ASSOCIATED ESTATES REALTY CORP
Form 8-K
August 23, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 8-K

CURRENT REPORT

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

Date of Report (Date of earliest event reported): May 10, 2004

Associated Estates Realty Corporation

(Exact name of registrant as specified in its charter)

Commission File Number 1-12486

Ohio	34-1747603
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
5025 Swetland Court, Richmond Hts., Ohio	44143-1467
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (216) 261-5000

ITEM 8.01. Other Events

During the quarter ended June 30, 2004, the Company disposed of a Market Rate property. This property has been consolidated in the results of operations of the Company since it was acquired in April 2002.

This Form 8-K is being filed to reflect the impact of the reclassification as discontinued operations of the consolidated property sold in May 2004, pursuant to the requirements of Statement of Financial Accounting Standards ("SFAS"), 144 - "Accounting for the Impairment or Disposal of Long Lived Assets" for the three years ended December 31, 2003, 2002 and 2001, including Management's Discussion and Analysis of Financial Condition and Results of Operations and Selected Financial Data.

In compliance with SFAS 144, the Company has reported revenues, expenses and the gain on the disposition from this property as income from discontinued operations for each period presented in its quarterly reports filed during 2004 (including the comparable periods of the prior year). Under SEC requirements, the same reclassification to discontinued operations as required by SFAS 144 subsequent to the sale of properties is required for previously issued annual financial statements for each of the years shown in the Company's last annual report on Form 10-K, if those financials are incorporated by reference in subsequent filings with the SEC made under the Securities Act of 1933, as amended, even though those financial statements relate to periods prior to the date of the sale. This reclassification has no effect on the Company's reported net income available to common shareholders.

This Report on Form 8-K updates Items 6, 7 and 8 of the Company's Form 10-K for the year ended December 31, 2003 to reflect the property sold during 2004 as discontinued operations, as appropriate. All other items of the Form 10-K remain unchanged. No attempt has been made to update matters in the Form 10-K except to the extent expressly provided above. Readers should refer to the Company's quarterly reports on Form 10-Q for information related to periods subsequent to December 31, 2003.

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Item 6. Selected Financial and Other Data

The following tables set forth selected financial and other data for the Company on a consolidated basis. The historical financial information contained in the tables has been derived from and should be read in conjunction with (i) the consolidated financial statements and notes thereto of the Company and (ii) Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company both included elsewhere herein.

Associated Estates Realty Corporation					
(Dollars in thousands except per share amounts and average monthly rental revenues)					
	2003	2002	2001	2000	1999
Operating Data:					
Revenues					
Rental	$ 134,617	$ 135,567	$ 139,087	$ 140,457	$ 140,227
Property and asset management, acquisition and disposition fees and reimbursements	14,053	20,142	23,471	21,675	23,075
Painting services	2,827	1,642	2,196	1,530	1,524
Other	3,635	3,497	4,122	3,191	2,884
Total revenues	155,132	160,848	168,876	166,853	167,710
Expenses and charges	167,029	167,837	170,270	169,393	169,107
(Loss) income before gain on disposition of properties and land, net, equity in net (loss) income of joint ventures, gain on sale of partnership interest, minority interest, income from discontinued operations, and cumulative effect of a change in accounting principle	(11,897)	(6,989)	(1,394)	(2,540)	(1,397)
Gain on disposition of properties and land, net	-	227	7,047	7,512	19,630
Equity in net (loss) income of joint ventures	(1,157)	(1,627)	(328)	(164)	585
Gain on sale of partnership interest	1,314	-	-	-	-
Minority interest expense	(75)	(324)	(478)	(400)	(241)
(Loss) income from continuing operations	(11,815)	(8,713)	4,847	4,408	18,577
Income from discontinued operations:					
Operating income	902	532	60	534	813
Gain on disposition of properties, net	-	9,660	-	-	-
Income from discontinued operations	902	10,192	60	534	813
Cumulative effect of a change in accounting principle	-	-	-	-	4,319
Net (loss) income	(10,913)	1,479	4,907	4,942	23,709
Preferred share dividends	(5,484)	(5,485)	(5,484)	(5,484)	(5,484)
Net (loss) income applicable to common shares	$ (16,397)	$ (4,006)	$ (577)	$ (542)	$ 18,225
Earnings per common share - Basic:					
(Loss) income from continuing operations applicable to common shares	$ (.89)	$ (.73)	$ (.03)	$ (.05)	$ .59
Income from discontinued operations	.04	.52	-	.02	.04
Cumulative effect of a change in accounting principle	-	-	-	-	.20
Net (loss) income applicable to common shares	$ (.85)	$ (.21)	$ (.03)	$ (.03)	$ .83
Weighted average number of common shares outstanding	19,401	19,343	19,415	19,733	22,051
Earnings per common share - Diluted:					
(Loss) income from continuing operations applicable to common shares	$ (.89)	$ (.73)	$ (.03)	$ (.05)	$ .59
Income from discontinued operations	.04	.52	-	.02	.04
Cumulative effect of a change in accounting principle	-	-	-	-	.20
Net (loss) income applicable to common shares	$ (.85)	$ (.21)	$ (.03)	$ (.03)	$ .83
Weighted average number of common shares outstanding	19,401	19,343	19,415	19,733	22,053
Dividends declared per common share	$ .68	$ .92	$ 1.25	$ 1.25	$ 1.125

	2003	2002	2001	2000	1999
Cash flow data:					
Cash flow provided by operations	$ 28,758	$ 32,897	$ 26,845	$ 31,618	$ 40,130
Cash flow (used for) provided by investing activity	(11,509)	13,260	(7,983)	(16,892)	(9,140)
Cash flow (used for) provided by financing activity	(15,937)	(48,421)	(16,264)	(50,545)	4,361

***Other Data*:**					
Net Operating Income (a) (d)	$ 69,748	$ 75,290	$ 81,692	$ 83,063	$ 80,539
Total properties (at end of period) - includes joint ventures	78	79	84	90	93
Total multifamily units (at end of period) - includes joint ventures	18,313	18,313	19,807	20,738	20,103
Average monthly rental revenues per multifamily unit	$ 670	$ 659	$ 653	$ 646	$ 633
Physical occupancy (b)	92.7%	87.4%	90.5%	91.5%	93.4%

Balance Sheet Data at December 31:					
Real estate assets, net	$ 661,585	$ 683,058	$ 716,079	$ 742,183	$ 777,072
Total assets	704,793	735,303	775,624	819,559	882,810
Total debt (c)	543,496	540,498	552,069	568,177	579,186
Total shareholders' equity	121,428	150,865	171,996	196,456	238,182

(a) The Company evaluates the performance of its reportable segments based on NOI. NOI is determined by deducting property operating and maintenance expenses, direct property management and service companies expenses and painting service expense from total revenues. The Company considers NOI to be an appropriate supplemental measure of our performance because it reflects the operating performance of our real estate portfolio and management and service company at the property and management and service company level and is used to assess regional property and management and service company level performance. NOI should not be considered an alternative to net income as a measure of performance or cash generated from operating activities in accordance with GAAP and, therefore, it should not be considered indicative of cash available to fund cash needs. Other real estate companies may define NOI in a different manner.

