ASSOCIATED ESTATES REALTY CORP
Form 10-Q
November 02, 2011
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

OR

o 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 1-12486
Associated Estates Realty Corporation
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| OHIO | 34-1747603 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

1 AEC Parkway, Richmond Hts., Ohio 44143-1467
(Address of principal executive offices)
(216) 261-5000
(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 x  No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x  No o

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

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

The number of shares outstanding as of October 26, 2011 was 42,325,439 shares.

ASSOCIATED ESTATES REALTY CORPORATION

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PART 1. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS
ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| (In thousands, except share and per share amounts) | September 30, 2011 | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| Real estate assets | | |
| Land | $185,418 | $169,955 |
| Buildings and improvements | 1,074,040 | 1,003,909 |
| Furniture and fixtures | 36,239 | 33,690 |
| Construction in progress | 17,440 | 2,735 |
| Gross real estate | 1,313,137 | 1,210,289 |
| Less: Accumulated depreciation | (351,342) | (335,289) |
| Net real estate | 961,795 | 875,000 |
| Cash and cash equivalents | 5,056 | 4,370 |
| Restricted cash | 8,224 | 8,959 |
| Accounts receivable, net | | |
| Rents | 1,312 | 1,238 |
| Construction | 5,222 | 9,119 |
| Other | 618 | 1,110 |
| Goodwill | 1,725 | 1,725 |
| Other assets, net | 15,806 | 16,714 |
| Total assets | $999,758 | $918,235 |
| LIABILITIES AND EQUITY | | |
| Mortgage notes payable | $465,867 | $463,166 |
| Unsecured revolving credit facility | 42,000 | 92,500 |
| Unsecured term loan | 125,000 | — |
| Total debt | 632,867 | 555,666 |
| Accounts payable and other liabilities | 26,239 | 25,045 |
| Construction accounts payable | 6,065 | 5,500 |
| Dividends payable | 7,587 | 7,242 |
| Resident security deposits | 3,476 | 3,256 |
| Accrued interest | 2,560 | 2,568 |
| Total liabilities | 678,794 | 599,277 |
| Noncontrolling redeemable interest | 1,734 | 1,734 |
| Equity | | |
| Common shares, without par value, $.10 stated value; 91,000,000 authorized; 46,570,763 issued and 42,325,439 and 41,380,205 outstanding at September 30, 2011 and December 31, 2010, respectively | 4,657 | 4,657 |
| Paid-in capital | 582,716 | 574,994 |
| Accumulated distributions in excess of accumulated net income | (219,044) | (205,021) |
| Less: Treasury shares, at cost, 4,245,324 and 5,190,558 shares at September 30, 2011 and December 31, 2010, respectively | (50,139) | (58,446) |
| Total shareholders' equity attributable to AERC | 318,190 | 316,184 |
| Noncontrolling interest | 1,040 | 1,040 |
| Total equity | 319,230 | 317,224 |
| Total liabilities and equity | $999,758 | $918,235 |

The accompanying notes are an integral part of these consolidated financial statements.

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ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands, except per share amounts) | 2011 | 2010 | 2011 | 2010 |
| Revenue | | | | |
| Property revenue | $40,985 | $33,232 | $117,191 | $95,684 |
| Management and service company revenue | — | 217 | — | 715 |
| Construction and other services | 5,602 | 5,717 | 16,067 | 8,448 |
| Total revenue | 46,587 | 39,166 | 133,258 | 104,847 |
| Expenses | | | | |
| Property operating and maintenance | 16,686 | 14,433 | 48,117 | 41,645 |
| Depreciation and amortization | 13,667 | 9,794 | 39,350 | 26,806 |
| Direct property management and service company expense | — | 192 | — | 602 |
| Construction and other services | 6,763 | 5,384 | 17,709 | 8,685 |
| General and administrative | 3,601 | 3,560 | 11,730 | 10,957 |
| Costs associated with acquisitions | 182 | 368 | 303 | 429 |
| Total expenses | 40,899 | 33,731 | 117,209 | 89,124 |
| Operating income | 5,688 | 5,435 | 16,049 | 15,723 |
| Interest income | 4 | 6 | 12 | 27 |
| Interest expense | (8,211) | (7,362) | (23,752) | (23,420) |
| (Loss) income from continuing operations | (2,519) | (1,921) | (7,691) | (7,670) |
| Income from discontinued operations: | | | | |
| Operating income | 130 | 137 | 672 | 432 |
| Gain on disposition of properties | 14,597 | — | 14,597 | — |
| Income from discontinued operations | 14,727 | 137 | 15,269 | 432 |
| Net income (loss) | 12,208 | (1,784) | 7,578 | (7,238) |
| Net income attributable to noncontrolling redeemable interest | (12) | (13) | (37) | (39) |
| Net income (loss) attributable to AERC | 12,196 | (1,797) | 7,541 | (7,277) |
| Preferred share dividends | — | — | — | (2,030) |
| Preferred share redemption costs | — | — | — | (993) |
| Net income (loss) applicable to common shares | $12,196 | $(1,797) | $7,541 | $(10,300) |
| | | | | |
| Earnings per common share - basic and diluted: | | | | |
| (Loss) income from continuing operations applicable to common shares | $(0.06) | $(0.06) | $(0.19) | $(0.40) |
| Income from discontinued operations | 0.35 | — | 0.37 | 0.02 |
| Net income (loss) applicable to common shares | $0.29 | $(0.06) | $0.18 | $(0.38) |
| | | | | |
| Weighted average number of common shares outstanding - basic and diluted | 41,697 | 31,906 | 41,458 | 26,846 |

