

Forestar Group Inc.
Form 10-Q
November 03, 2011

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

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

For the quarterly period ended September 30, 2011

or

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

For the transition period from _____ to _____

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

(Exact Name of Registrant as Specified in Its Charter)

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

26-1336998
*(I.R.S. Employer
Identification No.)*

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

(Address of Principal Executive Offices, Including Zip Code)

(512) 433-5200

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of Each Class	Number of Shares Outstanding as of October 31, 2011
Common Stock, par value \$1.00 per share	35,333,846

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Consolidated Balance Sheets**

	(Unaudited) Third Quarter-End 2011	Year-End 2010
	(In thousands)	
ASSETS		
Cash and cash equivalents	\$ 29,121	\$ 5,366
Real estate	587,226	562,192
Assets held for sale		21,122
Investment in unconsolidated ventures	98,089	101,166
Timber	15,656	17,959
Receivables, net	24,376	2,875
Prepaid expenses	2,409	2,034
Property and equipment, net	5,362	5,577
Oil and gas properties and equipment, net	3,713	322
Deferred tax asset	58,154	47,141
Goodwill and other intangible assets	5,720	6,527
Other assets	16,870	17,043
TOTAL ASSETS	\$ 846,696	\$ 789,324
LIABILITIES AND SHAREHOLDERS EQUITY		
Accounts payable	\$ 5,733	\$ 4,214
Accrued employee compensation and benefits	784	994
Accrued property taxes	6,996	3,662
Accrued interest	946	1,061
Income taxes payable	22,423	3,293
Other accrued expenses	10,713	8,168
Other liabilities	30,753	32,064
Debt	223,697	221,589
TOTAL LIABILITIES	302,045	275,045
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY		
Forestar Group Inc. shareholders equity:		
Preferred stock, par value \$0.01 per share, 25,000,000 authorized shares, none issued		
Common stock, par value \$1.00 per share, 200,000,000 authorized shares, 36,793,467 issued at third quarter-end 2011 and 36,667,210 issued at year-end 2010	36,793	36,667
Additional paid-in capital	396,898	391,352
Retained earnings	131,035	101,001

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Treasury stock, at cost, 1,459,621 shares at third quarter-end 2011 and 1,216,647 shares at year-end 2010	(22,873)	(19,456)
Total Forestar Group Inc. shareholders' equity	541,853	509,564
Noncontrolling interests	2,798	4,715
TOTAL SHAREHOLDERS' EQUITY	544,651	514,279
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 846,696	\$ 789,324

Please read the Notes to Consolidated Financial Statements.

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FORESTAR GROUP INC.
Consolidated Statements of Income
(Unaudited)

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
REVENUES				
Real estate sales	\$ 11,802	\$ 10,000	\$ 38,335	\$ 36,895
Income producing properties and other	7,258	5,139	21,479	17,041
Real estate	19,060	15,139	59,814	53,936
Mineral resources	5,871	6,654	17,784	18,387
Fiber resources and other	1,310	2,220	3,968	6,185
	26,241	24,013	81,566	78,508
COSTS AND EXPENSES				
Cost of real estate sales	(7,760)	(4,183)	(19,396)	(17,312)
Cost of income producing properties and other	(4,607)	(3,931)	(13,498)	(12,680)
Cost of mineral resources	(597)	(223)	(1,829)	(852)
Cost of fiber resources and other	(349)	(466)	(881)	(1,208)
Other operating	(11,771)	(10,323)	(33,928)	(29,760)
General and administrative	(2,770)	(4,797)	(15,590)	(16,493)
Gain on sale of assets	61,784	15,441	61,784	15,441
	33,930	(8,482)	(23,338)	(62,864)
OPERATING INCOME				
Equity in earnings of unconsolidated ventures	648	82	1,632	740
Interest expense	(4,271)	(3,913)	(12,933)	(12,562)
Other non-operating income	26	246	77	690
INCOME BEFORE TAXES				
Income tax expense	(19,609)	(2,860)	(16,069)	(1,507)
CONSOLIDATED NET INCOME				
Less: Net income attributable to noncontrolling interests	(537)	(164)	(901)	(328)
NET INCOME ATTRIBUTABLE TO FORESTAR GROUP INC.				
	\$ 36,428	\$ 8,922	\$ 30,034	\$ 2,677
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	35,514	35,934	35,482	36,109
Diluted	35,796	36,379	35,877	36,595
NET INCOME PER COMMON SHARE				
Basic	\$ 1.03	\$ 0.25	\$ 0.85	\$ 0.07

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Diluted

\$ 1.02

\$ 0.25

\$ 0.84

\$ 0.07

Please read the Notes to Consolidated Financial Statements.

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

	First Nine Months	
	2011	2010
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income	\$ 30,935	\$ 3,005
Adjustments:		
Depreciation and amortization	7,335	7,231
Deferred income taxes	(11,013)	(1,470)
Tax benefits not recognized for book purposes	144	91
Equity in (earnings) loss of unconsolidated ventures	(1,632)	(740)
Distributions of earnings of unconsolidated ventures	5,307	1,184
Distributions of earnings to noncontrolling interests	(2,899)	(569)
Non-cash share-based compensation	399	7,370
Non-cash real estate cost of sales	17,149	15,387
Non-cash cost of assets sold	24,931	6,604
Real estate development and acquisition expenditures	(49,530)	(11,499)
Acquisition of non-performing loan	(21,137)	
Reimbursements from utility and improvement districts	2,270	495
Other changes in real estate	(237)	133
Gain on termination of timber lease	(181)	(617)
Cost of timber cut	856	1,141
Deferred income	345	1,655
Asset impairments	450	900
Loss on sale of assets held for sale		277
Other	115	(51)
Changes in:		
Notes and accounts receivable	(464)	(9,729)
Proceeds due from qualified intermediary		(22,630)
Prepaid expenses and other	581	570
Accounts payable and other accrued liabilities	9,962	(4,220)
Income taxes	19,130	(8,219)
Net cash provided by (used for) operating activities	32,816	(13,701)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software and reforestation	(1,466)	(2,282)
Oil and gas properties and equipment	(3,414)	
Investment in unconsolidated ventures	(1,350)	(1,538)
Return of investment in unconsolidated ventures	688	4,790
Proceeds from sale of assets held for sale		2,602
Proceeds from termination of timber lease	290	
Proceeds from sale of property	103	
Net cash (used for) provided by investing activities	(5,149)	3,572
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt	(104,750)	(22,551)

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Additions to debt	106,858	36,698
Deferred financing fees	(3,746)	(5,969)
Return of investment to noncontrolling interest	(2)	(706)
Exercise of stock options	1,171	881
Repurchases of common stock	(2,126)	(15,178)
Payroll taxes on restricted stock and stock options	(1,290)	(49)
Tax benefit from share-based compensation	(110)	121
Other	83	314
Net cash used for financing activities	(3,912)	(6,439)
Net increase (decrease) in cash and cash equivalents	23,755	(16,568)
Cash and cash equivalents at beginning of period	5,366	21,051
Cash and cash equivalents at end of period	\$ 29,121	\$ 4,483

Please read the Notes to Consolidated Financial Statements.

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FORESTAR GROUP INC.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1 Basis of Presentation

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

We prepare our unaudited interim financial statements in accordance with U.S. generally accepted accounting principles and Securities and Exchange Commission requirements for interim financial statements. As a result, they do not include all the information and disclosures required for complete financial statements. However, in our opinion, all adjustments considered necessary for a fair presentation have been included. Such adjustments consist only of normal recurring items unless otherwise noted. We make estimates and assumptions about future events. Actual results can, and probably will, differ from those we currently estimate including those related to allocating cost of sales to real estate, minerals and fiber and measuring assets for impairment. These interim operating results are not necessarily indicative of the results that may be expected for the entire year. For further information, please read the financial statements included in our 2010 Annual Report on Form 10-K.

In 2011, we reclassified \$160,000 and \$557,000 from cost of income producing properties to operating expenses relating to third quarter and first nine months 2010 to conform to the current year's presentation. In addition, in third quarter 2011, we reclassified \$1,612,000 in assets held for sale to real estate and timber upon completing our strategic initiatives related to the sale of higher and better use timberland and reduction of debt.

Note 2 New and Pending Accounting Pronouncements**Accounting Standards Adopted in 2011**

In first quarter 2011, we adopted Accounting Standards Update (ASU) 2010-28 *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* and ASU 2010-29 *Disclosure of Supplementary Pro Forma Information for Business Combinations*. Adoption of these pronouncements did not affect our earnings or financial position.

Pending Accounting Standards

Pending ASU 2011-04 *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, ASU 2011-05 *Comprehensive Income: Presentation of Comprehensive Income* and ASU 2011-08 *Testing Goodwill for Impairment* will be effective first quarter 2012 though early adoption is permitted. We are evaluating whether we will adopt this ASU in fourth quarter 2011. Adoptions of these ASUs are not anticipated to have a significant effect on our earnings or financial position but may result in certain additional disclosures.

Note 3 Strategic Initiatives and Assets Held for Sale

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

In third quarter 2011, we sold 50,000 acres of timberland in Georgia and Alabama to Plum Creek Timberlands, L.P. for \$74,722,000 and 7,000 acres in Texas to The Conservation Fund for \$12,339,000. These transactions generated net proceeds of \$86,018,000, which were principally used to reduce debt. These transactions resulted in gains of \$61,784,000. We also repurchased 172,435 shares of our common stock for \$2,126,000, which are classified as treasury stock.

At third quarter-end 2011, we have completed our strategic initiatives related to the sale of higher and better use timberland and reduction of debt. Since announcing these initiatives, we have sold 176,000 acres of timberland in Georgia, Alabama and Texas for \$284,442,000 in eleven transactions. These transactions generated net proceeds of \$277,909,000 and resulted in gains of \$194,438,000. We used the proceeds principally to reduce debt, pay income taxes, reinvest in our business and repurchase stock. Our total debt has been reduced by \$151,986,000 since first quarter-end 2009, excluding \$26,500,000 in non-recourse borrowings secured by a 401 unit multifamily property we acquired in fourth quarter 2010. In addition, we have repurchased 1,173,422 shares of our common stock for \$17,304,000.

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Real estate consists of:

	Third Quarter-End 2011	Year-End 2010
	(In thousands)	
Entitled, developed and under development projects	\$ 406,311	\$ 403,059
Undeveloped land	90,969	86,608
Income producing properties	116,034	95,963
	613,314	585,630
Accumulated depreciation	(26,088)	(23,438)
	\$ 587,226	\$ 562,192

Included in entitled, developed and under development projects are the estimated costs of assets we expect to convey to utility and improvement districts of \$63,087,000 at third quarter-end 2011 and \$59,079,000 at year-end 2010, including \$36,552,000 included in both third quarter-end 2011 and year-end 2010 related to our Cibolo Canyons project near San Antonio, Texas. These costs relate to water, sewer and other infrastructure assets we have submitted to utility or improvement districts for approval and reimbursement. We submitted for reimbursement to these districts \$2,336,000 in first nine months 2011 and \$3,316,000 in first nine months 2010. We collected \$187,000 from these districts in first nine months 2011 and \$495,000 in first nine months 2010. We expect to collect the remaining amounts billed when these districts achieve adequate tax bases to support payment.

