cash on hand were used by the Company to pay the purchase price to the holders of an aggregate of $250 million principal amount of 6.875% Notes tendered in the 2019 Tender Offer and to pay accrued and unpaid interest payable on the tendered notes and, subsequently, to redeem the remaining 6.875% Notes not purchased in the 2019 Tender Offer.

The Company recorded a $2.5 million loss on the early extinguishment of debt during the year ended May 31, 2019, comprised of a write-off of $1.2 million of unamortized deferred financing fees related to the 6.875% Notes, $0.7 million of unamortized original issue discount on the 6.875% Notes, and the payment of $0.6 million of early tender premiums. The Company incurred deferred financing fees of $0.1 million and $5.1 million related to the issuance of the 9.875% Notes during the year ended May 31, 2020 and 2019, respectively.

On August 8, 2017, the Company and its wholly owned subsidiary, Ashton Woods Finance Co., issued and sold $250.0 million aggregate principal amount of their 6.750% Notes (the “6.750% Notes”) through a private placement to qualified institutional buyers pursuant to Rule 144A and Regulation S, promulgated under the Securities Act of 1933, as amended. The 6.750% Notes were issued at a price of 100.00% of the principal amount to yield 6.750%.

The net proceeds of the 6.750% Notes were used by the Company to (i) pay the purchase price to the holders of an aggregate of $100 million principal amount of 6.875% Notes tendered in a tender offer launched by the Company and Ashton Woods Finance Co. for up to $100.0 million principal amount of 6.875% Notes, (ii) to repay a portion of the indebtedness outstanding under the Company's senior secured revolving credit facility, and (iii) pay accrued and unpaid interest and prepayment premiums payable on any of the foregoing.

The Company recorded a $5.3 million loss on the early extinguishment of debt during the year ended May 31, 2018, comprised of a write-off of $1.0 million of unamortized deferred financing fees related to the 6.875% Notes, $0.5 million of unamortized original issue discount on the 6.875% Notes, and the payment of $3.8 million in repayment premiums. The Company incurred deferred financing fees during the year ended May 31, 2018 of $5.2 million related to the issuance of the 6.750% Notes.

See Note 8 for further discussion of the Company's debt.

Note 3 — Restructuring Plan

Beginning on March 31, 2020, the Company commenced and executed on a restructuring plan, together with other temporary compensation and benefit adjustments, to reduce operating costs and better align its workforce with the needs of its business following the broad business and social disruptions caused by COVID-19. Under this plan, the Company reduced its workforce by 136 employees (approximately 15%). Affected employees were eligible to receive severance payments, including 60 days of paid health insurance with timely COBRA election by the employee. Employee severance benefits were contingent upon an affected employee’s execution (and non-revocation) of a separation agreement, which includes a general release of claims against the Company. In connection with the restructuring, the Company incurred aggregate restructuring charges of $0.9 million during the year ended May 31, 2020, related to one-time termination severance payments and other employee-related costs and was included in selling, general and administrative expenses in the consolidated statements of income.

Note 4 — Pending and Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (“ASU 2016-02”), which requires, among other things, that lessees recognize the operating lease right-of-use assets and operating lease liabilities (“Lease liabilities”) arising from operating leases on the balance sheet. On June 1, 2019, the Company adopted ASU 2016-02 and related amendments using a modified retrospective approach with an effective date as of June 1, 2019. Prior year financial statements were not required to be recast under the new standard and, therefore, have not been reflected as such on our consolidated balance sheet as of May 31, 2019. We elected the package of transitional practical expedients, which allowed us to carryforward our historical assessment of (1) whether contracts are or contain leases, (2) lease classification, and (3) initial direct costs. Additionally, we have elected to apply the standard's practical expedients which allow us to (1) continue to apply existing accounting policies for all land easements that existed or expire before the date of adoption, (2) not recognize right-of-use assets or Lease liabilities for leases that qualify as short-term leases for all classes of underlying assets, and (3) not separate lease and non-lease components for all classes of underlying assets. The Company did not elect to apply the hindsight practical expedient when determining the term for our leases. The new standard requires disclosure of additional quantitative and qualitative information for our lease arrangements. These additional disclosures are included in Note 15.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”), which changes the impairment model for most financial assets and certain other instruments from an “incurred loss” approach to a new “expected credit loss” methodology. The effective date of ASU 2016-13 was amended by the release of ASU 2019-10 in November 2019 and was extended to fiscal years beginning after December 15, 2022, and for annual and interim periods thereafter. The standard requires an entity to recognize the effects of adopting the new standard as a cumulative effect adjustment to opening retained earnings in the period of adoption. The Company is currently evaluating the impact that adoption of ASU 2016-13 will have on its consolidated financial statements and related disclosures.

Note 5 — Inventory

Inventory consisted of the following at May 31, 2020 and 2019 (in thousands):

	May 31, 2020	May 31, 2019
Homes under construction and finished homes	$ 545,079	$ 596,312
Finished lots	215,419	194,129
Land under development	86,964	61,314
Land held for future development	28,231	20,303
Land held for sale	6,309	2,172
Commercial land	—	10
	$ 882,002	$ 874,240

The Company capitalizes all interest incurred to the extent its qualifying assets meet or exceed its debt obligations. If qualifying assets are less than the Company’s debt obligations, there are limits on the amount of interest that can be capitalized, and the remainder of interest incurred must be directly expensed. The Company directly expensed interest of $16.0 million, $7.6 million, and $11.6 million for the year ended May 31, 2020, 2019, and 2018, respectively, in the consolidated statements of income.

The following table summarizes interest costs incurred, charged to cost of sales and directly expensed during the year ended May 31, 2020 and 2019 (in thousands):

	Year ended May 31,		
	2020	2019	2018
Capitalized interest, beginning of period	$ 19,040	$ 13,824	$ 10,813
Interest incurred	57,753	47,667	42,361
Interest amortized to cost of sales	(39,127)	(34,860)	(27,710)
Interest expensed	(16,020)	(7,591)	(11,640)
Capitalized interest, end of period	$ 21,646	$ 19,040	$ 13,824

Note 6 — Other Assets

Other assets at May 31, 2020 and 2019 consisted of the following (in thousands):

	May 31, 2020	May 31, 2019
Real estate not owned	$ 79,738	$ 64,733
Right-of-use assets(1)	13,121	—
Prepaid expenses	8,885	7,929
Architecture plans	4,626	5,848
Deferred financing fees	2,725	1,879
Pre-acquisition costs	7,161	4,011
Other deposits	2,117	3,734
	$ 118,373	$ 88,134

(1) See Note 15, *Leases,* for additional information.

In the ordinary course of business, the Company enters into lot purchase agreements in order to procure lots for the construction of homes in the future. Pursuant to these lot purchase agreements, the Company generally will provide a deposit to the seller as consideration for the right, but not the obligation, to purchase lots at different times in the future, usually at predetermined prices. Depending on the circumstances of such lot purchase agreements, "Real estate not owned" may be recorded based on the application of different accounting provisions in accordance with ASC 810 or ASC 470-40. In applying these provisions, the Company regularly evaluates its land and lot purchase agreements.

