

Forestar Group Inc.
Form 10-Q
May 07, 2009

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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 March 31, 2009**

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. (Check one):

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 May 1, 2009 |
|--|---|
| Common Stock, par value \$1.00 per share | 35,856,419 |

**FORESTAR GROUP INC.
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Consolidated Balance Sheets**

| | (Unaudited) | |
|---|-----------------------|-------------------|
| | March | December |
| | 31, | 31, |
| | 2009 | 2008 |
| | (In thousands) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 8,464 | \$ 8,127 |
| Real estate | 559,588 | 610,586 |
| Assets held for sale | 76,139 | |
| Investment in unconsolidated ventures | 116,107 | 117,554 |
| Timber | 25,194 | 50,989 |
| Receivables, net | 3,730 | 4,262 |
| Prepaid expense | 1,961 | 2,425 |
| Property and equipment, net | 6,103 | 6,211 |
| Deferred tax asset | 20,913 | 17,184 |
| Other assets | 16,240 | 17,238 |
| TOTAL ASSETS | \$ 834,439 | \$ 834,576 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Accounts payable | \$ 4,945 | \$ 7,438 |
| Accrued employee compensation and benefits | 1,034 | 3,389 |
| Accrued property taxes | 3,203 | 6,808 |
| Accrued interest | 1,033 | 1,199 |
| Other accrued expenses | 10,569 | 11,448 |
| Other liabilities | 14,001 | 12,940 |
| Debt | 349,183 | 337,402 |
| TOTAL LIABILITIES | 383,968 | 380,624 |
| COMMITMENTS AND CONTINGENCIES | | |
| EQUITY | | |
| Forestar Group Inc. shareholders equity: | | |
| Preferred stock, par value \$0.01 per share, 25,000,000 authorized shares, none issued | | |
| Common stock, par value \$1.00 per share, 200,000,000 authorized shares, 35,950,127 issued at March 31, 2009 and 35,839,390 issued at December 31, 2008 | 35,950 | 35,839 |
| Additional paid-in capital | 378,628 | 377,810 |
| Retained earnings | 32,877 | 36,769 |
| Accumulated other comprehensive loss | (1,099) | (1,260) |
| | (1,884) | (1,866) |

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Treasury stock, at cost, 93,708 shares at March 31, 2009 and 90,819 at December 31, 2008

| | | |
|---|-------------------|-------------------|
| Total Forestar Group Inc. shareholders equity | 444,472 | 447,292 |
| Noncontrolling interests | 5,999 | 6,660 |
| TOTAL EQUITY | 450,471 | 453,952 |
| TOTAL LIABILITIES AND EQUITY | \$ 834,439 | \$ 834,576 |

Please read the notes to the consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Income
(Unaudited)

| | First Quarter | |
|---|---------------------------------------|-------------|
| | 2009 | 2008 |
| | (In thousands, except per share data) | |
| REVENUES | | |
| Real estate sales | \$ 14,059 | \$ 22,790 |
| Commercial operating properties and other | 4,728 | 5,653 |
| Real estate | 18,787 | 28,443 |
| Mineral resources | 5,921 | 6,268 |
| Fiber resources and other | 4,369 | 2,512 |
| | 29,077 | 37,223 |
| EXPENSES | | |
| Cost of real estate sales | (4,742) | (13,507) |
| Cost of commercial operating properties and other | (3,816) | (3,865) |
| Cost of mineral resources | (76) | |
| Cost of fiber resources | (833) | (546) |
| Other operating | (10,472) | (8,301) |
| General and administrative | (8,815) | (6,837) |
| | (28,754) | (33,056) |
| OPERATING INCOME | 323 | 4,167 |
| Equity in (loss) earnings of unconsolidated ventures | (572) | 1,534 |
| Interest expense | (5,166) | (5,666) |
| Other non-operating income | 51 | 82 |
| (LOSS) INCOME BEFORE TAXES | (5,364) | 117 |
| Income tax benefit | 2,315 | 145 |
| CONSOLIDATED NET (LOSS) INCOME | (3,049) | 262 |
| Less: Net income attributable to noncontrolling interests | (843) | (500) |
| NET LOSS ATTRIBUTABLE TO FORESTAR GROUP INC. | \$ (3,892) | \$ (238) |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING | | |
| Basic | 35,681 | 35,362 |
| Diluted | 35,681 | 35,362 |
| NET LOSS PER COMMON SHARE | | |
| Basic | \$ (0.11) | \$ (0.01) |
| Diluted | \$ (0.11) | \$ (0.01) |

Please read the notes to the consolidated financial statements.

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

| | First Quarter | |
|---|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Consolidated net (loss) income | \$ (3,049) | \$ 262 |
| Adjustments: | | |
| Depreciation and amortization | 2,111 | 1,793 |
| Deferred income taxes | (3,816) | 3 |
| Equity in loss (earnings) of unconsolidated ventures | 572 | (1,534) |
| Distributions of earnings of unconsolidated ventures | 23 | 784 |
| Distributions of earnings to noncontrolling interests | (1,495) | (2,318) |
| Share-based compensation | 1,706 | 2,681 |
| Non-cash real estate cost of sales | 4,770 | 12,852 |
| Real estate development and acquisition expenditures | (7,602) | (20,583) |
| Reimbursements from utility or improvement districts | 1,731 | |
| Other changes in real estate | 280 | (210) |
| Gain on termination of timber lease | (185) | (1,376) |
| Cost of timber cut | 796 | 547 |
| Deferred income | 930 | 569 |
| Asset impairments | 600 | |
| Other | 28 | (584) |
| Changes in: | | |
| Receivables | (32) | 26 |
| Prepaid and other | 74 | (1,829) |
| Accounts payable and other accrued liabilities | (7,951) | (5,133) |
| Net cash used in operating activities | (10,509) | (14,050) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Property, equipment, software and reforestation | (1,557) | (529) |
| Investment in unconsolidated ventures | (830) | (4,263) |
| Return of investment in unconsolidated ventures | 1,614 | 2,650 |
| Net cash used in investing activities | (773) | (2,142) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments of debt | (14,977) | (14,665) |
| Additions to debt | 26,758 | 33,540 |
| Deferred financing fees | | (1,037) |
| Return of investment to noncontrolling interests | (170) | |
| Exercise of stock options | 1 | 812 |
| Payroll taxes on restricted stock and stock options | (17) | (1,816) |
| Tax benefit from share-based compensation | | 77 |
| Other | 24 | 114 |

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| | | |
|--|----------|----------|
| Net cash provided by financing activities | 11,619 | 17,025 |
| Net increase in cash and cash equivalents | 337 | 833 |
| Cash and cash equivalents at beginning of period | 8,127 | 7,520 |
| Cash and cash equivalents at end of period | \$ 8,464 | \$ 8,353 |

Please read the notes to the consolidated financial statements.

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

Note 1 Background

Prior to December 28, 2007, we were a wholly-owned subsidiary of Temple-Inland Inc. On December 28, 2007, Temple-Inland distributed all of the issued and outstanding shares of our common stock to its shareholders in a transaction commonly referred to as a spin-off.

Note 2 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 interest in consolidated pass-through entities is 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 distribution 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 costs to real estate 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 2008 Annual Report on Form 10-K.

Certain prior year items have been reclassified to conform to the current year's presentation.

Note 3 New Accounting Pronouncements

Beginning January 2009, we adopted the following new accounting pronouncements:

FASB Staff Position (FSP) FAS 157-2, Effective Date of FASB Statement 157 This FSP delayed the effective date of Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements*, for certain nonfinancial assets and nonfinancial liabilities. Adoption of this FSP did not significantly affect how we determine fair value but has resulted in certain additional disclosures. Please read Note 10 for additional disclosures.

FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities This staff position specifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and should be included in the computation of earnings per share pursuant to the two-class method. Adoption of this FSP did not have an impact on our earnings per share.

SFAS No. 141(R), Business Combinations This standard requires most identifiable assets, liabilities, noncontrolling interests and goodwill acquired in a business combination to be recorded at full fair value. The standard also changes the approach to determining the purchase price; the accounting for acquisition cost; and several acquisition related accounting practices. Adoption of this pronouncement did not have a significant effect on our earnings or financial position.

SFAS No. 160, Noncontrolling Interest in Consolidated Financial Statements This standard specifies that noncontrolling interests be reported as a part of equity, not as a liability or other item outside of equity. Upon adoption, we reclassified \$6,660,000 of noncontrolling interest to shareholders' equity at year-end 2008 and

we reclassified \$500,000 of minority interest expense to net income attributable to noncontrolling interest for first three months 2008. The following table presents a reconciliation of the changes in shareholders' equity during the quarter ended March 31, 2009 (in thousands):

| | Forestar Group Inc. | Noncontrolling Interests | Total |
|--|--------------------------------|-------------------------------------|--------------|
| Balance as of December 31, 2008 | \$ 447,292 | \$ 6,660 | \$ 453,952 |
| Net (loss) income | (3,892) | 843 | (3,049) |
| Unrealized gain | 161 | | 161 |
| Distributions to noncontrolling interests | | (1,665) | (1,665) |
| Contributions from noncontrolling interest | | 161 | 161 |
| Other (primarily share-based compensation) | 911 | | 911 |
| Balance as of March 31, 2009 | \$ 444,472 | \$ 5,999 | \$ 450,471 |

SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133*. This standard requires enhanced disclosures about derivative instruments including how and why they are used; how they are accounted for; and how they affect an entity's financial position, financial performance and cash flows. Adoption of this pronouncement did not have a significant effect on our earnings or financial position.