(b) Physical occupancy represents the actual number of units leased divided by the total number of units available at the end of the period.

(c) Amount excludes the Company's share of mortgage indebtedness relating to the unconsolidated joint ventures of approximately $26,406, $32,659, $42,245, $24,986, and $17,249 at December 31, 2003, 2002, 2001, 2000 and 1999, respectively.

(d) Reconciliation of NOI to net (loss) income:

	2003	2002	2001	2000	1999
Net Operating Income	$ 69,748	$ 75,290	$ 81,692	$ 83,063	$ 80,539
Depreciation and amortization	(34,802)	(34,422)	(33,878)	(33,901)	(33,763)
General and administrative expense					
excluding service companies expense	(6,084)	(7,016)	(6,964)	(7,849)	(9,337)
Interest expense	(40,759)	(40,841)	(42,244)	(43,853)	(38,836)
Gain on disposition of properties and land, net	-	227	7,047	7,512	19,630
Equity in net (loss) income of joint ventures	(1,157)	(1,627)	(328)	(164)	585
Gain on sale of partnership interest	1,314	-	-	-	-
Minority interest in operating partnership	(75)	(324)	(478)	(400)	(241)
Income from discontinued operations:					

Operating income	902	532	60	534	813
Gain on disposition of properties, net	-	9,660	-	-	-
Cumulative effect of a change in accounting principle	-	-	-	-	4,319
Net (loss) income	$ (10,913)	$ 1,479	$ 4,907	$ 4,942	$ 23,709

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

The consolidated financial statements reflect the impact of the reclassification as discontinued operations of the consolidated property sold in May 2004, pursuant to the requirements of Statement of Financial Accounting Standards ("SFAS"), 144 - "Accounting for the Impairment or Disposal of Long-Lived Assets." The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Part II, Item 8 of this report on Form 8-K. Historical results and percentage relationships set forth in the Consolidated Statements of Operations contained in the consolidated financial statements, including trends which might appear, should not be taken as indicative of future operations. This discussion may also contain forward-looking statements based on current judgments and current knowledge of management, which are subject to certain risks, trends and uncertainties that could cause actual results to vary from those projected. Accordingly, readers are cautioned not to place undue reliance on forward-looking statements. These forward-looking statements are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "expects", "projects", "believes", "plans", and similar expressions are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance of these forward-looking statements, which speak only as of the date of the document. Investors are cautioned that the Company's forward-looking statements involve risks and uncertainty, including without limitation the following:

- changes in economic conditions in the markets in which the Company owns and manages properties, including interest rates, the overall level of economic activity, the availability of consumer credit and mortgage financing, unemployment rates and other factors;
- risks of a lessening of demand for the multifamily units owned or managed by the Company;
- competition from other available multifamily units and change in market rental rates;
- increases in property and liability insurance costs;
- changes in government regulations affecting the Affordable Housing Properties and other properties operated by the Company;
- changes in or termination of contracts relating to third party management and advisory business;
- inability to renew current Housing Assistance Payment ("HAP") contracts at existing rents;
- weather and other conditions that might adversely affect operating expenses;
- expenditures that cannot be anticipated such as utility rate and usage increases, unanticipated repairs, and real estate tax valuation reassessments;
- inability of the Company to achieve anticipated reductions in operating expenses and increases in revenues;

- the results of litigation filed or to be filed against the Company;
- risks related to the Company's joint ventures; and
- risks of personal injury claims and property damage related to mold claims because of diminished insurance coverage.

Overview. The Company is engaged primarily in the ownership and operation of multifamily residential units. Additionally, the Company and its subsidiaries provide asset and management services to third party owners of multifamily residential units for which the Company is paid fees. Approximately 87% of the Company's consolidated revenues are generated from the leasing of the owned residential units. Approximately 90% of the revenues generated by the owned properties are related to Market Rate properties. The operating performance of the properties and cash flows from operations, particularly the Market Rate properties, have been impacted by low mortgage rates, which have resulted in an increase in home purchases by existing and potential apartment residents, the overall weak economy and related unemployment rates. Increasing insurance costs and real estate taxes across the multifamily housing industry have also increased property operating expenses and reduced cash flows from operations.

The Company's total rental revenue collections are impacted by a combination of rental rates, rent concessions and occupancy levels, which the Company attempts to adjust from time to time in order to maintain projected revenues. Indicators that the Company uses in measuring these factors include average economic occupancy, physical occupancy and net collected rent. These indicators are more fully described in the Results of Operations Comparison.

For 2004, the Company expects its performance to be driven primarily by improvements in the market rate portfolio. The Company expects to increase net collected rents within a range of 2.0% to 2.5% for the year, by focusing on reducing the amount of rent concessions while maintaining the physical occupancy levels achieved at the end of the fourth quarter of 2003. The Company anticipates a reduction in property operating expenses of approximately 3.0% to 3.5%, which it expects to accomplish through continued careful management of controllable expenses. As a result, the Company anticipates growth in NOI for the market rate portfolio in the range of 6.5% to 8.5% for the year 2004. The Company does not anticipate changes in acquisition, disposition or development activity in 2004 that would materially change these expected results.

Federal Income Taxes. The Company has elected to be taxed as a Real Estate Investment Trust ("REIT") under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, commencing with its taxable year ending December 31, 1993. REITs are subject to a number of organizational and operational requirements including a requirement that 90.0% of the income that would otherwise be considered as taxable income be distributed to shareholders. Providing the Company continues to qualify as a REIT, it will generally not be subject to federal income tax on net income. However, the Company's Service Companies are subject to federal income tax.

On December 17, 1999, as part of a larger bill, the REIT Modernization Act ("RMA") was signed into law. Effective beginning January 1, 2001, the RMA amended the tax rules relating to the composition of a REIT's assets. Under prior law, REIT's were precluded from owning more than 10.0% of the outstanding voting securities of any one issuer, other than a wholly owned subsidiary or another REIT. Beginning in 2001, a REIT will generally remain subject to this current restriction and will also be precluded from owning more than 10.0% of the value of all securities of any one issuer.

As an exception to this prohibition, a REIT will be allowed to own up to 100% of the securities of a Taxable REIT Subsidiary ("TRS") that can provide non-customary services to REIT tenants and others without disqualifying the rents that a REIT receives from its tenants. However, no more than 20.0% of the value of a REIT's total assets can be represented by securities of one or more TRS's. The amount of intercompany interest and other expenses between a TRS and a REIT are subject to arms length allocations. The Company has elected TRS status for all of its Service Companies.