Also included in entitled, developed and under development projects is our investment in the resort development owned by third parties at our Cibolo Canyons project. In first nine months 2011, we received \$2,083,000 from the Special Improvement District (SID) from hotel occupancy and sales revenues collected as taxes by the SID. We currently account for these receipts as a reduction of our investment in the resort development. At third-quarter-end 2011, we have \$39,918,000 invested in the resort development.

At third quarter-end 2011, income producing properties primarily represents our investment in a 401 unit multifamily property in Houston, Texas with carrying value of \$46,998,000 and a 413 guest room hotel in Austin, Texas with carrying value of \$21,569,000. In addition, in second quarter 2011, we reclassified \$4,555,000 in land from entitled, developed and under development projects to income producing properties as result of commencing construction on a 289 unit multifamily project in Austin, Texas. At third-quarter end 2011, our investment in this project including land and construction in progress is \$9,394,000 with an estimated cost to complete construction of \$21,142,000.

We recognized asset impairment charges in second quarter 2011 of \$450,000 related to a residential real estate project located near Dallas, Texas and \$900,000 in second quarter 2010 related to a residential real estate project located near Salt Lake City, Utah.

Depreciation expense, primarily related to income producing properties, was \$2,650,000 in first nine months 2011 and \$2,067,000 in first nine months 2010 and is included in other operating expenses.

Note 5 Timber

We own directly or through ventures over 143,000 acres of timber, primarily in Georgia. The cost of timber cut and sold was \$856,000 in first nine months 2011 and \$1,141,000 in first nine months 2010.

Note 6 Shareholders Equity

A reconciliation of changes in shareholders equity at third quarter-end 2011 follows:

Forestar	Noncontrolling Interests	Total
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	Group Inc.	(In thousands)	
Balance at year-end 2010	\$ 509,564	\$ 4,715	\$ 514,279
Net income	30,034	901	30,935
Distributions to noncontrolling interests		(2,901)	(2,901)
Contributions from noncontrolling interests		83	83
Other (primarily share-based compensation)	2,255		2,255
Balance at third quarter-end 2011	\$ 541,853	\$ 2,798	\$ 544,651

In first nine months 2011, we issued 126,257 shares of our common stock as a result of stock option exercises and vesting of equity-settled restricted stock units.

In addition, we repurchased 172,435 shares of our common stock at a cost of \$2,126,000 in third quarter 2011. The repurchased shares are classified as treasury stock.

Table of Contents**Note 7 Investment in Unconsolidated Ventures**

At third quarter-end 2011, we had ownership interests ranging from 25 to 50 percent in 10 ventures that we account for using the equity method. We have no real estate ventures that are accounted for using the cost method. Our three largest ventures at third quarter-end 2011 are CL Realty, Temco and Palisades West. We own a 50 percent interest in both CL Realty and Temco, and Cousins Real Estate Corporation owns the other 50 percent interest. We own a 25 percent interest in Palisades West, Cousins Properties Incorporated owns a 50 percent interest and Dimensional Fund Advisors LP owns the remaining 25 percent interest. Information regarding these ventures follows:

CL Realty, L.L.C. was formed in 2002 for the purpose of developing residential and mixed-use communities in Texas and across the southeastern United States. At third quarter-end 2011, the venture has 14 residential and mixed-use communities, of which 10 are in Texas, three are in Florida and one is in Georgia, representing approximately 5,100 planned residential lots and 290 commercial acres.

Temco Associates, LLC was formed in 1991 for the purpose of acquiring and developing residential real estate sites in Georgia. At third quarter-end 2011, the venture has four residential and mixed-use communities, representing approximately 1,560 planned residential lots, all of which are located in Paulding County, Georgia. The venture also owns 5,712 acres of undeveloped land in Paulding County, Georgia.

Palisades West LLC was formed in 2006 for the purpose of constructing a commercial office park in Austin, Texas. The project includes two office buildings totaling approximately 375,000 square feet and an accompanying parking garage. At third quarter-end 2011, the buildings are approximately 99 percent leased. Our remaining commitment for investment in this venture as of third quarter-end 2011 is \$1,532,000. Effective fourth quarter 2008, we entered into a 10-year operating lease for approximately 32,000 square feet that we occupy as our corporate headquarters. In third quarter and first nine months 2011, rents paid under this operating lease were \$304,000 and \$864,000 and are included in general and administrative and other operating expenses. In third quarter and first nine months 2010, rents paid were \$296,000 and \$889,000 and are included in general and administrative expenses.

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

	Third Quarter-End 2011					Year-End 2010				
	CL Realty	Temco	Palisades West	Other Ventures	Total	CL Realty	Temco	Palisades West	Other Ventures	Total
	(In thousands)									
Real estate	\$ 81,844	\$ 59,641	\$ 120,474	\$ 66,634	\$ 328,593	\$ 85,436	\$ 60,454	\$ 124,696	\$ 69,612	\$ 340,198
Total assets	82,357	60,259	125,089	77,679	345,384	86,657	60,609	129,378	78,060	354,704
Borrowings										
(a)	1,047	2,824		75,330	79,201	2,664	2,929		74,605	80,198
Total liabilities	3,306	3,357	44,869 ^(b)	90,096	141,628	4,124	3,133	48,612 ^(b)	87,145	143,014
Equity	79,051	56,902	80,220	(12,417)	203,756	82,533	57,476	80,766	(9,085)	211,690
Our investment in real estate ventures:										
Our share of their equity ^(c)	39,525	28,451	20,055	13,221	101,252	41,267	28,738	20,191	14,075	104,271
Unrecognized deferred gain ^(d)	(2,164)			(999)	(3,163)	(2,190)			(915)	(3,105)

Investment in
real estate

ventures	\$ 37,361	\$ 28,451	\$ 20,055	\$ 12,222	\$ 98,089	\$ 39,077	\$ 28,738	\$ 20,191	\$ 13,160	\$ 101,166
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Combined summarized income statement information for our ventures accounted for using the equity method follows:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Revenues:				
CL Realty	\$ 2,290	\$ 1,120	\$ 5,808	\$ 5,332
Temco	89	233	435	2,110
Palisades West	4,142	3,414	12,256	10,145
Other ventures	2,678	1,549	8,343	9,769
Total	\$ 9,199	\$ 6,316	\$ 26,842	\$ 27,356
Earnings (Loss):				
CL Realty	\$ 1,091	\$ 964	\$ 2,481	\$ 2,184
Temco	(366)	(382)	(782)	430
Palisades West	1,461	1,124	4,372	3,406
Other ventures	(612)	(524)	(2,744)	(16,807)
Total	\$ 1,574	\$ 1,182	\$ 3,327	\$ (10,787)
Our equity in their earnings (loss):				
CL Realty	\$ 545	\$ 482	\$ 1,240	\$ 1,092
Temco	(183)	(191)	(391)	215
Palisades West	365	281	1,093	850
Other ventures ^(c)	(105)	(490)	(336)	(1,417)
Amortization of deferred gain	26		26	
Total	\$ 648	\$ 82	\$ 1,632	\$ 740

(a) Total includes current maturities of \$71,920,000 at third quarter-end 2011, of which \$43,169,000 is non-recourse to us, and \$75,121,000 at year-end 2010, of which \$43,166,000 is non-recourse to us.

(b) Includes \$42,792,000 of deferred income from leasehold improvements funded by tenants in excess of leasehold improvement allowances. These amounts are recognized as rental income over the lease term and are offset by depreciation expense related to these tenant improvements. There is no effect on venture net income.

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

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

In first nine months 2011, we invested \$1,350,000 in these ventures and received \$5,995,000 in distributions; in first nine months 2010, we invested \$1,538,000 in these ventures and received \$5,974,000 in distributions.

Distributions include both return of investments and distributions of earnings.

At third quarter-end 2011, other ventures include three partnerships we participate in that have total assets of \$51,301,000 and total liabilities of \$83,575,000, which includes \$67,557,000 of borrowings classified as current maturities. These partnerships are managed by third parties who intend to extend or refinance these borrowings; however, there is no assurance that this can be done. Although these borrowings may be guaranteed by third parties, we may under certain circumstances elect or be required to provide additional equity to these partnerships. We do not believe that the ultimate resolution of these matters will have a significant effect on our earnings or financial position. Our investment in these partnerships is \$2,362,000 at third quarter-end 2011. These three partnerships are variable interest entities. Please read **Note 17** for additional information.

In first nine months 2011, CL Realty's earnings include an impairment charge of \$500,000 related to a residential real estate project located in Tampa, Florida.

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

We have provided performance bonds and letters of credit on behalf of certain ventures totaling \$1,387,000 at third quarter-end 2011. Generally these performance bonds and letters of credit would be drawn on due to lack of performance by us or the ventures, such as failure to timely deliver streets and utilities in accordance with local codes and ordinances.

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Receivables consist of:

	Third Quarter-End 2011	Year-End 2010
	(In thousands)	
Non-performing loan	\$ 20,666	\$
Notes receivable, average interest rates of 7.73% at third quarter-end 2011 and 7.93% at year-end 2010	2,720	1,057
Due from qualified intermediary		1,347
Receivables and accrued interest	1,052	615
	24,438	3,019
Allowance for bad debts	(62)	(144)
	\$ 24,376	\$ 2,875

In second quarter 2011, we acquired a non-performing loan from a financial institution for \$21,137,000. The original loan commitment was \$38,000,000 and the outstanding balance is about \$34,087,000. The loan matured in February 2010. The note is secured by a lien on 900 acres of developed and undeveloped real estate located near Houston, Texas designated for single-family residential and commercial development. We are not currently accruing interest and have not recorded any accretable yield due to the non-performing status of the loan. We cannot estimate the anticipated future cash flows because the borrower is in bankruptcy. In third quarter 2011, we received \$471,000 in payments and accounted for these receipts as a reduction of the carrying value of the non-performing loan.

Notes receivable generally are secured by a deed of trust and generally due within three years.

Receivables and accrued interest principally include miscellaneous operating receivables arising in the normal course of business.

Note 9 Debt

Debt consists of:

	Third Quarter-End 2011	Year-End 2010
	(In thousands)	
Senior secured credit facility		
Term loan facility average interest rate of 6.50% at third quarter-end 2011 and year-end 2010	\$ 130,000	\$ 125,000
Revolving line of credit		
Secured promissory notes average interest rate of 4.31% at third quarter-end 2011 and 4.51% at year-end 2010	41,900	41,716
Other indebtedness due through 2017 at variable and fixed interest rates ranging from 5.00% to 8.00%	51,797	54,873
	\$ 223,697	\$ 221,589

Our debt agreements contain financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At third quarter-end 2011, we were in compliance with the financial covenants of these agreements.