In April 2009, the FASB issued the following to provide additional guidance and disclosures regarding fair value measurements and impairments of securities:

FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidance for estimating fair value when the volume and level of activity for an asset or liability have significantly decreased. Based on our current understanding, we do not expect that the adoption of this pronouncement will have a significant effect on our earnings or financial position.

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FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which changes the requirements for recognizing other-than-temporary impairments for debt securities. Based on our current understanding, we do not expect that the adoption of this pronouncement will have a significant effect on our earnings or financial position.

FSP FAS 107-1 and Accounting Principles Board (APB) Opinion 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which require an entity to provide disclosures about fair value of financial instruments in interim financial and summarized financial information. Based on our current understanding, we do not expect that the adoption of this pronouncement will have a significant effect on our earnings or financial position.

These are effective for interim and annual periods ending after June 15, 2009.

Note 4 Strategic Initiatives and Assets Held for Sale

On February 11, 2009, we announced the following strategic initiatives to enhance shareholder value:

Generate significant cash flow, principally from the sale of approximately 175,000 acres of higher and better use (HBU) timberland;

Reduce debt by approximately \$150 million; and

Repurchase up to 20% of our common stock.

Debt reduction and share repurchases will be funded by proceeds from the sale of the HBU timberland. Share repurchases will be accomplished from time to time through open market or privately negotiated transactions, subject to market conditions and other factors.

In first quarter 2009, we have reclassified to assets held for sale about 171,000 acres of undeveloped land principally located in Alabama and Georgia with a carrying value of \$51,390,000 and related timber with a carrying value of \$24,749,000. These assets are being actively marketed.

Note 5 Real Estate

Real estate consists of:

| | March 31, 2009 | December 31, 2008 |
|--|-------------------------------|----------------------------------|
| | (In thousands) | |
| Entitled, developed and under development projects | \$ 446,283 | \$ 445,394 |
| Undeveloped land | 91,467 | 143,749 |
| Commercial operating properties | 44,828 | 43,987 |
| | 582,578 | 633,130 |
| Accumulated depreciation | (22,990) | (22,544) |
| | \$ 559,588 | \$ 610,586 |

Included in entitled, developed and under development projects are the estimated costs of assets we expect to convey to utility or improvement districts of \$75,388,000 at first quarter-end 2009 and \$76,173,000 at year-end 2008, including \$49,529,000 at first quarter-end 2009 and year-end 2008 related to our Cibolo Canyons project near San Antonio, Texas. These costs relate to water, sewer and other infrastructure assets for which the utility or improvement districts have agreed to reimburse us. In first three months 2009, we did not bill these districts. In first three months

2008, we billed these districts \$12,011,000. In first three months 2009, we collected \$1,731,000 from these districts. In first three months 2008, we did not collect from these districts. We expect to collect the remaining amounts billed when these districts achieve adequate tax bases to support payment.

We recognized asset impairment charges of \$600,000 in first three months 2009 related to a condominium project in Texas. We did not recognize any asset impairment charges in first three months 2008. Asset impairment charges are included in cost of real estate sales.

Depreciation expense primarily related to commercial operating properties was \$446,000 in first three months 2009 and \$400,000 in first three months 2008 and is included in other operating expense.

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We have over 338,000 acres of timber, primarily in Georgia. The cost of timber cut was \$796,000 in first three months 2009 and \$547,000 in first three months 2008.

Note 7 Investment in Unconsolidated Ventures

At first quarter-end 2009, 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 first quarter-end 2009 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 first quarter-end 2009, the venture had 15 residential and mixed-use communities, of which 10 are in Texas, 3 are in Florida and 2 are in Georgia, representing about 7,600 residential lots and 560 commercial acres.

Temco Associates, LLC was formed in 1991 for the purpose of acquiring and developing residential real estate sites in Georgia. At first quarter-end 2009, the venture had 5 residential and mixed-use communities, representing about 1,560 residential lots, all of which are located in Paulding County, Georgia. The venture also owns approximately 5,600 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. Construction of the project was completed in fourth quarter 2008 and is approximately 68% leased. Our remaining commitment for investment in this venture as of first quarter-end 2009 is \$2,686,000. We have entered into a 10-year operating lease for approximately 32,000 square feet that we occupy as our corporate headquarters effective in fourth quarter 2008.

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

| | March 31, 2009 | | | | | December 31, 2008 | | | | |
|---|-------------------|-----------|----------------|-----------------|--------------------|-------------------|-----------|----------------|-----------------|--------------------|
| | CL Realty | Temco | Palisades West | Other Ventures | Total | CL Realty | Temco | Palisades West | Other Ventures | Total |
| | (in thousands) | | | | | | | | | |
| Real estate | \$ 122,660 | \$ 60,377 | \$ 125,180 | \$ 92,198 | \$ 400,415 | \$ 124,417 | \$ 60,791 | \$ 120,953 | \$ 94,094 | \$ 400,255 |
| Total assets | 125,234 | 61,852 | 128,815 | 102,114 | 418,015 | 126,726 | 61,832 | 123,290 | 102,930 | 414,778 |
| Borrowings, principally non-recourse (a) | 4,968 | 3,168 | | 75,966 | 84,102 | 4,901 | 3,198 | | 75,638 | 83,737 |
| Total liabilities | 7,077 | 3,853 | 54,687 | 88,124 | 153,741 | 8,683 | 3,570 | 50,548 | 89,580 | 152,381 |
| Equity | 118,157 | 57,999 | 74,128 | 13,990 | 264,274 | 118,043 | 58,262 | 72,742 | 13,350 | 262,397 |
| Our investment in real estate ventures: Our share of their equity ^(b) | 59,078 (7,059) | 29,000 | 18,148 | 17,554 (614) | 123,780 (7,673) | 59,022 (7,059) | 29,131 | 18,779 | 18,295 (614) | 125,227 (7,673) |

Unrecognized
deferred
gain^(c)

Investment in
real estate

| | | | | | | | | | | |
|----------|-----------|-----------|-----------|-----------|------------|-----------|-----------|-----------|-----------|------------|
| ventures | \$ 52,019 | \$ 29,000 | \$ 18,148 | \$ 16,940 | \$ 116,107 | \$ 51,963 | \$ 29,131 | \$ 18,779 | \$ 17,681 | \$ 117,554 |
|----------|-----------|-----------|-----------|-----------|------------|-----------|-----------|-----------|-----------|------------|

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

| | First Quarter | |
|---|-----------------------|--------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Revenues: | | |
| CL Realty | \$ 1,600 | \$ 3,085 |
| Temco | 857 | 677 |
| Palisades West | 1,729 | 54 |
| Other ventures | 2,163 | 3,196 |
| Total | \$ 6,349 | \$ 7,012 |
| Earnings: | | |
| CL Realty | \$ 504 | \$ 2,313 |
| Temco | (420) | (279) |
| Palisades West | 148 | 38 |
| Other ventures | 1,195 | (299) |
| Total | \$ 1,427 | \$ 1,773 |
| Our equity in their earnings: | | |
| CL Realty ^(c) | \$ 252 | \$ 1,143 |
| Temco | (210) | (141) |
| Palisades West | 37 | 9 |
| Other ventures ^(b) | (651) | 523 |
| Recognition of deferred gain ^(c) | | |
| Total | \$ (572) | \$ 1,534 |

(a) Total includes current maturities of \$15,971,000 at first quarter-end 2009 and \$21,150,000 at year-end 2008.

(b) 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.

- (c) In 2003, we contributed real estate with a \$13,800,000 carrying value to CL Realty in exchange for \$13,800,000 cash and a 50 percent interest in the partnership. We deferred the \$14,587,000 gain on the sale and are recognizing it as the partnership sells the real estate to third parties. The deferred gain is reflected as an offset to our investment in unconsolidated ventures.

In first three months 2009, we invested \$830,000 in these ventures and received \$1,637,000 in distributions; in first three months 2008, we invested \$4,263,000 in these ventures and received \$3,434,000 in distributions. Distributions include both return of investments and distributions of earnings.

Note 8 Debt

Debt consists of:

| | March 31, 2009 | December 31, 2008 |
|---|-------------------------------|----------------------------------|
| | (In thousands) | |
| Term loan facility average interest rate of 4.54% at first quarter-end 2009 and 4.77% at year-end 2008 | \$ 175,000 | \$ 175,000 |
| Revolving loan facility average interest rate of 4.56% at first quarter-end 2009 and 5.12% at year-end 2008 | 69,700 | 59,900 |

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| | | |
|---|------------|------------|
| Secured promissory note interest rate of 3.02% at first quarter-end 2009 and 3.01% at year-end 2008 | 19,716 | 16,000 |
| Other indebtedness due through 2011 at variable interest rates based on prime (3.25% at first quarter-end 2009 and year-end 2008) and fixed interest rates ranging from 6.00% to 9.50%) | 84,767 | 86,502 |
| | \$ 349,183 | \$ 337,402 |

Our senior credit facility and other debt agreements contain terms, conditions and financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At first quarter-end 2009, we were in compliance with the terms, conditions and financial covenants of these agreements.