The accompanying notes are an integral part of these consolidated financial statements.

ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|---|---|
| (In thousands) | 2011 | 2010 |
| Cash flow from operations: | | |
| Net income (loss) | $7,578 | $(7,238) |
| Adjustments to reconcile net income (loss) to net cash provided by operations: | | |
| Depreciation and amortization | 40,276 | 27,716 |
| Loss on fixed asset replacements write-off | 39 | 39 |
| Gain on disposition of properties | (14,597) | — |
| Amortization of deferred financing costs and other | 1,457 | 1,003 |
| Write-off of unamortized debt procurement costs | — | 727 |
| Share-based compensation | 2,542 | 2,153 |
| Net change in assets and liabilities: | | |
| Accounts receivable - construction | 3,897 | (5,631) |
| Accounts receivable | 175 | 242 |
| Construction accounts payable | (565) | 5,257 |
| Accounts payable and accrued expenses | 3,426 | (591) |
| Other operating assets and liabilities | (963) | (3,076) |
| Total adjustments | 35,687 | 27,839 |
| Net cash flow provided by operations | 43,265 | 20,601 |
| Cash flow from investing activities: | | |
| Recurring fixed asset additions | (6,968) | (6,672) |
| Revenue enhancing/non-recurring fixed asset additions | (1,509) | (5,716) |
| Acquisition/development fixed asset additions | (131,052) | (154,533) |
| Net proceeds from disposition of operating properties | 28,967 | — |
| Other investing activity | (345) | (594) |
| Net cash flow used for investing activities | (110,907) | (167,515) |
| Cash flow from financing activities: | | |
| Principal amortization payments on mortgage notes payable | (1,964) | (2,325) |
| Principal repayments of mortgage notes payable | (53,317) | (57,268) |
| Payment of debt procurement costs | (1,457) | (457) |
| Proceeds from mortgage notes obtained | 57,982 | 36,000 |
| Proceeds from term loan borrowings | 125,000 | — |
| Revolving credit facility borrowings | 207,000 | 189,650 |
| Revolving credit facility repayments | (257,500) | (105,950) |
| Principal repayments of unsecured trust preferred securities | — | (25,780) |
| Common share dividends paid | (20,956) | (11,921) |
| Preferred share dividends paid | — | (2,029) |
| Operating partnership distributions paid | (37) | (39) |
| Purchase of operating partnership units | — | (59) |
| Exercise of stock options | 793 | 5,405 |
| Issuance of common shares | 13,330 | 169,199 |
| Purchase of treasury shares | (857) | (595) |
| Redemption of preferred shares | — | (48,263) |
| Noncontrolling interest investment in partnership | — | 1,040 |
| Other financing activities, net | 311 | — |
| Net cash flow provided by financing activities | 68,328 | 146,608 |
| Increase (decrease) in cash and cash equivalents | 686 | (306) |

| | | |
|---|---|---|
| Cash and cash equivalents, beginning of period | 4,370 | 3,600 |
| Cash and cash equivalents, end of period | $5,056 | $3,294 |
| Supplemental disclosure of cash flow information: | | |
| Dividends declared but not paid | $7,587 | $5,611 |
| Issuance from treasury shares for share based compensation | 1,466 | 1,097 |
| Net change in accounts payable related to fixed asset additions | (389) | 505 |
| Reclassification of deferred directors' compensation | — | 2,233 |

The accompanying notes are an integral part of these consolidated financial statements.