At various times in 2011, we supplemented and amended our senior secured credit facility to provide us with, among other matters, additional flexibility with respect to the borrowing base, collateral coverage and leverage requirements. As a result, in third quarter 2011 we increased our unused borrowing capacity by over \$70,000,000 and extended the maturity of our revolving line of credit by one year, to August 6, 2014.

At third quarter-end 2011, our senior secured credit facility provides for a \$130,000,000 term loan maturing August 6, 2015 and a \$200,000,000 revolving line of credit maturing August 6, 2014. The term loan includes a 1 percent prepayment penalty for payments in excess of \$25,000,000 prior to February 6, 2012 and no prepayment penalty thereafter. The revolving line of credit may be prepaid at any time without penalty. The revolving line of credit includes a \$100,000,000 sublimit for letters of credit, of which \$984,000 is outstanding at third quarter-end 2011. Total borrowings under our senior secured credit facility (including the face amount of letters of credit) may not exceed a borrowing base formula. At third quarter-end 2011, we had \$176,337,000 in net unused borrowing capacity under our senior secured credit facility.

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

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At third quarter-end 2011, secured promissory notes include a \$26,500,000 non-recourse loan collateralized by a 401 unit multifamily project located in Houston, Texas with a carrying value of \$46,998,000. In addition, in third quarter 2011, we borrowed \$15,400,000 which is secured by a 413 guest room hotel located in Austin, Texas with a carrying value of \$21,569,000. This financing replaced debt retired in second quarter 2011.

At third quarter-end 2011, other indebtedness, primarily non-recourse, is collateralized by entitled, developed and under development projects with a carrying value of \$116,602,000.

At third quarter-end 2011, we have \$9,101,000 in unamortized deferred financing fees, including \$3,746,000 incurred in 2011 principally related to our senior secured credit facility, which are included in other assets. Amortization of deferred financing fees was \$2,161,000 in first nine months 2011 and \$3,747,000 in first nine months 2010 and is included in interest expense.

Note 10 Fair Value

Non-financial assets measured at fair value on a non-recurring basis principally include real estate assets and assets held for sale, which are measured for impairment. In second quarter 2011, a real estate asset was remeasured and reported at fair value due to events or circumstances that indicated the carrying value may not be recoverable. We determined estimated fair value based on the present value of future probability weighted cash flows expected from the sale of the long-lived asset. As a result, we recognized asset impairment of \$450,000 in second quarter 2011. The carrying value of this asset may have subsequently increased or decreased from the fair value due to activity that has occurred since the measurement date.

	Fair Value Measurements			Third
	Level	Level	Level 3	Quarter-End
	1	2		2011
	(In thousands)			
<i>Non-Financial Assets</i>				
Real estate	\$	\$	\$ 1,725	\$ 1,725

We elected not to use the fair value option for cash and cash equivalents, accounts receivable, other current assets, variable debt, accounts payable and other current liabilities. The carrying amounts of these financial instruments approximate their fair values due to their short-term nature or variable interest rates. We determine the fair value of fixed rate financial instruments using quoted prices for similar instruments in active markets.

Information about our fixed rate financial instruments not measured at fair value follows:

	Third Quarter-End 2011		Year-End 2010		Valuation Technique
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	
	(In thousands)				
Fixed rate debt	\$ (29,931)	\$ (32,431)	\$ (29,931)	\$ (30,164)	Level 2

Note 11 Capital Stock

Pursuant to our stockholder rights plan, each share of common stock outstanding is coupled with one-quarter of a preferred stock purchase right (Right). Each Right entitles our stockholders to purchase, under certain conditions, one one-hundredth of a share of newly issued Series A Junior Participating Preferred Stock at an exercise price of \$100. Rights will be exercisable only if someone acquires beneficial ownership of 20 percent or more of our common shares or commences a tender or exchange offer, upon consummation of which they would beneficially own 20 percent or more of our common shares. We will generally be entitled to redeem the Rights at \$0.001 per Right at any time until the 10th business day following public announcement that a 20 percent position has been acquired. The Rights will expire on December 11, 2017.

Please read **Note 18** for information about additional shares of common stock that could be issued under terms of our share-based compensation plans.

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As a result of the 2007 spin-offs from Temple-Inland, at third quarter-end 2011, personnel of Temple-Inland and the other spin-off entity held 19,000 awards that will be settled in our common stock and options to purchase 1,123,000 shares of our common stock. The options have a weighted average exercise price of \$21.51 and a weighted average remaining contractual term of three years. At third quarter-end 2011, the options have an aggregate intrinsic value of \$231,000.

Note 12 Other Comprehensive Income

Other comprehensive income consists of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Consolidated net income	\$ 36,965	\$ 9,086	\$ 30,935	\$ 3,005
Change in fair value of interest rate swap agreement				393
Income tax effect of change in fair value				(137)
Other comprehensive income	36,965	9,086	30,935	3,261
Less: Comprehensive income attributable to noncontrolling interests	(537)	(164)	(901)	(328)
Other comprehensive income attributable to Forestar Group Inc.	\$ 36,428	\$ 8,922	\$ 30,034	\$ 2,933

Note 13 Earnings per Share

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

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Earnings available to common shareholders:				
Consolidated net income	\$ 36,965	\$ 9,086	\$ 30,935	\$ 3,005
Less: Net income attributable to noncontrolling interest	(537)	(164)	(901)	(328)
Net income attributable to Forestar Group Inc.	\$ 36,428	\$ 8,922	\$ 30,034	\$ 2,677
Weighted average common shares outstanding basic	35,514	35,934	35,482	36,109
Dilutive effect of stock options	84	154	163	224
Dilutive effect of restricted stock and equity-settled awards	198	291	232	262
Weighted average common shares outstanding diluted	35,796	36,379	35,877	36,595
Anti-dilutive awards excluded from diluted weighted average shares outstanding	2,250	1,602	1,998	1,574

Note 14 Income Taxes

Our effective tax rate was 35 percent in third quarter 2011 and 34 percent in first nine months 2011, which includes a 1 percent benefit for noncontrolling interests and 1 percent non-cash charge for share-based compensation. Our effective tax rate was 24 percent in third quarter 2010 and 33 percent in first nine months 2010, which included a

4 percent benefit attributable to noncontrolling interests. In addition, 2011 and 2010 effective tax rates include the effect of state income taxes, nondeductible items, benefits of percentage depletion and charitable contributions related to timberland conservation.

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

At third quarter-end 2011, our unrecognized tax benefits totaled \$7,767,000, of which \$6,391,000 would affect our effective tax rate if recognized.

Note 15 Commitments and Contingencies

Litigation

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

Table of Contents**Environmental**

Environmental remediation liabilities arise from time to time in the ordinary course of doing business, and we believe we have established adequate reserves for any probable losses that we can reasonably estimate. We own 288 acres near Antioch, California, portions of which were sites of a former Temple-Inland paper manufacturing operation that are in remediation. We have received certificates of completion on all but 80 acres, a portion of which includes subsurface contamination. In third quarter 2011, we increased our reserves for environmental remediation by \$2,500,000 due to additional testing and remediation requirements by the state regulatory agencies. We estimate the cost to complete remediation activities will be approximately \$3,500,000, which is included in other accrued expenses. It is possible that remediation or monitoring activities could be required in addition to those included within our estimate, but we are unable to determine the scope, timing or extent of such activities.

Note 16 Segment Information

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

Assets allocated by segment are as follows:

	Third Quarter-End 2011	Year-End 2010
	(In thousands)	
Real estate	\$ 713,867	\$ 669,363
Mineral resources	15,653	13,399
Fiber resources	15,856	18,258
Assets not allocated to segments	101,320	88,304
Total assets	\$ 846,696	\$ 789,324

We evaluate performance based on segment earnings (loss) before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures and net (income) loss attributable to noncontrolling interests. Items not allocated to our business segments consist of general and administrative expense, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense. The accounting policies of the segments are the same as those described in the accounting policy note to the consolidated financial statements. Our revenues are derived from our U.S. operations and all of our assets are located in the U.S. In first nine months 2011, no single customer accounted for more than 10 percent of our total revenues.

Segment revenues and earnings are as follows:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Revenues:				
Real estate	\$ 19,060	\$ 15,139	\$ 59,814	\$ 53,936
Mineral resources	5,871	6,654	17,784	18,387
Fiber resources	1,310	2,220	3,968	6,185
Total revenues	\$ 26,241	\$ 24,013	\$ 81,566	\$ 78,508

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Segment earnings (loss):				
Real estate	\$ (4,266)	\$ (1,883)	\$ (684)	\$ 883
Mineral resources	3,592	6,196	12,292	16,640
Fiber resources	446	1,372	1,790	3,900
Total segment earnings (loss)	(228)	5,685	13,398	21,423
Items not allocated to segments ^(a)	56,265	6,097	32,705	(17,239)
Income before taxes attributable to Forestar Group Inc.	\$ 56,037	\$ 11,782	\$ 46,103	\$ 4,184

^(a) Items not allocated to segments consist of:

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	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
General and administrative expense	\$ (4,827)	\$ (3,860)	\$ (15,824)	\$ (13,438)
Share-based compensation expense	3,553	(1,817)	(399)	(7,370)
Gain on sale of assets	61,784	15,441	61,784	15,441
Interest expense	(4,271)	(3,913)	(12,933)	(12,562)
Other non-operating income	26	246	77	690
	\$ 56,265	\$ 6,097	\$ 32,705	\$ (17,239)

In third quarter 2011, gain on sale of assets represents the sale of 57,000 acres of timberland in Georgia, Alabama and Texas for \$87,061,000 in accordance with our strategic initiatives.

Third quarter and first nine months 2011 share-based compensation decreased as a result of a decline in our stock price and its impact on vested cash-settled awards.

In third quarter and first nine months 2011, general and administrative expense includes \$459,000 and \$3,187,000 associated with proposed private debt offerings that we withdrew as a result of deterioration of the terms available to us in the capital markets.

Note 17 Variable Interest Entities

At third quarter-end 2011, we are the primary beneficiary of two VIEs that we consolidate. We have provided the majority of equity to these VIEs, which absent our contributions or advances do not have sufficient equity to fund their operations. We have the authority to approve project budgets and the issuance of additional debt. At third quarter-end 2011, our consolidated balance sheet includes \$14,687,000 in principally real estate assets and \$4,605,000 in liabilities related to these two VIEs. In first nine months 2011, we contributed or advanced \$2,826,000 to these VIEs. In first nine months 2010, real estate assets decreased by \$11,865,000, debt decreased by \$13,207,000 and other liabilities increased by \$1,342,000 due to lender foreclosure of a lien on property owned by one of these VIEs. In second quarter 2011, our earnings benefited from a \$1,342,000 reallocation of a previously recognized loss related to foreclosure of a lien on property in the above VIE. Based on our access to new information, we determined this loss and related liability should be allocated from us to the noncontrolling financial interests as we believe the likelihood we will be subject to any potential lender liabilities is remote. We have a nominal general partner interest in this VIE and could be held responsible for certain of its liabilities.