Our senior credit facility provides for a \$175,000,000 term loan and a \$290,000,000 revolving line of credit. The revolving line of

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credit may be prepaid at any time without penalty. The term loan may be prepaid at any time; however, repayment prior to June 1, 2009 requires a fee of 1.00% of the principal amount. There is no prepayment fee for the term loan on or after June 1, 2009. The senior credit facility matures December 1, 2010. The revolving line of credit includes a \$100,000,000 sublimit for letters of credit, of which \$13,071,000 was outstanding at first quarter-end 2009. Total borrowings under our senior credit facility (including the face amount of letters of credit) may not exceed a borrowing base formula, and include a \$35,000,000 minimum liquidity requirement at each quarter-end. At first quarter-end 2009, we had \$172,000,000 in net unused borrowing capacity under our senior credit facility.

At our option, we can borrow at LIBOR plus 4 percent or Prime plus 2 percent. All borrowings under the senior credit facility are secured by (a) an initial pledge of approximately 250,000 acres of undeveloped 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, and (e) negative pledge (without a mortgage) on all other wholly-owned assets. The senior credit facility provides for releases of real estate provided that borrowing base compliance is maintained.

We incurred origination and other fees related to our credit facility of \$10,573,000, of which \$6,045,000 is unamortized at first quarter-end 2009 and is included in other assets. Amortization of deferred financing fees in connection with our senior credit facility was \$883,000 in first three months 2009 and \$855,000 in first three months 2008.

At first quarter-end 2009, commercial operating properties having a book value of \$21,476,000 were subject to liens in connection with \$19,716,000 of debt.

At first quarter-end 2009, entitled, developed and under development projects having a book value of \$161,290,000 were subject to liens in connection with \$84,767,000 of principally non-recourse debt.

Note 9 Derivative Instruments

We are exposed to certain risks arising from both our business operations and economic conditions. We principally manage exposures to a wide variety of business and operational risks through management of our core business activities. We manage economic risks including interest rate, liquidity and credit risk by managing the amount, sources, and duration of our debt funding and through the use of derivative instruments. Specifically, we may enter into derivative instruments to mitigate the risk inherent in interest rate fluctuations.

Cash Flow Hedges

Our objective for using interest rate derivatives is to manage exposure to significant movements in interest rates. To accomplish this objective, we use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for our fixed-rate payment over the life of the agreements without exchange of the underlying notional amount.

As of March 31, 2009, our \$100,000,000 notional amount interest rate swap agreement, which matures in 2010, requires that we pay a fixed interest rate of 6.57 percent and receive a floating interest rate of one month LIBOR plus 4 percent (4.50 percent at first quarter-end 2009).

We defer and include in other comprehensive income the effective portion of changes in the fair value of our cash flow hedge. We recognize the ineffective portion of the hedge as income or loss. The effectiveness of the hedge relationship is periodically assessed by comparing the present value of the cumulative change in the expected future cash flows on the variable leg of the swap with the present value of the cumulative change in the expected future hedged cash flows. In first three months 2009 and 2008, there was no hedge ineffectiveness.

The table below presents the fair value of our derivative instrument as well as its classification on the consolidated balance sheets as of March 31, 2009 and December 31, 2008:

| | | Liability Derivatives | | | |
|----------------------|--------------|------------------------------|--------------|--------------------------|--|
| | | March 31, 2009 | | December 31, 2008 | |
| Balance Sheet | Fair | Balance Sheet | Fair | | |
| Location | Value | Location | Value | | |
| | | | | | |

(in thousands)

Derivatives designated as
hedging instruments under
SFAS 133:

| | | | | |
|--------------------|----------------------|---------|----------------------|---------|
| Interest Rate Swap | Other liabilities | \$1,691 | Other liabilities | \$1,939 |
|--------------------|----------------------|---------|----------------------|---------|

The change in fair value of our interest rate swap recognized in other comprehensive income was a gain of \$161,000 in first three months 2009 and a loss of \$330,000 in first three months 2008. No amounts were reclassified from other comprehensive income into income in first three months 2009 or first three months 2008.

See **Note 10 Fair Value** for a description of how the above derivative instrument is valued in accordance with SFAS No. 157.

Note 10 Fair Value

SFAS 157, *Fair Value Measurements*, provides a framework for measuring fair value and expands disclosures required about fair value measurements. This pronouncement establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs Unadjusted quoted prices for identical assets or liabilities in active markets;

Level 2 Inputs Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 Inputs Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. Such inputs typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

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| | Fair Value Measurements | | | March 31, 2009 |
|--|-------------------------|--|-------------------|-------------------|
| | Level 1 Inputs | Level 2 Inputs (In thousands) | Level 3 Inputs | |
| <i>Financial Assets and Liabilities:</i> | | | | |
| Interest Rate Swap Agreement | \$(1,691) | \$ | \$ | \$(1,691) |

Non-Financial Assets and Liabilities:

| | | | | |
|-------------|----|----|----------|----------|
| Real estate | \$ | \$ | \$15,164 | \$15,164 |
|-------------|----|----|----------|----------|

Financial liabilities measured at fair value on a recurring basis include our interest rate swap agreement. The fair value of the interest rate swap agreement was determined using quoted prices in active markets for identical assets. In first three months 2009, the fair value of our interest rate swap increased, and as a result, we recognized an after-tax gain of \$161,000 in accumulated other comprehensive income.

Non-financial assets measured at fair value on a non-recurring basis include real estate assets measured for impairment. In first three months 2009, certain assets were remeasured and reported at fair value due to events or circumstances that indicated that 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 assets. As a result, we recognized asset impairment of \$600,000 in first three months 2009.

Note 11 Capital Stock

Pursuant to our shareholder rights plan, each share of common stock outstanding is coupled with one-quarter of a preferred stock purchase right (Right). Each Right entitles our shareholders 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 16 for information about additional shares of common stock that could be issued under terms of our share-based compensation plans.

As a result of our spin-off from Temple-Inland, all of Temple-Inland's outstanding share-based compensation awards were equitably adjusted into separate awards: one related to our common stock, one related to Temple-Inland common stock and one related to Guaranty Financial Group, Inc. common stock. Guaranty was another wholly-owned subsidiary of Temple-Inland that was spun off on December 28, 2007. All awards issued as part of this adjustment are subject to their original vesting schedules.

At first quarter-end 2009, Temple-Inland and Guaranty directors and employees held 27,000 equity-settled restricted stock awards on our stock.

The following table summarizes outstanding stock option awards on our stock held by Temple-Inland and Guaranty directors and employees at first quarter-end 2009:

| | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term (In years) | Aggregate Intrinsic Value (Current Value Less Exercise Price) |
|--------|---|---|--|
| Shares | | | |

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| | (In thousands) | | | (In thousands) |
|-------------|---------------------------|----------|---|---------------------------|
| Outstanding | 1,749 | \$ 19.30 | 5 | \$ 8 |
| Exercisable | 1,571 | \$ 18.76 | 5 | \$ 8 |
| | 11 | | | |

Table of Contents**Note 12 Other Comprehensive Loss**

Other comprehensive loss consists of:

| | First Quarter | |
|--|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Consolidated net (loss) income | \$ (3,049) | \$ 262 |
| Change in fair value of interest rate swap agreement, net of taxes | 161 | (330) |
| Other comprehensive loss | (2,888) | (68) |
| Less: Comprehensive income attributable to noncontrolling interest | (843) | (500) |
| Other comprehensive loss attributable to Forestar Group Inc. | \$ (3,731) | \$ (568) |

Note 13 Net Loss per Share

Our basic and diluted weighted average common shares outstanding used to compute net loss per share are as follows:

| | First Quarter | |
|--|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Weighted average common shares outstanding basic | 35,681 | 35,362 |
| Dilutive effect of stock options | | |
| Dilutive effect of restricted stock and restricted stock units | | |
| Weighted average common shares outstanding diluted | 35,681 | 35,362 |

At first quarter-end 2009, the effect of 3,047,000 stock options and unvested shares of restricted stock were not included in the computation of diluted weighted average shares outstanding because their impact would have been anti-dilutive as a result of our net loss.

At first quarter-end 2008, the effect of 2,664,000 stock options and unvested shares of restricted stock were not included in the computation of diluted weighted average shares outstanding because their impact would have been anti-dilutive as a result of our net loss.

Note 14 Commitments and Contingencies***Litigation***

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

Environmental

Environmental remediation liabilities arise from time to time in the ordinary course of doing business, and we believe we have established adequate reserves for any probable losses. We own 288 acres near Antioch, California, portions of which were sites of a Temple-Inland paper manufacturing operation that are in remediation. In 2008, we increased our reserves for environmental remediation by about \$2,900,000. We estimate the cost to complete remediation activities will be about \$3,200,000, which is included in other accrued expenses and will likely be paid in 2009. Our estimate requires us to make assumptions regarding the scope of required remediation, the effectiveness of planned remediation activities, and approvals by regulatory authorities. Our estimate is subject to revision as new information becomes available.

