ASSOCIATED ESTATES REALTY CORP
Form 10-Q
August 05, 2008

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 June 30, 2008

OR

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

For the transition period from ________ to ______

Commission File Number 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 [ ]

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

Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ] Smaller reporting company [ ]

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

The number of shares outstanding as of July 30, 2008 was 16,379,851 shares

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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 amounts)	June 30, 2008	December 31, 2007
ASSETS		
Real estate assets		
Land	$ 110,350	$ 107,912
Buildings and improvements	810,783	826,226
Furniture and fixtures	28,889	30,154
	950,022	964,292
Less: accumulated depreciation	(268,586)	(305,427)
	681,436	658,865
Construction in progress	1,238	721
Real estate, net	682,674	659,586
Cash and cash equivalents	2,625	1,549
Restricted cash	6,880	6,730
Accounts and notes receivable, net		
Rents	1,138	1,128
Affiliates	364	1,875
Other	971	820
Goodwill	1,725	1,725
Other assets, net	10,255	13,383
Total assets	$ 706,632	$ 686,796
LIABILITIES AND SHAREHOLDERS' EQUITY		
Mortgage notes payable	$ 511,659	$ 510,915
Unsecured revolving credit facility	13,100	20,000
Unsecured debt	25,780	25,780
Total debt	550,539	556,695
Accounts payable, accrued expenses and other liabilities	22,687	25,909
Dividends payable	2,858	2,848
Resident security deposits	3,406	3,826
Funds held on behalf of managed properties - affiliates	264	344
Funds held on behalf of managed properties - other	470	1,476
Accrued interest	2,433	2,737
Accumulated losses in excess of investments in joint ventures	1,391	1,346
Total liabilities	584,048	595,181
Operating partnership minority interest	1,829	1,829
Shareholders' equity		
Preferred shares, without par value; 9,000,000 shares authorized; 8.70% Class B Series II cumulative redeemable, $250 per share liquidation preference, 232,000 issued and 220,850 outstanding	55,213	55,213
Common shares, without par value, $.10 stated value; 41,000,000 authorized; 22,995,763 issued and 16,378,018 and 16,353,700 outstanding at June 30, 2008 and December 31, 2007, respectively	2,300	2,300
Paid-in capital	281,418	281,152
Accumulated distributions in excess of accumulated net income	(149,962)	(180,436)
Accumulated other comprehensive loss	(1,330)	(1,050)
Less: Treasury shares, at cost, 6,617,745 and 6,642,063 shares at June 30, 2008 and December 31, 2007, respectively	(66,884)	(67,393)
Total shareholders' equity	120,755	89,786
Total liabilities and shareholders' equity	$ 706,632	$ 686,796

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

ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands, except per share amounts)	2008	2007	2008	2007
Revenue				
Property revenue	$ 33,435	$ 28,274	$ 64,866	$ 55,650
Management and service company revenue:				
Fees, reimbursements and other	397	3,149	950	5,843
Painting services	188	620	325	1,236
Total revenue	34,020	32,043	66,141	62,729
Expenses				
Property operating and maintenance	14,292	13,163	27,531	24,852
Depreciation and amortization	9,463	6,784	18,011	13,400
Direct property management and service company expenses	398	3,629	793	6,871
Painting services	277	563	520	1,153
General and administrative	3,183	2,699	6,711	5,411
Total expenses	27,613	26,838	53,566	51,687
Operating income	6,407	5,205	12,575	11,042
Interest income	92	64	108	329
Interest expense	(8,977)	(9,882)	(18,111)	(21,087)
(Loss) income before equity in net loss of joint ventures, minority interest and income from discontinued operations	(2,478)	(4,613)	(5,428)	(9,716)
Equity in net loss of joint ventures	(23)	(144)	(45)	(216)
Minority interest in operating partnership	(13)	(13)	(27)	(27)
(Loss) income from continuing operations	(2,514)	(4,770)	(5,500)	(9,959)
Income from discontinued operations:				
Operating income (loss)	42	2,517	(1,237)	3,595
Gain on disposition of properties	2,293	12,482	45,203	17,043
Income from discontinued operations	2,335	14,999	43,966	20,638
Net (loss) income	(179)	10,229	38,466	10,679
Preferred share dividends	(1,201)	(1,261)	(2,402)	(2,523)
Preferred share repurchase costs	-	(172)	-	(172)
Net (loss) income applicable to common shares	$ (1,380)	$ 8,796	$ 36,064	$ 7,984
Earnings per common share - basic and diluted:				
(Loss) income from continuing operations applicable to common shares	$ (0.23)	$ (0.36)	$ (0.49)	$ (0.74)
Income from discontinued operations	0.14	0.87	2.72	1.21
Net (loss) income applicable to common shares	$ (0.09)	$ 0.51	$ 2.23	$ 0.47
Dividends declared per common share	$ 0.17	$ 0.17	$ 0.34	$ 0.34
Weighted average number of common shares outstanding - basic and diluted	16,200	17,153	16,184	17,131