Pursuant to ASC 810, when the Company enters into a purchase agreement to acquire land or lots from an entity and pays a non-refundable deposit, the Company has concluded that a variable interest entity ("VIE"), for which consolidation is required, may be created because it is deemed to have provided subordinated financial support that will absorb some or all of an entity's expected losses if they occur. For each VIE, the Company assesses whether it is the primary beneficiary of the VIE and thus must consolidate the entity by first determining if it has the ability to control the activities of the VIE that most significantly impact its economic performance. Such activities include, but are not limited to, the ability to determine the budget and scope of land development work, if any; the ability to control financing decisions for the VIE; the ability to acquire additional land into the VIE or dispose of land in the VIE not under contract; and the ability to change or amend the existing purchase contract with the VIE. If the Company is determined not to control such activities, it is not considered the primary beneficiary of the VIE. If it does have the ability to control such activities, it will continue the analysis by determining if it is expected to absorb a potentially significant amount of the VIE's losses or, if no party absorbs the majority of such losses, if it will benefit from potentially a significant amount of the VIE's expected gain. If the Company determines that it is the primary beneficiary of the VIE, it will consolidate the VIE in its financial statements and reflect such assets as "Real estate not owned" and the related liabilities as "Liabilities related to real estate not owned." At May 31, 2020 and May 31, 2019, no purchase contracts or investments in unconsolidated entities were determined to require consolidation under ASC 810.

Pursuant to ASC 470-40*,* if a buying entity participates in an arrangement in which it is economically compelled to purchase land, then the entity is required to consolidate such an arrangement. From time to time, the Company enters into arrangements in which it identifies lots that it desires to purchase, finds an investor to purchase the lots and then enters into option purchase agreements to acquire the lots in staged takedowns. In consideration for such options, the

Company generally makes nonrefundable deposits. While the Company is generally not obligated to purchase the lots that are the subject of such agreements, it would forfeit the remaining deposits if the lots are not purchased. Although the Company is not obligated to purchase the lots under option unless it enters into a contract with specific performance obligations, if, at the reporting date, the Company believes that due to the terms of the purchase contracts it is compelled to purchase the lots under option, the Company will record "Real estate not owned" and the related liabilities as "Liabilities related to real estate not owned" in connection with such option purchase agreements. The Company has one lot purchase agreement with an unaffiliated investor group that is accounted for pursuant to ASC 470-40. At May 31, 2020 and May 31, 2019, the Company recorded real estate not owned of $24.9 million and $33.3 million, respectively, related to the lot purchase agreement accounted for pursuant to ASC 470-40.

Also, based on the provisions of ASC Subtopic 606-10, *Revenue From Contracts With Customers*, a seller may not recognize as a sale property it sells if an entity has an obligation or a right to repurchase lots and if the repurchase agreement is considered to be a financing arrangement. ASC 606 considers a repurchase option contract to be a financing arrangement, in accordance with ASC 606-10-55-70, if the entity will repurchase the lots for an amount that is equal to or greater than the original selling price of the asset. Therefore, if the Company enters into lot purchase option agreements for land it has sold and determines that the repurchase agreement is considered to be a financing arrangement, the Company records the lots subject to such sale as "Real estate not owned" and the related liabilities, under option agreement, as "Liabilities related to real estate not owned." At May 31, 2020 and May 31, 2019, the Company recorded real estate not owned of $54.9 million and $31.5 million, respectively, for the sale of lots because its repurchase agreements related to this real estate were considered to be financing arrangements. While these option agreements contain no specific performance obligations, should the Company choose not to purchase the land, it will forfeit the deposited amount.

Architecture plans are comprised of the costs incurred related to architecture plans, associated engineering costs, and interactive floor plans for house plans, and are amortized through cost of sales on a per closing basis.

Deferred financing fees included in other assets are comprised of costs incurred in connection with the issuance of senior notes by the Company and obtaining financing under the senior secured revolving credit facility. Deferred financing fees are amortized as interest over the terms of the related financing arrangement using the effective interest method. The Company incurred deferred financing fees of $4.6 million during the year ended May 31, 2020 as a result of the issuance of the 6.625% Notes, as discussed above in Note 2 and below in Note 8. The Company incurred deferred financing fees of $0.1 million and $5.1 million during the year ended May 31, 2020 and 2019, respectively, as a result of the issuance of the 9.875% Notes as discussed above in Note 2 and below in Note 8. The Company incurred deferred financing fees of $2.2 million during the year ended May 31, 2018 as a result of the amendment to the Company's senior secured revolving credit facility, as discussed below in Note 8, and $5.2 million during the year ended May 31, 2018 as a result of the issuance of the 6.750% Notes as discussed above in Note 2 and below in Note 8.

See Note 1(h) for additional information on pre-acquisition costs.

Note 7 — Investments in Unconsolidated Entities

The Company enters into land joint ventures from time to time as a means of accessing larger parcels of land and lot positions, managing its risk profile and leveraging its capital base. As of May 31, 2020, the Company had an equity investment in one land joint venture with an affiliate of certain of the beneficial owners of the Company's equity or their affiliates (individually and collectively, the "Investors"). The Company has a 49% limited partner interest in this joint venture, does not have a controlling interest in this unconsolidated entity, and has accounted for it under the equity method. The lot purchase agreement permits the Company to purchase finished lots owned by the land joint venture. Lot prices are generally negotiated prices that approximate fair value when the purchase contract is signed. The Company's share of the unconsolidated entity's earnings on the sale of lots to the Company is deferred until homes related to the lots purchased by the Company are delivered and title passes to a homebuyer. The partners generally share profits and losses in accordance with their ownership interests. As of May 31, 2020, the Company had recorded $1.1 million for its investment in this unconsolidated entity in the consolidated balance sheets. The Company has also entered into a services agreement with the joint venture to provide accounting and administrative services to the joint venture. The Company receives a monthly fee of $6,000 for these services that is included in other income in the consolidated statements of income. The Company is a party to a lot purchase agreement with the joint venture, which required a 10% deposit, and has no specific performance requirements for the Company. As of May 31, 2020, the total purchase price of lots remaining to be purchased under this agreement was approximately $14.5 million. As of May 31, 2020, the joint venture had $3.7 million of debt outstanding, which is non-recourse to the joint venture and to the

Company. The loan was obtained to fund land development for one phase of the property. The Company provided the lender with a performance guarantee for the substantial completion of this phase of development. The guarantee of performance may include the payment of money for costs incurred during the completion of the development. In the event the Company pays money or performs any services pursuant to the guarantee, the joint venture has agreed to indemnify and reimburse the Company for any such costs incurred.

The Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, Charleston, Raleigh, Orlando, Phoenix, and Southwest Florida through an unconsolidated mortgage joint venture. The Company has an ownership interest of 49% in this mortgage joint venture. The Company's investment in this mortgage joint venture is accounted for under the equity method. The debt of the mortgage joint venture is non-recourse to the Company.

Summarized unaudited financial information related to unconsolidated entities that are accounted for using the equity method as of May 31, 2020 and 2019 and for the year ended May 31, 2020 and 2019 was as follows (in thousands):

	May 31, 2020	May 31, 2019
Assets:		
Cash	$ 5,650	$ 6,274
Mortgage notes receivable	54,472	48,049
Real estate	9,384	9,337
Other	713	650
Total assets	$ 70,219	$ 64,310
Liabilities and equity:		
Liabilities:		
Accounts payable and other accruals	$ 5,274	$ 5,859
Notes payable (1)	55,643	47,819
Total liabilities	60,917	53,678
Equity	9,302	10,632
Total liabilities and equity	$ 70,219	$ 64,310

(1) The notes payable balance at May 31, 2020 is comprised of $52.0 million outstanding on two warehouse lines and $3.7 million of secured debt, all of which are non-recourse to the Company. The notes payable balance at May 31, 2019 is comprised of $46.0 million outstanding on two warehouse lines and $1.8 million of secured debt that is non-recourse to the Company.

