



June 1, 2007

Via email to Mary_Robertson@hsgac.senate.gov

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Senate Committee on Homeland Security and Government Affairs
340 Senate Dirksen Building
Washington, D.C. 20510

The Honorable Norm Coleman
Ranking Minority Member
Permanent Subcommittee on Investigations
Senate Committee on Homeland Security and Government Affairs
340 Senate Dirksen Building
Washington, D.C. 20510

Dear Chairman Levin and Senator Coleman:

In your letter dated May 21, 2007, you notified us that the U.S. Senate Permanent Subcommittee on Investigations (the "Subcommittee") would conduct a hearing on June 5, 2007 regarding executive stock options and current policies that require stock option compensation to be treated differently for accounting and tax purposes. That letter also requested a written response by KB Home (KB Home or the Company) with respect to six specific matters. Listed below are those six matters, along with the Company's responses:

1. KB Home's policy and procedures for granting stock options to its executives, including the role of KB Home's Compensation Committee in approving general stock option plans and individual stock option grants.

On February 1, 2007, the Management Development and Compensation Committee (the "Compensation Committee") of KB Home's Board of Directors adopted an Equity-Based Award Grant Policy (the "Grant Policy"). The Grant Policy sets forth KB Home's policies and procedures for granting stock options to its executives.

The Grant Policy requires all grants of equity-based awards, and their terms, to be approved by the Compensation Committee (or the Board of Directors), which the Grant Policy refers to as the "Granting Body." The Grant Policy does not permit any delegation of granting authority to management. The grant date of any equity-based award will be the date on which the Granting Body met to approve the grant unless the Granting Body by written resolution

sets a later date. The exercise price of any stock option award will not be less than the price of KB Home's common stock on the grant date.

The Grant Policy, among other things, is designed to enhance the process by which KB Home grants equity-based awards, including stock options and restricted stock, and in doing so it addresses concerns identified in the recent internal Stock Option Review (defined and discussed separately below in response to matter #5). The Grant Policy is also designed to enhance KB Home's internal control over the processing, recording, external reporting, internal communication and administration of equity-based awards. The Grant Policy includes approval procedures for equity-based awards and establishes specific responsibilities for relevant KB Home personnel, with detailed recordkeeping requirements and multiple layers of review.

A full copy of the Grant Policy was included with KB Home's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 19, 2007. A copy of that Form 8-K was included in the materials previously provided to the Committee.

KB Home's practices with respect to executive compensation, prior to the adoption of the Grant Policy, are described at length in the proxy statements filed by KB Home with the Securities and Exchange Commission from 1999 through 2006 (including the "Compensation Committee Reports on Executive Compensation" contained therein); stock plans used by KB Home during the years 1999-2006, from which stock-based executive compensation was granted; and the Form 10-Ks filed by KB Home with the Securities and Exchange Commission from 1999-2006, which include information related to stock options granted by KB Home. In addition to these materials, KB Home's practices are also reflected in various other materials provided to the Subcommittee, including the 1999-2006 Minutes of the Meetings of the Compensation Committee of the Board of Directors of KB Home, the 1999-2006 Minutes of the Meetings, and the Form 10-Q and Form 10-K filed by the company with the Securities and Exchange Commission on February 13, 2007. Rather than provide an incomplete and potentially inaccurate summary of those practices, KB Home will respectfully refer the Subcommittee to those previously provided materials.

2. The number of stock options awarded to KB Home's former chief executive officer (CEO) Bruce Karatz each year since 1998; the value of each such stock option grant at the time of the grant; the number of stock options exercised by Mr. Karatz each year since 1998; the gain in dollars obtained from each such exercise; and the number of unexercised stock options still in his possession as of the end of 2006.

KB Home has previously provided tables to the Subcommittee listing the number of stock options granted to Mr. Karatz during calendar years 1999, 2000, 2001, 2002, 2003, 2004, 2005, and 2006. Those tables also listed the number of stock options held by Karatz at the end of each of these years; the total number

of stock options exercised by Karatz during each year, and the total amount of dollar gains Karatz obtained during each year from such exercises. Rather than provide an incomplete and potentially inaccurate summary of those tables, KB Home will respectfully refer the Subcommittee to those previously provided materials.

3. With respect to the CEO stock options that were exercised from 2002 to 2006, how the stock option compensation expense was reported on KB Home's financial statements under Generally Accepted Accounting Principles; how the same compensation was reported as a business deduction on KB Home's tax returns; and what the differential was between the two figures.

Following extensive discussions with the Subcommittee Staff, KB Home has previously provided tables to the Subcommittee showing this information for the years 2004 and 2005; KB Home's former CEO did not exercise any stock options in 2002, 2003 or 2006. The Subcommittee has in turn produced its own chart based upon the information provided by KB Home and KB Home has now confirmed the data contained in the Subcommittee's own chart. Rather than provide an incomplete and potentially inaccurate summary of those tables, KB Home will respectfully refer the Subcommittee to those previously provided materials, as well as the Subcommittee's own chart.