Also at third quarter-end 2011, we are not the primary beneficiary of three VIEs that we account for using the equity method. The unrelated managing partners oversee the day-to-day operations and guarantee some of the debt of the VIEs while we have the authority to approve project budgets and the issuance of additional debt. Although some of the debt is guaranteed by the managing partners, we may under certain circumstances elect or be required to provide additional funds to these VIEs. At third quarter-end 2011, these three VIEs have total assets of \$51,301,000, substantially all of which represent developed and undeveloped real estate and total liabilities of \$83,575,000, which includes \$67,557,000 of borrowings classified as current maturities. These amounts are included in other ventures in the combined summarized balance sheet information for ventures accounted for using the equity method in **Note 7**. At third quarter-end 2011, our investment in these three VIEs is \$2,362,000 and is included in investment in unconsolidated ventures. In first nine months 2011, we contributed or advanced \$151,000 to these VIEs. Our maximum exposure to loss related to these VIEs is estimated at \$36,037,000, which exceeds our investment as we have a nominal general partner interest in two of these VIEs and could be held responsible for their liabilities. The maximum exposure to loss represents the maximum loss that we could be required to recognize assuming all the ventures' assets (principally real estate) are worthless, without consideration of the probability of a loss or of any actions we may take to mitigate any such loss.

Note 18 Share-Based Compensation

Share-based compensation expense (income) consists of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Cash-settled awards	\$ (4,893)	\$ 422	\$ (4,212)	\$ 3,187
Equity-settled awards	265		676	
Restricted stock	612	923	1,882	2,538
Stock options	463	472	2,053	1,645
	\$ (3,553)	\$ 1,817	\$ 399	\$ 7,370

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Share-based compensation expense (income) is included in:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
General and administrative expense	\$ (2,057)	\$ 937	\$ (234)	\$ 3,055
Other operating expense	(1,496)	880	633	4,315
	\$ (3,553)	\$ 1,817	\$ 399	\$ 7,370

Third quarter and first nine months 2011 share-based compensation decreased as a result of a decline in our stock price and its impact on vested cash-settled awards.

The fair value of awards granted to retirement eligible employees and expensed at the date of grant was \$654,000 in first nine months 2011 and \$286,000 in first nine months 2010. Unrecognized share-based compensation expense related to non-vested equity-settled awards, restricted stock and stock options is \$8,424,000 at third quarter-end 2011. The weighted average period over which this amount will be recognized is estimated to be two years. We did not capitalize any share-based compensation in first nine months 2011 or 2010.

In first nine months 2011, we withheld 70,539 shares having a value of \$1,290,000 in connection with vesting of restricted stock awards and exercises of stock options. In first nine months 2010, we withheld 2,601 shares having a value of \$49,000 in connection with vesting of restricted stock awards and exercises of stock options. These shares are included in treasury stock and are reflected in financing activities in our consolidated statement of cash flows.

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

Cash-settled awards

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

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

The following table summarizes the activity of cash-settled restricted stock unit awards in first nine months 2011:

	Equivalent Units (In thousands)	Weighted Average Grant Date Fair Value (Per unit)
Non-vested at beginning of period	376	\$ 11.88
Granted	159	18.10
Vested	(77)	17.53
Forfeited		
Non-vested at end of period	458	\$ 13.10

The following table summarizes the activity of cash-settled stock appreciation rights in first nine months 2011:

	Rights Outstanding (In thousands)	Weighted Average Exercise Price (Per share)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Current Value Less Exercise Price) (In thousands)
Balance at beginning of period	909	\$ 11.28	8	\$ 7,289
Granted				
Exercised	(12)	9.29		
Forfeited				
Balance at end of period	897	\$ 11.30	8	\$ 1,109
Exercisable at end of period	380	\$ 10.48	8	\$ 529

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The fair value of awards settled in cash was \$184,000 in first nine months 2011 and \$731,000 in first nine months 2010. At third quarter-end 2011, the fair value of vested cash-settled awards is \$9,567,000 and is included in other liabilities. The aggregate current value of non-vested cash-settled awards is \$5,577,000 at third quarter-end 2011 based on a quarter-end stock price of \$10.91.

Equity-settled awards

Equity-settled awards granted to our employees include restricted stock units (RSU), which vest ratably over three years from the date of grant, and beginning first quarter 2011, market-leveraged stock units (MSU), which vest after three years. The following table summarizes the activity of equity-settled awards in first nine months 2011:

	Equivalent Units (In thousands)	Weighted Average Grant Date Fair Value (Per share)
Non-vested at beginning of period		\$
Granted	160	20.73
Vested		
Forfeited		
Non-vested at end of period	160	\$ 20.73

In first quarter 2011, we granted 124,700 MSU awards. These awards will be settled in common stock based upon our stock price performance over three years from the date of grant. The number of shares to be issued could range from a high of 187,050 shares if our stock price increases by 50 percent or more, to a low of 62,350 shares if our stock price decreases by 50 percent, or could be zero if our stock price decreases by more than 50 percent, the minimum threshold performance. MSU awards are valued using a Monte Carlo simulation pricing model, which includes expected stock price volatility and risk-free interest rate assumptions. Compensation expense is recognized regardless of achievement of performance conditions, provided the requisite service period is satisfied.

Unrecognized share-based compensation expense related to non-vested equity-settled awards is \$2,480,000 at third quarter-end 2011. The weighted average period over which this amount will be recognized is estimated to be two years.

Restricted stock

Restricted stock awards vest either ratably over or after three years, generally if we achieve a minimum one percent annualized return on assets over such three-year period. The following table summarizes the activity of restricted stock awards in first nine months 2011:

	Restricted Shares (In thousands)	Weighted Average Grant Date Fair Value (Per share)
Non-vested at beginning of period	636	\$ 17.56
Granted	20	12.74
Vested	(223)	24.23
Forfeited		

Non-vested at end of period	433	\$	13.91
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Unrecognized share-based compensation expense related to non-vested restricted stock awards is \$2,848,000 at third quarter-end 2011. The weighted average period over which this amount will be recognized is estimated to be one year.

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Stock options have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, disability or if there is a change in control. Options were granted with an exercise price equal to the market value of our stock on the date of grant. The following table summarizes the activity of stock option awards in first nine months 2011:

	Options Outstanding (In thousands)	Weighted Average Exercise Price (Per share)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Current Value Less Exercise Price) (In thousands)
Balance at beginning of period	957	\$ 23.45	8	\$ 1,890
Granted	327	18.59		
Exercised				
Forfeited				
Balance at end of period	1,284	\$ 22.22	8	\$ 262
Exercisable at end of period	642	\$ 25.61	7	\$ 131

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

	First Nine Months 2011	2010
Expected dividend yield	0.0%	0.0%
Expected stock price volatility	56.2%	51.0%
Risk-free interest rate	2.4%	2.3%
Expected life of options (years)	6	6
Weighted average estimated fair value of options granted	\$ 10.11	\$ 8.98

We have limited historical experience as a stand-alone company so we utilized alternative methods in determining our valuation assumptions. The expected life was based on the simplified method utilizing the midpoint between the vesting period and the contractual life of the awards. In 2011, the expected stock price volatility was based on a blended rate utilizing our historical volatility and historical prices of our peers' common stock for a period corresponding to the expected life of the options. In 2010, the expected stock price volatility was based on historical prices of our peers' common stock for a period corresponding to the expected life of the options. Pre-vesting forfeitures are estimated based upon the pool of participants and their expected activity and historical trends.

Unrecognized share-based compensation expense related to non-vested stock options is \$3,096,000 at third quarter-end 2011. The weighted average period over which this amount will be recognized is estimated to be two years.

Pre-Spin Awards

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

Stock options have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, disability or if there is a change in control. A summary of

stock option awards outstanding at third quarter-end 2011 follows:

	Options Outstanding (In thousands)	Weighted Average Exercise Price (Per share)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (Current Value Less Exercise Price) (In thousands)
Outstanding and exercisable on Forestar stock	77	\$ 22.08	4	\$ 21
Outstanding and exercisable on Temple-Inland stock	108	20.95	4	1,126
				\$ 1,147

The intrinsic value of options exercised was \$706,000 in first nine months 2011 and \$553,000 in first nine months 2010.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2010 Annual Report on Form 10-K. Unless otherwise indicated, information is presented as of third quarter-end 2011, and references to acreage owned includes all acres owned by ventures regardless of our ownership interest in a venture.

Forward-Looking Statements

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

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

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

- significant customer concentration;

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

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

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

- the development of relationships with strategic partners;

- fluctuations in costs and expenses;

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

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

- competitive actions by other companies;

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

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

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

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

the effect of limitations, restrictions and natural events on our ability to harvest and deliver timber;

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

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

Other factors, including the risk factors described in Item 1A of our 2010 Annual Report on Form 10-K, may also cause actual results to differ materially from those projected by our forward-looking statements. New factors emerge from time to time and it is not possible for us to predict all such factors, nor can we assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

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

Strategy

Our strategy is:

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

Growing through strategic and disciplined investments.

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

In third quarter 2011, we sold 50,000 acres of timberland in Georgia and Alabama to Plum Creek Timberlands, L.P. for \$74,722,000 and 7,000 acres in Texas to The Conservation Fund for \$12,339,000. These transactions generated net proceeds of \$86,018,000, which were principally used to reduce debt. These transactions resulted in gains of \$61,784,000. We also repurchased 172,435 shares of our common stock for \$2,126,000, which are classified as treasury stock.

At third quarter-end 2011, we have completed our strategic initiatives related to the sale of higher and better use timberland and reduction of debt. Since announcing these initiatives, we have sold 176,000 acres of timberland in Georgia, Alabama and Texas for \$284,442,000 in eleven transactions. These transactions generated net proceeds of \$277,909,000 and resulted in gains of \$194,438,000. We used the proceeds principally to reduce debt, pay income taxes, reinvest in our business and repurchase stock. Our total debt has been reduced by \$151,986,000 since first quarter-end 2009, excluding \$26,500,000 in non-recourse borrowings secured by a 401 unit multifamily property we acquired in fourth quarter 2010. In addition, we have repurchased 1,173,422 shares of our common stock for \$17,304,000.