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

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

	Six Months Ended June 30,	
(In thousands)	2008	2007
Cash flow from operating activities:		
Net income	$ 38,466	$ 10,679
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization (including discontinued operations)	18,764	15,563
Loss on fixed asset replacements write-off	38	64
Gain on disposition of properties	(45,203)	(17,043)
Amortization of deferred financing costs and other	664	956
Amortization of swap termination payments received	-	(132)
Share-based compensation	996	709
Equity in net loss of joint ventures and minority interest expense	72	243
Net change in assets and liabilities:		
Accounts and notes receivable	1,505	(499)
Accounts payable and accrued expenses	(4,926)	862
Other operating assets and liabilities	858	857
Restricted cash	(150)	(344)
Total adjustments	(27,382)	1,236
Net cash flow provided by operations	11,084	11,915
Cash flow from investing activities:		
Recurring fixed asset additions	(3,756)	(3,832)
Revenue enhancing/non-recurring fixed asset additions	(360)	(804)
Acquisition fixed asset additions	(34,310)	(70,547)
Net proceeds from disposition of operating properties	88,357	37,921
Contribution to joint ventures	-	(46)
Purchase of operating partnership units	-	(22)
Net cash flow provided by (used for) investing activities	49,931	(37,330)
Cash flow from financing activities:		
Principal payments on mortgage notes payable	(44,258)	(117,978)
Payment of debt procurement costs	(601)	(1,407)
Proceeds from mortgage notes obtained	-	55,038
Revolver borrowings	77,850	97,250
Revolver repayments	(84,750)	(21,900)
Common share dividends paid	(5,534)	(5,908)
Preferred share dividends paid	(2,402)	(2,523)
Operating partnership distributions paid	(27)	(27)
Exercise of stock options	-	173
Purchase of preferred and/or treasury shares	(217)	(3,254)
Net cash flow used for financing activities	(59,939)	(536)
Increase (decrease) in cash and cash equivalents	1,076	(25,951)
Cash and cash equivalents, beginning of period	1,549	30,010
Cash and cash equivalents, end of period	$ 2,625	$ 4,059
Supplemental disclosure of cash flow information:		
Dividends declared but not paid	$ 2,784	$ 2,954
Cash paid for interest	20,077	21,486
Fixed asset replacement and other write-offs	1,345	1,344
Net change in accounts payable related to recurring fixed asset additions	(189)	748
Assumption of debt in connection with property acquisition	45,002	42,000

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

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" and the "Company" in this report collectively refer to Associated Estates Realty Corporation and its consolidated subsidiaries.

Business

We are a self-administered and self-managed equity real estate investment trust ("REIT") engaged in property acquisition, advisory, development, management, disposition, operation and ownership activities. Our main source of income is rental revenue. Additional income is derived from property and asset management fees.

As of June 30, 2008, our property portfolio consisted of: (i) 50 apartment communities containing 12,672 units in eight states that are wholly owned, either directly or indirectly through subsidiaries; (ii) one joint venture Affordable Housing property containing 108 units; (iii) three apartment communities that we manage for third party owners consisting of 616 units; and (iv) a 186-unit apartment community and a commercial property containing approximately 145,000 square feet that we asset manage for a government sponsored pension fund.

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, 2007.

Share-Based Compensation

During the three months ended June 30, 2008 and 2007, we recognized total share-based compensation cost of $429,000 and $365,000, respectively, in "General and administrative expense" in the Consolidated Statements of Operations. During the six months ended June 30, 2008 and 2007, we recognized total share-based compensation cost of $900,000 and $665,000, respectively, in "General and administrative expense" in the Consolidated Statements of Operations.