4. How Financial Accounting Standard 123R would have affected the reporting of that stock option compensation on KB Home's financial statements had it been in effect when the stock option grants were made.

The grant date fair value of the stock options was reported in a note to KB Home's consolidated financial statements. Had Financial Accounting Standard 123R been adopted by KB Home during this period, KB Home would have reported these fair values as stock-based compensation expense, an adjustment to the selling, general and administrative expense line item in its consolidated statements of income instead of in the notes to these consolidated financial statements.

5. The circumstances surrounding KB Home's involvement with stock option backdating and the restatement of its financial statements.

On July 25, 2006, KB Home commenced a voluntary independent review of our stock option grant practices (the "Stock Option Review") to determine whether we had used appropriate measurement dates for, among other awards, the twelve annual stock option grants we made from January 1995 to November 2005. The Stock Option Review was directed by a subcommittee of our Audit and Compliance Committee (the "Audit Subcommittee") — consisting solely of outside directors who have never served on our Compensation Committee — with the advice of independent counsel and forensic accountants. The Audit Subcommittee and its advisors conducted 66 interviews, including seven with

current and former members of our Compensation Committee, and collected more than 1.2 million documents relating to the Company's stock option grant practices from 64 individuals.

On November 12, 2006, KB Home announced that the Audit Subcommittee had substantially completed its investigation and concluded that the Company had used incorrect measurement dates for financial reporting purposes for the eight annual stock option grants made since 1998. At the same time, KB Home announced the departure of its Chairman and Chief Executive Officer and its head of human resources.

The evidence developed through the Stock Option Review indicates that KB Home's Compensation Committee met in October each year since 1998 to consider and approve annual stock option awards for the next year. At those meetings, the Compensation Committee specifically approved the number of stock options to be granted to the former Chief Executive Officer and other senior management, as well as an unallocated block of stock options to be allocated by the former Chief Executive Officer and the former head of human resources to other employees.

In addition to allocating annual stock options among other employees, starting with the annual stock option grant approved by the Compensation Committee in October 1998, the former Chief Executive Officer and former head of human resources also selected the grant date. The Audit Subcommittee discovered evidence confirming or, in some years, suggesting that hindsight was used to secure favorable exercise prices for seven of the eight annual stock option grants since 1998.

Based on the evidence developed through the Stock Option Review, senior management involvement in, and knowledge of, the hindsight pricing practices was limited to the former Chief Executive Officer and the former head of human resources. The Audit Subcommittee concluded that these hindsight pricing practices did not involve any of KB Home's current senior management, including the Company's new Chief Executive Officer, its principal financial officer, or its principal accounting officer, nor were any of those individuals aware of these practices. The Audit Subcommittee further concluded that none of KB Home's other accounting or finance employees were involved in, or aware of, the hindsight pricing practices.

Based on the findings of the Audit Subcommittee, KB Home changed the measurement dates for the annual stock option grants since 1998 from the grant dates selected by its former Chief Executive Officer and its former head of human resources to the dates KB Home's employees were first notified of their grants. These measurement date changes resulted in an understatement of stock-based compensation expense arising from each of the Company's annual stock option grants since 1998, which affected KB Home's consolidated financial statements for each year beginning with the year ended November 30, 1999.

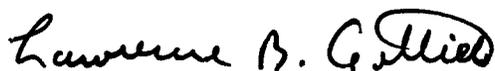
KB Home has determined that the aggregate understatement of stock-based compensation expense for the seven-year restatement period from 1999 through 2005 was \$36.3 million. In connection with the restatement of its consolidated financial statements to reflect the stock-based compensation adjustments associated with the stock option measurement date changes, KB Home also recorded an aggregate increase of \$4.8 million in its income tax provision for the seven-year restatement period. This amount represents the cumulative income tax impact related to Internal Revenue Code Section 162(m), partially offset by the income tax impact of the additional stock-based compensation expense. The stock-based compensation expense and related income tax impacts reduced net income by \$41.1 million for the years ended November 30, 1999 through 2005. The related tax effects on our consolidated balance sheet include an increase of \$72.3 million in accrued expenses and other liabilities, and a decrease of \$77.8 million in stockholders' equity.

All of this information is contained in the Form 10-Q and the Form 10-K filed by KB Home with the Securities and Exchange Commission on February 13, 2007, each of which include an extended discussion of the options issues at the Company and the resulting restatement of the Company's financial statements. KB Home has previously provided these filings and other related materials to the Subcommittee.

6. KB Home's views, if any, regarding current policies that require different accounting and tax treatment of stock option compensation.

KB Home has no views regarding this matter and will abide by whatever additional laws or regulations are promulgated with respect to it.

Sincerely yours,



Lawrence B. Gottlieb
Vice President
Government and Public Affairs
Associate General Counsel