LIQUIDITY AND CAPITAL RESOURCES

Long Term Contractual Obligations. The following table summarizes the Company's long term contractual obligations at December 31, 2003.

	Payments Due In				
(In thousands)					2009 and
Contractual Obligations	Total	2004	2005 - 2006	2007 - 2008	Later Years
Debt	$ 546,145	$ 30,854	$ 47,697	$ 131,968	$ 335,626
Capital lease obligations	147	85	62	-	-
Operating leases	4,779	284	400	304	3,791
Purchase obligations	7,745	7,319	405	21	-
Total	$ 558,816	$ 38,542	$ 48,564	$ 132,293	$ 339,417

Debt. Debt includes principal payments on all property specific mortgages, lines of credit, medium-term notes of the Company, and accrued interest at December 31, 2003, but not any interest for subsequent periods. For detailed information about the Company's debt, see Note 6 of the Notes to Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 8-K.

Capital and Operating Leases. The Company leases certain equipment and facilities under both capital and operating leases. For detailed information about the Company's lease obligations, see Note 10 of the Notes to Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 8-K.

Purchase Obligations. Purchase obligations represent agreements to purchase goods or services that are legally binding and enforceable and that specify all significant terms of the agreement. Purchase obligations of the Company include, but are not limited to, contracts that individual properties have entered into in the normal course of operations, such as landscaping, snow removal, elevator maintenance, security, etc, as well as obligations entered into at the corporate level. Obligations included in the above table represent agreements dated December 31, 2003 or earlier.

The Company has not included in the above table guarantees that it has with respect to joint venture debt and possible redemption of OP units. Both of these items are described in greater detail under "Guarantees" and "Operating Partnership", respectively.

Dividends. On December 11, 2003, the Company declared a dividend of $0.17 per common share which was paid on February 2, 2004 to shareholders of record on January 15, 2004. Also, on February 12, 2004, the Company announced that a dividend of $0.60938 per Depositary Share on its Class A Cumulative Preferred Shares (the "Perpetual Preferred Shares") will be paid on March 15, 2004 to shareholders of record on March 1, 2004.

The Company anticipates that it will meet its liquidity requirements for the upcoming year generally through its net cash provided by operations, secured borrowings (primarily through the use of the Company's two lines of credit, which had $12.2 million available at December 31, 2003), and property sales' proceeds. The Company believes that these sources will be sufficient to meet operating requirements, capital additions, mortgage amortization payments and the payment of dividends in accordance with REIT requirements.

The Company anticipates the following commitments for capital expenditures for 2004:

. $9.6 million for recurring capital expenditures. This includes replacement of worn carpet and appliances and property common area parking lots, roofs and similar items in accordance with the Company's current property expenditure plan. This commitment is expected to be funded largely from cash flow provided by operating activities;

. $3.9 million for investment/revenue enhancing expenditures. This commitment is expected to be funded largely from borrowings on the Company's lines of credit; and

. $400,000 for non-recurring capital expenditures. This commitment is expected to be funded largely from cash flow provided by operating activities.

The Company has a shelf registration statement on file with the Securities and Exchange Commission relating to a possible offering, from time to time, of up to $368.8 million of debt securities, preferred shares, depositary shares, common shares and common share warrants. Although $62.5 million of MTN's remain available under the shelf registration, it is unlikely that the Company will have access to the market for MTN securities in the near future.

While the Company currently estimates that its net cash provided by operations for 2004 should exceed 2003, certain factors could adversely impact the Company's results of operations in 2004 including, but not limited to, continued low mortgage interest rates, continuation of a recessionary economy (primarily employment levels) and higher than anticipated insurance and utility costs. The Company believes that if net cash provided by operations is below 2004 projections, the other sources of cash previously mentioned will be sufficient to cover the liquidity requirements of the Company.

Cash Flows. Significant sources and uses of cash in the past three years are summarized as follows:

Cash Sources (Uses):

	For the year ended December 31,		
(In thousands)	2003	2002	2001
Net cash provided by operating activities	$ 28,758	$ 32,897	$ 26,845
Real estate and fixed asset additions	(13,850)	(16,234)	(14,250)
Net proceeds from property dispositions	-	33,894	11,806
Joint venture distribution from sale proceeds	2,582	-	-
Purchase of operating partnership units	(211)	(3,100)	(393)
Investments in joint ventures - net	(30)	(1,300)	(5,146)
Increases (decreases) in debt - net	3,000	(23,367)	9,208
Cash dividends and operating partnership distributions paid	(18,809)	(25,362)	(25,381)
Net cash from other financing activities	(128)	308	(91)
Cash increase (decrease)	$ 1,312	$ (2,264)	$ 2,598

Cash Flows Provided by Operating Activities. Cash flows from operating activities have historically been driven by net income (loss) levels and fluctuations in accounts payable and accounts receivable balances. The $4.1 million decrease in cash flow from operating activities in 2003 compared to 2002 was primarily a result of an increase in net loss before property and partnership interest dispositions, equity in net loss of joint ventures, and minority interest expense of $4.7 million. Cash flows provided by operating activities increased in 2002 compared to 2001 primarily as a result of large deposits to escrows in 2001 related to the joint venture swap and changes in accounts payable and accrued expenses resulting primarily from property sales and the timing of the payment of liabilities. This increase in cash flow was partially offset by an increase in net loss before property and partnership interest dispositions, equity in net loss of joint ventures and minority interest expense of $4.9 million in 2002 compared to 2001.

Cash Flows Provided by (Used For) Investing Activities. Cash provided by investing activities decreased $24.8 million in 2003 compared to 2002 primarily as a result of $33.9 million received in 2002 from property dispositions. This was partially offset by $2.6 million received from the sale of the Company's partnership interest in a joint venture, a reduction in capital asset expenditures of $2.4 million, and a reduction in cash paid for the purchase of operating partnership units in 2003. Cash provided by investing activities increased $21.2 million in 2002 compared to 2001 primarily as a result of $33.9 million received in 2002 from property dispositions compared to $11.8 million received in 2001 for property dispositions.

Cash Flows Used For Financing Activities. Cash used for financing activities decreased $32.5 million in 2003 compared to 2002 primarily as a result of a reduction in principal payments on secured debt of $19.6 million, a net borrowing on the Company's lines of credit of $5.0 million during 2003 compared to a net repayment of $3.5 million in 2002 that resulted in a net increase in cash flow of $8.5 million, and a reduction in the amount of common share dividends paid of $6.2 million in 2003 compared to 2002. The secured debt and line of credit reductions were primarily related to the cash generated from the property dispositions. Cash used for financing activities increased $32.2 million in 2002 compared to 2001 primarily as a result of the increased principal payments on secured debt of $19.2 million in 2002 related to the property dispositions, a net repayment on the Company's lines of credit of $3.5 million in 2002 compared to a net borrowing of $3.5 million during 2001 that resulted in a net decrease in cash flow of $7.0 million, and a reduction of $7.0 million in 2002 compared to 2001 in additional secured debt funding.