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ASSOCIATED ESTATES REALTY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

Except as the context otherwise requires, all references to "we," "our," "us," "AERC" and the "Company" in this report collectively refer to Associated Estates Realty Corporation and its consolidated subsidiaries.

Business

We are a fully-integrated, self-administered and self-managed equity real estate investment trust ("REIT") specializing in multifamily ownership, operation, acquisition, development, construction, disposition and property management activities. Our primary source of income is rental revenue. Additional income is derived primarily from construction services. We own a taxable REIT subsidiary that performs construction services for our own account and for third parties. As of September 30, 2011, our operating property portfolio consisted of 52 apartment communities containing 13,684 units in eight states that are owned either directly or indirectly through subsidiaries. On October 17, 2011, we acquired a 224-unit apartment community located in Dallas, Texas. On October 24, 2011, we announced that we were winding down our third party construction services and would exit that business. We intend to continue to provide construction services for our own account.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and applicable rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting only of normal and recurring adjustments considered necessary for a fair statement, have been included. The reported results of operations are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the audited financial statements and accompanying notes in our Annual Report on Form 10-K for the year ended December 31, 2010.

Segment Reporting

All of our properties are multifamily communities that have similar economic characteristics. Management evaluates the performance of our properties on an individual basis. Our multifamily properties provided approximately 87.9% of our consolidated revenue for the nine months ended September 30, 2011. Our subsidiary, Merit Enterprises, Inc. ("Merit"), is a general contractor that acts as our in-house construction division and has provided general contracting and construction management services to third parties. However, we intend to exit the third party construction business and anticipate to substantially complete all remaining third party projects by the end of 2011. For the nine months ended September 30, 2011, construction services provided approximately 12.1% of our consolidated revenue. These two segments, multifamily properties and construction and other services, represent our two reportable segments.

Share-Based Compensation

During the three and nine months ended September 30, 2011, we recognized total share-based compensation cost of \$802,000 and \$2.5 million, respectively, in "General and administrative expense" in the Consolidated Statements of Operations. During the three and nine months ended September 30, 2010, we recognized total share-based compensation cost of \$654,000 and \$2.2 million, respectively, in "General and administrative expense" in the Consolidated Statements of Operations.

Stock Options. During the nine months ended September 30, 2011, there were no stock options awarded and 77,456 options exercised. During the nine months ended September 30, 2010, there were no stock options awarded and 613,724 options exercised.

Restricted Shares. The following table represents restricted share activity for the nine months ended September 30, 2011:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested at beginning of period | 595,842 | $6.69 |
| Granted | 130,565 | $15.19 |
| Vested | 172,245 | $9.34 |
| Forfeited | 112 | $9.67 |
| Nonvested at end of period | 554,050 | $7.87 |

At September 30, 2011, there was $3.0 million of unrecognized compensation cost related to non-vested restricted share awards that we expect to recognize over a weighted average period of 2.1 years.

Share Equivalent Units. We have two compensation plans under which our officers and directors may elect to defer the receipt of restricted shares. An individual bookkeeping account is maintained for each participant, under which deferred restricted share awards are reflected as share equivalent units. Dividend credits are made to such account in the form of additional share equivalent units. Distribution of all accumulated and vested share equivalents is made in the form of common shares upon the end of the deferral period. The vesting of such share equivalent units (together with associated dividend credits) occurs on the same schedule as the restricted shares made subject to the deferral election. At September 30, 2011, there were 539,710 share equivalent units deferred under these plans and $577,000 of unrecognized compensation cost that we expect to recognize over a weighted average period of 1.8 years. These amounts are in addition to, and not included in, the table above under "Restricted Shares."

Derivative Instruments and Hedging Activities

We record all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows or other types of forecasted transactions are considered cash flow hedges.

For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item relating to the hedged risk are recognized in earnings. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. Hedge ineffectiveness is measured by comparing the changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. For derivatives not designated as hedges, changes in fair value are recognized in earnings.

We do not use derivatives for trading or speculative purposes. Further, we have a policy of only entering into contracts with major financial institutions based upon their credit ratings and other factors. When viewed in conjunction with the underlying and offsetting exposure that the derivatives are designed to hedge, we have not sustained a material loss from these hedges.

We have utilized interest rate swaps and caps to add stability to interest expense and to manage our exposure to interest rate movements. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. Interest rate caps designated as cash flow hedges involve the receipt of variable-rate amounts if interest rates rise above a certain level in exchange for an upfront premium.