Stock Options. We use the Black-Scholes option pricing model to estimate the fair value of share-based awards. There were no stock options awarded or exercised during the six months ended June 30, 2008. During the six months ended June 30, 2007, there were 4,000 options awarded and 18,979 options exercised.

Restricted Shares. The following table represents restricted share activity for the six months ended June 30, 2008:

	Number of Shares	Weighted Average Grant-Date Fair Value
Nonvested at beginning of period	210,213	$ 11.36
Granted	55,961	$ 10.45
Vested	62,684	$ 11.25
Forfeited	11,029	$ 9.20
Nonvested at end of period	192,461	$ 11.34

At June 30, 2008, there was $2.4 million of unrecognized compensation cost related to nonvested restricted share awards that we expect to recognize over a weighted average period of 2.7 years. Certain of our officers elected to defer the receipt of a portion of the restricted shares granted them during the six months ended June 30, 2008, pursuant to the terms of the Associated Estates Realty Corporation Elective Deferred Compensation Program.

Derivative Instruments and Hedging Activities

During the six months ended June 30, 2008**,** we had two interest rate swaps outstanding that were used to mitigate the economic impact of changes in interest rates. These swaps are designated as cash flow hedges and are being used to offset the risk of changes in cash flows associated with benchmark interest payments on two of our variable rate mortgage loans. We reassess these hedges on a quarterly basis to determine if they continue to be effective. The effective portion of the changes in the fair value of these hedges are recorded in other comprehensive income ("OCI") and the amounts in OCI will be reclassified into earnings over the term of the loan as interest payments are made. As of June 30, 2008, there was no hedge ineffectiveness. These swaps were reported at fair value on the Consolidated Balance Sheets as "Accounts payable, accrued expenses and other liabilities" in the amount of $1.3 million and $1.0 million at June 30, 2008 and December 31, 2007, respectively.

Restricted Cash

Restricted cash represents legally restricted deposits with financial institutions for taxes and insurance, security deposits, and reserve funds for replacements. The reserve funds for replacements are intended to provide cash to defray future maintenance costs for certain mortgaged properties.

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. We define revenue enhancing/non-recurring fixed asset additions to be capital expenditures that increase the value of the property and/or enable us to increase rents. We define acquisition fixed asset additions to be 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.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement No. 157, Fair Value Measurements ("SFAS 157"). SFAS 157 provides guidance for using fair value to measure assets and liabilities. This statement clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing the asset or liability. SFAS 157 establishes a fair value hierarchy, giving the highest priority to quoted prices in active markets and the lowest priority to unobservable data. SFAS 157 applies whenever other standards require assets or liabilities to be measured at fair value. SFAS 157 also provides for certain disclosure requirements, including, but not limited to, the valuation techniques used to measure fair value and a discussion of changes in valuation techniques, if any, during the period. We adopted this statement on January 1, 2008, except for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value on a recurring basis, for which the effective date is January 1, 2009. The adoption of this standard did not have a material effect on our financial position and results of operations. See Note 8 for additional information on the adoption of SFAS 157.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which gives entities the option to measure eligible financial assets, financial liabilities and firm commitments at fair value on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes (i.e., unrealized gains and losses) in fair value must be recorded in earnings. Additionally, SFAS 159 allows for a one-time election for existing positions upon adoption, with the transition adjustment recorded to beginning retained earnings. We adopted this statement on January 1, 2008. We did not elect the fair value option for any instruments.

In December 2007, the FASB issued Statement No. 141 (revised 2007), "Business Combinations" ("SFAS 141(R)"), which establishes principles and requirements for how the acquirer shall recognize and measure in its financial statements the identifiable assets acquired, liabilities assumed, any noncontrolling interest in the acquiree and goodwill acquired in a business combination. This statement is effective for us for business combinations for which the acquisition date is on or after January 1, 2009. We are currently assessing the potential impact that the adoption of SFAS 141(R) will have on our financial position and results of operations.

In December 2007, the FASB issued Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51" ("SFAS 160"), which establishes and expands accounting and reporting standards for minority interests, which will be recharacterized as noncontrolling interests, in a subsidiary and the deconsolidation of a subsidiary. SFAS 160 is effective for us beginning on January 1, 2009. Earlier adoption is prohibited. We are currently assessing the potential impact that the adoption of SFAS 160 will have on our financial position and results of operations.