Results of Operations

A summary of our consolidated results by business segment follows:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Revenues:				
Real estate	\$ 19,060	\$ 15,139	\$ 59,814	\$ 53,936
Mineral resources	5,871	6,654	17,784	18,387
Fiber resources	1,310	2,220	3,968	6,185
Total revenues	\$ 26,241	\$ 24,013	\$ 81,566	\$ 78,508
Segment earnings (loss):				
Real estate	\$ (4,266)	\$ (1,883)	\$ (684)	\$ 883
Mineral resources	3,592	6,196	12,292	16,640
Fiber resources	446	1,372	1,790	3,900
Total segment earnings	(228)	5,685	13,398	21,423
Items not allocated to segments:				
General and administrative expense	(4,827)	(3,860)	(15,824)	(13,438)
Share-based compensation expense	3,553	(1,817)	(399)	(7,370)
Gain on sale of assets	61,784	15,441	61,784	15,441

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Interest expense	(4,271)	(3,913)	(12,933)	(12,562)
Other non-operating income	26	246	77	690
Income before taxes	56,037	11,782	46,103	4,184
Income tax expense	(19,609)	(2,860)	(16,069)	(1,507)
Net income attributable to Forestar Group Inc.	\$ 36,428	\$ 8,922	\$ 30,034	\$ 2,677

Significant aspects of our results of operations follow:

Third Quarter and First Nine Months 2011

Real estate segment earnings were negatively impacted by lower undeveloped land sales volume and prices as a result of current market conditions. In addition, we recognized a \$2,500,000 charge related to environmental remediation activities. These items were partially offset by increased residential sales activity.

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Mineral resources segment earnings declined primarily due to lower lease bonus revenues and increased costs associated with developing our water resources initiatives. These items were partially offset by increased oil production volumes and prices.

Fiber resources segment earnings decreased principally due to reduction in volume as a result of selling about 30,000 acres of timberland in 2010 and postponing harvest plans on acres previously classified as held for sale.

In third quarter and first nine months 2011, general and administrative expense includes \$459,000 and \$3,187,000 associated with proposed private debt offerings that we withdrew as a result of deterioration of terms available to us in the credit markets.

Share-based compensation decreased as a result of a decline in our stock price and its impact on vested cash-settled awards.

In third quarter 2011, gain on sale of assets represents the gain from selling 57,000 acres of timberland in Georgia, Alabama and Texas for \$87,061,000.

Third Quarter and First Nine Months 2010

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

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

Fiber resources segment earnings decreased principally due to reduction in volume as a result of selling over 113,000 acres of timberland in 2009 and postponing harvest plans on acres classified as held for sale.

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

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

Interest expense decreased as a result of lower debt levels.

Current Market Conditions

Current U.S. market conditions in the single-family residential industry continue to be challenging, characterized by high unemployment rates, low consumer confidence, depressed sales volumes and prices, difficult financing environment for purchasers and competition from foreclosure inventory. While all markets are being negatively affected by overall poor economic conditions, not all geographic areas and products have been affected to the same extent or with equal severity. It is difficult to predict when and at what rate these broader negative conditions will improve, or when the homebuilding industry will experience a sustained recovery. Multifamily market conditions are improving, with many markets experiencing healthy occupancy levels and positive rent growth. This improvement has been driven primarily by limited new construction activity, reduced mortgage credit availability, and the increased propensity to rent among the millennial generation of the U.S. population.

Oil prices have increased principally due to supply uncertainty and ongoing unrest in oil-producing regions. Natural gas prices have remained soft due to increased levels of production and high levels of inventory. Shale resource drilling and production remains strong and working gas inventories are expected to remain relatively high. In the East Texas Basin, exploration and production companies continue to focus drilling on natural gas prospects in

order to extend and hold existing mineral leases. In the Gulf Coast Basin, in Louisiana, activity has increased as operators have shifted exploration efforts to oil and high liquid natural gas plays. These conditions may impact the demand for new mineral leases, new exploration activity and the amount of royalty revenues we receive.

Pulpwood and sawtimber sales are depressed because dry weather conditions in our areas of operations continue to increase access to supply while market demand remains low.

Business Segments

We manage our operations through three business segments:

Real estate,

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Mineral resources, and

Fiber resources.

We evaluate performance based on earnings (loss) before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures and net (income) loss attributable to noncontrolling interests. Items not allocated to our business segments consist of general and administrative expenses, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense. The accounting policies of the segments are the same as those described in the accounting policy note to the consolidated financial statements.

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

Real Estate

We own directly or through ventures over 159,000 acres of real estate located in nine states and 12 markets. Our real estate segment secures entitlements and develops infrastructure on our lands, primarily for single-family residential and mixed-use communities. We own 114,000 acres in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. We target investments principally in our strategic growth corridors, regions across the southern half of the United States that possess key demographic and growth characteristics that we believe make them attractive for long-term real estate investment. We own and manage our projects either directly or through ventures. Our real estate segment revenues are principally derived from the sales of residential single-family lots and tracts, undeveloped land and commercial real estate and from the operation of income producing properties, primarily a hotel and a multifamily property.

A summary of our real estate results follows:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Revenues	\$ 19,060	\$ 15,139	\$ 59,814	\$ 53,936
Cost of sales	(12,367)	(8,114)	(32,894)	(29,992)
Operating expenses	(10,717)	(8,313)	(27,064)	(22,164)
	(4,024)	(1,288)	(144)	1,780
Equity in earnings (loss) of unconsolidated ventures	295	(431)	361	(569)
Less: Net income attributable to noncontrolling interests	(537)	(164)	(901)	(328)
Segment earnings (loss)	\$ (4,266)	\$ (1,883)	\$ (684)	\$ 883

In third quarter 2011, cost of sales includes an \$857,000 charge related to an obligation for future road improvements near a mixed-use project located in Austin, Texas and, in first nine months 2011, includes a \$450,000 non-cash impairment charge related to a residential real estate project located near Dallas, Texas. In first nine months 2010, cost of sales includes a \$900,000 non-cash impairment charge related to a residential real estate project located near Salt Lake City, Utah.

In first nine months 2011, segment earnings include a benefit of \$1,342,000 associated with reallocation of a previously recognized loss related to foreclosure of a lien on a property owned by a consolidated venture. Based on new information, we determined this loss should be allocated from us to the noncontrolling financial interests as we believe the likelihood we will be subject to any potential lender liabilities is remote.

Revenues in our owned and consolidated ventures consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Residential real estate	\$ 10,276	\$ 5,615	\$ 27,503	\$ 19,443
Commercial real estate			736	157
Undeveloped land	1,526	4,385	10,096	17,295
Income producing properties	6,653	4,987	20,400	16,220
Other	605	152	1,079	821
Total revenues	\$ 19,060	\$ 15,139	\$ 59,814	\$ 53,936

Residential real estate revenues principally consist of the sale of single-family lots to national, regional and local homebuilders. In third quarter and first nine months 2011, residential real estate revenues increased principally as a result of increased lot sales volume due to demand for finished lot inventory by homebuilders in markets where supply has diminished. In addition, in third quarter 2011, we

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sold 25 entitled acres from our Gables at North Hill project located near Dallas, Texas for \$1,930,000 which generated \$387,000 in segment earnings. This was the final tract available for sale in this project and represented approximately 80 undeveloped lots.

In third quarter and first nine months 2011, undeveloped land sales decreased due to lower volume and prices from our retail land sales program as a result of current market conditions primarily resulting from limited credit availability, low consumer confidence and alternate investment options to buyers in the marketplace.

In third quarter and first nine months 2011, income producing properties revenue principally increased as a result of our fourth quarter 2010 acquisition of a 401 unit multifamily property located in Houston, Texas.

Units sold in our owned and consolidated ventures consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
Residential real estate:				
Lots sold	155	105	458	356
Revenue per lot sold	\$ 52,197	\$ 52,342	\$ 55,277	\$ 54,091
Commercial real estate:				
Acres sold			4.0	1.3
Revenue per acre sold	\$	\$	\$ 185,344	\$ 121,705
Undeveloped land:				
Acres sold	548	1,153	3,938	4,713
Revenue per acre sold	\$ 2,786	\$ 3,803	\$ 2,564	\$ 3,669

Operating expenses consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Property taxes	\$ 2,023	\$ 1,878	\$ 6,484	\$ 6,460
Employee compensation and benefits	1,893	1,543	5,730	4,674
Professional services	1,174	1,646	3,405	3,080
Depreciation and amortization	1,344	641	3,938	2,187
Environmental	2,527	37	2,607	108
Other	1,756	2,568	4,900	5,655
Total operating expenses	\$ 10,717	\$ 8,313	\$ 27,064	\$ 22,164

Employee compensation and benefits and professional services increased principally due to developing and staffing our multifamily organization. Depreciation and amortization increased primarily as a result of the acquisition of a 401 unit multifamily property in fourth quarter 2010. In third quarter 2011, environmental costs increased as a result of a \$2,500,000 charge related to environmental remediation activities at our Antioch, California project.

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

	Third Quarter-End	
	2011	2010
Owned and consolidated ventures:		
Entitled, developed and under development projects		
Number of projects	54	54
Residential lots remaining	18,679	17,811
Commercial acres remaining	1,808	1,775
Undeveloped land and land in the entitlement process		
Number of projects	16	18
Acres in entitlement process	27,590	29,670
Acres undeveloped	110,115	179,736
Ventures accounted for using the equity method:		
Ventures – lot sales (for first nine months)		
Lots sold	350	261
Average price per lot sold	\$ 40,592	\$ 43,402
Ventures – entitled, developed and under development projects		
Number of projects	21	22
Residential lots remaining	9,295	11,369
Commercial acres sold (for first nine months)	20.0	15.4
Average price per acre sold	\$ 152,460	\$ 81,318
Commercial acres remaining	538	829
Ventures – undeveloped land and land in the entitlement process		
Number of projects		
Acres in entitlement process		
Acres sold (for first nine months)	19.2	
Average price per acre sold	\$ 3,000	\$
Acres undeveloped	5,712	5,517

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

In third quarter 2011, we acquired 180 fully developed lots in Houston, Texas for \$8,950,000, which includes the right to receive about \$4,000,000 in reimbursements, excluding interest, under a development agreement with the City of Houston. We also acquired two multifamily development sites located in Austin and Dallas for \$8,672,000.

Mineral Resources

We own directly or through ventures 602,000 net acres of mineral interests. Our mineral resources segment revenues are principally derived from royalties and other revenues from our oil and natural gas mineral interests located principally in Texas, Louisiana, Georgia and Alabama. At third quarter-end 2011, we have 59,000 net acres under lease and 30,000 net acres held by production from 510 oil and natural gas wells owned and operated by exploration and production companies.

A summary of our mineral resources results follows:

Third Quarter		First Nine Months	
2011	2010	2011	2010
(In thousands)			

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Revenues	\$ 5,871	\$ 6,654	\$ 17,784	\$ 18,387
Cost of sales	(597)	(223)	(1,829)	(852)
Operating expenses	(2,030)	(748)	(4,918)	(2,204)
	3,244	5,683	11,037	15,331
Equity in earnings of unconsolidated ventures	348	513	1,255	1,309
Segment earnings	\$ 3,592	\$ 6,196	\$ 12,292	\$ 16,640

Cost of sales represents our share of oil and natural gas production severance taxes, which are calculated based on a percentage of oil and natural gas produced, costs related to our oil and gas non-operating working interests and delay rental payments related to ground water leases in central Texas.