	Year ended May 31,		
	2020	2019	2018
Revenues:			
Lot sales	$ 5,658	$ 11,509	$ 11,469
Financial services	20,753	12,842	8,900
Total revenues	26,411	24,351	$ 20,369
Gross profit	14,824	10,606	8,033
General and administrative expenses:			
Lot sales	—	47	$ 65
Financial services	3,164	2,116	1,467
Total general and administrative expenses	3,164	2,163	$ 1,532
Net earnings	$ 11,660	$ 8,443	$ 6,501

Note 8 — Debt

Debt at May 31, 2020 and 2019 consisted of the following (in thousands):

	May 31, 2020	May 31, 2019
6.625% Notes (1)	$ 245,610	$ —
9.875% Notes (2)	249,182	248,268
6.750% Notes (3)	246,878	246,173
Senior secured revolving credit facility	—	20,427
Notes payable	4,725	—
	$ 746,395	$ 514,868

(1) Net of $4.4 million of unamortized deferred financing costs as of May 31, 2020.
(2) Net of $4.2 million and $5.0 million of unamortized deferred financing costs and $1.6 million and $1.8 million of unamortized discount as of May 31, 2020 and May 31, 2019, respectively.
(3) Net of $3.1 million and $3.8 million of unamortized deferred financing costs as of May 31, 2020 and May 31, 2019, respectively.

The 6.625% Notes

On January 23, 2020, the Company issued $250.0 million principal amount of 6.625% Senior Notes due 2028 (the “6.625% Notes”) in a private offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. The 6.625% Notes were issued at a price of 100.00% of the principal amount to yield 6.625%.

The 6.625% Notes mature on January 15, 2028. Interest is payable on the 6.625% Notes on January 15 and July 15 of each year. The 6.625% Notes are senior, unsecured obligations of the Company and rank equally in right of payment to all of the Company’s existing and future senior debt and senior in right of payment to the Company’s existing and future subordinated debt. The 6.625% Notes are effectively subordinated to any of the Company’s existing and future secured debt, including the Company's senior secured revolving credit facility, to the extent of the value of the assets securing such debt. The obligations under the 6.625% Notes are jointly and severally guaranteed by each Restricted Subsidiary, as defined, other than certain Restricted Subsidiaries that have assets with a book value of less than $2.0 million. All of the Company's subsidiaries are Restricted Subsidiaries with respect to the 6.625% Notes, with the exception of AW Mortgage Holdings L.L.C., which has been designated an Unrestricted Subsidiary pursuant to the indenture governing the 6.625% Notes.

The indenture governing the 6.625% Notes gives the Company the option to redeem the 6.625% Notes at any time or from time to time, in whole or in part, (a) until January 15, 2023, at a redemption price equal to 100% of their principal amount, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, plus an applicable premium as defined in the indenture governing the 6.625% Notes, (b) on or after January 15, 2023 until January 15, 2026, at certain redemption prices set forth in the indenture governing the 6.625% Notes together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, and (c) on or after January 15, 2026, at 100% of the principal amount to be redeemed, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date.

The indenture governing the 6.625% Notes contains a number of covenants, including covenants relating to the following:

- Limitations on indebtedness;
- Limitations on restricted payments;
- Limitations on dividends;
- Limitations on transactions with affiliates;
- Limitations on liens;
- Limitations on asset sales;
- Limitations on designation of unrestricted subsidiaries; and
- Limitations on mergers.

As of May 31, 2020, the Company was in compliance with the covenants in the indenture governing the 6.625% Notes.

The 9.875% Notes

On March 27, 2019, the Company issued $255.0 million principal amount of 9.875% Senior Notes due 2027 (the "9.875% Notes") in a private offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. The 9.875% Notes were issued at a price of 99.301% of the principal amount to yield 10.000%.

The 9.875% Notes mature on April 1, 2027. Interest is payable on the 9.875% Notes on April 1 and October 1 of each year. The 9.875% Notes are senior, unsecured obligations of the Company and rank equally in right of payment to all of the Company's existing and future senior debt and senior in right of payment to the Company's existing and future subordinated debt. The 9.875% Notes are effectively subordinated to any of the Company's existing and future secured debt, including the Company's senior secured revolving credit facility, to the extent of the value of the assets securing such debt. The obligations under the 9.875% Notes are jointly and severally guaranteed by each Restricted Subsidiary, as defined, other than certain Restricted Subsidiaries that have assets with a book value of less than $2.0 million. All of the Company's subsidiaries are Restricted Subsidiaries with respect to the 9.875% Notes, with the exception of AW Mortgage Holdings L.L.C., which has been designated an Unrestricted Subsidiary pursuant to the indenture governing the 9.875% Notes.

The indenture governing the 9.875% Notes gives the Company the option to redeem the 9.875% Notes at any time or from time to time, in whole or in part, (a) until April 1, 2022, at a redemption price equal to 100% of their principal amount, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, plus an applicable premium as defined in the indenture governing the 9.875% Notes, (b) on or after April 1, 2022 until April 1, 2025, at certain redemption prices set forth in the indenture governing the 9.875% Notes together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, and (c) on or after April 1, 2025, at 100% of the principal amount to be redeemed, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date.

The indenture governing the 9.875% Notes contains a number of covenants, including covenants relating to the following:

- Limitations on indebtedness;
- Limitations on restricted payments;
- Limitations on dividends;
- Limitations on transactions with affiliates;
- Limitations on liens;
- Limitations on asset sales;
- Limitations on designation of unrestricted subsidiaries; and
- Limitations on mergers.

As of May 31, 2020, the Company was in compliance with the covenants in the indenture governing the 9.875% Notes.

The 6.750% Notes

On August 8, 2017, the Company issued $250 million principal amount of 6.750% Senior Notes due 2025 (the "6.750% Notes") in a private offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. The 6.750% Notes were issued at a price of 100.00% of the principal amount to yield 6.750%.

The 6.750% Notes mature on August 1, 2025. Interest is payable on February 1 and August 1 of each year, commencing February 1, 2018. The 6.750% Notes are senior, unsecured obligations of the Company and rank equally in right of payment to all of the Company's existing and future senior debt and senior in right of payment to all the Company's existing and future subordinated debt. The 6.750% Notes are effectively subordinated to any of the Company's existing and future secured debt, including the senior secured revolving credit facility, to the extent of the value of the assets securing such debt. The obligations under the 6.750% Notes are jointly and severally guaranteed by each Restricted Subsidiary, as defined, other than certain Restricted Subsidiaries that have assets with a book value of less than $2.0 million. All of the Company's subsidiaries are Restricted Subsidiaries with respect to the 6.750% Notes, with the exception of AW Mortgage Holdings L.L.C., which has been designated an Unrestricted Subsidiary pursuant to the indenture governing the 6.750% Notes.

The Company has the option to redeem the 6.750% Notes at any time or from time to time, in whole or in part, (a) until August 1, 2020, at a redemption price equal to 100% of their principal amount, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, plus an applicable premium as defined in the indenture governing the 6.750% Notes, (b) on or after August 1, 2020 until August 1, 2023, at certain redemption prices set forth in the indenture governing the 6.750% Notes together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, and (c) on or after August 1, 2023, at 100% of the principal amount to be redeemed, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date.