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"), which amends and expands the disclosure requirements of SFAS 133. This statement requires entities to provide enhanced disclosures about how and why it uses derivate instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. This statement requires disclosure of the fair values of derivative instruments and their gains and losses in a tabular format, and disclosure of credit risk related features. This statement also requires cross-referencing within the footnotes to help users of financial statements locate important information about derivative instruments. SFAS 161 is effective for us beginning on January 1, 2009. We are currently assessing the potential impact that the adoption of SFAS 161 will have on our financial position and results of operations.

Reclassifications

Certain reclassifications have been made to the 2007 financial statements to conform to the 2008 presentation.

2. ACQUISITION AND DISPOSITION ACTIVITY

Acquisition Activity

On April 21, 2008, we acquired two apartment communities located in the Richmond, Virginia metropolitan area totaling 536 units for a purchase price of $75.0 million. The acquisition also included a 5.92 acre future development land parcel, adjacent to one of the properties. This purchase was primarily funded by the assumption of mortgage loans on the acquired properties, by 1031 cash proceeds received from the disposition of a Same Community property that we sold on March 19, 2008, and by borrowings on our revolving credit facility.

The following pro forma financial information is presented as if the 2008 acquisitions had occurred at the beginning of each period presented. This information is presented for informational purposes only and is not necessarily indicative of what the Company's actual results of operations would have been had the acquisitions occurred at such times:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands except per share data)	2008	2007	2008	2007
Pro forma revenue	$ 34,171	$ 33,720	$ 68,011	$ 66,083
Pro forma net (loss) income applicable to common shares	(1,473)	8,008	35,311	6,407
Earnings per common share - basic and diluted:				
Pro forma net (loss) income applicable to common shares	$ (0.09)	$ 0.47	$ 2.18	$ 0.37

On May 25, 2007, we acquired the ground lessor's interest and accompanying land on which one of our Affordable Housing communities was located for a purchase price of $897,000. This property was subsequently sold in March 2008, as noted below.

On June 8, 2007, we acquired a 268-unit multifamily community located in Norfolk, Virginia for a purchase price of $48.3 million. The purchase was funded primarily with 1031 proceeds from the disposition of a Same Community property which we sold on May 30, 2007 and with borrowings from our revolving credit facility.

On June 29, 2007, we acquired our joint venture partner s 51.0% interest in Idlewylde Apartments, a multifamily property located in Atlanta, Georgia. We previously owned a 49.0% interest in this partnership and had accounted for this investment under the equity method of accounting. We paid our partner $21.6 million in cash. This acquisition was structured as a 1031 reverse exchange and was funded with borrowings from our revolving credit facility. Commencing June 29, 2007, the results of operations, financial condition, including the existing $42.0 million non-recourse mortgage loan, and cash flows of this property have been included in our consolidated financial statements.

Disposition Activity

We report the results of operations and gain/loss related to the sale of real estate assets as discontinued operations in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). 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 many 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 March 19, 2008, we completed the sale of ten of our eleven formerly wholly owned Affordable Housing properties located in Northeastern Ohio. The total sales proceeds were $41.3 million resulting in a gain of $29.0 million. We used the sales proceeds primarily to reduce debt and for general corporate purposes. As a condition of the sale, we acquired the ground lessor s interest in six of those properties for a combined purchase price of $5.2 million. On April 25, 2008, we completed the sale of our last remaining wholly owned Affordable Housing property for a sales price of $3.5 million resulting in a gain of $2.3 million. The proceeds were primarily used to reduce debt and for general corporate purposes.

On March 19, 2008, we also completed the sale of four Same Community properties located in Toledo, Ohio. The total sales proceeds were $47.0 million resulting in a gain of $13.9 million. The proceeds from one of those properties were placed in escrow to be used in connection with a 1031 exchange. The remaining proceeds were primarily used to reduce debt and for general corporate purposes.

On May 30, 2007, we completed the sale of a Same Community property located in Northeast Ohio. The sales price was a net $34.6 million resulting in a gain of $12.5 million. This property was part of a 1031 exchange.