At September 30, 2011 and December 31, 2010, we had no derivatives outstanding. During 2010, we had two interest rate swaps that were executed in 2007 to hedge the cash flows of two existing variable rate loans. In January 2010, we prepaid one of these loans but we did not terminate the corresponding interest rate swap and as a result reclassified the fair value of the related interest rate swap of $777,000 from other comprehensive income to earnings. This derivative matured in June 2010, and the change in fair value was recorded in earnings.

The following table presents the effect of our prior derivative financial instruments on the Consolidated Statements of Operations (see Note 6 for additional information regarding the effect of these derivative instruments on total comprehensive income):

The Effect of Derivative Instruments on the Consolidated Statements of Operations

| (In thousands) | Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) | | | Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | | | Amount of Gain or (Loss) Recognized in Income or Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) | |
|---|---|---|---|---|---|---|---|---|
| Derivatives in Cash Flow Hedging Relationships | Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2010 | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2010 | Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effective Testing) | Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2010 |
| Interest rate swaps | $(20) | $(59) | Interest expense | $(187) | $(571) | Interest expense | $— | $(777) |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) in Income on Derivative | Amount of Gain or (Loss) Recognized in Income on Derivative Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2010 |
|---|---|---|---|
| Interest rate swaps | Interest expense | $— | $(18) |

Real Estate and Depreciation

Real estate assets are stated at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Buildings and improvements | 5 - 30 years |
| Furniture, fixtures and equipment | 5 - 10 years |

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We capitalize replacements and improvements, such as HVAC equipment, structural replacements, windows, appliances, flooring, carpeting and kitchen/bath replacements and renovations. Ordinary repairs and maintenance, such as unit cleaning, painting and appliance repairs are expensed when incurred. We capitalize interest costs on funds used in construction, real estate taxes and insurance from the commencement of development activity through the time the property is ready for leasing. We also capitalize direct and indirect internal costs attributable to the construction of a property or asset. Such costs are included in construction in progress during the development period. Capitalized costs related to construction are transferred to buildings and improvements and furniture and fixtures, respectively, upon substantial completion of the project.

Classification of Fixed Asset Additions

We define recurring fixed asset additions to a property to be capital expenditures made to replace worn out assets to maintain the property's value. Revenue enhancing/non-recurring fixed asset additions are defined as capital expenditures that increase the value of the property and/or enable us to increase rents. Acquisition/development fixed asset additions are defined as capital expenditures for the purchase or construction of new properties to be added to our portfolio, or fixed asset additions identified at the time of purchase that are not made until subsequent periods.

Reclassifications

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 presentation.

2. ACQUISITION, DEVELOPMENT, CONSTRUCTION, AND DISPOSITION ACTIVITY

Acquisition Activity

On August 9, 2011, we acquired Dwell Vienna Metro, a 250-unit community located in Fairfax, Virginia for $82.6 million in cash.

On June 15, 2011, we acquired Waterstone at Wellington Apartments, a 222-unit community located in Wellington, Florida for $32.8 million in cash.

The purchase price allocations for the operating properties acquired during 2011 were as follows:

| (In thousands) | |
|---|---|
| Land | $ 17,189 |
| Buildings and improvements | 92,586 |
| Furniture and fixtures | 1,930 |
| Existing leases and tenant relationships (Other assets)(1) | 3,715 |
| Total | $ 115,420 |

(1) See Note 4 for additional information related to intangible assets identified as existing leases and tenant relationships.

We recognized costs totaling $127,000 and $192,000 related to these acquisitions during the three and nine months ended September 30, 2011, respectively, which are included in "Costs associated with acquisitions" in the Consolidated Statements of Operations. The amount of revenue and net income (loss) related to these acquisitions that is included in our Consolidated Statements of Operations and the pro forma financial information as if these acquisitions had occurred on January 1, 2010, are presented in the following table. This pro forma information is presented for informational purposes only and is not necessarily indicative of what our actual results of operations would have been had the acquisitions occurred at such time.

| (In thousands) | Three Months Ended September 30, 2011 | Three Months Ended September 30, 2010 | Nine Months Ended September 30, 2011 | Nine Months Ended September 30, 2010 |
|---|---|---|---|---|
| Actual revenue from acquisition | $1,669 | $— | $1,808 | $— |
| Actual net (loss) income from acquisition | (366) | — | (376) | — |
| Pro forma revenue | 47,298 | 41,338 | 138,292 | 112,744 |
| Pro forma net income (loss) applicable to common shares [(1)] | 13,036 | (1,212) | 9,040 | (12,601) |
| Pro forma earnings per common share - basic and diluted: | | | | |
| Pro forma net income (loss) applicable to common shares | $0.31 | $(0.04) | $0.22 | $(0.47) |

(1) Pro forma net income (loss) for the three and nine months ended September 30, 2011, were adjusted to exclude $127,000 and$192,000, respectively, of acquisition-related costs incurred during 2011. Pro forma net income (loss) for the nine months ended September 30, 2010, was adjusted to include total acquisition-related costs of $192,000.