The indenture governing the 6.750% Notes contains a number of covenants, including covenants relating to the following:

- Limitations on indebtedness;
- Limitations on restricted payments;
- Limitations on dividends;
- Limitations on transactions with affiliates;
- Limitations on liens;
- Limitations on asset sales;
- Limitations on designation of unrestricted subsidiaries; and
- Limitations on mergers.

As of May 31, 2020, the Company was in compliance with the covenants in the indenture governing the 6.750% Notes.

Senior Secured Revolving Credit Facility

On August 28, 2019, the Company amended its senior secured revolving credit facility by entering into its Second Amendment to the Fifth Amended and Restated Credit Agreement (as amended, the “Restated Revolver”), providing for, among other things, (i) an aggregate revolving loan commitment of up to $350.0 million with up to $50.0 million available for the issuance of letters of credit and a $20.0 million swingline facility, and with an accordion feature to permit the size of the facility to be increased in the future up to $420.0 million (dependent upon Company needs and available lender commitments), (ii) a maturity date of August 28, 2023, and (iii) modification of certain covenants and restating the agreement to reflect such changes. The Restated Revolver limits the principal amount of the aggregate commitment available at any time to the amount that is permitted by the indentures governing the Company's 6.625% Notes, 9.875% Notes, and 6.750% Notes, which is 30% of Consolidated Tangible Assets, as defined therein.

Interest accrues on borrowings under the Restated Revolver at the London Interbank Offered Rate (LIBOR) plus an applicable margin that ranges from 275 to 335 basis points. Letters of credit may be issued under the Restated Revolver at a rate of 100 basis points if secured by cash, or at a rate of 275 to 335 basis points if not secured by cash. The Restated Revolver has a maturity date of August 28, 2023, subject to an extension in accordance with the terms set forth therein. The Restated Revolver is secured by a continuing first priority security interest in the real property of certain operating divisions selected by the Company for inclusion in the borrowing base, and the personal property of the Company and its subsidiaries affixed to, placed upon, used in connection with, arising from or appropriated for use on the pledged real property and the continuing guarantee of substantially all of its subsidiaries. The Company may pledge additional collateral as needed to increase the borrowing base consistent with the maximum availability under the Restated Revolver.

The Restated Revolver contains the following material financial covenants:

- A minimum level of Tangible Net Worth;
- A maximum Leverage Ratio;
- A minimum Interest Coverage Ratio;
- Minimum liquidity;
- Maximum level of land supply; and
- Maximum level of Speculative Housing Units and Model Housing Units.

Availability under the Restated Revolver is based upon a borrowing base formula. The Restated Revolver contains other affirmative and negative covenants in addition to the financial covenants noted above. The Restated Revolver permits sales and transfers of ownership interests in the Company so long as no change of control, as defined in the

Restated Revolver, occurs, permits certain tax distributions to Members and permits certain other distributions to Members if certain Leverage Ratio and other conditions are met. As of May 31, 2020, the Company was in compliance with the covenants in the Restated Revolver.

At May 31, 2020, there were no borrowings outstanding under the Restated Revolver and $2.7 million of letters of credit outstanding. As of May 31, 2020, the Company had available additional borrowing capacity of $207.9 million under the Restated Revolver based on outstanding borrowings on the Restated Revolver, outstanding letters of credit, the value of collateral pledged to secure the facility, and the borrowing base formula.

Notes Payable

On December 13, 2019, the Company issued a $4.7 million note payable to an unaffiliated third party, related to a purchase of land, which matures on July 13, 2022. The note payable has an interest rate of 10.00%. The note is collateralized by the land to which it relates and has no recourse to any other assets or to the Company. As of May 31, 2020, the outstanding note payable balance, including accrued interest, totaled $4.7 million.

Note 9 — Other Liabilities

Other liabilities at May 31, 2020 and 2019 consisted of the following (in thousands):

	May 31, 2020	May 31, 2019
Liabilities related to real estate not owned (1)	$ 55,210	$ 41,467
Salaries, bonuses, and benefits	35,080	27,786
Lease liabilities(2)	14,410	—
Accrued interest	15,718	11,120
Warranty accruals	10,122	11,932
Accrued long-term compensation	12,674	8,245
Accrued real estate taxes	4,027	2,912
Other	20,134	16,530
	$ 167,375	$ 119,992

(1) Net of deposits of $23.3 million in both May 31, 2020 and 2019.
(2) See Note 15, *Leases,* for additional information.

Note 10 — Members' Equity, Amended Regulations, and Ownership

The Second Amended and Restated Regulations (as amended, the "Regulations") of the Company created three classes of members and associated membership interests as follows: (1) Class A Membership Interest, which is held by Little Shots Nevada, L.L.C. ("Little Shots"), (2) Class B Membership Interests initially issued to the holders of our former 11.0% Senior Subordinated Notes due 2015, the majority of which are now held by Little Shots, and (3) Class C Membership Interests created in June 2010, the majority of which are held by Little Shots. The Regulations set forth each Member's respective membership interests and sharing ratio. No Member is required to make any additional contributions to the Company. Subject to certain limited exceptions, including for tax distributions, all items of income, gain, loss, deduction and credit of Ashton Woods will be allocated among the Members in accordance with their sharing ratios.

At May 31, 2020, there were 20,628,729 membership interests outstanding, comprised as follows:

	Membership Interests	Ownership percentage	Percentage of membership class
Little Shots Nevada L.L.C.			
Class A	8,027,200	38.91%	100.00%
Class B	1,922,151	9.32%	97.43%
Class C	8,167,244	39.59%	76.84%
Total Little Shots Nevada L.L.C.	18,116,595	87.82%	
Various Holders			
Class B	50,649	0.25%	2.57%
Class C	2,461,485	11.93%	23.16%
	20,628,729	100.00%	

Note 11 — Transactions with Related Parties

Services agreement

The Company is a party to a services agreement with the Investors that provides the Company with a license, as well as development and support, for certain of the Company's computer systems and administrative services. The Company pays a fee of $800 per home closing quarterly, in arrears, for these services, which is included in selling, general and administrative expenses in the consolidated statements of income. The Company incurred fees of $4.1 million, $3.5 million, and $2.9 million during the year ended May 31, 2020, 2019, and 2018, respectively, under the services agreement. As of May 31, 2020 and 2019, the balance due to the Investors under the terms of the service agreement was $1.4 million and $1.3 million, respectively, and was included in other liabilities in the consolidated balance sheets.

Lease

The Company is a party to a lease as a lessee with the Investors to rent approximately 8,500 square feet of commercial space in Dallas, Texas. The Company has 31 months remaining on the lease as of May 31, 2020. Total minimum lease payments due under the lease were $0.3 million and $0.2 million as of May 31, 2020 and 2019, respectively.

Lot purchase agreements

The Company is a party to eight lot purchase agreements with the Investors. A deposit ranging from 10% to 20% was required under each of the purchase agreements, and there are no specific performance requirements for the Company. We are required to record one of these lot purchase agreements as real estate not owned in the consolidated balance sheets. As of May 31, 2020, the total purchase price of lots remaining to be purchased under such agreements was approximately $48.2 million.

Joint venture

The Company is a party to a land joint venture with the Investors, which is accounted for under the equity method. The Company has an equity investment of less than 50% in the joint venture and does not have a controlling interest in the unconsolidated entity. Also, the Company is a party to a lot purchase agreement with the joint venture to purchase 130 lots. A 10% deposit was required under the purchase agreement and there are no specific performance requirements for the Company. As of May 31, 2020, the total purchase price of lots remaining to be purchased was $14.5 million. As of May 31, 2020, the joint venture had $3.7 million of debt outstanding, which is non-recourse to the joint venture and to the Company. The loan was obtained to fund land development for one phase of the property. The Company provided the lender with a performance guarantee for the substantial completion of this phase of development. The guarantee of performance may include the payment of money for costs incurred during the completion of the development. In the event the Company pays money or performs any services pursuant to the guarantee, the joint venture has agreed to indemnify and reimburse the Company for any such costs incurred.