Note 15 Segment Information

We manage our operations through three 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 commercial operating properties. Mineral resources manages our oil and gas mineral interests. Fiber resources manages our timber and recreational leases.

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Assets allocated by segment are as follows:

| | March 31, 2009 | December 31, 2008 |
|----------------------------------|-------------------------------|----------------------------------|
| | (In thousands) | |
| Real estate | \$ 730,815 | \$ 732,401 |
| Mineral resources | 416 | 376 |
| Fiber resources | 50,262 | 51,321 |
| Assets not allocated to segments | 52,946 | 50,478 |
| Total assets | \$ 834,439 | \$ 834,576 |

We evaluate performance based on segment earnings before unallocated items and income taxes. Segment earnings consist of operating income, equity in earnings of unconsolidated ventures and net income attributable to noncontrolling interest. Unallocated items consist of general and administrative expense, share-based compensation, other non-operating income and expense and interest expense. All our revenues are derived from U.S. operations and all our assets are located in the U.S. For first three months 2009, revenues from one customer of our real estate segment and one customer of our fiber resources segment exceeded 10% of our total revenues.

Segment revenues and earnings are as follows:

| | First Quarter | |
|--|-----------------------|------------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Revenues: | | |
| Real estate | \$ 18,787 | \$ 28,443 |
| Mineral resources | 5,921 | 6,268 |
| Fiber resources | 4,369 | 2,512 |
| Total revenues | \$ 29,077 | \$ 37,223 |
| Segment earnings: | | |
| Real estate | \$ 542 | \$ 3,543 |
| Mineral resources | 4,782 | 6,505 |
| Fiber resources | 2,909 | 2,840 |
| Total segment earnings | 8,233 | 12,888 |
| Items not allocated to segments ^(a) | (14,440) | (13,271) |
| Income before taxes | \$ (6,207) | \$ (383) |

(a) Items not allocated to segments consists of:

| | First Quarter | |
|------------------------------------|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| General and administrative expense | \$ (7,619) | \$ (5,006) |
| Share-based compensation expense | (1,706) | (2,681) |
| Interest expense | (5,166) | (5,666) |
| Other non-operating income | 51 | 82 |
| | \$ (14,440) | \$ (13,271) |

In first three months 2009, general and administrative expense includes \$3,180,000 paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal.

Note 16 Share-Based Compensation

Post-Spin Awards

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

Table of Contents***Cash-settled awards***

Cash-settled awards granted to our employees in the form of restricted stock units or stock appreciation rights vest over two to four years from the date of grant and generally provide for accelerated vesting upon death, disability or if there is a change in control. Vesting for some awards is also conditioned upon achievement of a minimum one percent annualized return on assets over a three-year period.

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 awards granted under our plan for first three months 2009:

| | Equivalent Units (In thousands) | | Weighted Average Grant Date Fair Value Per Unit |
|------------------------------------|--|----|--|
| Non-vested as of December 31, 2008 | 5 | \$ | 28.85 |
| Granted | 1,106 | | 5.72 |
| Vested | (105) | | 9.71 |
| Forfeited | (1) | | 28.85 |
| Non-vested as of March 31, 2009 | 1,005 | \$ | 5.41 |

In first three months 2009, we paid \$22,000 to settle vested cash awards. The aggregate current value of non-vested awards as of March 31, 2009 is \$2,055,000.

Equity-settled awards

There were no equity-settled awards in the form of restricted stock units granted in first three months 2009, and there were no unvested equity-settled restricted stock unit awards at first quarter-end 2009.

Restricted stock

Restricted stock awards vest after three years if we achieve a minimum one percent annualized return on assets over such three-year period. The following table summarizes the activity of awards granted under our plan for first three months 2009:

| | Restricted Shares (In thousands) | | Weighted Average Grant Date Fair Value Per Share |
|------------------------------------|---|----|---|
| Non-vested as of December 31, 2008 | 207 | \$ | 21.89 |
| Granted | 110 | | 9.29 |
| Vested | | | |
| Forfeited | (1) | | 28.85 |
| Non-vested as of March 31, 2009 | 316 | \$ | 17.45 |

The aggregate current value of non-vested awards as of first quarter-end 2009 is \$2,416,000, or \$7.65 per share.

Stock options

Stock options have a ten-year term, generally become exercisable ratably over three to four years and provide for accelerated or continued vesting upon retirement, death, disability or if there is a change in control. Options were granted with an exercise price equal to the market value of our stock on the date of grant. The following table summarizes the activity of awards granted under our plan for first three months 2009:

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| | Options Outstanding (In thousands) | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term (In years) |
|--|---|--|---|
| Balance as of December 31, 2008 | 622 | \$ 28.85 | 9 |
| Granted | 161 | 9.29 | |
| Exercised | | | |
| Forfeited | (3) | 28.85 | |
| Balance as of March 31, 2009 | 780 | \$ 24.80 | 9 |
| Options Exercisable as of March 31, 2009 | 183 | \$ 28.85 | 9 |

There was no aggregate intrinsic value for stock options outstanding or exercisable at first quarter-end 2009.

Stock options are valued based upon the Black-Scholes option pricing model. Awards granted in first three months 2009 were valued based upon the following assumptions:

| | |
|--|--------|
| Expected dividend yield | 0.0% |
| Expected stock price volatility | 41.8% |
| Risk-free interest rate | 1.8% |
| Expected life of options (years) | 6 |
| Weighted average estimated fair value of options granted | \$3.94 |

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

Pre-Spin Awards

Prior to the spin-off, we participated in Temple-Inland's share-based compensation plans, and as a result, certain of our directors and employees received share-based compensation in the form of restricted or performance stock units, restricted stock, or options to purchase shares of Temple-Inland's common stock. Concurrent with Temple-Inland's distribution of our common stock, all outstanding Temple-Inland awards were adjusted into three separate awards: one related to Forestar common stock, one related to Guaranty common stock and one related to Temple-Inland common stock.

Cash-settled awards

Cash-settled awards generally vest and are paid after three years from the date of grant or the attainment of defined performance goals, generally measured over a three-year period. A summary of cash-settled awards outstanding to our directors and employees at first quarter-end 2009, following the adjustments described previously, follows:

| | Equivalent Units (In thousands) | Aggregate Current Value |
|--------------------------|--|--|
| Awards on Forestar stock | 24 | \$ 182 |
| Awards on Guaranty stock | 24 | 25 |

| | | |
|-------------------------------|----|--------|
| Awards on Temple-Inland stock | 72 | 384 |
| | | \$ 591 |

In first three months 2009, we paid \$394,000 to settle vested cash awards.

Table of Contents**Stock options**

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 Temple-Inland common stock on the date of grant. A summary of stock option awards outstanding to our directors and employees at first quarter-end 2009, following the adjustments described previously, follows:

| | Shares (In thousands) | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term (In years) | Aggregate Value (Current Value Less Exercise Price) (In thousands) |
|------------------------------------|-----------------------------|--|---|---|
| Outstanding on Forestar stock | 86 | \$ 21.12 | 6 | \$ |
| Outstanding on Guaranty stock | 86 | 13.55 | 6 | |
| Outstanding on Temple-Inland stock | 255 | 16.89 | 6 | |
| | | | | \$ |
| Exercisable on Forestar stock | 70 | \$ 19.34 | 5 | \$ |
| Exercisable on Guaranty stock | 70 | 12.41 | 5 | |
| Exercisable on Temple-Inland stock | 209 | 15.47 | 5 | |
| | | | | \$ |

No options were exercised in first three months 2009.

Share-Based Compensation Expense

Share-based compensation expense for post-spin and pre-spin awards consists of:

| | First Quarter 2009 2008 (In thousands) | |
|--|---|----------|
| Cash-settled awards | \$ 780 | \$ 140 |
| Equity-settled awards | | 750 |
| Restricted stock | 344 | 189 |
| Stock options | 582 | 1,602 |
| Pre-tax share-based compensation expense | 1,706 | 2,681 |
| Income tax benefit | (631) | (1,019) |
| | \$ 1,075 | \$ 1,662 |

The fair value of awards granted to retirement-eligible employees and expensed at the date of grant was \$135,000 in first three months 2009 and \$1,321,000 in first three months 2008.

Pre-tax share-based compensation expense is included in:

| | First Quarter | |
|------------------------------------|-----------------------|-----------------|
| | 2009 | 2008 |
| | (In thousands) | |
| General and administrative expense | \$ 1,196 | \$ 1,831 |
| Other operating expense | 510 | 850 |
| | \$ 1,706 | \$ 2,681 |

We did not capitalize any share-based compensation in first three months 2009 or 2008.

Unrecognized share-based compensation for post-spin awards not vested was \$7,953,000 at first quarter-end 2009. The weighted average period over which this amount will be recognized is estimated to be 2.5 years. Unrecognized share-based compensation for pre-spin awards not vested was \$396,000 at first quarter-end 2009. The weighted average period over which this amount will be recognized is estimated to be 1.3 years.