Development Activity

During the quarter ended September 30, 2011, we acquired a vacant parcel of land adjacent to San Raphael Apartments located in Dallas, Texas, which we intend to use for future development of approximately 100 units.
During 2010, we began development on Vista Germantown, a 242-unit apartment community located in Nashville, Tennessee. The total cost incurred at September 30, 2011, of this development includes $5.6 million for land and $16.7 million for construction costs. During the nine months ended September 30, 2011, we recorded capitalized interest of $465,000. See Note 5 for additional information related to this development.
During 2010, we completed construction of a 60-unit expansion of the existing 240-unit River Forest apartment community located in the Richmond, Virginia metropolitan market area. Capitalized interest related to this expansion for the nine months ended September 30, 2010 was $192,000.

Construction Activity

Our subsidiary, Merit, is engaged as a general contractor and construction manager that acts as our in-house construction division and also has provided general contracting and construction management services to third parties. However, we intend to exit the third party construction business and anticipate to substantially complete all remaining third party projects by the end of 2011. We account for construction contracts using the percentage-of-completion method. Under this method, we recognize revenue in the ratio of costs incurred to total estimated costs, with any changes in estimates recognized in the period in which they are known on a prospective basis. We recognized $5.6 million and $16.1 million in revenue under this method during the three and nine months ended September 30, 2011 and $5.7 million and $8.5 million in revenue under this method during the three and nine months ended September 30, 2010. For the three and nine months ended September 30, 2011, under the percentage of completion method, we reported costs of $6.4 million and $16.6 million. For the three and nine months ended September 30, 2010, under this method, we reported $5.0 million and $7.5 million of costs.

Disposition Activity

The results of operations for all periods presented and gain/loss related to the sale of operating properties are reported in "Income from discontinued operations" in the accompanying Consolidated Statements of Operations. Real estate assets that are classified as held for sale are also reported as discontinued operations. We classify properties as held for sale when all significant contingencies surrounding the closing have been resolved. In most transactions, these contingencies are not satisfied until the actual closing of the transaction. Interest expense included in discontinued operations is limited to interest on mortgage debt specifically associated with properties sold or classified as held for sale.

On September 19, 2011, we completed the sale of Remington Place apartments, a 234-unit property located in Central Ohio. The sales price was $12.5 million and we recorded a gain of $4.2 million.

On September 19, 2011, we completed the sale of Residence at Turnberry apartments, a 216-unit property located in Central Ohio. The sales price was $18.0 million and we recorded a gain of $10.4 million.

"Income from discontinued operations" in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010, includes the operating results and related gains recognized for the properties sold in 2011. The following table summarizes "Income from discontinued operations:"

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2011 | 2010 | 2011 | 2010 |
| REVENUE | | | | |
| Property revenue | $981 | $1,124 | $3,223 | $3,279 |
| | | | | |
| EXPENSES | | | | |
| Property operating and maintenance | 545 | 501 | 1,556 | 1,475 |
| Depreciation and amortization | 306 | 332 | 926 | 910 |
| Total expenses | 851 | 833 | 2,482 | 2,385 |
| Operating income | 130 | 291 | 741 | 894 |
| Interest expense | — | (154) | (69) | (462) |
| Gain on disposition of properties | 14,597 | — | 14,597 | — |
| Income from discontinued operations | $14,727 | $137 | $15,269 | $432 |

3. DEBT

The following table identifies our total debt outstanding and weighted average interest rates:

| | September 30, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| (Dollar amounts in thousands) | Balance Outstanding | Weighted Average Interest Rate | Balance Outstanding | Weighted Average Interest Rate |
| | | | | |
| FIXED RATE DEBT | | | | |
| Mortgages payable - CMBS | $44,079 | 7.9 % | $98,212 | 7.7 % |
| Mortgages payable - other | 377,521 | 5.6 % | 330,648 | 5.7 % |
| Total fixed rate debt | 421,600 | 5.8 % | 428,860 | 6.2 % |
| | | | | |
| VARIABLE RATE DEBT | | | | |
| Mortgages payable | 33,876 | 4.7 % | 34,306 | 4.7 % |
| Construction loan | 10,391 | 3.5 % | — | N/A |
| Unsecured revolving credit facility | 42,000 | 2.5 % | 92,500 | 2.7 % |
| Unsecured term loan | 125,000 | 2.0 % | — | N/A |
| Total variable rate debt | 211,267 | 2.6 % | 126,806 | 3.2 % |
| Total debt | $632,867 | 4.8 % | $555,666 | 5.5 % |
| | | | | 0.047 |