Equity in earnings of unconsolidated ventures includes our share of royalty revenue from producing wells in the Barnett Shale natural gas formation.

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Revenues consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Royalties	\$ 5,424	\$ 3,217	\$ 13,056	\$ 10,542
Other revenues	447	3,437	4,728	7,845
Total revenues	\$ 5,871	\$ 6,654	\$ 17,784	\$ 18,387

In third quarter and first nine months 2011, royalty revenues increased as a result of higher oil prices and increased oil production partially offset by decreases in natural gas production in owned and consolidated properties. In third quarter 2011, increases in net oil and natural gas prices contributed \$1,172,000 and changes in net oil and gas production contributed \$1,035,000 as compared to third quarter 2010. In first nine months 2011, changes in net oil and natural gas prices contributed \$1,878,000 and changes in net oil and gas production contributed \$636,000 as compared to first nine months 2010.

In third quarter 2011, other revenues principally includes \$100,000 in lease bonus payments as a result of leasing about 380 net mineral acres for an average of \$265 per acre and \$253,000 related to delay rental payments. In third quarter 2010, other lease revenues include \$2,549,000 in lease bonus payments as a result of leasing about 9,600 net mineral acres for an average of \$266 per acre and \$890,000 related to delay rental payments.

In first nine months 2011, other revenues include \$2,232,000 in lease bonus payments as a result of leasing 7,700 net mineral acres for an average of \$288 per acre, \$1,555,000 related to mineral seismic exploration agreement associated with 31,100 acres in Louisiana and \$479,000 related to delay rental payments. In first nine months 2010, other lease revenues include \$5,733,000 in lease bonus payments as a result of leasing over 11,700 net mineral acres for an average of \$490 per acre and \$2,084,000 related to delay rental payments.

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

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
<i>Consolidated entities:</i>				
Oil production (barrels)	42,300	27,700	102,200	87,600
Average price per barrel	\$ 97.83	\$ 71.41	\$ 94.23	\$ 72.53
Natural gas production (millions of cubic feet)	295.9	298.5	850.1	946.0
Average price per thousand cubic feet	\$ 4.33	\$ 4.15	\$ 4.03	\$ 4.43
<i>Our share of ventures accounted for using the equity method:</i>				
Natural gas production (millions of cubic feet)	112.1	138.1	398.3	345.6
Average price per thousand cubic feet	\$ 4.10	\$ 4.02	\$ 3.80	\$ 4.25
<i>Total consolidated and our share of equity method ventures:</i>				
Oil production (barrels)	42,300	27,700	102,200	87,600
Average price per barrel	\$ 97.83	\$ 71.41	\$ 94.23	\$ 72.53
Natural gas production (millions of cubic feet)	408.0	436.6	1,248.4	1,291.6
Average price per thousand cubic feet	\$ 4.27	\$ 4.11	\$ 3.96	\$ 4.38

At third quarter-end 2011, there were 510 active wells owned and operated by others on our leased mineral acres compared to 491 wells at third quarter-end 2010.

In first nine months 2011, our share of ventures natural gas production increased as a result of 16 wells that began producing from the Barnett Shale natural gas formation in 2010.

Operating expenses consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Professional and consulting services	\$ 792	\$ 115	\$ 2,086	\$ 351
Employee compensation and benefits	614	307	1,495	888
Property taxes	78	78	228	225
Other	546	248	1,109	740
Total operating expenses	\$ 2,030	\$ 748	\$ 4,918	\$ 2,204

Professional and consulting services increased \$429,000 in third quarter and \$1,286,000 in first nine months 2011 primarily due to non-cash amortization of contingent consideration paid to the seller of a water resources company acquired in fourth quarter 2010. These costs are being amortized ratably over the performance period assuming certain milestones are achieved by July 2014. Employee compensation and benefits increased in third quarter and first nine months 2011 as a result of incremental staffing to support our oil, gas and water interests.

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In addition, we have water interests in 1,600,000 acres, including a 45 percent nonparticipating royalty interest in groundwater produced or withdrawn for commercial purposes or sold from 1,400,000 acres in Texas, Louisiana, Georgia and Alabama and 17,800 acres of ground water leases in central Texas. We have not received significant income from these interests.

Fiber Resources

Our fiber resources segment focuses principally on the management of our timber holdings and recreational leases. We own directly or through ventures over 143,000 acres of timber, primarily in Georgia, and 17,000 acres of timber under lease. Our fiber resources segment revenues are principally derived from the sales of wood fiber from our land and leases for recreational uses. We have sold over 204,000 acres of undeveloped land since year-end 2008 through our retail land sales program and as a result of our strategic initiatives. As a result of the reduced acreage from executing these land sales, future segment revenues and earnings are anticipated to be lower.

A summary of our fiber resources results follows:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Revenues	\$ 1,310	\$ 2,220	\$ 3,968	\$ 6,185
Cost of sales	(349)	(466)	(881)	(1,208)
Operating expenses	(520)	(502)	(1,494)	(1,694)
	441	1,252	1,593	3,283
Other operating income		120	181	617
Equity in earnings of unconsolidated ventures	5		16	
Segment earnings	\$ 446	\$ 1,372	\$ 1,790	\$ 3,900

Other operating income represents gains from partial termination of timber leases.

Revenues consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Fiber	\$ 978	\$ 1,767	\$ 2,695	\$ 4,797
Recreational leases and other	332	453	1,273	1,388
Total revenues	\$ 1,310	\$ 2,220	\$ 3,968	\$ 6,185

Fiber sold consists of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
Pulpwood tons sold	85,800	116,900	222,100	295,600
Average pulpwood price per ton	\$ 7.57	\$ 9.41	\$ 8.57	\$ 10.31
Sawtimber tons sold	22,900	37,500	51,200	90,900
Average sawtimber price per ton	\$ 14.33	\$ 17.79	\$ 15.47	\$ 19.23
Total tons sold	108,700	154,400	273,300	386,500
Average price per ton	\$ 8.99	\$ 11.45	\$ 9.86	\$ 12.41

In third quarter and first nine months 2011, total fiber tons sold decreased principally due to the sale of about 30,000 acres of timberland in 2010 and postponing harvest plans on acres previously classified as held for sale. The

majority of our fiber sales were to Temple-Inland at market prices.

Information about our recreational leases follows:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
Average recreational acres leased	164,600	205,900	185,300	209,900
Average price per leased acre	\$ 8.28	\$ 8.60	\$ 8.84	\$ 8.33

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Operating expenses consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Employee compensation and benefits	\$ 229	\$ 224	\$ 696	\$ 909
Facility and long-term timber lease costs	109	116	337	306
Other	182	162	461	479
Total operating expenses	\$ 520	\$ 502	\$ 1,494	\$ 1,694

In first nine months 2010, \$197,000 in employee compensation and benefits related to employee severance costs.

Items Not Allocated to Segments

Unallocated items represent income and expenses managed on a company-wide basis and include general and administrative expenses, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense. General and administrative expenses principally consist of accounting and finance, tax, legal, human resources, internal audit, information technology and our board of directors. These functions support all of our business segments and are not allocated.

General and administrative expenses consist of:

	Third Quarter		First Nine Months	
	2011	2010	2011	2010
	(In thousands)			
Professional services	\$ 1,600	\$ 583	\$ 6,025	\$ 2,665
Employee compensation and benefits	1,394	1,410	4,221	4,145
Depreciation and amortization	347	371	1,050	1,113
Insurance costs	276	295	809	936
Facility costs	210	301	594	912
Other	1,000	900	3,125	3,667
Total general and administrative expenses	\$ 4,827	\$ 3,860	\$ 15,824	\$ 13,438

In third quarter and first nine months 2011, professional services includes \$459,000 and \$3,187,000 of expenses associated with proposed private debt offerings that we withdrew as a result of deterioration in terms available to us in the capital markets.

Income Taxes

Our effective tax rate was 35 percent in third quarter 2011 and 34 percent in first nine months 2011, which includes a 1 percent benefit for noncontrolling interests and 1 percent non-cash charge for share-based compensation. Our effective tax rate was 24 percent in third quarter 2010 and 33 percent in first nine months 2010, which included a 4 percent benefit attributable to noncontrolling interests. In addition, 2011 and 2010 effective tax rates include the effect of state income taxes, nondeductible items, benefits of percentage depletion and charitable contributions related to timberland conservation.

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

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

We operate in cyclical industries and our cash flows fluctuate accordingly. Our principal operating cash requirements are for the acquisition and development of real estate, either directly or indirectly through ventures, taxes, interest and compensation. Our principal sources of cash are proceeds from the sale of real estate and timber,

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

Cash Flows from Operating Activities

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

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In first nine months 2011, net cash provided by operating activities was \$32,816,000 as proceeds from the sale of 57,000 acres of timberland in accordance with our strategic initiatives generated net proceeds of \$86,018,000. Expenditures for development and acquisitions exceeded non-cash real estate cost of sales principally due to our acquisition of a non-performing loan secured by a lien on 900 acres of developed and undeveloped land near Houston, Texas for \$21,137,000, \$25,481,000 in four real estate acquisitions located in various Texas markets and payment of \$7,956,000 in federal and state income taxes, net of refunds. In first nine months 2010, net cash (used for) operating activities was (\$13,701,000) as we funded a \$10,000,000 loan to a third-party equity investor in the JW Marriott® San Antonio Hill Country Resort & Spa and paid income taxes of \$11,031,000.

Cash Flows from Investing Activities

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

In first nine months 2011, net cash (used for) investing activities was (\$5,149,000) and is principally related to \$3,414,000 invested in oil and gas properties as non-operating working interests, \$662,000 in net contributions to unconsolidated ventures and \$1,466,000 in property, equipment, software and reforestation. In first nine months 2010, net cash provided by investing activities was \$3,572,000 principally due to net distributions from unconsolidated ventures of \$3,252,000. We invested \$2,282,000 in property, equipment, software and reforestation offset by \$2,602,000 in proceeds related to the sale of our undivided interest in corporate aircraft.

Cash Flows from Financing Activities

In first nine months 2011, net cash (used for) financing activities was (\$3,912,000) and is principally related to the payment of \$3,746,000 in deferred financing fees primarily related to supplementing and amending our senior secured credit facility and \$2,126,000 related to repurchasing 172,435 shares of our common stock. This was partially offset by a net increase in our debt of \$2,108,000. In first nine months 2010, net cash (used for) financing activities was (\$6,439,000) as we repurchased 1,000,987 shares of our common stock for \$15,178,000 and incurred \$5,969,000 in deferred financing fees primarily related to our amendment and extension of our senior secured credit facility, which was partially offset by a net increase in our debt of \$14,147,000.