On February 20, 2007, we completed the sale of a congregate care property located in Northeast Ohio. The sales price was $5.2 million resulting in a gain of $4.6 million. The proceeds from this sale were primarily used to fund revenue enhancing/non-recurring capital expenditures and for general corporate purposes.

"Income from discontinued operations" in the accompanying Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007, includes the operating results for the properties sold in 2008 and prior years, as well as the gains recognized on the property sales referenced above. The following table summarizes "Income from discontinued operations" for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2008	2007	2008	2007
REVENUE				
Property revenue	$ 69	$ 7,493	$ 4,084	$ 14,144
EXPENSES				
Property operating and maintenance	12	3,609	2,234	7,686
Depreciation and amortization	10	1,017	764	2,163
Total expenses	22	4,626	2,998	9,849
Operating income	47	2,867	1,086	4,295
Interest income	-	9	3	15
Interest expense (1)	(5)	(359)	(2,326)	(715)
Gain on disposition of properties	2,293	12,482	45,203	17,043
Income from discontinued operations	$ 2,335	$ 14,999	$ 43,966	$ 20,638

(1) Interest expense for the six months ended June 30, 2008, includes $2.0 million of defeasance and other prepayment costs.

3. DEBT

Mortgage Notes Payable

During the six months ended June 30, 2008, we prepaid seven fixed rate mortgage loans totaling $31.9 million that had a weighted average interest rate of 7.9% and were scheduled to mature in June 2008. We also defeased/prepaid an $11.0 million loan that had been secured by a property that was sold on March 19, 2008 and recognized $2.0 million in defeasance/prepayment costs in connection therewith. These costs are included in "Income from discontinued operations" in the Consolidated Statements of Operations for the six months ended June 30, 2008. Additionally, we assumed two mortgage loans aggregating $45.0 million in connection with the two properties we acquired in April 2008; one in the amount of $18.9 million at a fixed rate of 5.7% which is secured by one property and the other in the amount of $26.1 million at a fixed rate of 5.6% which is secured by the other property. These loans were recorded at their fair value on the date of acquisition, which approximated the amounts assumed. Both of these loans mature in 2046.

During the six months ended June 30, 2007, we defeased/prepaid five fixed rate mortgage loans totaling $47.2 million and we completed the refinancing of four fixed rate mortgage loans that were to mature in 2007 totaling $53.3 million. Two of the refinanced loans totaling $35.0 million are variable rate mortgage loans that mature in 2009. The interest rate on one of these loans is LIBOR plus 1.1% and the interest rate on the other is LIBOR plus 1.2%. The other two refinanced loans totaling $20.0 million, are 5.4% fixed rate mortgage loans that mature in 2014. Additionally, we prepaid two variable rate mortgage loans totaling $15.7 million with funds borrowed on our revolving credit facility. In connection with these defeasances, other prepayments and refinancings, we recognized $4.2 million in defeasance and other prepayment costs, which are included in "Interest expense" in the Consolidated Statements of Operations.

On June 29, 2007, we acquired our joint venture partner s 51.0% interest in Idlewylde Apartments. In connection with the acquisition, effective June 29, 2007, we included the results of operations, financial condition, including the existing $42.0 million non-recourse mortgage loan, and cash flows in our consolidated financial statements. This loan has a floating interest rate of LIBOR plus 1.1%, however, in August 2007 we executed an interest rate swap that effectively fixed the interest rate at 5.9%. This loan matures in 2010. See Note 2 for additional information regarding this acquisition and Note 1 for additional information regarding the interest rate swap.

Revolving Credit Facility/Lines of Credit

On March 20, 2008, we increased the borrowing capacity on our unsecured revolving credit facility up to $150.0 million from $100.0 million. We also extended the maturity date of that facility for an additional year to March 20, 2011 and modified various financial covenants. Currently, this facility accrues interest at a variable rate of LIBOR plus 1.6%. The weighted average interest rate on borrowings outstanding at June 30, 2008, was 4.1%. Our outstanding borrowings on this facility were $13.1 million and $20.0 million at June 30, 2008, and December 31, 2007, respectively.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

In June 1998, we recorded goodwill in connection with the MIG Realty Advisors, Inc. merger. The goodwill was allocated fully to the Management and Service Operations Segment.