Financing and Other Commitments. At December 31, 2003, the Company had 54 conventional mortgages payable aggregating $533.8 million, each collateralized by the respective real estate and resident leases having a net book value of $600.1 million. Fifty-one of these nonrecourse project specific loans accrue interest at fixed rates ranging from 6.55% to 7.94% and have maturity dates ranging from 2004 to 2012 and three of these loans accrue interest at variable rates ranging from 3.14% to 3.19% and have maturity dates ranging from 2005 to 2007. Additionally, the Company had two HUD insured mortgages aggregating $4.6 million, each collateralized by the respective real estate and residential leases having a net book value of $2.9 million. One of these loans accrues interest at a fixed rate of 7.0% and matures in 2012, and the other accrues interest at a variable rate, which was 3.36% at December 31, 2003, and matures in 2013. During 2003, the Company repaid a $2.7 million HUD insured mortgage, replacing it with a $3.9 million conventional mortgage, and repaid a $2.3 million conventional mortgage, replacing it with a $5.5 million conventional mortgage. The Company incurred prepayment penalties totaling $339,000 in connection with the prepayment of these mortgages. The Company currently intends to refinance each loan as it matures. Maturities for such mortgages in 2004 are nominal at $17.5 million.

The Company currently has 15 properties which are unencumbered (one of which may be sold pursuant to the purchase agreement referenced under "Dispositions"), 12 of which are Affordable Housing Properties. These 15 properties had net income of $4.1 million for the year ended December 31, 2003, and a net book value of $9.5 million at December 31, 2003. The Company believes that it should be able to obtain financing on these properties should the need arise; however, certain financing vehicles may be unavailable or limited because many of these properties are ground leased and one is subject to a right of reverter.

The Company currently has two lines of credit. The first line of credit is a $15.0 million line secured by one of the Company's properties. This line of credit was obtained on July 23, 2003 and replaced the $20.0 million line that matured in 2003. The new line matures on July 31, 2006. The Company intends to seek an extension upon maturity. Borrowings under this line are currently restricted up to an amount of $8.9 million and bear interest at a rate of LIBOR plus 1.5% or approximately 2.62% at December 31, 2003. There were $5.0 million in borrowings outstanding under this line of credit at December 31, 2003. There were no borrowings outstanding at December 31, 2002 on the line that was replaced.

The second line of credit is a $14.0 million line secured by two of the Company's properties of which $1.6 million is reserved exclusively for derivative transactions. The remaining $12.4 million is available for regular borrowings and letter of credit transactions. At December 31, 2003, letters of credit totaling $4.1 million have been issued against this line. The maturity of this line of credit was extended from December 31, 2003 to December 31, 2004. The Company intends to seek an extension upon maturity. The Company's borrowings under this line of credit bear interest at either the prime rate or LIBOR plus 2.0% at the Borrower's option (approximately 3.12% at December 31, 2003). There were no borrowings outstanding at either December 31, 2003 or December 31, 2002.

At December 31, 2003, the Company had one Medium-Term Note outstanding in the amount of $105,000. This loan bears interest at 6.88%, is unsecured and matures in December 2004. The Company intends to repay this loan in full at maturity.

The Company leases certain equipment under capital leases. The Company also leases certain equipment and facilities under operating leases. Future minimum lease payments under all capital and noncancellable operating leases in which the Company is the lessee, principally for ground leases, are included in the above table of contractual obligations.

The ground lease agreements contain provisions which, upon expiration of the lease, require reversion of the land and building to the lessor. Such provisions exist for nine properties included in the consolidated financial statements and expire at various dates from 2021 to 2086. Total revenues derived from such properties were $10.2 million, $10.1 million and $10.3 million for the years ended December 31, 2003, 2002 and 2001, respectively. Furthermore, at the end of the term of the lease, any remaining replacement reserves revert to the lessor. Management believes that most of the replacement reserves will be utilized for their intended purpose prior to the end of the lease term. Such cash reserves included in restricted cash were $681,000 and $615,000 at December 31, 2003 and 2002, respectively. With respect to such leases, the Company incurred ground rent expense of $101,000 for each of the years ended December 31, 2003, 2002 and 2001.

The Company owns one property which is subject to a warranty deed reversion provision. This provision requires that the land and real estate assets revert to the deed holder at expiration, which is September 2037. The net book value of this property was $1.1 million at December 31, 2003. The property generated revenues and net income of $943,000 and $352,000 for 2003, $943,000 and $378,000 for 2002 and $958,000 and $449,000 for 2001.

Guarantees. In connection with the refinancing of the Watergate Apartments, a 949 unit multifamily community located in Euclid, Ohio, the Company has guaranteed completion of certain improvements totaling approximately $7.0 million. This obligation is secured by a $3.5 million letter of credit. Furthermore, the Company has guaranteed the payment of a $26.0 million loan in connection with the Idlewylde Apartments Phase II, a 535 unit multifamily community located in Atlanta, Georgia in which the Company is a 49.0% owner. This loan matures December 10, 2005. The Company has recorded no liability in relation to this guarantee at December 31, 2003. Subsequent to December 31, 2003, this guarantee was reduced to 50.0% of the loan balance, or approximately $13.0 million, per the guarantee provision. The Company has also guaranteed the payment of the $15.8 million construction loan in connection with the development of Courtney Chase Apartments, a 288-unit multifamily community located in Orlando, Florida, which was developed by the Company and its pension fund joint venture partner. This loan matures June 1, 2005, with an option to extend the maturity for two additional years conditional upon the satisfaction of various conditions and requirements. The Company has recorded no liability in relation to this guarantee at December 31, 2003.

Off-Balance Sheet Investments. The Company has investments in three joint ventures that own a total of four multifamily apartment communities. The operations of these properties are similar to the operations of the Company's wholly owned portfolio. These investments enable the Company to exercise significant influence over the operations of the properties and share in their profits, while earning additional fee income. The Company accounts for its investments in unconsolidated joint ventures under the equity method of accounting as the Company exercises significant influence, but does not control these entities. These investments are initially recorded at cost, as investments in joint ventures and subsequently adjusted for equity in earnings and cash contributions and distributions.

For summarized financial information at 100% for these joint ventures, reference is made to Note 7 of the Notes to the Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 8-K.