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In connection with restricted stock vested and stock options exercised, we withheld shares having a value of \$17,000 for payment of payroll taxes in first three months 2009. These shares are accounted for as treasury stock. Payroll taxes on restricted stock and stock options are reflected in financing activities in our consolidated statement of cash flows.

Note 17 Income Taxes

Our effective tax rate was a benefit of 43% in the first three months 2009 of which 6% is attributable to noncontrolling interests, and a benefit of 124% in the first three months 2008 of which 86% is attributable to noncontrolling interests. As a result of our adoption of SFAS No. 160, income (loss) before income taxes includes income from pass-through entities allocable to noncontrolling interests for which there is no income tax provided.

We anticipate that our effective tax rate in 2009 will be about 37% of which less than one percent will be attributable to noncontrolling interests.

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.

Note 18 Subsequent Event

In accordance with our strategic initiatives, effective May 2, 2009, we entered into a definitive agreement with the Hancock Timber Resource Group division of Hancock Natural Resource Group, Inc., acting on behalf of its investor clients, to sell about 75,000 acres of timberland in Georgia and Alabama for \$120,000,000 in a cash transaction. The transaction is expected to close in second quarter 2009, subject to customary closing conditions. We intend to use the after-tax cash proceeds from this sale to reduce our outstanding debt.

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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 2008 Annual Report on Form 10-K. Unless otherwise indicated, information is presented as of March 31, 2009, and references to acreage owned include all acres owned by ventures regardless of our ownership interest in a venture.

Forward-Looking Statements

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

- general economic, market or business conditions;
- 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;
- future residential or commercial entitlements;
- expected development timetables and projected timing for sales of lots or other parcels of land;
- development approvals and the ability to obtain such approvals;
- the anticipated price ranges of lots in our developments;
- the number, price and timing of land sales or acquisitions;
- absorption rates and expected gains on land and lot sales;
- the levels of resale inventory in our development projects and the regions in which they are located;
- the development of relationships with strategic partners;
- fluctuations in costs and expenses;
- demand for new housing, which can be affected by the availability of mortgage credit;
- government energy policies;
- demand for oil and gas;
- fluctuations in oil and gas prices;
- competitive actions by other companies;

changes in laws or regulations and actions or restrictions of regulatory agencies;

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

our partners' ability to fund their capital commitments;

the ability to complete merger, acquisition or divestiture plans; regulatory or other limitations imposed as a result of a merger, acquisition or divestiture; and the success of the business following a merger, acquisition or divestiture;

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

our customers may be unwilling or unable to meet lot takedown commitments due to liquidity limitations or slowing market conditions.

Other factors, including the risk factors described in Item 1A of our 2008 Annual Report on Form 10-K, may also cause actual results to differ materially from those projected by our forward-looking statements. New factors emerge from time to time and it is not possible for us to predict all such factors, nor can we assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

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

Background

Prior to December 28, 2007, we were a wholly-owned subsidiary of Temple-Inland Inc. On December 28, 2007, Temple-Inland distributed all our issued and outstanding shares of common stock to its shareholders in a transaction commonly referred to as a spin-off. In 2008, we operated our first full year as a stand-alone public company and the following discussion and analysis reflect the post-spin results of operations and the effect on our financial condition.

Strategy

Our strategy is to maximize and grow long-term shareholder value through:

Entitlement and development of real estate;

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

Strategic and disciplined investment in our business.

On February 11, 2009, we announced the following strategic initiatives to enhance shareholder value:

Generate significant cash flow, principally from the sale of approximately 175,000 acres of higher and better use (HBU) timberland;

Reduce debt by approximately \$150 million; and

Repurchase up to 20% of our common stock.

Debt reduction and share repurchases will be funded by proceeds from the sale of the HBU timberland. Share repurchases will be accomplished from time to time through open market or privately negotiated transactions, subject to market conditions and other factors.

In first quarter 2009, we have reclassified to assets held for sale about 171,000 acres of undeveloped land principally located in Alabama and Georgia with a carrying value of \$51,390,000 and related timber with a carrying value of \$24,749,000. These assets are being actively marketed.

In accordance with our strategic initiatives, effective May 2, 2009, we entered into a definitive agreement with the Hancock Timber Resource Group division of Hancock Natural Resource Group, Inc., acting on behalf of its investor clients, to sell about 75,000 acres of timberland in Georgia and Alabama for \$120,000,000 in a cash transaction. The transaction is expected to close in second quarter 2009, subject to customary closing conditions. We intend to use the after-tax cash proceeds from this sale to reduce our outstanding debt.

Results of Operations

Net loss was \$(3,892,000) or \$(0.11) per basic and diluted share, in first three months 2009, compared with \$(238,000), or \$(0.01) per basic and diluted share, in first three months 2008.

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A summary of our consolidated results follows:

| | First Quarter | |
|--|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Revenues: | | |
| Real estate | \$ 18,787 | \$ 28,443 |
| Mineral resources | 5,921 | 6,268 |
| Fiber resources | 4,369 | 2,512 |
| Total revenues | \$ 29,077 | \$ 37,223 |
| Segment earnings: | | |
| Real estate | \$ 542 | \$ 3,543 |
| Mineral resources | 4,782 | 6,505 |
| Fiber resources | 2,909 | 2,840 |
| Total segment earnings | 8,233 | 12,888 |
| Items not allocated to segments: | | |
| General and administrative expense | (7,619) | (5,006) |
| Share-based compensation expense | (1,706) | (2,681) |
| Interest expense | (5,166) | (5,666) |
| Other non-operating income | 51 | 82 |
| Loss before taxes | (6,207) | (383) |
| Income tax benefit | 2,315 | 145 |
| Net loss attributable to Forestar Group Inc. | \$ (3,892) | \$ (238) |

Significant aspects of our results of operations follow:

First Three Months 2009 and 2008

Real Estate segment earnings declined principally due to a continued decrease in the sales of residential real estate, decreased commercial sales activity and increased costs associated with asset impairments and legal reserves.

Mineral Resources segment earnings declined principally due to lower lease bonus revenues, lower oil prices and increased costs associated with developing and staffing our mineral resources organization.

Fiber Resources segment revenues increased as result of increased prices related to a higher mix of larger pine sawtimber sold. In first three months 2008, segment earnings included a gain from partial termination of a timber lease.

In first three months 2009, general and administrative expense includes \$3,180,000 paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal.

In first three months 2009, share-based compensation included \$135,000 related to accelerated expense recognition in conjunction with awards granted to retirement-eligible employees compared to \$1,321,000 in

first three months 2008.

Current Market Conditions

Current market conditions in the residential development industry are extremely difficult due to the oversupply of housing, diminished sales volume and sales prices for existing and new homes and a significant tightening of mortgage credit. Consumer confidence is near or at an all time low. Many home builders are experiencing liquidity shortfalls and are unwilling or unable to close lot purchases. All geographic markets and products have not been affected to the same extent or with equal severity, but most have experienced declines. It is likely these conditions will continue throughout 2009.

Current market conditions in the oil and gas industry have declined as oil and gas commodity prices have decreased from recent highs. Exploration and production companies have reduced capital expenditures for lease acquisition and production due to lower world wide demand and higher inventories resulting in lower oil and gas commodity prices. These conditions may impact the demand for new mineral leases, new exploration activity and the amount of royalty revenues we receive.

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Pulpwood demand in our markets has declined as a result of weak demand for these products due to temporary mill curtailments. Sawtimber prices have declined due to the decrease in demand for lumber products consistent with the decline in the housing industry.

Business Segments

We manage our operations through three business segments:

Real estate,

Mineral resources, and

Fiber resources.

We evaluate performance based on earnings before unallocated items and income taxes. Segment earnings consist of operating income and equity in earnings of unconsolidated ventures, less net income attributable to noncontrolling interest. Unallocated items consist of general and administrative expense, share-based compensation, other non-operating income and expense, and interest 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 sentiment, new housing starts, real estate values, employment levels, changes in the market prices for oil, gas, and timber, and the overall strength or weakness of the U.S. economy.

Real Estate

We own directly or through ventures over 363,000 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 about 297,000 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 of accelerated growth across the southern half of the United States that possess key demographic and growth characteristics that we believe make them attractive for long-term real estate investment. We own and manage our projects either directly or through ventures. Our real estate segment revenues are principally derived from the sales of residential single-family lots, undeveloped land sales and commercial real estate and to a lesser degree from the operation of commercial properties, primarily a hotel.

A summary of our real estate results follows:

| | First Quarter | |
|--|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Revenues | \$ 18,787 | \$ 28,443 |
| Cost of sales | (8,558) | (17,372) |
| Operating expenses | (8,165) | (7,778) |
| | 2,064 | 3,293 |
| Equity in earnings of unconsolidated ventures | (679) | 750 |
| Less: Net income attributable to noncontrolling interest | (843) | (500) |
| Segment earnings | \$ 542 | \$ 3,543 |

In first three months 2009, operating expenses principally consist of \$2,826,000 in property taxes, \$1,802,000 in employee compensation and benefits, \$650,000 related to legal reserves for probable losses, \$639,000 in professional services, \$528,000 in depreciation expense and \$191,000 related to marketing and advertising. In first three months 2008, operating expenses principally consist of \$2,733,000 in property taxes, \$1,967,000 in employee compensation and benefits, \$944,000 in professional services, \$459,000 in depreciation expense and \$416,000 related to marketing

and advertising.