Note 12 — Long-Term Incentive Plan

In July 2012, the Board of Directors adopted the Ashton Woods USA L.L.C. 2013 Performance Share Plan (the "2013 Plan"), a long-term incentive compensation program designed to align the interests of the Company and its executives by enabling key employees to participate in the Company's future growth. In July 2013, the Board of Directors adopted the Amended and Restated Performance Share Plan (the "First Amended Plan"), and in July 2016, the Board of Directors adopted the Second Amended and Restated Performance Share Plan, with an effective date of June 1, 2016 (the "Second Amended Plan") (together with the 2013 Plan and the First Amended Plan, the "Plan"). The Plan provides for the grant to participants of full-value performance shares and appreciation-only performance shares, which are the equivalent of phantom equity awards. Full-value performance shares allow the participant to receive a cash payment equal to the total value of the performance share on the designated date of payment. Appreciation-only performance shares allow the participant to receive a cash payment equal to the increase in value of the performance share measured from the date of grant to the designated date of payment. In each July of 2013 through 2020, the Board of Directors awarded outstanding performance shares to the Company's executive officers, and certain officers and members of the corporate and operating division senior management teams.

The value of a performance share awarded under the 2013 Plan and the First Amended Plan is determined by multiplying the Company's book value, as defined under the Plan, by a multiple that is equal to the weighted average multiple of a book value of a share of common stock of a predetermined group of publicly traded homebuilders, divided by the number of hypothetical shares as defined by the Plan. The value of a performance share under the Second Amended Plan is determined by dividing the Company's book value, as defined under the Plan, by the number of hypothetical shares as defined by the Plan. Generally, except as determined by the Board upon grant, performance shares awarded under the Plan will vest ratably over three years and will be subject to forfeiture upon the occurrence of certain events, including termination of employment for cause. The performance shares will become fully vested upon a participant's resignation for good reason, the participant's death or disability or a change of control, and with respect to certain grants upon an equity sale, as defined in the Plan. In the absence of a payment event otherwise defined in the Plan, the full-value performance share awards pay out after the third anniversary of the award date, and the appreciation-only performance share awards pay out after the fifth anniversary of the award date.

The following table represents a rollforward of the outstanding performance shares for the year ended May 31, 2020:

	Full-value shares	**Appreciation-only shares**	**Total shares**
Outstanding performance shares as of May 31, 2019	232,159	618,064	850,223
Performance shares awarded during the period	82,807	165,614	248,421
Shares forfeited during the period	(3,565)	(7,130)	(10,695)
Fully vested performance shares paid	(71,768)	(72,626)	(144,394)
Total outstanding performance shares as of May 31, 2020	239,633	703,922	943,555
Total vested performance shares as of May 31, 2020	156,817	538,293	695,110

The Company has elected to account for performance shares awarded under the Plan using the intrinsic value method. The Company's liability for performance shares awarded under the Plan is remeasured quarterly to reflect the intrinsic value of the performance shares awarded as of the balance sheet date. As a result, the Company may record an increase or decrease in compensation expense in any period. Compensation expense for the full-value and appreciation-only performance shares is included in selling, general and administrative expenses in the consolidated statements of income.

The total number of performance shares vested as of May 31, 2020 and 2019 was 695,110 and 600,038, respectively. The Company recorded $7.1 million, $4.4 million, and $3.8 million for the year ended May 31, 2020, 2019, and 2018, respectively, in compensation expense associated with the full-value and appreciation-only performance shares. For the year ended May 31, 2020, 2019, and 2018, $2.9 million (144,394 units), $2.5 million (135,933 units), and $1.7 million (87,512 units), respectively, of vested performance shares were paid out to employees. As of May 31, 2020 and 2019, the Company's liability for the performance shares was $12.4 million and $8.2 million, respectively, which is recorded in other liabilities in the consolidated balance sheets.

Note 13 — Employee Benefit Plan

The Company has a 401(k) plan for all full and eligible part-time employees who have been with the Company for a period of three months or more. Through March 31, 2020, the Company matched 50% of employees' voluntary contributions up to 6% of employees' compensation, limited by the maximum allowed under federal guidelines. Beginning April 1, 2020, as part of the restructuring plan discussed above in Note 3, the Company suspended all 401(k) Company matches. The total amount of Company matches funded for the employees' voluntary contributions for the years ended May 31, 2020, 2019, and 2018 was $1.9 million, $2.1 million, and $1.8 million, respectively, of which approximately $191.3 thousand, $160.1 thousand, and $151.1 thousand was funded by forfeitures for the year ended May 31, 2020, 2019, and 2018, respectively. The remaining Company match is included within selling, general and administrative expenses in the consolidated statements of income.

Note 14 — Fair Value Disclosures

ASC Subtopic 820, *Fair Value Measurement,* defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This standard establishes a three-level hierarchy for fair value measurements based upon the significant inputs used to determine fair value. Observable inputs are those that are obtained from market participants external to the Company while unobservable inputs are generally developed internally, utilizing management's estimates, assumptions and specific knowledge of the assets/liabilities and related markets. The three levels are defined as follows:

- **Level 1:** Valuation is based on quoted prices in active markets for identical assets and liabilities.
- **Level 2:** Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant inputs are observable in the market.
- **Level 3:** Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on the Company's own estimates about the assumptions that market participants would use to value the asset or liability.

The carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, customer deposits, notes payable, and the Restated Revolver, as reported in the accompanying consolidated balance sheets, approximate their fair values due to their short-term maturity or floating interest rate terms, as applicable. The factors considered in determining fair values of the Company's communities when necessary under ASC 360 are described in the discussion of the Company's inventory impairment analysis (see Note 1), and are classified as Level 2 or Level 3 valuations. The following table summarizes ranges for the significant quantitative unobservable inputs we utilized in our fair value measurements with respect to the inventory impairments recorded during the periods presented:

Unobservable Inputs:	**Year ended May 31, 2020**
Average selling price	$300,000 - $667,000
Annual discount rate	12%

The following table presents the carrying amounts and estimated fair values of the Company's 6.625% Notes, 9.875% Notes, and 6.750% Notes at May 31, 2020 and 2019:

		May 31, 2020		**May 31, 2019**	
	Fair Value Hierarchy	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Liabilities:		(in thousands)			
6.625% Notes	Level 2	$ 245,610	$ 226,875	$ —	$ —
9.875% Notes	Level 2	249,182	263,288	248,268	262,650
6.750% Notes	Level 2	246,878	237,500	246,173	233,750
		$ 741,670	$ 727,663	$ 494,441	$ 496,400

The Company's 6.625% Notes, 9.875% Notes, and 6.750% Notes are recorded at their carrying values in the consolidated balance sheets, which may differ from their respective fair values. The carrying values of the Company's 6.625% Notes, 9.875% Notes, and 6.750% Notes reflect their face amount, adjusted for any unamortized debt issuance costs and discount. The fair values of the 6.625% Notes, 9.875% Notes, and 6.750% Notes are derived from quoted market prices by independent dealers (Level 2).