Mortgage Notes Payable

The following table provides information on mortgage loans repaid and obtained during 2011:

| (Dollar amounts in thousands) | Loans Repaid | | | Loans Obtained | | | | |
|---|---|---|---|---|---|---|---|---|
| Property | Amount | Interest Rate | | Amount | | Rate | | Maturity |
| Central Park Place | $6,170 | 7.6% | | $— | | N/A | | N/A |
| Perimeter Lakes | 5,485 | 7.6% | | — | | N/A | | N/A |
| Residence at Turnberry | 7,756 | 7.6% | | — | | N/A | | N/A |
| Residence at Christopher Wren | 9,052 | 7.6% | | — | | N/A | | N/A |
| Clinton Place Apartments | 8,145 | 7.6% | | — | | N/A | | N/A |
| Heathermoor | 8,232 | 7.6% | | — | | N/A | | N/A |
| Summer Ridge | 8,477 | 7.6% | | — | | N/A | | N/A |
| The Ashborough | — | N/A | | 47,591 | (1) | 4.6% | | May 2018 |
| Vista Germantown | — | N/A | | 10,391 | (2) | 3.5% | (3) | November 2013 |
| Total / weighted average rate | $53,317 | 7.6% | (4) | $57,982 | | 4.4% | (4) | |

(1) Debt procurement costs related to this loan were $450,000.
(2) Debt procurement costs totaling $317,000 related to this loan were paid during 2010.
(3) Denotes variable rate construction loan.
(4) Represents weighted average interest rate for the loans listed.

During 2008, 2007 and 2006, we defeased 21 CMBS loans. These loans were defeased pursuant to the terms of the underlying loan documents. In accordance with GAAP, we removed those financial assets and the mortgage loans from our financial records. All risk of loss associated with these defeasances have been transferred from us to the successor borrower and any ongoing relationship between the successor borrower and us was deemed inconsequential at the time of completion of the respective transfers. However, we subsequently learned that for certain defeasance transactions completed prior to June 2007, the successor borrower was able to prepay certain loans thus enabling us to receive a refund of a portion of the costs incurred in connection with the transaction. We received defeasance refunds of $553,000 for the nine months ended September 30, 2010, which were included as a reduction to interest expense. We will not have the right to receive any further defeasance refunds in respect to these CMBS loans.

Cash paid for interest, excluding $468,000 and $192,000 of capitalized interest, was $22.3 million and $22.4 million for the nine months ended September 30, 2011 and 2010, respectively. Cash paid for interest was reduced by the defeasance refund received of $553,000 for the nine months ended September 30, 2010, as discussed above. Additionally, included in the cash paid for interest is a one-time non cash charge to interest expense of $727,000 related to the redemption of the 7.92% Trust Preferred Securities for the nine months ended September 30, 2010.

Unsecured Debt

On June 3, 2011, we closed on a $125.0 million unsecured, five year term loan. This loan has a variable interest rate, which was 2.0% at September 30, 2011, and matures June 2, 2016. Proceeds from the term loan were used to pay down borrowings outstanding on our $250.0 million unsecured line of credit and for general corporate purposes. Debt procurement costs related to this loan were $1.0 million.

## 4. GOODWILL AND OTHER INTANGIBLE ASSETS

### Goodwill

We have a policy of completing our annual review of goodwill during the first quarter of each year and more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. The review that was completed during the three months ended March 31, 2011, determined that goodwill was not impaired and no other events have occurred which would require that goodwill be reevaluated, as such, there were no changes to the carrying value of goodwill as of September 30, 2011. In performing this analysis, we use a multiple of revenues to the range of potential alternatives. We then assign a probability to the various alternatives under our consideration. Should the estimates used to determine alternatives or the probabilities of the occurrence thereof change, impairment may result which could materially impact our results of operations for the period in which it is recorded.

### Intangible Assets

We allocate a portion of the total purchase price of a property acquisition to any intangible assets identified, such as in place leases and tenant relationships. The intangible assets are amortized over the remaining lease terms or estimated life of the tenant relationship, which is approximately 12 months. Due to the short term nature of residential leases, we believe that existing lease rates approximate market rates; therefore, no allocation is made for above/below market leases.