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Revenues in our owned and consolidated ventures consist of:

| | First Quarter | |
|---------------------------------|-----------------------|------------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Residential real estate | \$ 5,612 | \$ 14,670 |
| Commercial real estate | 143 | 1,863 |
| Undeveloped land | 8,304 | 6,257 |
| Commercial operating properties | 4,592 | 5,155 |
| Other | 136 | 498 |
| Total revenues | \$ 18,787 | \$ 28,443 |

Units sold in our owned and consolidated ventures consist of:

| | First Quarter | |
|---------------------------------|----------------------|-------------|
| | 2009 | 2008 |
| Residential real estate: | | |
| Lots sold | 78 | 324 |
| Revenue per lot sold | \$ 71,928 | \$43,593 |
| Commercial real estate: | | |
| Acres sold | 0.3 | 22 |
| Revenue per acre sold | \$424,696 | \$85,000 |
| Undeveloped land: | | |
| Acres sold | 2,192 | 1,349 |
| Revenue per acre sold | \$ 3,789 | \$ 4,639 |

Residential real estate revenues principally consist of the sale of single-family lots to national, regional and local homebuilders. In first three months 2009, residential real estate revenues continued to decline as result of decreased demand for single-family lots due to the overall decline in the housing industry. We expect difficult housing markets and credit conditions throughout 2009. In first three months 2008, residential lots sold includes the sale of 192 high density lots for approximately \$24,300 per lot at a mixed-use venture located near Houston, Texas.

In first three months 2009, we sold 2,192 acres of undeveloped land from our owned and consolidated ventures at an average price of \$3,789 per acre, generating \$8,304,000 in revenue. In first three months 2008, we sold 1,349 acres from our owned and consolidated ventures at an average price of \$4,639 per acre, generating \$6,257,000 in revenue.

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

| | First Quarter-End | |
|---|--------------------------|-------------|
| | 2009 | 2008 |
| Owned and consolidated ventures: | | |
| Entitled, developed and under development projects | | |
| Number of projects | 54 | 54 |
| Residential lots remaining | 20,467 | 19,985 |
| Commercial acres remaining | 1,704 | 1,385 |
| Undeveloped land and land in the entitlement process | | |
| Number of projects | 22 | 21 |
| Acres in entitlement process | 32,520 | 30,200 |
| Acres undeveloped ^(a) | 307,093 | 320,749 |
| Ventures accounted for using the equity method: | | |
| Ventures – lot sales (for first three months) | | |
| Lots sold | 29 | 64 |
| Revenue per lot sold | \$ 73,647 | \$ 59,242 |
| Ventures – entitled, developed and under development projects | | |
| Number of projects | 21 | 21 |
| Residential lots remaining | 9,298 | 9,319 |
| Commercial acres sold (for first three months) | 4 | 22 |
| Revenue per acre sold | \$ 196,996 | \$ 85,000 |
| Commercial acres remaining | 645 | 697 |
| Ventures – undeveloped land and land in the entitlement process | | |
| Number of projects | 2 | 2 |
| Acres in entitlement process | 1,080 | 870 |
| Acres sold (for first three months) | | |
| Revenue per acre sold | \$ | \$ |
| Acres undeveloped | 5,641 | 6,127 |

(a) Includes
171,000 acres
classified as
assets held for
sale.

Mineral Resources

We own directly or through ventures about 622,000 net acres of oil and gas mineral interests. Our mineral resources segment is focused on maximizing the value from royalties and other lease revenues from our oil and gas mineral interests located in Texas, Louisiana, Alabama and Georgia. At first quarter-end 2009, we have about 120,000 net acres under lease and about 26,000 net acres held by production.

A summary of our mineral resources results follows:

| | First Quarter | |
|--------------------|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Revenues | \$ 5,921 | \$ 6,268 |
| Cost of sales | (76) | |
| Operating expenses | (1,170) | (547) |

| | | |
|---|----------|----------|
| | 4,675 | 5,721 |
| Equity in earnings of unconsolidated ventures | 107 | 784 |
| Segment earnings | \$ 4,782 | \$ 6,505 |

In first three months 2009, operating expenses principally consist of \$443,000 in employee compensation and benefits, \$268,000 related to oil and gas production severance taxes, \$188,000 in professional services and \$66,000 in property taxes. Cost of sales represents our share of costs related to our non-operating working interests. In first three months 2008, operating expenses principally consist of \$343,000 in professional services as we resourced our operations with a contract workforce while recruiting our mineral resources team.

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In first three months 2009, equity in earnings of unconsolidated ventures includes our share of royalty revenue as a result of new production activity from a new well in a venture located within the Barnett Shale natural gas formation. In first three months 2008, equity in earnings of consolidated ventures includes our share of a lease bonus payment as a result of leasing 241 net mineral acres for \$1,568,000.

Revenues consist of:

| | First Quarter | |
|----------------------|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Royalties | \$ 3,478 | \$ 3,338 |
| Other lease revenues | 2,443 | 2,930 |
| Total revenues | \$ 5,921 | \$ 6,268 |

Additional information about our royalties^(a) follows:

| | First Quarter | |
|---|----------------------|-------------|
| | 2009 | 2008 |
| Oil production (barrels) | 26,200 | 19,400 |
| Average price per barrel | \$ 47.24 | \$ 83.57 |
| Natural gas production (millions of cubic feet) | 394.7 | 255.9 |
| Average price per thousand cubic feet | \$ 6.16 | \$ 6.38 |

(a) Includes ventures.

In first three months 2009, other lease revenues include \$2,121,000 in lease bonus payments as a result of leasing over 6,100 net mineral acres and \$322,000 related to delay rental payments. In first three months 2008, other lease revenues include \$2,021,000 in lease bonus payments as a result of leasing over 5,000 net mineral acres and \$695,000 related to delay rental payments.

A summary of our oil and gas mineral interests^(a) at first quarter-end 2009 follows:

| State | Unleased^(b) | Leased^(c) | Held By | Total^(e) |
|--------------|-------------------------------|-----------------------------|---------------------------------|----------------------------|
| | | | Production^(d) | |
| | | | (Net acres) | |
| Texas | 124,000 | 101,000 | 19,000 | 244,000 |
| Louisiana | 104,000 | 10,000 | 7,000 | 121,000 |
| Alabama | 48,000 | 9,000 | | 57,000 |
| Georgia | 200,000 | | | 200,000 |
| | 476,000 | 120,000 | 26,000 | 622,000 |

(a) Includes ventures.

(b) Includes approximately 11,200 net acres subject to lease

option.

(c) Includes leases in primary lease term only.

(d) Acres being held by production are producing oil or gas in paying quantities.

(e) Texas and Louisiana net acres are calculated as the gross number of surface acres multiplied by our percentage ownership of the mineral interest.

Alabama and Georgia net acres are calculated as the gross number of surface acres multiplied by our estimated percentage ownership of the mineral interest based on county sampling.

We also have a 45 percent nonparticipating royalty interest in groundwater produced or withdrawn for commercial purposes or sold from approximately 1.38 million acres in Texas, Louisiana, Georgia and Alabama. We have not received any income from this interest.

Fiber Resources

Our fiber resources segment focuses principally on the management of our timber holdings. We have over 338,000 acres of timber, primarily in Georgia, and about 18,000 acres of timber under lease. We sell wood fiber from our land and lease land for hunting and other recreational uses.

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A summary of our fiber resources results follows:

| | First Quarter | |
|------------------------|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Revenues | \$ 4,369 | \$ 2,512 |
| Cost of sales | (833) | (546) |
| Operating expenses | (812) | (502) |
| | 2,724 | 1,464 |
| Other operating income | 185 | 1,376 |
| Segment earnings | \$ 2,909 | \$ 2,840 |

In first three months 2009, operating expenses principally consist of \$387,000 in employee compensation and benefits, \$152,000 related to professional services and \$66,000 related to timber severance taxes. In first three months 2008, operating expenses principally consist of \$317,000 in employee compensation and benefits and \$30,000 in professional services.

In first three months 2008, other operating income principally reflects a gain from partial termination of a timber lease.

Revenues consist of:

| | First Quarter | |
|-------------------------------|-----------------------|-------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Fiber | \$ 3,755 | \$ 2,037 |
| Recreational leases and other | 614 | 475 |
| Total revenues | \$ 4,369 | \$ 2,512 |

Fiber sold consists of:

| | First Quarter | |
|---------------------------------|----------------------|-------------|
| | 2009 | 2008 |
| Pulpwood tons sold | 206,600 | 173,800 |
| Average pulpwood price per ton | \$ 8.15 | \$ 7.83 |
| Sawtimber tons sold | 90,700 | 35,400 |
| Average sawtimber price per ton | \$ 22.84 | \$ 19.11 |
| Total tons sold | 297,300 | 209,200 |
| Average price per ton | \$ 12.63 | \$ 9.73 |

In first three months 2009, total price per ton increased because we harvested and sold a higher mix of larger pine sawtimber. The majority of our sales were to Temple-Inland at market prices.