Joint Venture Financing Commitments. The Company has two guarantee obligations related to its joint ventures. These obligations were previously discussed under Guarantees.

At December 31, 2003, all of the Company's joint venture investments were encumbered by debt. The Company's share of this debt was $26.4 million.

Operating Partnership. As provided in the AERC HP Investors Limited Partnership Agreement ("DownREIT Partnership"), the Company, as general partner, has guaranteed the obligation of the DownREIT Partnership to redeem OP units held by the limited partners. The DownREIT Partnership was formed in 1998 in connection with the MIG merger transactions. Under the terms of the DownREIT Partnership Agreement, the DownREIT Partnership is obligated to redeem OP units for common shares of the Company or cash, at the Company's discretion, at a price per OP unit equal to the 20 day trailing price of the Company's common shares for the immediate 20 day period preceding a limited partner's redemption notice. After giving effect to the transactions described in the following paragraphs, there are 93,023 OP units remaining having a carrying value of $2.2 million. Through December 31, 2003, 429,009 of the original 522,032 OP units have been redeemed. These transactions had the effect of increasing the Company's interest in the DownREIT Partnership from 85.0% to 97.0%. These redemption transactions are more fully described in the following paragraphs.

In 2003, 35,003 of the OP units were purchased for cash in the amount of $211,000. These units had a recorded amount of approximately $800,000 when issued. The difference of the cash paid and the recorded amount was approximately $589,000 which reduced the recorded amount of the underlying real estate. In 2002, 2001 and 2000, a total of 393,976 of the OP units were purchased for cash in the amount of $3.6 million. These units had a recorded amount of $9.0 million when issued. The difference of the cash paid and the recorded amount was $5.3 million which reduced the recorded amount of the underlying real estate.

Acquisitions, Dispositions and Development. Any future multifamily property acquisitions or developments would be financed with the most appropriate sources of capital, which may include the assumption of mortgage indebtedness, bank and other institutional borrowings, through the exchange of properties, undistributed earnings, secured debt financings, or the issuance of shares or units exchangeable into common shares.

Dispositions: In January 2004, the Company entered into a contract for sale of a Market Rate property located in Northeast Ohio. The closing of the transaction occurred May 10, 2004. The following is a summary of disposition transactions completed for the year ended December 31, 2003.

On April 17, 2003, the Company and its joint venture partner completed the sale of a 36 unit Market Rate property located in Northeast Ohio in which the Company was a 50.0% partner. The sales price was $990,000. The Company's proportionate share of the gain was $450,000 which is included in "Equity in net loss of joint ventures" in the Consolidated Statements of Operations.

On October 17, 2003, the Company completed the sale of its partnership interest in a 252 unit residential joint venture property located in Cranberry Township, Pennsylvania. The Company received cash proceeds of $2.0 million and a $491,000 note. The Company recorded a gain on the sale of its partnership interest of $1.3 million.

Development. During the year ended December 31, 2003, the Company and its joint venture partner completed the construction of Courtney Chase Apartments, a 288 unit development located in Orlando, Florida. As of December 31, 2003, 243 units have been leased. The Company is a 24.0% partner in this project. In connection with the construction of this property, the Company has guaranteed the repayment of the $15.8 million construction loan.

Management and Service Operations. In March 2003, MIG was directed by one of its clients to initiate the sale of all of the client's real estate investments. Upon the successful sale of these investments, the Company will no longer receive the property and asset management fee revenue associated with them. Revenue received from these investments for the year ended December 31, 2003 was $1.7 million or 1.0% of total consolidated revenues. At December 31, 2003, two of these properties have been sold. Additionally, one of these properties was sold in January 2004, and another was sold in February 2004. The Company anticipates the two remaining properties will be sold during 2004. For each property sold for this client, the Company receives a one time disposition fee. The Company received disposition fees of $423,000 for the year ended December 31, 2003.

In November 2003, the Company was informed by one of its advisory clients that it intended to sell the commercial properties for which MIG provided asset management services. Upon the successful sale of these investments, the Company will no longer receive the asset management fee revenue associated with them. MIG manages or advises both commercial and multifamily properties for this client. Revenue received from the commercial investments sold or to be sold for the year ended December 31, 2003, was $528,000. At December 31, 2003, two of these properties have been sold. Additionally, a third property was sold in January 2004.

In October 2003, five properties which the Company managed on behalf of an affiliate owner were sold to an unrelated third party. The Company was retained by the new owner to continue to manage these five properties, however, the management fees payable by the new owner are less than those payable under the old management contracts. The estimated annual fees for these five properties at the old rate was approximately $795,000, while the estimated annual fees at the new rate are approximately $625,000, which represents an estimated annual decline of approximately $170,000.

In November 2003, the Company entered into three new property management contracts for properties located in Pennsylvania owned by an unrelated third party. Additionally, in February 2004, the Company entered into a fourth property management contract for a property owned by an unrelated third party. This property is also located in Pennsylvania. The Company expects to receive fee revenue of approximately $170,000 in 2004 from these contracts.

Management Contract Cancellation. During 2003, the Company's property management and/or asset management contracts associated with the following properties were terminated or transferred:

Effective Date of Termination	Management Company	Management Contract Canceled/Transferred	Property and/or Asset Management Fees Earned During 2003	Approximate Property and/or Asset Management Fees Lost in 2003
			(In thousands)	
04/17/03	AERC	Highland House (50.0% joint venture)	$ 3	$ 8
10/17/03	AERC	Berkley Manor (49.0% joint venture)	57	12
Advisory Properties:				
11/06/03	AERC	Advised Asset	74	10
12/16/03	AERC	Advised Asset	280	11
12/23/03	AERC	Advised Asset	335	7
12/30/03	AERC	Advised Asset	286	1

During 2004, the Company's property management and/or asset management contracts associated with the following properties will be/could be terminated or transferred:

Effective Date of Termination	Management Company	Management Contract	Approximate Annualized 2004 Property and/or Asset Management Fees
			(In thousands)
01/30/04	AERC	Advised Asset	$ 242
01/30/04	MIG	Advised Asset	75
02/13/04	AERC	Advised Asset	161
Unknown	AEMC	University Circle	85
Unknown	MIG	Advised Asset	93
Unknown	AERC	Advised Asset	300
Unknown	AERC	Advised Asset	329

RESULTS OF OPERATIONS FOR 2003 COMPARED WITH 2002 AND 2002 COMPARED WITH 2001

In the following discussion of the comparison of the year ended December 31, 2003 to the year ended December 31, 2002 and the year ended December 31, 2002 to the year ended December 31, 2001, Market Rate properties refers to the Same Store Market Rate property portfolio. Market Rate properties represent 60 wholly owned properties. Acquired/Disposed properties represent two acquired properties and properties which have been sold. Affordable Housing represents 12 properties subject to HUD regulations.