We completed our annual review of goodwill during the three months ended March 31, 2008. In performing this analysis, we use a multiple of revenues to the range of potential alternatives and assign a probability of the various alternatives under consideration by management. Based on this analysis, we determined that goodwill was not impaired as of March 31, 2008. As such, there were no changes to the carrying amount of goodwill during the six months ended June 30, 2008. 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

In accordance with SFAS 141, "Business Combinations", we allocate a portion of the total purchase price of a property acquisition to any intangible assets identified, such as existing 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 to 16 months. Due to the short term nature of residential leases, we believe that existing lease rates approximate market rates, and therefore, no allocation is made for above/below market leases.

In connection with two property acquisitions completed during 2008, as discussed in Note 2, we recorded total intangible assets in the amount of $1.9 million related to existing leases, which are being amortized over 12 months, and $680,000 related to tenant relationships, which are being amortized over 16 months. We are in the process of completing our valuations of the real estate and certain other assets acquired, and as a result, the purchase price allocation recorded as of June 30, 2008 is preliminary and subject to change.

In connection with two property acquisitions completed during 2007, as discussed in Note 2, we recorded total intangible assets in the amount of $2.6 million related to existing leases, which were amortized over 12 months, and $589,000 related to tenant relationships, which are being amortized over 16 months.

5. TRANSACTIONS WITH AFFILIATES AND JOINT VENTURES

We provide management and other services to (and are reimbursed for certain expenses incurred on behalf of) a non-owned property in which our Chief Executive Officer ("CEO") and/or other related parties have an ownership interest. The entity that owns this property, as well as other related parties, are referred to as "affiliates." We also provide similar services to a joint venture property. Property management fees and other service company revenues recognized for the three and six months ended June 30, 2008, were $27,000 and $54,000, respectively. Property management fees and service company revenues recognized for the three and six months ended June 30, 2007 were $126,000 and $250,000, respectively.

In the normal course of business, we have advanced funds on behalf of affiliates and joint ventures and held funds for the benefit of affiliates and joint ventures. Funds due from affiliates were $293,000 and $452,000 at June 30, 2008 and December 31, 2007, respectively.

Merit Enterprises, Inc., ("Merit"), a subsidiary of ours, has from time to time provided services to JAS Construction, Inc. ("JAS") related to property rehabilitation and other work. JAS is owned by a son of our CEO. Reported revenue related to work performed by Merit for JAS for the three and six months ended June 30, 2008 were $0 and $4,000, respectively. Reported revenue related to work performed by Merit for JAS for the three and six months ended June 30, 2007 were $405,000 and $889,000, respectively. Accounts receivable related to JAS at June 30, 2008 and December 31, 2007, was $0 and $360,000, respectively.

In April 2008 we executed a $2.0 million contract with JAS, which was approved by our Board of Directors, under which JAS will provide general contractor services for the interior rehabilitation of one of our properties. As of June 30, 2008, we have paid $270,000 to JAS pursuant to this contract.

6. SHAREHOLDERS' EQUITY

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

	Six Months Ended June 30, 2008			
(In thousands)	Paid-In Capital	Accumulated Distributions In Excess of Accumulated Net Income	Accumulated Other Comprehensive Income	Treasury Shares (at Cost)
Balance, December 31, 2007	$ 281,152	$ (180,436)	$ (1,050)	$ (67,393)
Comprehensive income:				
Net income	-	38,466	-	-
Other comprehensive (loss) income:				
Change in fair value of hedge	-	-	(280)	-
Total comprehensive income	-	38,466	(280)	-
Share-based compensation	266	4	-	726
Purchase of common shares	-	-	-	(217)
Common share dividends declared	-	(5,594)	-	-
Preferred share dividends declared	-	(2,402)	-	-
Balance, June 30, 2008	$ 281,418	$ (149,962)	$ (1,330)	$ (66,884)

The following table identifies total comprehensive income:

	Six Months Ended June 30,	
(In thousands)	2008	2007
Comprehensive income:		
Net income	$ 38,466	$ 10,679
Other comprehensive (loss) income:		
Change in fair value of hedge instruments	(280)	71
Total comprehensive income	$ 38,186	$ 10,750

During the six months ended June 30, 2007, we repurchased 111,500 Class B Series II Preferred Depositary Shares at a cost of $2.9 million. These purchases were made under a $50.0 million repurchase authorization for common and preferred shares.