Note 15 — Commitments and Contingencies

The Company is involved in lawsuits and other contingencies in the ordinary course of business. The amounts demanded by the claimants in these lawsuits and claims may vary widely, with large demands made in certain cases, which are disputed and aggressively defended by the Company. We establish liabilities for legal claims and related matters when such matters are both probable of occurring and any potential loss is reasonably estimable. We accrue for such matters based on the facts and circumstances specific to each matter and revise these estimates as the matters evolve. In such cases, there may exist an exposure to loss in excess of any amounts currently accrued. In view of the inherent difficulty of predicting the outcome of these legal and related matters, we generally cannot predict the ultimate resolution of the pending matters, the related timing, or the eventual loss. While the outcome of such contingencies cannot be predicted with certainty, we do not believe that the resolution of such matters will have a material adverse effect on the Company’s results of operations, financial condition, or cash flows. However, to the extent the liability arising from the ultimate resolution of any matter exceeds the estimates reflected in the recorded reserves relating to such matter, we could incur additional charges that could be significant.

In addition, on June 27, 2016, FCC Marsh, LLC (the “Seller”) filed a complaint against Ashton Tampa Residential, LLC (“Ashton Tampa”), a wholly owned subsidiary of Ashton Woods USA L.L.C. (“Ashton Woods USA”), in the Circuit Court for Collier County, Florida, alleging that Ashton Tampa breached a lot purchase agreement that provided the Seller with a specific performance right against Ashton Tampa, subject to certain conditions, by allegedly failing to close on certain lot purchases (the “Lawsuit”). The Seller dismissed its claim for specific performance, and sought declaratory relief and damages. Ashton Tampa filed a counterclaim in the Lawsuit seeking declaratory relief, return of the earnest money deposit, foreclosure of the mortgage that secured that deposit, and damages for the Seller's breach of a lease agreement between the parties. On April 5, 2019, the Seller filed a motion to amend its complaint in the Lawsuit to add Ashton Woods USA as a defendant, and to assert a tortious interference claim against Ashton Woods USA, which motion was granted by the court. Subsequently, on April 30, 2019, the Seller filed a separate complaint against Ashton Woods USA in the Circuit Court for Collier County, Florida asserting the identical tortious interference claim (together with the Lawsuit, the “Lawsuits”). At a hearing on September 16, 2019, the court granted the Seller's motion for summary judgment in the Lawsuit on Ashton Tampa’s claim for declaratory relief with respect to the $1.4 million earnest money deposit and ordered that those funds be released to the Seller. In July 2019, Seller submitted an expert report in which it claimed $22.8 million in damages. The parties settled the Lawsuits at a court-ordered mediation in February 2020. In exchange for a payment by Ashton Tampa of $6.3 million, which payment was made in March 2020, the Seller dismissed the Lawsuits with prejudice, and the parties agreed to release all claims against one another. The charge for the settlement is included in Selling, General and Administrative expense on the consolidated statements of income.

The Company has entered into employment agreements with its executive officers and certain other employees that provide for severance payments based on salary and the most recent bonus paid or target bonus upon termination without cause, or, with respect to certain of these officers, following a change of control, by the Company without cause or by the executive for good reason.

In the normal course of business, the Company provides letters of credit and surety bonds to third parties to secure performance and provide deposits under various contracts and commitments. At May 31, 2020 and May 31, 2019, the Company had letters of credit outstanding of $2.7 million and $4.3 million, respectively, and surety bonds outstanding of $73.6 million and $56.6 million, respectively. As of May 31, 2020, the Company had $47.3 million of unused letter of credit capacity under the Restated Revolver.

The Company enters into various option purchase agreements to acquire land. In connection with such agreements, as of May 31, 2020, the Company has made nonrefundable deposits of $168.3 million, which includes $23.3 million of nonrefundable deposits related to purchase and option agreements recorded under ASC 606 or ASC 470-40 (See Note 6). The Company would forfeit the remaining deposits if the lots are not purchased. The total purchase price of lots remaining to be purchased under option agreements with nonrefundable deposits was approximately $1.3 billion as of May 31, 2020.

Leases

The Company leases office space and equipment under various operating leases with varying commencement dates and renewal options for use in our operations. We recognize lease expense for these leases on a straight-line basis over the lease term and combine lease and non-lease components for all leases. Right-of-use assets and Lease liabilities are recorded on the consolidated balance sheets for all leases with an expected term of at least one year. Some leases include one or more options to renew. The exercise of lease renewal options is generally at our discretion. The depreciable lives of right-of-use assets and leasehold improvements are limited to the expected lease term. Our lease agreements do not contain any residual value guarantees or material restrictive covenants.

Right-of-use assets are classified within other assets on the consolidated balance sheets, while Lease liabilities are classified within other liabilities on the consolidated balance sheets. Right-of-use assets and Lease liabilities were $13.1 million and $14.4 million at May 31, 2020, respectively. During the year ended May 31, 2020, there was $0.1 million of additions to the right-of-use assets under operating leases. Payments on Lease liabilities during the year ended May 31, 2020 totaled $4.0 million.

Lease expense includes costs for leases with terms in excess of one year as well as short-term leases with terms of less than one year. For the year ended May 31, 2020 and 2019 our total lease expense approximated $5.6 million and $4.9 million, respectively, inclusive of short-term lease costs. Sublease income, short-term lease costs, and variable lease costs are not material to the consolidated financial statements.

The future minimum lease payments required under our leases as of May 31, 2020 are as follows (in thousands):

Year ending May 31, 2021	$	4,216
Year ending May 31, 2022		4,102
Year ending May 31, 2023		3,478
Year ending May 31, 2024		2,861
Year ending May 31, 2025		2,167
Thereafter		2,201
Total future minimum lease payments[a]		19,025
Less: Interest [b][c]		4,615
Total future minimum lease payments less interest[c]	$	14,410

(a) Lease payments include options to extend lease terms that are reasonably certain of being exercised.

(b) Our leases do not provide a readily determinable implicit rate. Therefore, we estimate our discount rate for such leases to determine the present value of lease payments at the lease commencement date.

(c) The weighted average lease term and weighted average discount rate used in calculating our Lease liabilities were 4.8 years and 7.7%, respectively, at May 31, 2020.

Note 16 — Information on Segments

The Company's homebuilding reportable segments are as follows:

1) East:	Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota, and Naples)
2) Central:	Houston, Dallas, Austin, San Antonio, and Phoenix

The following table summarizes revenue, gross profit, depreciation and amortization, equity in earnings in unconsolidated entities, and net income for each of the Company's reportable segments (in thousands):

	Year ended May 31,		
Revenues:	**2020**	**2019**	**2018**
Homebuilding:			
East	$ 805,731	$ 935,124	$ 753,805
Central	961,327	730,873	720,878
Total homebuilding revenues	1,767,058	1,665,997	$ 1,474,683
Land sales	8,753	20,805	3,353
Financial services and other revenue	40,291	8,744	—
Total revenues	$ 1,816,102	$ 1,695,546	$ 1,478,036
Gross profit [1]:			
Homebuilding:			
East	$ 122,180	$ 145,767	$ 123,107
Central	195,256	133,801	129,979
Total homebuilding gross profit	317,436	279,568	253,086
Land sales gross profit	1,517	1,242	702
Financial services and other revenue gross profit	11,390	6,728	—
Total gross profit	$ 330,343	$ 287,538	$ 253,788

(1) Includes inventory impairments on homes totaling $2.7 million, $2.6 million, and $65.0 thousand for the east segment during the year ended May 31, 2020, 2019, and 2018, respectively, and $41.0 thousand, $0.6 million, and $266.0 thousand for the central segment during the year ended May 31, 2020, 2019, and 2018, respectively.