Overall, the loss from continuing operations increased $3.1 million when comparing 2003 to 2002 and increased $13.6 million when comparing 2002 to 2001. The decrease in total revenues was primarily the result of a decrease in reimbursements received from managed properties in both 2003 and 2002 when comparing each to the previous year. These reimbursements, which are primarily payroll related, are included in direct property management expense in the same amounts as they are in revenues. Therefore, the decrease from year to year had the same effect on both total revenues and total expenses. After removing this effect, total revenues decreased $1.3 million in 2003 compared to 2002 and $5.8 million in 2002 compared to 2001. The 2003 decrease was primarily due to a decrease in property and asset management fees received, offset by an increase in painting service revenues. The 2002 decrease was primarily due to decreases in rental revenues and property and asset management fees received. Total expenses, after removal of the effect of reimbursements, increased $3.5 million in 2003 compared to 2002 and decreased $248,000 in 2002 compared to 2001. The 2003 increase was primarily due to increased property operating and maintenance expenses, which are partially offset by decreased direct property management expenses. The 2002 decrease was primarily a result of a decrease in interest expense.

The following chart reflects the amount and percentage change in line items that are relevant to the changes in overall operating performance when comparing the year ended December 31, 2003 to 2002 and 2002 to 2001:

	Increase (decrease) when comparing the year ended December 31,			
	2003 to 2002		2002 to 2001	
(Amounts in thousands)				
Rental revenue	$ (950)	(0.70)%	$ (3,520)	(2.53)%
Property management fees and reimbursements	(5,693)	(32.52)%	(3,088)	(15.0)%
Asset management fees	(819)	(31.05)%	(241)	(8.37)%
Asset disposition fees	423	N/A	-	N/A
Painting services revenue	1,185	72.17%	(554)	(25.23)%
Other revenues	160	4.52%	(580)	(14.07))%
Property operating and maintenance expenses	5,163	7.95%	1,410	2.22%
Direct property management expenses	(6,354)	(33.78)%	(2,729)	(12.67)%
Painting services expenses	1,017	56.75%	(307)	(14.63)%
General and administrative	(932)	(13.28)%	52	0.75%
Interest expense	(82)	(0.20)%	(1,403)	(3.32)%
Gain on disposition of properties and land, net	(227)	(100.0)%	(6,820)	(96.78)%
Equity in net loss of joint ventures	470	(28.89)%	(1,299)	396.04%
Gain on sale of partnership interest	$ 1,314	N/A	$ -	N/A

Rental Revenues. Rental revenue collections are impacted by a combination of rental rates, rent concessions and occupancy levels. The Company measures these factors using indicators such as average economic occupancy (potential rent less vacancies and allowances divided by potential rent), physical occupancy (number of units occupied divided by total number of units), and net collected rent per unit (gross potential rents less vacancies and allowances divided by total number of units). This information is presented in the following table for the years ended December 31, 2003, 2002 and 2001:

For the year ended December 31, 2003

	Average Economic Occupancy	Physical Occupancy	Net Collected Rent Per Unit
Acquisitions/Dispositions	82.4%	92.4%	$443
Market Rate	84.1%	92.7%	$681
Affordable Housing	99.3%	98.8%	$623

	For the year ended December 31, 2002		
	Average Economic Occupancy	Physical Occupancy	Net Collected Rent Per Unit
Acquisitions/Dispositions	84.5%	88.8%	$443
Market Rate	85.1%	87.3%	$694
Affordable Housing	98.8%	99.5%	$619

	For the year ended December 31, 2001		
	Average Economic Occupancy	Physical Occupancy	Net Collected Rent Per Unit
Acquisitions/Dispositions	N/A	N/A	N/A
Market Rate	88.8%	90.7%	$707
Affordable Housing	98.9%	98.8%	$622

For the Market Rate properties, the Company focused on increasing physical occupancy rates in 2003. This was accomplished by reducing rents in certain markets to remain competitive and reflect current market rents, resulting in an average rent charged per unit of $810 in 2003 compared to $816 in 2002, and by additional concessions. This resulted in slightly lower rental revenue in 2003 compared to 2002. The achievement of the occupancy goal has positioned the Company to focus on maintaining rent at current levels or potentially increasing where possible without negatively impacting occupancy during 2004. The combination of increased occupancy, reduced concessions and maintained or increased rental rates is expected to result in increased net collected rent in 2004. Rental revenue decreased $2.1 million in 2002 compared to 2001 primarily as a result of increased concessions given and decreased occupancy rates during 2002 compared to 2001.

Rental revenues for the Affordable Housing Properties increased $49,000 in 2003 compared to 2002 primarily as a result of four properties receiving HUD approved rent increases during 2003. This was partially offset by a decrease in occupancy rates. Rental revenue for this segment decreased approximately $81,000 when comparing 2002 to 2001. These revenues are primarily dependent upon the Company being entitled to receive rental assistance subsidies from HUD via monthly housing assistance payments ("HAP Payments"). The amount of each monthly HAP Payment is equal to the rent amount (the "Contract Rent") stated in the HAP Contract with HUD, less the amount payable by the Eligible Resident for such month.

Below is a table setting forth the expiration dates of the HAP Contracts and the HAP revenue recognized for the Company's Affordable Housing Properties as of December 31, 2003:

(In thousands)	Final	Revenue Recognized During		
Property	Expiration Date	2003	2002	2001
Ellet Development	December 2017	$ 426	$ 433	$ 425
Hillwood I	July 2016	465	488	501
Lakeshore Village (50.0% joint venture)(a)	January 2004	789	732	744
Puritas Place	September 2011	699	691	680
St. James (Riverview)	November 2009	462	466	463
Shaker Park Gardens II	June 2004	662	684	766
State Road Apartments	December 2016	420	404	370
Statesman II	November 2004	296	287	288
Sutliff Apartments II	November 2019	805	802	807
Tallmadge Acres	March 2004	726	699	692
Twinsburg Apartments	June 2009	440	433	445
Village Towers	November 2009	429	432	443
West High Apartments	November 2004	554	544	506

(a) Amounts shown represents 100% payment.

All thirteen properties shown in the above table had positive cash flow during 2003 and are anticipated to have positive cash flow for the remaining contract terms. Therefore, none of the HAP contracts are considered to be loss contracts.

Contract Rents may be adjusted at least annually in accordance with the annual adjustment factor method for some of the properties. Generally, these types of adjustments are only permitted if current rents are below the HUD published Fair Market Rent ("FMR") threshold. If current rents exceed FMRs, a rent comparability study must be completed to demonstrate that the property's rents are below "market."