In connection with our property acquisition completed on August 9, 2011, as discussed in Note 2, we recorded total intangible assets in the amount of $2.7 million related to existing leases and tenant relationships, which are being amortized over 12 months.

In connection with our property acquisition completed on June 15, 2011, as discussed in Note 2, we recorded total intangible assets in the amount of $1.1 million related to existing leases and tenant relationships, which are being amortized over 12 months.

## 5. INVESTMENT IN PARTNERSHIP

On September 24, 2010, we entered into a partnership agreement with Bristol Development Group, an unrelated third-party, for the development of Vista Germantown, a 242-unit apartment community located in downtown Nashville, Tennessee. We contributed $9.4 million to the partnership and hold a 90.0% equity interest. We have determined that this entity is not a variable interest entity and that we hold a controlling financial interest in the entity. As such, this entity is included in our consolidated financial statements. We have also determined that the noncontrolling interest in this entity meets the criterion to be classified as a component of permanent equity.

6. EQUITY

The following table provides a reconciliation of activity in equity accounts:

| | Nine Months Ended September 30, 2011 | | | | |
|---|---|---|---|---|---|
| (In thousands) | Common Shares (at $.10 stated value) | Paid-In Capital | Accumulated Distributions in Excess of Accumulated Net Income | Treasury Shares (at Cost) | Noncontrolling Interest |
| Balance, December 31, 2010 | $4,657 | $574,994 | $(205,021) | $(58,446) | $ 1,040 |
| Total comprehensive income | — | — | 7,541 | — | — |
| Share-based compensation | — | 1,273 | 4 | 1,466 | — |
| Purchase of common shares | — | — | — | (857) | — |
| Option exercises from treasury shares | — | 141 | — | 677 | — |
| Issuance of common shares from treasury shares | — | 6,308 | — | 7,021 | — |
| Common share dividends declared | — | — | (21,568) | — | — |
| Balance, September 30, 2011 | $4,657 | $582,716 | $(219,044) | $(50,139) | $ 1,040 |

The following table identifies total comprehensive income (loss):

| | Nine Months Ended September 30, | |
|---|---|---|
| (In thousands) | 2011 | 2010 |
| Comprehensive income (loss): | | |
| Net income (loss) attributable to AERC | $7,541 | $(7,277) |
| Other comprehensive income: | | |
| Change in fair value and reclassification of hedge instruments | — | 1,290 |
| Total comprehensive income (loss) | $7,541 | $(5,987) |

7. COMMON SHARES

In August 2010, we registered a continuous at-the-market ("ATM") program under which we can sell up to $25.0 million of our common shares in open market transactions at the then market price per share. During the three months ended September 30, 2011, we sold 788,676 shares under the ATM program for total gross proceeds of $13.7 million, or $13.3 million net of sales commissions and other costs. The proceeds were used to reduce borrowings on our unsecured revolver and for general corporate purposes. The shares sold under the ATM program were issued from Treasury. There were no shares sold prior to the three months ended September 30, 2011, under this program.

8. EARNINGS PER SHARE

There were approximately 692,000 and 750,000 options to purchase common shares outstanding at September 30, 2011 and 2010, respectively. The dilutive effect of these options were not included in the calculation of diluted earnings per share for the periods presented as their inclusion would be anti-dilutive to the net loss from continuing operations applicable to common shares.

The effect of exercise of rights for exchange of non-controlling interests into common shares was also not included in the computation of diluted EPS because we intend to settle the exchange of these interests in cash.

The following table presents a reconciliation of basic and diluted earnings per common share:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands, except per share amounts) | 2011 | 2010 | 2011 | 2010 |
| Numerator - basic and diluted: | | | | |
| (Loss) income from continuing operations | $(2,519) | $(1,921) | $(7,691) | $(7,670) |
| Net income attributable to noncontrolling redeemable interest | (12) | (13) | (37) | (39) |
| Preferred share dividends | — | — | — | (2,030) |
| Preferred share redemption costs | — | — | — | (993) |
| (Loss) income from continuing operations applicable to common shares | $(2,531) | $(1,934) | $(7,728) | $(10,732) |
| Income from discontinued operations applicable to common shares | $14,727 | $137 | $15,269 | $432 |
| Denominator - basic and diluted: | 41,697 | 31,906 | 41,458 | 26,846 |
| Net income (loss) applicable to common shares - basic and diluted: | | | | |
| (Loss) income from continuing operations applicable to common shares | $(0.06) | $(0.06) | $(0.19) | $(0.40) |
| Income from discontinued operations | 0.35 | — | 0.37 | 0.02 |
| Net income (loss) applicable to common shares - basic and diluted | $0.29 | $(0.06) | $0.18 | $(0.38) |

## 9. FAIR VALUE

Accounts and notes receivable, other assets, accounts payable, accrued expenses and other liabilities are carried at amounts that reasonably approximate corresponding fair values.