	Year ended May 31,		
	2020	**2019**	**2018**
Depreciation and amortization:			
East	$ 4,187	$ 5,239	$ 5,184
Central	5,358	5,100	5,921
Total depreciation and amortization	$ 9,545	$ 10,339	$ 11,105
Equity in earnings of unconsolidated entities:			
East	$ 677	$ 202	$ —
Central	5,078	3,696	2,935
Total equity in earnings of unconsolidated entities	$ 5,755	$ 3,898	$ 2,935
Net income:			
East	$ 7,019	$ 32,807	$ 26,905
Central	75,239	37,866	42,517
	82,258	70,673	69,422
Other [2]	(6,442)	(10,080)	(16,952)
Total net income	$ 75,816	$ 60,593	$ 52,470

(2) "Other" primarily consists of interest directly expensed and a loss from the early extinguishment of debt.

The following table summarizes total assets for each of the Company's reportable segments (in thousands):

	May 31, 2020	May 31, 2019
Assets:		
Homebuilding:		
East	$ 644,009	$ 607,778
Central	537,735	513,553
	1,181,744	1,121,331
Other [(1)]	270,501	8,985
Total assets	$ 1,452,245	$ 1,130,316

(1) "Other" is comprised of cash, restricted cash, and corporate assets.

The following table summarizes additions to property and equipment for each of the Company's reportable segments for the periods presented (in thousands):

	Year ended May 31,		
	2020	2019	2018
Additions to property and equipment:			
Homebuilding:			
East	$ 3,640	$ 4,913	$ 3,633
Central	3,746	4,856	1,997
	7,386	9,769	5,630
Other [(1)]	230	12	1,004
Total additions to property and equipment	$ 7,616	$ 9,781	$ 6,634

(1) "Other" is comprised of property and equipment additions for the Company's corporate office.

Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

Item 9A. *Controls and Procedures*

Pursuant to section 4.03 of each of the indentures governing the 6.625% Notes, 9.875% Notes, and 6.750% Notes, the Company is not required to comply with Section 302 or Section 404 of the Sarbanes-Oxley Act of 2002, or related Items 307 and 308 of Regulation S-K promulgated by the Securities and Exchange Commission.

Item 9B. *Other Information*

None.

PART III.
Item 10. *Directors, Executive Officers, and Corporate Governance*

The following table presents information with respect to our executive officers and directors:

Executive officers and directors

Name	Age	Position
Jerry Patava	66	Director, Chairman of the Board
Elly Reisman	70	Director
Seymour Joffe	67	Director, Chairman of the Audit Committee
Kris Miller	54	Director
Joseph Beard	59	Director
Ken Balogh	49	President and Chief Executive Officer
Cory Boydston	61	Chief Financial Officer
Deborah Danzig	47	Chief Legal Officer and Corporate Secretary
Ryan Lewis	42	Chief Operating Officer

Mr. Patava, a member of our Board since February 2009, served as the Chief Executive Officer of the Great Gulf Group of Companies (the "Great Gulf Group"), an affiliate of the Company through common ownership, from July 2007 until January 2020. Mr. Patava currently serves on the Board and Investment Committee at Terra Firma Capital Corporation. Between January 2005 and 2007, he served on several public company Boards. Between 1998 and 2005 Mr. Patava served as Executive Vice President and Chief Financial Officer of Fairmont Hotels & Resorts Inc., between 1990 and 1998 as Vice President and Treasurer of Canadian Pacific Limited, and between 1986 and 1990 as Vice President and Director of RBC Dominion Securities. Mr. Patava has a Bachelor of Arts degree from the University of Toronto and a Master of Business Administration degree from York University.

Mr. Reisman, a member of our Board since April 2013, is the chair and co-founder of the Great Gulf Group. Mr. Reisman has over 40 years of real estate development and management experience throughout North America. Under his guidance, the Great Gulf Group has grown from a regional homebuilder to a broadly diversified real estate company.

Mr. Joffe, a member of our Board or our prior management committee since 1997, is a co-founder and principal of the Great Gulf Group. Prior to 1983, Mr. Joffe worked in real estate and public accounting. Mr. Joffe qualified as a Chartered Accountant in South Africa and in Canada.

Mr. Miller, a member of our Board since February 2009, has served as President of Ackerman & Co., a company involved in the development and acquisition of office, medical, retail and mixed use real estate space, since 1997. Mr. Miller joined Ackerman in 1996 as Chief Financial Officer. Prior to joining Ackerman, Mr. Miller was a Vice President of Citicorp, where he managed Citicorp's Atlanta real estate office. Mr. Miller is a graduate of Harvard University with an A.B. in Economics and attended the London School of Economic and Political Science in Citicorp's Institute of Global Finance and Management Program.

Mr. Beard, a member of our Board since April 2013, co-founded in 1991 and serves as President and Chief Executive Officer of Westdale Asset Management, Ltd. a subsidiary of Canada-based Westdale Properties. Westdale Asset Management is a nationwide real estate investment, property management, leasing, and construction firm. Prior to forming Westdale Asset Management, Mr. Beard was responsible for the development and acquisition of over 10,000 apartment units. Mr. Beard is a graduate of Southern Methodist University where he obtained a degree in History with minors in Political Science and Psychology.

Mr. Balogh joined our Company as an executive vice president in September 2009 and was promoted to Chief Operating Officer in March 2010. In January 2011, he was appointed President and Chief Executive Officer. Prior to joining the Company, Mr. Balogh worked for Centex Homes (now part of the Pulte Group) for 16 years, serving in various positions including as Executive Vice President of its East Region (Florida, the Carolinas, Virginia and New Jersey). Prior to that, he served in various other roles at Centex, including Division President, Division Manager, Vice President of Land Acquisitions, Entitlement and Development, Vice President of Finance, Division Controller, Assistant Controller, and Accountant. He currently sits on the Board of Directors for HomeAid, one of the nation's leading non-profit providers of housing for the homeless population. Mr. Balogh has been in the homebuilding industry for over 20 years and has a finance degree from the University of Central Florida.

Mrs. Boydston has served as our Chief Financial Officer since August 2009. Prior to joining the Company, Mrs. Boydston worked for Starwood Land Ventures for one and a half years, where she served as Senior Vice President and Chief Financial Officer. Prior to that, she was with Beazer Homes USA Inc., where she worked for 10 years and served as Senior Vice President and Treasurer. Between 1987 and 1997, Mrs. Boydston was with Lennar Corporation, where she served as Vice President of Finance and Chief Financial Officer, Corporate Controller, and Division Controller. She was also a Senior Auditor at Arthur Andersen LLP. In March 2018, she was appointed to the Board of Directors and the Audit Committee of BMC Holdings, Inc. (Nasdaq: BMCH), a leading provider of diversified building products and services in the U.S. residential construction market. Mrs. Boydston is also the Co-Founder of Women's Housing Leadership Group. Mrs. Boydston has a Bachelor of Science in Accounting degree from Florida State University and is a Certified Public Accountant.

Mrs. Danzig has been our Chief Legal Officer since July 2011 and our Corporate Secretary since October 2011. Prior to joining the Company, Mrs. Danzig was with Beazer Homes USA Inc. for six years where she served most recently as Vice President, Compliance Officer. Prior to joining Beazer Homes USA Inc., Mrs. Danzig was in private practice with Sutherland, Asbill & Brennan in Atlanta, Georgia and Davis Polk & Wardwell in New York, New York. Mrs. Danzig also clerked for the Honorable Phyllis A. Kravitch of the U.S. Court of Appeals for the Eleventh Circuit. Mrs. Danzig obtained her law degree from Cornell Law School and her B.A. from Emory University.