Prior to HAP Contract expiration, "Contract Renewal Request Forms" must be submitted by the Company 120 days prior to the HAP anniversary date to HUD (or its corresponding contract agent) in order to renew the existing HAP contract. Current options available to the Company for the expiring HAP contracts are as follows: (i) renew at current rents plus an operating cost adjustment factor ("OCAF") that is set by HUD on an annual basis. These rents are below the market comparisons for properties that have a mortgage; (ii) renew at current rents plus an operating cost adjustment factor for properties without a mortgage; or, (iii) opt out of the Section 8 program. Opting out of the Section 8 program requires an additional one-year notice to HUD (or the contract agent) and the affected residents.

The Company believes, that upon expiration of the contracts, the contracts will be renewed, or the Company will enter into another government subsidized or mortgage restructuring program, or that the properties will be operated as conventional, market-rate properties.

The following represents the Company's current expectations concerning those HAP contracts which expire in 2004.

Lakeshore Village. On October 7, 2002, the Company requested a referral to the Office of Multifamily Housing Assistance Restructuring ("OMHAR") for the full restructuring of the mortgage and reduction of Section 8 rents to comparable market rents, and to renew the HAP Contract. On February 20, 2003, the partnership was notified by HUD that the property is eligible for the full restructuring of the mortgage and that the property was assigned to a participating administrative entity for further processing. The current HAP contract was extended by OMHAR through January 31, 2004 to allow for the closing of the mortgage restructuring deal, which is scheduled for March 31, 2004. The corresponding renewed HAP Contract will be at reduced rents retroactive to February 1, 2004. In the event that the partnership and HUD fail to reach an agreement on the Restructuring Application, the current contract rents most likely would be reduced to market rents without a decrease in debt service. The Company anticipates that the contract will be renewed and that any reduction of rents to current market rents would be partially offset by a reduction in debt service payments. Currently, the estimated new market rents for the property are approximately $636,000, while the current annual contract rents are approximately $866,000, a difference of $230,000. This property is a joint venture property in which the Company has a 50.0% investment accounted for using the equity method. Therefore, a reduction in rents, without a corresponding reduction in debt service payments, would decrease net income to the Company by approximately $115,000. This reduction would be reflected in the Consolidated Statements of Operations in the line "Equity in net (loss) income of joint ventures."

Shaker Park Gardens II. In May 2003, the Company requested a renewal of the current contract for a one-year term with an increase in rents of 3%, as calculated using the OCAF published on February 11, 2003. The Company's request for an OCAF increase was granted and the contract was renewed for a one-year term through June 30, 2004. Upon expiration of the current contract, the Company intends to request a renewal for an additional one year period.

Statesman II. In July 2003, the Company requested a renewal of the current contract for a one-year term with an increase in rents of 3%, as calculated using the OCAF published on February 11, 2003. The Company's request for an OCAF increase was granted and the contract was renewed for a one-year term through November 30, 2004. Upon expiration of the current contract, the Company intends to request a renewal for an additional one year period.

Tallmadge Acres. The Company requested a renewal of the current contract for a one-year term with an increase in rents of 3.1%, as calculated using the OCAF published on February 11, 2004. The Company anticipates that its request for an OCAF increase will be granted and the contract will be renewed for a one-year term through March 31, 2005.

West High. In July 2003, the Company requested a renewal of the current contract for a one-year term with an increase in rents of 3%, as calculated using the OCAF published on February 11, 2003. The Company's request for an OCAF increase was granted and the contract was renewed for a one-year term through November 30, 2004. Upon expiration of the current contract, the Company intends to request a renewal for an additional one year period.

Fees. The management and service operations recognized a reduction in property management fee income (after removing the effect of reimbursements) of $1.3 million when comparing 2003 to 2002, and $900,000 when comparing 2002 to 2001. Asset management fees decreased $800,000 when comparing 2003 to 2002, and $200,000 when comparing 2002 to 2001. These decreases are primarily due to the loss in 2003 of the four advised properties and the two joint venture management contracts, as discussed above in "Dispositions" and "Management and Service Operations," the 2002 transfer of eleven advisory contracts to another advisor and the loss of five additional advised properties, and the 2001 termination of six property management contracts. These decreases were partially offset by the addition of three property management contracts in November 2003, as discussed above in "Management and Service Operations." The Management and Service Operations segment recognized asset disposition fees in 2003 of $423,000 as a result of the successful disposition of the two advised assets in the fourth quarter of 2003. It should be noted that the management and advisory fees attributed to properties owned by pension fund clients are earned pursuant to contracts that are generally terminable upon 30 days notice.

Direct Property Management Expenses Reimbursements. Direct property management expenses include service companies expense and reimbursements received from managed properties. The reimbursements, in accordance with EITF 01-14 "Income Statement Recharacterization of Reimbursements Received for Out-of-Pocket Expenses Incurred," represent certain expense reimbursements, primarily payroll expenses, that the Company includes in revenue with an equal amount included in expense. These revenue amounts are included in property management fees and reimbursements. For each of the three years ended December 31, 2003, 2002 and 2001, the amount included in revenues and expenses was $8.8 million, $13.2 million, and $15.3 million, respectively. The decreases from year to year are the result of the loss of management contracts and advised assets in 2003 and 2002.

Painting Service Revenues and Expenses. Painting service revenues and expenses both increased in 2003 compared to 2002 primarily as a result of contracts that were entered into by the Company's subsidiary, Merit Painting Services. As of March 1, 2004, contracts for the rehabilitation of seven properties had been signed. Work on the above contracts is expected to be completed by the end of 2004. Painting service revenues and expenses both decreased in 2002 compared to 2001 primarily as a result of projects at joint venture and managed properties that were primarily completed in 2001.

Property Operating and Maintenance Expenses. Property operating and maintenance expenses increased $5.2 million when comparing 2003 to 2002 and $1.4 million when comparing 2002 to 2001. The increase in 2003 compared to 2002 was primarily a result of an increase of $1.8 million in real estate taxes and insurance resulting from increases in assessed property values and millage rate increases at certain properties and increased insurance rates. Additionally, utility expenses increased $1.0 million in 2003 primarily due to increased gas consumption as a result of a colder winter and spring in 2003 that affected the Company's midwest portfolio. Repair and maintenance expenses increased $1.5 million in 2003 as a result of increased unit turnover expenses and landscaping costs. Personnel costs increased $700,000 primarily as a result of increased salaries and leasing commission bonuses relating to on-site staff. The increase in 2002 compared to 2001 was primarily due to an increase in property and liability insurance and also increased payroll and benefit costs.

General and Administrative Expenses. General and administrative expenses decreased $932,000 when comparing 2003 to 2002 primarily as a result of the reduction in payroll expense related to the 2002 restructuring of the advisory business.