7. EARNINGS PER SHARE

Earnings per share ("EPS") has been computed pursuant to the provisions of SFAS 128, "Earnings per Share." There were 1.6 million and 1.9 million options to purchase common shares outstanding and 192,461 and 219,207 nonvested restricted share awards outstanding at June 30, 2008 and 2007, respectively. The dilutive effect of these options and restricted share awards were not included in the calculation of diluted earnings per share for the periods presented as their inclusion would be antidilutive to the net loss applicable to common shares from continuing operations.

The exchange of operating partnership minority interests into common shares was also not included in the computation of diluted EPS because we plan to settle these OP units in cash.

8. FAIR VALUE

On January 1, 2008, we adopted certain provisions of SFAS 157. See "Recent accounting pronouncements" in Note 1 for information regarding additional provisions of SFAS 157 that will be effective January 1, 2009. SFAS 157 clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing the asset or liability, and establishes the following fair value hierarchy:

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access;
Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as interest rates and yield curves that are observable at commonly quoted intervals; and
Level 3 inputs are unobservable inputs for the asset or liability that are typically based on an entity s own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the fair value measurement will fall within the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents the financial liability that we measured at fair value on a recurring basis as of June 30, 2008:

(In thousands)	Level 1	Level 2	Level 3	Total
Interest rate swaps	$ -	$ 1,330	$ -	$ 1,330

To comply with the provisions of SFAS 157, we incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and that of the respective counterparty in the fair value measurements. The credit valuation adjustments utilize Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by the either the respective counterparty or us. However, we determined that as of June 30, 2008, the impact of the credit valuation adjustments were not significant to the overall valuation of the swaps. See "Derivative instruments and hedging activity" in Note 1 for additional information regarding the swaps.

9. EQUITY BASED AWARD PLANS

On May 7, 2008, our shareholders approved the 2008 Equity Based Award Plan (the "Plan") which previously had been adopted by our Board of Directors (the "Board") on March 14, 2008, subject to shareholder approval. Subsequent to receiving shareholder approval on May 7, 2008, the Board adopted amended language to the Plan consistent with the additional proxy materials filed by the Company on May 1, 2008.

Under the Plan, a total of 750,000 common shares are available for awards. The Plan provides for the grant to our officers, other employees and directors, of options to purchase our common shares, rights to receive the appreciation in value of common shares, awards of common shares subject to vesting and restrictions on transfer, awards of common shares issuable in the future upon satisfaction of certain conditions and other awards based on common shares.

10. INTERIM SEGMENT REPORTING

We have three reportable segments: (1) Acquisition/Disposition Multifamily Properties; (2) Same Community Multifamily Properties; and (3) Management and Service Operations. We previously reported a fourth segment, Affordable Housing Multifamily Properties; however, during the first half of 2008, all of our wholly owned Affordable Housing properties were sold. Therefore, the financial information at June 30, 2008, and all prior periods for all of the wholly owned Affordable Housing properties are reported as discontinued operations in the Acquisition/Disposition Multifamily Properties segment. We have identified our reportable segments based upon how management makes decisions regarding resource allocation and performance assessment. The Acquisition/Disposition properties represent acquired or developed properties which have not yet reached stabilization (we consider a property stabilized when its occupancy rate reaches 93.0% and we have owned the property for one year), and properties that have been sold or are classified as held for sale in accordance with SFAS 144. The Same Community properties are conventional multifamily residential apartments that have been owned during the entirety of the comparison periods. The Management and Service Operations provide management and advisory services to the Acquisition/Disposition and Same Community properties that we own, as well as to third party clients and properties, both affiliate and non-affiliates. All of our segments are located in the United States.

The accounting policies of the reportable segments are the same as those described in the "Basis of Presentation and Significant Accounting Policies" in our Annual Report on Form 10-K for the year ended December 31, 2007. We evaluate the performance of our reportable segments based on Net Operating Income ("NOI"). NOI is determined by deducting property operating and maintenance expenses from property revenue for the Acquisition/Disposition (excluding amounts classified as discontinued operations), and Same Community segments and deducting direct property management and service company expenses and painting service expenses from Management and Service Company revenue for the Management and Service Operations segment. We consider 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 companies at the property and management and service company level and is used to assess regional property level performance. NOI should not be considered (i) as an alternative to net income (determined in accordance with GAAP), (ii) as an indicator of financial performance, (iii) as cash flow from operating activities (determined in accordance with GAAP) or (iv) as a measure of liquidity; nor is it necessarily indicative of sufficient cash flow to fund all of our needs. Other real estate companies may define NOI in a different manner.