Liquidity

At various times in 2011, we supplemented and amended our senior secured credit facility to provide us with, among other matters, additional flexibility with respect to the borrowing base, collateral coverage and leverage requirements. As a result, in third quarter 2011 we increased our unused borrowing capacity by over \$70,000,000 and extended the maturity of our revolving line of credit by one year, to August 6, 2014.

At third quarter-end 2011, our senior secured credit facility provides for a \$130,000,000 term loan maturing August 6, 2015 and a \$200,000,000 revolving line of credit maturing August 6, 2014. The term loan includes a 1 percent prepayment penalty for payments in excess of \$25,000,000 prior to February 6, 2012 and no prepayment penalty thereafter. The revolving line of credit may be prepaid at any time without penalty. The revolving line of credit includes a \$100,000,000 sublimit for letters of credit, of which \$984,000 is outstanding at third quarter-end 2011. Total borrowings under our senior secured credit facility (including the face amount of letters of credit) may not exceed a borrowing base formula. At third quarter-end 2011, we had \$176,337,000 in net unused borrowing capacity under our senior secured credit facility. Our unused borrowing capacity during first nine months 2011 ranged from a high of \$176,337,000 to a low of \$94,872,000. This facility is used primarily to fund our operating cash needs, which fluctuate due to timing of residential real estate sales, undeveloped land sales, mineral lease bonus payments, timber sales, payment of payables and expenses and capital expenditures.

In third quarter 2011, we borrowed \$15,400,000 which is collateralized by a 413 guest room hotel located in Austin, Texas with a carrying value of \$21,569,000. This financing replaced debt retired in second quarter 2011.

Our senior secured credit facility and other debt agreements contain financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At third quarter-end 2011, we were in compliance with the financial covenants of these agreements.

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

Financial Covenant	Requirement	Third Quarter-End 2011
Interest Coverage Ratio ^(a)	≥ 1.05:1.0	6.59:1.0
Revenues/Capital Expenditures Ratio ^(b)	≥ 1.00:1.0	2.20:1.0
Total Leverage Ratio ^(c)	≤ 40%	23%
Net Worth ^(d)	> \$439 million	\$536 million
Collateral Value to Loan Commitment Ratio ^(e)	≥ 1.50:1.0	1.82 :1.0

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- (a) Calculated as EBITDA (earnings before interest, taxes, depreciation and amortization), plus non-cash compensation expense, plus other non-cash expenses, divided by interest expense excluding loan fees. This covenant is applied at the end of each quarter on a rolling four quarter basis.
- (b) Calculated as total gross revenues, plus our pro rata share of the operating revenues from unconsolidated ventures, divided by capital expenditures. Capital expenditures are defined as consolidated development and acquisition expenditures plus our pro rata share of unconsolidated ventures' development and acquisition expenditures. This covenant is applied at the end of each quarter on a rolling four quarter basis.
- (c) Calculated as total funded debt divided by adjusted asset value. Total funded debt includes indebtedness for borrowed funds, secured liabilities and reimbursement obligations with respect to letters of credit or similar instruments. Adjusted asset value is defined as the sum of unrestricted cash and cash equivalents, timberlands, high value timberlands, raw entitled lands, entitled land under development, minerals business, other real estate owned at book value without regard to any indebtedness and our pro rata share of joint ventures' book value without regard to any indebtedness. This covenant is applied at the end of each quarter.
- (d) Calculated as the amount by which consolidated total assets exceeds consolidated total liabilities. At third quarter-end 2011, the requirement is \$439,000,000, computed as: \$411,000,000, plus 85 percent of the aggregate net proceeds received by us from any equity offering, plus 75 percent of all positive net income, on a cumulative basis. This covenant is applied at the end of each quarter.
- (e) Calculated as the total collateral value of timberland, high value timberland and our minerals business, divided by total aggregate loan commitment. This covenant is applied at the end of each quarter.

To make additional investments, acquisitions, or distributions, we must maintain available liquidity of equal to the lesser of \$35,000,000 or 10% of the aggregate commitments in place. At third quarter-end 2011, the minimum liquidity requirement was \$33,000,000, resulting in \$203,852,000 in available liquidity based on the unused borrowing capacity under our senior secured credit facility plus unrestricted cash and cash equivalents. The failure to maintain such minimum liquidity does not constitute a default or event of default of our senior secured credit facility.

Contractual Obligations and Off-Balance Sheet Arrangements

In second quarter 2011, we began construction on a 289 unit multifamily project in Austin, Texas in which the estimated cost at completion, including land, is approximately \$30,536,000. At third quarter-end 2011, our investment in this project is \$9,394,000 and the estimated cost to complete construction is \$21,142,000.

At third quarter-end 2011, we participate in three partnerships that have total assets of \$51,301,000 and total liabilities of \$83,575,000, which includes \$67,557,000 of borrowings classified as current maturities. These partnerships are managed by third parties who intend to extend or refinance these borrowings; however, there is no assurance that this can be done. Although these borrowings are guaranteed by third parties, we may under certain circumstances elect or be required to provide additional equity to these partnerships. We do not believe that the ultimate resolution of these matters will have a significant effect on our earnings or financial position. Our investment in these partnerships is \$2,362,000 at third quarter-end 2011. These three partnerships are variable interest entities.

Cibolo Canyons – San Antonio, Texas

Cibolo Canyons consists of the JW Marriott[®] San Antonio Hill Country Resort & Spa development owned by third parties and a mixed-use development we own. We have \$86,637,000 invested in Cibolo Canyons at third quarter-end 2011.

Resort Hotel, Spa and Golf Development

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

consisting of golf course construction materials, substantially all of which has been provided.

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

The amounts we collect under this agreement are dependent on several factors including the amount of revenues generated by and ad valorem taxes imposed on the resort and the amount of any applicable debt service incurred by the SID. As a result, there is significant uncertainty as to the amount and timing of collections under this agreement. Until these uncertainties are clarified, amounts collected

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under the agreement will be accounted for as a reduction of our investment in the resort development. The resort began operations on January 22, 2010.

In third quarter 2011, we received \$480,000 from the SID. Since inception, we have received \$3,083,000 in reimbursements and have accounted for this as a reduction of our investment. At third quarter-end 2011, we have \$39,918,000 invested in the resort development.

Mixed-Use Development

The mixed-use development we own consists of 2,100 acres planned to include approximately 1,420 residential lots and 220 commercial acres designated for multifamily and retail uses, of which 694 lots and 68 commercial acres have been sold through third quarter-end 2011.

In 2007, we entered into an agreement with the SID providing for reimbursement of certain infrastructure costs related to the mixed-use development. Reimbursements are subject to review and approval by the SID and unreimbursed amounts accrue interest at 9.75 percent. The SID's funding for reimbursements is principally derived from its ad valorem tax collections and bond proceeds collateralized by ad valorem taxes, less debt service on these bonds and annual administrative and public service expenses. Through third quarter-end 2011, we have submitted and received approval for reimbursement of approximately \$57,322,000 of infrastructure costs and have received reimbursements totaling \$20,770,000. At third quarter-end 2011, we have \$36,552,000 in approved and pending reimbursements, excluding interest.

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

At third quarter-end 2011, we have \$46,719,000 invested in the mixed-use development.

Critical Accounting Policies and Estimates

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

Recent Accounting Standards

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

Table of Contents**Statistical and Other Data**

A summary of our real estate projects in the entitlement process ^(a) at third quarter-end 2011 follows:

Project	County	Market	Project Acres^(b)
California			
Hidden Creek Estates	Los Angeles	Los Angeles	700
Terrace at Hidden Hills	Los Angeles	Los Angeles	30
Georgia			
Ball Ground	Cherokee	Atlanta	500
Crossing	Coweta	Atlanta	230
Fincher Road	Cherokee	Atlanta	3,890
Fox Hall	Coweta	Atlanta	960
Garland Mountain	Cherokee/Bartow	Atlanta	350
Home Place	Coweta	Atlanta	1,510
Martin s Bridge	Banks	Atlanta	970
Mill Creek	Coweta	Atlanta	770
Serenity	Carroll	Atlanta	440
Waleska	Cherokee	Atlanta	100
Wolf Creek	Carroll/Douglas	Atlanta	12,230
Yellow Creek	Cherokee	Atlanta	1,060
Texas			
Lake Houston	Harris/Liberty	Houston	3,700
San Jacinto	Montgomery	Houston	150
Total			27,590

(a) A project is deemed to be in the entitlement process when customary steps necessary for the preparation of an application for governmental land-use approvals, like conducting pre-application meetings or similar discussions with governmental officials, have commenced, or an application has been filed. Projects listed may have significant steps remaining, and there is no assurance that entitlements ultimately will be received.

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

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A summary of activity within our projects in the development process, which includes entitled^(a), developed and under development real estate projects, at third quarter-end 2011 follows:

Project	County	Market	Interest Owned ^(b)	Residential Lots ^(c)		Commercial Acres ^(d)	
				Lots Sold Since Inception	Lots Remaining	Acres Sold Since Inception	Acres Remaining
Projects we own							
California							
San Joaquin River	Contra Costa/ Sacramento	Oakland	100%				288
Colorado							
Buffalo Highlands	Weld	Denver	100%		164		
Johnstown Farms	Weld	Denver	100%	115	497	2	7
Pinery West	Douglas	Denver	100%				115
Stonebraker	Weld	Denver	100%		603		13
Texas							
Arrowhead Ranch	Hays	Austin	100%		259		6
Barrington	Harris	Houston	100%		180		
Kingwood							
Caruth Lakes	Rockwall	Dallas/Fort Worth	100%	362	287		
Cibolo Canyons	Bexar	San Antonio	100%	694	721	68	153
Harbor Lakes	Hood	Dallas/Fort Worth	100%	202	247	2	12
Hunter's Crossing	Bastrop	Austin	100%	378	112	38	71
La Conterra	Williamson	Austin	100%	78	422		58
Maxwell Creek	Collin	Dallas/Fort Worth	100%	719	280	10	
Oak Creek Estates	Comal	San Antonio	100%	90	557	13	
The Colony	Bastrop	Austin	100%	418	729	22	31
The Gables at North Hill	Collin	Dallas/Fort Worth	100%	203			
The Preserve at Pecan Creek	Denton	Dallas/Fort Worth	100%	329	465		7
The Ridge at Ribelin Ranch	Travis	Austin	100%			195	
Westside at Buttercup Creek	Williamson	Austin	100%	1,369	145	66	
Other projects (9)	Various	Various	100%	1,557	16	197	24
Georgia							
The Villages at Burt Creek	Dawson	Atlanta	100%		1,715		57
Towne West	Bartow	Atlanta	100%		2,674		121
Other projects (13)	Various	Atlanta	100%		2,834		705
Missouri and Utah							
Other projects (2)	Various	Various	100%	466	88		
				6,980	12,995	613	1,668