Mr. Lewis joined our Company as Division President of the Company’s Charleston operating division in 2013 and later also became the Division President of the Company's Raleigh operating division. In February 2017, he was appointed to the position of Chief Operating Officer. Prior to joining the Company, from 2009 to 2013, Mr. Lewis worked for Pulte Group as Area Vice President of Construction Operations—Southeast Region and Vice President of Construction Operations—Atlanta Division. From 2000 to 2009, Mr. Lewis worked for Centex Homes, in several operational roles with progressive responsibilities. Mr. Lewis holds a degree in Construction Management from Georgia Southern University.

The Company does not currently have a separately designated compensation committee or nominating and corporate governance committee. The full Board performs all functions these committees would otherwise perform. The Company has an Audit Committee of the Board of Directors comprised of Messrs. Patava and Joffe. The Audit Committee’s primary function is to assist the Board in (a) the financial reporting process, including the integrity of the Company’s financial statements and systems of internal controls regarding finance and accounting; (b) the qualifications and independence of the Company’s independent auditors; (c) management of the Company’s financial policies and procedures; and (d) the performance of the Company’s independent auditors. The Audit Committee has direct responsibility for the appointment, compensation, retention, and oversight of the work of our outside accounting firm, Ernst & Young LLP. The Board has determined that each of the Audit Committee members satisfies the requirements for financial literacy under current SEC requirements. The Board has also determined that Mr. Patava and Mr. Joffe each is an “audit committee financial expert,” as that term is defined by the SEC. Although neither Mr. Patava nor Mr. Joffe is an independent director, the Board chose them to serve on the Audit Committee due to their financial expertise and their expertise in the homebuilding and real estate industries, including their level of experience with financial matters related to these industries. The Audit Committee operates pursuant to a written charter.

The Company maintains a Code of Business Conduct and Ethics, which applies to all of its employees including its executive officers. The Company will provide to any person without charge, upon request to Deborah Danzig at 678-597-2122, a copy of its Code of Business Conduct and Ethics.

Item 11. *Executive Compensation*

Pursuant to section 4.03 of each of the indentures governing the 6.625% Notes, 9.875% Notes, and 6.750% Notes, the Company is not required to provide disclosure regarding executive compensation, a description of employment agreements with officers, or a description of any incentive plans.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters*

The following table sets forth certain information as of May 31, 2020 regarding the beneficial ownership of the membership interests in the Company by executive officers, directors and owners of greater than 5% of the Company's equity. The Company has three classes of membership interests, Class A, Class B, and Class C, which are pari passu and share ratably in the ownership of the Company. Percentages below are based on sharing ratios held directly or indirectly in the Company.

Name and address of beneficial owner	Membership interest (1)
Seymour Joffe (2)(3)	6.27%
Elly Reisman (2)(4)	34.49%
Jerry Patava	—
Kris Miller	—
Joseph Beard (5)	11.83%
Ken Balogh	—
Cory Boydston	—
Deborah Danzig	—
Ryan Lewis	—
All directors and executive officers as a group	52.60%
Little Shots Nevada L.L.C. (2)	87.82%
Little Shots Holdings L.L.C. (2)	18.83%
Westdale Properties America I, Ltd. (5)	11.83%
Harry Nevada Inc. (2)(6)	6.27%
Norman Nevada Inc. (2)(7)	34.49%
Bruce Nevada Inc. (2)(8)	6.27%

(1) Beneficial ownership is determined in accordance with Section 13 of the Exchange Act and the rules promulgated thereunder. Accordingly, if an individual or entity is a member of a "group" which has agreed to act together for the purpose of acquiring, holding, voting, or disposing of membership interests, such individual or entity is deemed to be the beneficial owner of the membership interests held by all members of the group. Further, if an individual or entity has or shares the power to vote or dispose of membership interests held by another entity, beneficial ownership of the interests held by such entity may be attributed to such other individuals or entities.

(2) The address of this beneficial owner is 3751 Victoria Park Avenue, Toronto, Ontario M1W 3Z4 Canada.

(3) Mr. Joffe holds an interest in the Company through ownership by Seymour Nevada, Inc. of a 33.33% membership interest in Little Shots Holdings L.L.C., which holds an 18.83% interest in the Company through its 21.44% ownership interest in Little Shots Nevada L.L.C. For beneficial ownership purposes, the membership interests held by Little Shots Nevada L.L.C. are attributable to Little Shots Holdings L.L.C. based on its ownership interest and ultimately to Mr. Joffe.

(4) Mr. Reisman holds an interest in the Company through ownership by Elly Nevada Inc. of a 39.28% interest in Little Shots Nevada L.L.C.

(5) The address of this beneficial owner is 3100 Monticello Avenue, Suite 660, Dallas, Texas 75205. This interest is held of record by Westdale Properties America I, Ltd. ("Westdale"). Mr. Beard, through wholly owned entities, serves as the general partner of and has a 10% ownership interest in Westdale. Mr. Beard disclaims beneficial ownership of the interests held by Westdale except to the extent of his 10% pecuniary interest.

(6) This entity, which is owned by entities and/or family trusts associated with Harry Rosenbaum, holds an interest in the Company through its 33.33% membership interest in Little Shots Holdings L.L.C.

(7) This entity, which is owned by entities and/or family trusts associated with Norman Reisman, holds an interest in the Company through its ownership of a 39.28% interest in Little Shots Nevada L.L.C.

(8) This entity, which is owned by entities and/or family trusts associated with Bruce Freeman, holds an interest in the Company through its 33.33% membership interest in Little Shots Holdings L.L.C.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

Pursuant to section 4.03 of each of the indentures governing the 6.625% Notes, 9.875% Notes, and 6.750% Notes, the Company is not required to disclose related party transactions outside of the financial statement footnotes.

Our board of directors, which we refer to as our Board, consists of five members—Messrs. Patava (Chairman), Reisman, Joffe, Miller, and Beard. As required by our Regulations, Messrs. Patava, Reisman, and Joffe are Class A Directors elected by our Class A Unit holder, Mr. Beard is a Class B Director elected by our Class B Unit holders, and Mr. Miller is an Independent Director, as defined by our Regulations, elected by our Class A, Class B, and Class C Unit holders voting as a class. Each director serves a term of one year automatically renewed until a successor is elected and qualified, or until his earlier death, resignation, or removal. We do not have any equity listed on a securities exchange, and therefore are not required to comply with any independence requirements imposed by the exchanges. Pursuant to our regulations, we are required to have one independent director, as defined by the regulations, but are not required to have a specified number in excess of that. Our Board has concluded that for the year ended 2020, Mr. Miller was an independent director under the requirements of our regulations and under the standards applicable to companies listed on the New York Stock Exchange.

Item 14. *Principal Accounting Firm Fees and Service*

Ernst & Young LLP served as the Company's independent auditor for the 2020, 2019, and 2018 fiscal years. For the year ended May 31, 2020 and 2019, total audit fees incurred were $0.6 million and $0.7 million, respectively, as well as $0.1 million and $0.1 million of audit-related fees during the year ended May 31, 2020 and 2019, respectively, related to the debt transactions discussed in Note 2 to our consolidated financial statements.