Items Not Allocated to Segments

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

General and administrative expense principally consists of accounting and finance, tax, legal, human resources, internal audit, information technology and our Board of Directors. These functions support all of our business segments and are not allocated. In first three months 2009, general and administrative expense principally consists of \$1,725,000 in employee compensation and benefits, \$432,000 in depreciation expense, \$316,000 related to insurance

costs, \$283,000 in occupancy, \$264,000 in board of director fees and \$3,873,000 in professional services of which \$3,180,000 was paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal.

Income Taxes

Our effective tax rate was a benefit of 43% in the first three months 2009 of which 6% is attributable to noncontrolling interests, and a benefit of 124% in the first three months 2008 of which 86% is attributable to noncontrolling interests. As a result of our adoption of SFAS No. 160, income (loss) before income taxes includes income from pass-through entities allocable to noncontrolling interests for which there is no income tax provided.

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We anticipate that our effective tax rate in 2009 will be about 37% of which less than one percent will be attributable to noncontrolling interests.

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 commercial operating properties, and borrowings. 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. 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 or 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, timber sales, and mineral and recreational leases are classified as operating cash flows.

In first three months 2009, net cash used for operating activities was \$10,509,000 as expenditures for real estate development exceeded non-cash cost of sales due to our development of existing real estate projects, principally in the major markets of Texas where sales activity supports investment in development. We invested \$3,433,000 in our Cibolo Canyons mixed-use project near San Antonio, Texas. In first three months 2008, net cash used in operating activities was \$14,050,000 as expenditures for real estate development and acquisitions exceeded non-cash cost of sales principally due to our continued development of existing real estate projects, principally in the major markets of Texas. We invested \$5,562,000 in Cibolo Canyons in first three months 2008.

Cash Flows from Investing Activities

Capital contributions to and capital distributions from unconsolidated ventures are classified as investing activities. In addition, expenditures related to reforestation activities in our fiber resources segment are classified as investing activities.

In first three months 2009, net cash used in investing activities was \$773,000 as property, equipment and software costs exceeded our net distributions from our unconsolidated ventures. In first three months 2008, net cash used in investing activities was \$2,142,000 as capital contributions to our unconsolidated ventures exceeded our capital distributions.

Cash Flows from Financing Activities

In first three months 2009, net cash provided by financing activities was \$11,619,000. In first three months 2008, net cash provided by financing activities was \$17,025,000. In first three months 2009 and 2008, the increase in our debt funded our expenditures for real estate development, principally in the major markets of Texas.

Liquidity, Contractual Obligations and Off-Balance Sheet Arrangements

There have been no significant changes in our liquidity, contractual obligations and off-balance sheet arrangements since year-end 2008.

Senior Credit Facility

Our senior credit facility and other debt agreements contain terms, conditions and financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At first quarter-end 2009, we were in compliance with the terms, conditions and financial covenants of these agreements. The following table details our compliance with the financial covenants of these agreements:

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| Financial Covenant | Requirement | March 31, 2009 | December 31, 2008 |
|--|-------------------------------|---------------------------|------------------------------|
| Interest Coverage Ratio ^(a) | ³ 1.50:1.0 | 2.41:1.0 | 2.68:1.0 |
| Revenues/Capital Expenditures Ratio ^(b) | ³ 0.80:1.0 | 1.62:1.0 | 1.47:1.0 |
| Total Leverage Ratio ^(c) | <40% | 25.5% | 23.7% |
| Minimum Liquidity ^(d) | >\$35 million | \$211 million | \$223 million |
| Net Worth ^(e) | >\$356 million ^(e) | \$450 million | \$447 million |

(a) Calculated as EBITDA (earnings before interest, taxes, depreciation and amortization) plus all non-cash compensation expenses plus other non-cash expenses, divided by interest expense. This covenant is applied at the end of each quarter on a rolling four quarter basis, and the requirement increases to 2.0:1.0 in second quarter 2009.

(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, and the requirement increases to 1.0:1.0 after third quarter 2009.

- (c) Calculated as total funded debt divided by adjusted asset value. Total funded debt includes all indebtedness for borrowed funds, all secured liabilities, and all 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, and all 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 available for drawing under the revolving commitment, plus unrestricted cash, plus cash equivalents which are not pledged or encumbered and the use of which is not restricted by the terms of any agreement. This covenant is applied at the end of each quarter.
- (e) Calculated as the amount by which consolidated total assets exceeds

consolidated
total liabilities.
At first
quarter-end
2009, the
requirement is
\$356 million,
computed as:
\$350 million,
plus eighty five
percent of the
aggregate net
proceeds
received by us
from any equity
offering, plus
fifty percent of
all positive net
income, on a
cumulative
basis. This
covenant is
applied at the
end of each
quarter.

Based on our current operating projections, we believe that we will remain in compliance with our senior credit facility covenants in the future. However, if market conditions continue to deteriorate or continue for an extended period, we may be unable to comply with our financial covenants and may need to seek amendments, waivers or forbearance of our senior credit facility, or may need to refinance. There can be no assurance that we will be able to obtain any amendments, waivers or forbearance when, as and if needed, or if the lenders would be willing to refinance on terms acceptable to us, or at all. Any amended facilities could be on terms that are both more expensive and more restrictive than our current senior credit facility.

There can be no assurance that these covenants will not adversely affect our ability to finance our future operations or capital needs or to pursue available business opportunities. A breach of any of these covenants or our inability to maintain the required financial ratios could result in a default of the senior credit facility. If a default occurs, the affected lenders could elect to declare the indebtedness, together with accrued interest and other fees, to be immediately due and payable.

Cibolo Canyons San Antonio, Texas

Mixed-Use Development / Resort Hotel, Spa and Golf

The Cibolo Canyons mixed-use development consists of 2,100 acres planned to include 1,749 residential lots and 145 commercial acres designated for multifamily and retail uses, of which 554 lots and 64 commercial acres have been sold at first quarter-end 2009. We have \$66,577,000 invested in the development at first quarter-end 2009.

In 2007, we entered into agreements to facilitate third-party construction and ownership of the JW Marriott[®] San Antonio Hill Country Resort & Spa, planned to include a 1,002 room destination resort and two PGA Tour[®] Tournament Players Club[®] golf courses. Under these agreements, we transferred to the third-party owners about 700 acres of undeveloped land and we agreed to provide about \$38,500,000. In exchange, the third-party owners assigned to us certain rights under an Economic Development Agreement, including the right to receive 9% of hotel occupancy revenues and 1.5% of sales generated within the resort through 2034. At first quarter-end 2009, we have provided \$26,862,000 and expect to fund our remaining commitment of \$11,638,000 by year-end 2009. If the resort hotel is not open and operating on July 1, 2011, the City of San Antonio could terminate the Special Purpose Improvement

District (SPID) and there would be no source of revenue to fund payments under the Economic Development Agreement.

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The resort hotel is under construction and is currently scheduled to open well before July 1, 2011.

Until the SPID achieves an adequate tax base to support issuance of bonds, the proceeds of which will be used by the SPID to reimburse us for qualified infrastructure costs, we will not include the estimated reimbursements as a reduction of our real estate cost of sales. At first quarter-end 2009, we have billed the SPID \$49,529,000 for qualified infrastructure costs. These costs have been audited by the SPID and approved for payment, and are included in our investment in the mixed-use development. The construction and opening of the resort hotel will satisfy a condition to our right to obtain reimbursement of infrastructure costs related to the mixed-use development under an Ad Valorem Tax and Non Resort Sales and Use Tax Public Improvement Financing Agreement between us and the SPID. If the resort hotel is not open and operating on July 1, 2011, the City of San Antonio could terminate the SPID and we would have no payor for reimbursement of qualified infrastructure costs.

Critical Accounting Policies and Estimates

There have been no significant changes in our critical accounting policies or estimates in first three months 2009 from those disclosed in our 2008 Annual Report on Form 10-K.

Recent Accounting Standards

Please read Note 3 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 March 31, 2009 follows:

| Project | County | Market | Project Acres^(b) |
|---------------------------------|-----------------|---------------|------------------------------------|
| California | | | |
| Hidden Creek Estates | Los Angeles | Los Angeles | 700 |
| Terrace at Hidden Hills | Los Angeles | Los Angeles | 30 |
| Georgia | | | |
| Ball Ground | Cherokee | Atlanta | 500 |
| Burt Creek | Dawson | Atlanta | 970 |
| Creekview | Troup | Atlanta | 470 |
| Crossing | Coweta | Atlanta | 230 |
| Dallas Highway | Haralson | Atlanta | 1,060 |
| Fincher Road | Cherokee | Atlanta | 3,950 |
| Fox Hall | Coweta | Atlanta | 960 |
| Garland Mountain | Cherokee/Bartow | Atlanta | 350 |
| Home Place | Coweta | Atlanta | 1,510 |
| Hutchinson Mill | Troup | Atlanta | 880 |
| Jackson Park | Jackson | Atlanta | 700 |
| Martin s Bridge | Banks | Atlanta | 970 |
| Mill Creek | Coweta | Atlanta | 770 |
| Serenity | Carroll | Atlanta | 440 |
| Three Creeks | Troup | Atlanta | 740 |
| Waleska | Cherokee | Atlanta | 150 |
| Wolf Creek | Carroll/Douglas | Atlanta | 12,230 |
| Yellow Creek | Cherokee | Atlanta | 1,060 |
| Texas | | | |
| Lake Houston | Harris/Liberty | Houston | 3,700 |
| San Jacinto | Montgomery | Houston | 150 |
| Entrada ^(c) | Travis | Austin | 240 |
| Woodlake Village ^(c) | Montgomery | Houston | 840 |
| Total | | | 33,600 |

^(a) A project is deemed to be in the entitlement process when customary steps necessary for the preparation and submittal of an application, 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.
- (c) We own a 50 percent interest in these projects.