**Projects in entities
we consolidate**

Texas

City Park	Harris	Houston	75%	1,176	135	50	115
Lantana	Denton	Dallas/Fort Worth	55% (e)	723	1,537		
Light Farms	Collin	Dallas/Fort Worth	65%		2,501		
Stoney Creek	Dallas	Dallas/Fort Worth	90%	110	644		
Timber Creek	Collin	Dallas/Fort Worth	88%		614		
Other projects (4)	Various	Various	Various	710	253	26	25
				2,719	5,684	76	140

**Total owned and
consolidated**

9,699 18,679 689 1,808

**Projects in
ventures that we
account for using
the equity method**

Georgia

Seven Hills	Paulding	Atlanta	50%	641	452	26	113
The Georgian	Paulding	Atlanta	38%	289	1,095		
Other projects (3)	Various	Atlanta	Various	1,710	77	3	

Texas

Bar C Ranch	Tarrant	Dallas/Fort Worth	50%	269	930		
Entrada	Travis	Austin	50%		821		3
Fannin Farms West	Tarrant	Dallas/Fort Worth	50%	323	58		15
Harper s Preserve	Montgomery	Houston	50%	42	1,683		72
	Denton	Dallas/Fort Worth	Various (e)	1,438	94	14	44
Lantana							
Long Meadow Farms	Fort Bend	Houston	19%	838	1,245	107	113
Southern Trails	Brazoria	Houston	40%	475	552		
Stonewall Estates	Bexar	San Antonio	25%	280	108		
Summer Creek Ranch	Tarrant	Dallas/Fort Worth	50%	806	468		71
Summer Lakes	Fort Bend	Houston	50%	382	748	56	
Village Park	Collin	Dallas/Fort Worth	50%	368	203	3	2
Waterford Park	Fort Bend	Houston	50%		210		90
Other projects (2)	Various	Various	Various	298	226		15

Florida

Other projects (3)	Various	Tampa	Various	520	325		
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Total in ventures

8,679 9,295 209 538

Combined total

18,378 27,974 898 2,346

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- (a) A project is deemed entitled when all major discretionary governmental land-use approvals have been received. Some projects may require additional permits and/or non-governmental authorizations for development.
- (b) Interest owned reflects our net equity interest in the project, whether owned directly or indirectly. There are some projects that have multiple ownership structures within them. Accordingly, portions of these projects may appear as owned, consolidated or accounted for using the equity method.
- (c) Lots are for the total project, regardless of our ownership interest. Lots remaining represent vacant developed lots, lots under development and future planned lots and are subject to change based on business plan revisions.
- (d) Commercial acres are for the total project, regardless of our ownership interest, and are net developable acres, which may be fewer than the gross acres available in the project.
- (e) The Lantana project consists of a series of 22 partnerships in which our voting interests range from 25 percent to 55 percent. We account for three of these partnerships using the equity method and we consolidate the remaining partnerships.

A summary of our significant commercial and income producing properties at third quarter-end 2011 follows:

Project	County	Market	Interest Owned^(a)	Type	Acres	Description
Broadstone Memorial	Harris	Houston	100%	Multifamily	9	401 unit luxury apartment
Radisson Hotel	Travis	Austin	100%	Hotel	2	413 guest rooms and suites
Palisades West	Travis	Austin	25%	Office	22	375,000 square feet
Las Brisas	Williamson	Austin	59%	Multifamily	30	414 unit luxury apartment
Promesa ^(b)	Travis	Austin	100%	Multifamily	16	289 unit luxury apartment (construction in progress)

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

- (b) Formerly marketed as Ridge at Ribelin Ranch.

A summary of our oil and gas mineral interests ^(a) at third quarter-end 2011 follows:

State	Unleased	Leased^(b)	Held By Production^(c)	Total^(d)
			(Net acres)	
Texas	191,000	36,000	25,000	252,000
Louisiana	116,000	23,000	5,000	144,000
Georgia	164,000			164,000
Alabama	40,000			40,000
California	1,000			1,000
Indiana	1,000			1,000
	513,000	59,000	30,000	602,000

- (a) Includes ventures.

- (b)

Includes leases in primary lease term or for which a delay rental payment has been received. In the ordinary course of business, leases covering a significant portion of leased net mineral acres may expire from time to time in a single reporting period.

- (c) Acres being held by production are producing oil or natural gas in paying quantities.
- (d) Texas, Louisiana, California and Indiana net acres are calculated as the gross number of surface acres multiplied by our percentage ownership of the mineral interest. Georgia and Alabama net acres are calculated as the gross number of surface acres multiplied by our estimated percentage ownership of the mineral interest based on county sampling. Excludes 477 net mineral acres located in Colorado including 379 acres leased and 29 acres held by production.

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A summary of our Texas and Louisiana mineral acres ^(a) by county or parish at third quarter-end 2011 follows:

Texas		Louisiana	
County	Net Acres	Parish	Net Acres
Trinity	46,000	Beauregard	79,000
Angelina	42,000	Vernon	39,000
Houston	29,000	Calcasieu	17,000
Anderson	25,000	Allen	7,000
Cherokee	24,000	Rapides	1,000
Sabine	23,000	Other	1,000
Red River	14,000		144,000
Newton	13,000		
San Augustine	13,000		
Jasper	12,000		
Other	11,000		
	252,000		

(a) Includes ventures.

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

Our interest rate risk is principally related to our variable-rate debt. Interest rate changes impact earnings due to the resulting increase or decrease in the cost of our variable-rate debt, which is \$193,766,000 at third quarter-end 2011 and \$191,658,000 at year-end 2010.

The following table illustrates the estimated effect on our pre-tax income of immediate, parallel, and sustained shifts in interest rates for the next 12 months on our variable-rate debt at third quarter-end 2011, with comparative year-end 2010 information. This estimate assumes that debt reductions from contractual payments will be replaced with short-term, variable-rate debt; however, that may not be the financing alternative we choose.

Change in Interest Rates	Third	Year-End
	Quarter-End	2010
	2011	2010
	(In thousands)	
+2%	\$ (3,307)	\$ (3,728)
+1%	(1,938)	(1,917)
-1%	1,938	1,917
-2%	3,875	3,833

Foreign Currency Risk

We have no exposure to foreign currency fluctuations.

Commodity Price Risk

We have no significant exposure to commodity price fluctuations.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (or the Exchange Act)) as of the end of the period covered by

this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and are effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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(b) Changes in Internal Control over Financial Reporting

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

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There are no material changes from the risk factors disclosed in our 2010 Annual Report on Form 10-K, except as follows:

If the Temple-Inland mill complex in Rome, Georgia were to permanently cease operations, the price we receive for our wood fiber may decline, and the cost of delivering logs to alternative customers could increase.

Prior to our 2007 spin-off from Temple-Inland Inc. (Temple-Inland), we entered into an agreement to sell wood fiber to Temple-Inland at market prices, primarily for use at Temple-Inland's Rome, Georgia mill complex. The agreement expires in 2013, although the purchase and sale commitments (including the sale price) are established annually based on our annual harvest plan. A significant portion of our fiber resources revenues are generated through this agreement. The Temple-Inland Rome mill complex is a significant consumer of wood fiber within the immediate area in which a substantial portion of our Georgia timberlands are located. If Temple-Inland was to permanently cease operations at its Rome, Georgia mill complex (although we have no indication that it intends to do so), was not willing to pay for wood fiber at a price we deem acceptable or was to cease purchasing wood fiber from us after the expiration of our agreement in 2013, we may not be able to enter into agreements with alternative customers for the wood fiber, any agreements with alternative customers we do enter into may be for lower rates than we currently receive from Temple-Inland and the cost of delivering wood fiber to such alternative customers could increase.

Our ability to harvest and deliver timber may be affected by our sales of timberland and may be subject to other limitations, which could adversely affect our operations.

We have sold 176,000 acres of our timberland in accordance with our near-term strategic initiatives announced in 2009, and we now own directly or through ventures about 143,000 acres of timberland. Sales of our timberland reduce the amount of timber that we have available for harvest.

In addition, weather conditions, timber growth cycles, access limitations, availability of contract loggers and haulers, and regulatory requirements associated with the protection of wildlife and water resources may restrict harvesting of timberlands as may other factors, including damage by fire, insect infestation, disease, prolonged drought, flooding and other natural disasters. Although damage from such natural causes usually is localized and affects only a limited percentage of the timber, there can be no assurance that any damage affecting our timberlands will in fact be so limited. As is common in the forest products industry, we do not maintain insurance coverage with respect to damage to our timberlands.

The revenues, income and cash flow from operations for our fiber resources segment are dependent to a significant extent on the pricing of our products and our continued ability to harvest timber at adequate levels.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
Issuer Purchases of Equity Securities ^(a)**

Period	Total Number of Shares Purchased ^(b)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
Month 1 (7/1/2011 - 7/31/2011)		\$		5,999,013
Month 2 (8/1/2011 - 8/31/2011)	178,511	\$ 12.33	172,435	5,826,578
Month 3 (9/1/2011 - 9/30/2011)	26	\$ 10.91		5,826,578
Total	178,537	\$ 12.33	172,435	

(a) On February 11, 2009, we announced that our Board of Directors authorized the repurchase of up to 7,000,000 shares of our common stock. We have purchased 1,173,422 shares under this authorization, which has no expiration date. We have no repurchase plans or programs that expired during the period covered by the table above and no repurchase plans or programs that we intend to terminate prior to expiration or under which we no longer intend to make further purchases.

(b) Includes shares withheld to pay taxes in connection with vesting of restricted stock awards and exercises of stock options.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 6. Exhibits

- 10.1 Purchase and Sale Agreement dated July 6, 2011, by and among Forestar (USA) Real Estate Group Inc., as seller, Plum Creek Timberlands, L.P., as purchaser, and First American Title Insurance Company, as escrow agent, as amended by First Amendment to Purchase and Sale Agreement dated July 29, 2011, by and among Forestar (USA) Real Estate Group Inc., Plum Creek Timberlands, L.P., and First American Title Insurance Company.
- 10.2 Second Amendment to Amended and Restated Revolving and Term Credit Agreement, dated as of September 30, 2011, by and among the Company, Forestar (USA) Real Estate Group Inc. and its wholly-owned subsidiaries signatory thereto, KeyBank National Association, as administrative agent, and the lenders party thereto (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the Commission on October 3, 2011).

10.3

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Exercise of option to extend revolving credit maturity date under Amended and Restated Revolving and Term Credit Agreement, dated September 30, 2011, by Forestar (USA) Real Estate Group Inc.

- 31.1 Certification of Chief Executive Officer pursuant to Exchange Act rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Exchange Act rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.1 The following materials from Forestar's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements, tagged as blocks of text.

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SIGNATURES

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

FORESTAR GROUP INC.

Date: November 3, 2011

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

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

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