Mortgage notes payable, unsecured revolving debt and other unsecured debt with an aggregate carrying value of $632.9 million and $555.7 million at September 30, 2011 and December 31, 2010, respectively, have an estimated aggregate fair value of $634.3 million and $570.2 million, respectively. Estimated fair value is based on interest rates available to us as of the dates reported for issuance of debt with similar terms and remaining maturities. Considerable judgment is necessary to interpret market data and develop estimated fair values. Accordingly, the estimates presented herein are not necessarily indicative of the amounts for which we could be liable upon disposition of the financial instruments. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

## 10. CONTINGENCIES

### Legal Proceedings

We are subject to legal proceedings, lawsuits and other claims, including proceedings by government authorities (collectively "Litigation"). Litigation is subject to uncertainties and outcomes are difficult to predict. We believe any current Litigation will not have a material adverse impact on us after final disposition. However, because of the uncertainties of Litigation, one or more lawsuits could ultimately result in a material obligation.

## 11. SEGMENT REPORTING

We have two reportable segments, which are multifamily properties and construction and other services. Our multifamily segment owns and manages multifamily communities and our construction and other services segment is a general contractor that acts as our in-house construction division and provides general contracting and construction management services to third parties. We have decided to exit the third party construction business and expect to substantially complete all remaining projects by December 31, 2011.

The accounting policies of our segments are the same as those described in Note 1, "Basis of Presentation and Accounting Policies." All of our properties are multifamily communities that have similar economic characteristics. We evaluate the performance of our properties on an individual and segment basis based on property Net Operating Income ("NOI"). We evaluate the performance of our construction and other services segment based on income from construction services, which includes direct as well as allocated general and administrative expenses.

Segment information for the three and nine months ended September 30, 2011 and 2010, respectively, is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2011 | 2010 | 2011 | 2010 |
| Revenue | | | | |
| Property operations: | | | | |
| Total segment revenue | $40,985 | $33,232 | $117,191 | $95,684 |
| Less: Intersegment revenue | — | — | — | — |
| Total net segment revenue | 40,985 | 33,232 | 117,191 | 95,684 |
| | | | | |
| Construction and other services: | | | | |
| Total segment revenue | 11,663 | 7,877 | 29,078 | 13,248 |
| Less: Intersegment revenue | (6,061) | (2,160) | (13,011) | (4,800) |
| Total net segment revenue | 5,602 | 5,717 | 16,067 | 8,448 |
| | | | | |
| Reconciliation of segment revenue to total consolidated revenue: | | | | |
| Total revenue for reportable segments | 52,648 | 41,109 | 146,269 | 108,932 |
| Elimination of intersegment revenue | (6,061) | (2,160) | (13,011) | (4,800) |
| Management and service company revenue | — | 217 | — | 715 |
| Total consolidated revenue | $46,587 | $39,166 | $133,258 | $104,847 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2011 | 2010 | 2011 | 2010 |
| Profit (net of intersegment revenue and expense) | | | | |
| Property operations | | | | |
| Property revenue | $40,985 | $33,232 | $117,191 | $95,684 |
| Property expenses | (16,686) | (14,433) | (48,117) | (41,645) |
| Property operations NOI | 24,299 | 18,799 | 69,074 | 54,039 |
| | | | | |
| Construction and other services | | | | |
| Construction revenue | 5,602 | 5,717 | 16,067 | 8,448 |
| Construction expenses - direct | (6,436) | (5,047) | (16,582) | (7,576) |
| Construction expenses - general and administrative [(1)] | (327) | (337) | (1,127) | (1,109) |
| Construction and other services (loss) income | (1,161) | 333 | (1,642) | (237) |
| Total profit for reportable segments | 23,138 | 19,132 | 67,432 | 53,802 |
| | | | | |
| Reconciliation of segment profit to consolidated income (loss): | | | | |
| Total profit for reportable segments | 23,138 | 19,132 | 67,432 | 53,802 |
| Management and service company revenue | — | | | |