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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 March 31, 2009 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 | 493 | 2 | 8 |
| Pinery West | Douglas | Denver | 100% | | | | 115 |
| Stonebraker | Weld | Denver | 100% | | 603 | | 13 |
| Westlake Highlands | Jefferson | Denver | 100% | | 21 | | |
| Texas | | | | | | | |
| Arrowhead Ranch | Hays | Austin | 100% | | 232 | | 6 |
| Caruth Lakes | Rockwall | Dallas/Fort Worth | 100% | 245 | 404 | | |
| Cibolo Canyons | Bexar | San Antonio | 100% | 554 | 1,193 | 64 | 81 |
| Harbor Lakes | Hood | Dallas/Fort Worth | 100% | 199 | 250 | | 14 |
| Harbor Mist | Calhoun | Corpus Christi | 100% | | 200 | | |
| Hunter's Crossing | Bastrop | Austin | 100% | 308 | 183 | 38 | 68 |
| La Conterra | Williamson | Austin | 100% | 34 | 475 | | 60 |
| Maxwell Creek | Collin | Dallas/Fort Worth | 100% | 650 | 361 | 10 | |
| Oak Creek Estates | Comal | San Antonio | 100% | 9 | 639 | 13 | |
| The Colony | Bastrop | Austin | 100% | 409 | 2,236 | 22 | 49 |
| The Gables at North Hill | Collin | Dallas/Fort Worth | 100% | 195 | 88 | | |
| The Preserve at Pecan Creek | Denton | Dallas/Fort Worth | 100% | 209 | 609 | | 9 |
| The Ridge at Ribelin Ranch | Travis | Austin | 100% | | | 179 | 16 |
| Westside at Buttercup Creek | Williamson | Austin | 100% | 1,281 | 240 | 66 | |
| Other projects (7) | Various | Various | 100% | 1,544 | 25 | 197 | 23 |
| Georgia | | | | | | | |
| Towne West | Bartow | Atlanta | 100% | | 2,674 | | 121 |
| Other projects (14) | Various | Atlanta | 100% | | 2,836 | | 705 |
| Missouri and Utah | | | | | | | |

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| | | | | | | | |
|---|----------|-------------------|---------|--------------|---------------|------------|--------------|
| Other projects (2) | Various | Various | 100% | 400 | 364 | | |
| | | | | 6,152 | 14,290 | 591 | 1,576 |
| Projects in entities we consolidate | | | | | | | |
| Texas | | | | | | | |
| City Park | Harris | Houston | 75% | 1,099 | 212 | 50 | 105 |
| Lantana | Denton | Dallas/Fort Worth | 55% (e) | 414 | 1,867 | | |
| Light Farms | Collin | Dallas/Fort Worth | 65% | | 2,517 | | |
| Stoney Creek | Dallas | Dallas/Fort Worth | 90% | 59 | 695 | | |
| Timber Creek | Collin | Worth | 88% | | 614 | | |
| Other projects (5) | Various | Various | Various | 935 | 272 | 24 | 23 |
| | | | | 2,507 | 6,177 | 74 | 128 |
| Total owned and consolidated | | | | 8,659 | 20,467 | 665 | 1,704 |
| Projects in ventures that we account for using the equity method | | | | | | | |
| Georgia | | | | | | | |
| Seven Hills | Paulding | Atlanta | 50% | 634 | 446 | 26 | |
| The Georgian | Paulding | Atlanta | 38% | 288 | 1,097 | | |
| Other projects (5) | Various | Atlanta | Various | 1,845 | 249 | 3 | |
| Texas | | | | | | | |
| Bar C Ranch | Tarrant | Dallas/Fort Worth | 50% | 176 | 1,023 | | |
| Fannin Farms West | Tarrant | Dallas/Fort Worth | 50% | 265 | 115 | | 15 |

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| Project | County | Market | Interest Owned ^(b) | Residential Lots ^(c) | | Commercial Acres ^(d) | |
|--------------------------|--------------|---------------------------|-------------------------------|---------------------------------|----------------|---------------------------------|-----------------|
| | | | | Lots Sold Since Inception | Lots Remaining | Acres Sold Since Inception | Acres Remaining |
| Lantana | Denton Fort | Dallas/Fort Worth | Various ^(e) | 1,427 | 43 | 14 | 75 |
| Long Meadow Farms | Bend | Houston | 19% | 604 | 1,502 | 72 | 138 |
| Southern Trails | Brazoria | Houston San Antonio | 40% | 326 | 736 | | |
| Stonewall Estates | Bexar | Antonio | 25% | 180 | 201 | | |
| Summer Creek Ranch | Tarrant Fort | Dallas/Fort Worth | 50% | 796 | 1,772 | | 363 |
| Summer Lakes | Bend | Houston Dallas/Fort Worth | 50% | 325 | 798 | 56 | |
| Village Park | Collin Fort | Worth | 50% | 339 | 221 | 3 | 2 |
| Waterford Park | Bend | Houston | 50% | | 493 | | 37 |
| Other projects (2) | Various | Various | Various | 294 | 230 | | 15 |
| Florida | | | | | | | |
| Other projects (3) | Various | Tampa | Various | 473 | 372 | | |
| Total in ventures | | | | 7,972 | 9,298 | 174 | 645 |
| Combined total | | | | 16,631 | 29,765 | 839 | 2,349 |

(a) A project is deemed entitled when all major discretionary land-use approvals have been received. Some projects may require additional permits 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, and/or accounted for using the equity method.

- (c) Lots are for the total project, regardless of our ownership interest.
- (d) Commercial acres are for the total project, regardless of our ownership interest, and are net developable acres, which may be fewer than the gross acres available in the project.
- (e) The Lantana project consists of a series of 15 partnerships in which our voting interests range from 25 percent to 55 percent. We account for three of these partnerships

using the equity method and we consolidate the remaining partnerships.

A summary of our commercial operating properties, commercial projects and condominium projects at March 31, 2009 follows:

| Project | County | Market | Interest Owned^(a) | Type | Description |
|--------------------------|---------------|-------------------|-------------------------------------|--------------|------------------------------|
| Radisson Hotel | Travis | Austin | 100 % | Hotel | 413 guest rooms and suites |
| Palisades West | Travis | Austin | 25 % | Office | 375,000 square feet |
| Presidio at Judge s Hill | Travis | Austin | 60 % | Condominium | 45 units |
| Las Brisas | Williamson | Austin | 49 % | Multi-Family | 414 unit luxury apartment |
| Harbor Lakes Golf Club | Hood | Dallas/Fort Worth | 100 % | Golf Club | 18 hole golf course and club |
| Gulf Coast Apartments | Various | Various | 2 % | Multi-Family | 9 apartment communities |

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

Table of Contents**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 was \$230,559,000 at first quarter-end 2009 and \$229,030,000 at year-end 2008.

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 at first quarter-end 2009, with comparative year-end 2008 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 would choose.

| Change in Interest Rates | March 31, 2009 | December 31, 2008 |
|---------------------------------|---------------------------|----------------------------------|
| | (In thousands) | |
| +2% | \$(4,611) | \$ (4,581) |
| +1% | (2,306) | (2,290) |
| -1% | 2,306 | 2,290 |
| -2% | 4,611 | 4,581 |

Changes in interest rates affect the value of our interest rate swap agreement (\$100,000,000 notional amount at first quarter-end 2009). We believe any change in the value of this agreement would not be significant.

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.

(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 first quarter 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**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 2008 Annual Report on Form 10-K.

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

In first three months 2009, a total of 1,589 restricted shares of our common stock were withheld (all in February 2009) to pay taxes due in connection with vesting of restricted stock awards. The terms of the awards provide that the value of the restricted shares withheld will be based on the closing price per share of our common stock on the vesting date, as reported on the New York Stock Exchange. The price was \$10.50.

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, to be funded principally from the sale of approximately 175,000 acres of higher and better use timberland. We have not purchased any shares under this authorization, which has no expiration date, and no repurchases will be made under this repurchase authorization until after completion of the asset sales. We have no repurchase plans or programs that expired during the first quarter 2009 and no repurchase plans or programs that we intend to terminate prior to expiration or under which we no longer intend to make further purchases.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

| | |
|-------|--|
| 10.1 | Form of Stock Appreciation Rights Agreement (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 12, 2009). |
| 10.2 | Form of Restricted Stock Units Agreement for senior executives (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 12, 2009). |
| 31.1* | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Filed herewith.

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SIGNATURES

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

FORESTAR GROUP INC.

Date: May 7, 2009

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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