Interest Expense. Interest expense in 2003 decreased $82,000 or 0.2% compared to 2002. Interest expense decreased $1.4 million in 2002 compared to 2001. The 2002 decrease was primarily attributable to both the Market Rate segment, which declined as a result of amortization of existing loans and the refinancing of an $11.0 million loan whose interest rate dropped to 3.40% from 9.61%, and the Management and Service Operations segment which declined approximately $371,000. This decline was due to the Company recording in 2001 additional interest expense in connection with the additional loan fundings on two joint venture properties that were guaranteed by the Company and borrowings by the Company for major refurbishment at the properties. These two properties were two of the three properties of which the Company became the 100% owner as a result of the 2002 joint venture exchange.

Gain on Sales. The net gain on the disposition of properties and land, net, of $227,000 for 2002 was primarily due to the sale of a Market Rate Property which was classified as held for sale at December 31, 2001. The net gain on disposition of properties and land, net, of $7.0 million for 2001 resulted from the sale of seven Market Rate operating properties.

Gain on Sale of Partnership Interest. In 2003, the Company sold its partnership interest in a joint venture property located in Cranberry Township, Pennsylvania. The Company recognized a gain of $1.3 million related to this sale.

Equity in Net Loss of Joint Ventures. The combined equity in net loss of joint ventures decreased $470,000 in 2003 compared to 2002, and increased $1.3 million in 2002 compared to 2001. The decrease when comparing 2003 to 2002 was primarily due to the recognition of a gain on the sale of a 50.0% owned joint venture of which the Company's proportionate share was $450,000. The increase in the equity in net loss of joint ventures when comparing 2002 to 2001 was primarily due to two properties in which the Company is a 49.0% owner, completing construction and having available all of their units for leasing by the end of 2002. One of these properties, with 252 units, was approximately 79.0% leased at the end of 2002 and the other was approximately 49.0% leased. The Company's share of the net loss for 2002 for these two properties was $1.2 million, while for 2001 the Company's share was $29,000.

The following table presents the historical statements of operations of the Company's beneficial interest in the operations of the joint ventures for the years ended December 31, 2003, 2002 and 2001.

	For the year ended December 31,		
(In thousands)	2003	2002	2001
Beneficial interests in joint venture operations			
Rental revenues	$ 3,521	$ 4,217	$ 7,753
Cost of operations	2,220	2,927	5,250
	1,301	1,290	2,503
Interest income	2	6	46
Interest expense	(1,344)	(1,343)	(1,824)
Depreciation	(1,199)	(1,001)	(949)
Amortization of joint venture deferred costs	(70)	-	-
(Loss) income before discontinued operations:			
Operating loss	(297)	(579)	(104)
Gain on disposition of property	450	-	-
(Income) loss from discontinued operations	153	(579)	(104)
Equity in net loss of joint ventures	$ (1,157)	$ (1,627)	$ (328)

Income From Discontinued Operations. Effective January 1, 2002, in accordance with FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company presents the results of operations and the gains/(losses) for operating properties sold, which became held for sale after January 1, 2002, as "Income from discontinued operations." At December 31, 2003, the Company had no properties classified as held for sale. The operating income from discontinued operations for 2003 and 2002 includes $902,000 and $699,000, respectively, for a property that was sold May 10, 2004. Prior to April 2002, this property was a joint venture and as such was accounted for under the equity method. In 2002, five properties were disposed of whose operating results and gains/(losses) were classified as discontinued operations. The operating (loss) income for these five properties was $(167,000) for 2002 and $60,000 for 2001. The gain on disposition of properties, net, included gains on the sales of three of these properties of $10.3 million and a loss of $632,000 on the sale of a fourth property. This property was purchased in November 2000 as a 6.9 acre parcel of land for $5.2 million. The Company was developing this property as a multi-use property to include apartments, commercial building and a marina. The Company had recorded $3.4 million of costs in developing the property and had completed and was operating the marina. In November 2002, the Company received an unsolicited offer to purchase the property for $8.0 million. The Company accepted the offer and completed the sale on December 31, 2002 resulting in the above reported loss. The fifth property disposed of was Gates Mills III which was involved in the 2002 joint venture swap and for which no gain or loss was recorded.

For further details on "Income from discontinued operations," reference is made to Note 2 of the Notes to Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 8-K.

Inflation. Management's belief is that the effects of inflation would be minimal on the operational performance of its portfolio primarily due to the high correlation between inflation and housing costs combined with the short term nature, typically one year, of the leases. The Company also faces limited exposure to interest rate fluctuations due to its high proportion of fixed rate financing.

Critical Accounting Policies and Estimates.

The consolidated financial statements of the Company include accounts of the Company, all subsidiaries, the Service Companies and the Operating Partnership structured as a DownREIT. The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the consolidated financial statements and related notes. In preparing these consolidated financial statements, management has utilized information available including industry practice and its own past history in forming its estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. It is possible that the ultimate outcome as anticipated by management in formulating its estimates inherent in these consolidated financial statements may not materialize. However, application of the accounting policies below involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. In addition, other companies may utilize different estimates, which may impact comparability of the Company's results of operations to those of companies in similar businesses.

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," requires management to assess the recoverability of the carrying value of long-lived assets when an event of impairment has occurred. In performing this analysis, the Company estimates holding periods of the assets, changes in fair market value of the assets and cash flows related to the operations of the assets to determine the range of potential alternatives and assigns a probability of the various alternatives under consideration by management. Should the estimates used to determine alternatives or the probabilities of the occurrence thereof change, an impairment may result which could materially impact the results of operations of the Company. The Company did not record an impairment loss related to the carrying value of its long-lived assets during any of the years ended December 31, 2003, 2002 or 2001.

SFAS No. 142, "Goodwill and Other Intangible Assets," requires management to review goodwill annually and when an event of impairment has occurred. In performing this analysis, the Company determines the range of potential alternatives and assigns a probability of the various alternatives under consideration by management. In determining the potential alternatives, the Company estimates cash flows from management fee revenue and the related expenses of management contracts that could be in effect in the future. The estimates are based upon expected sale dates of existing assets, anticipated acquisition dates of new assets and the fee revenue and operating expenses related to these assets. Should estimates used to determine the alternatives considered or the probabilities of the occurrence thereof change, an impairment may result which could materially impact the results of operations of the Company. The Company did not record an impairment loss related to goodwill during any of the years ended December 31, 2003, 2002 or 2001.

The Company estimates the amount of real estate taxes for which it will be liable based upon assumptions relating to possible changes in millage rates and property value reassessments. In certain circumstances, it is possible that the actual millage rates or reassessment values are not available until the following reporting period and that these rates or values could differ from assumptions and require material adjustments to the liabilities recorded.

Replacements and improvements, such as HVAC equipment, structural replacements, windows, appliances, flooring, carpeting and kitchen/bath replacements and renovations a