Segment information for the three and six months ended June 30, 2008 and 2007 is as follows:

	Three Months Ended June 30, 2008			
(In thousands)	Acquisition/ Disposition	Same Community	Management and Service Operations	Total Consolidated
Total segment revenue	$ 4,490	$ 28,950	$ 2,033	$ 35,473
Elimination of intersegment revenue	-	(5)	(1,448)	(1,453)
Consolidated revenue	4,490	28,945	585	34,020
Operating income from discontinued operations	42	-	-	42
*NOI	2,911	16,232	(90)	19,053
Total assets	186,539	507,935	12,158	706,632

*Intersegment revenue and expenses have been eliminated in the computation of NOI for each of the segments.

	Three Months Ended June 30, 2007			
(In thousands)	Acquisition/ Disposition	Same Community	Management and Service Operations	Total Consolidated
Total segment revenue	$ 242	$ 28,041	$ 5,572	$ 33,855
Elimination of intersegment revenue	-	(9)	(1,803)	(1,812)
Consolidated revenue	242	28,032	3,769	32,043
Operating income from discontinued operations	2,517	-	-	2,517
*NOI	126	14,985	(423)	14,688
Total assets	165,216	526,143	15,439	706,798

*Intersegment revenue and expenses have been eliminated in the computation of NOI for each of the segments.

	Six Months Ended June 30, 2008			
(In thousands)	Acquisition/ Disposition	Same Community	Management and Service Operations	Total Consolidated
Total segment revenue	$ 7,542	$ 57,330	$ 4,365	$ 69,237
Elimination of intersegment revenue	-	(6)	(3,090)	(3,096)
Consolidated revenue	7,542	57,324	1,275	66,141
Operating loss from discontinued operations	(1,237)	-	-	(1,237)
*NOI	4,846	32,489	(38)	37,297
Total assets	186,539	507,935	12,158	706,632

*Intersegment revenue and expenses have been eliminated in the computation of NOI for each of the segments.

	Six Months Ended June 30, 2007			
(In thousands)	Acquisition/ Disposition	Same Community	Management and Service Operations	Total Consolidated
Total segment revenue	$ 242	$ 55,426	$ 10,703	$ 66,371
Elimination of intersegment revenue	-	(18)	(3,624)	(3,642)
Consolidated revenue	242	55,408	7,079	62,729
Operating income from discontinued operations	3,595	-	-	3,595
*NOI	125	30,673	(945)	29,853
Total assets	165,216	526,143	15,439	706,798

*Intersegment revenue and expenses have been eliminated in the computation of NOI for each of the segments.

A reconciliation of total NOI to total consolidated net (loss) income is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2008	2007	2008	2007
Property NOI	$ 19,143	$ 15,111	$ 37,335	$ 30,798
Management and service operations NOI	(90)	(423)	(38)	(945)
Depreciation and amortization	(9,463)	(6,784)	(18,011)	(13,400)
General and administrative expense	(3,183)	(2,699)	(6,711)	(5,411)
Interest income	92	64	108	329
Interest expense (1)	(8,977)	(9,882)	(18,111)	(21,087)
Equity in net loss of joint ventures	(23)	(144)	(45)	(216)
Minority interest in operating partnership	(13)	(13)	(27)	(27)
Income from discontinued operations:				
Operating income (loss)	42	2,517	(1,237)	3,595
Gain on disposition of properties	2,293	12,482	45,203	17,043
Income from discontinued operations	2,335	14,999	43,966	20,638
Consolidated net (loss) income	$ (179)	$ 10,229	$ 38,466	$ 10,679

(1) 2007 includes defeasance and other prepayment costs of $1,520 and $4,183 for the three and six months ended June 30, respectively.

11. 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. Consequently, we are unable to estimate ultimate aggregate monetary liability or financial impact with respect to the Litigation matter described in the following paragraph as of June 30, 2008, and no accrual has been made for this matter. We believe that other 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.

Pending Lawsuits

On or about April 14, 2002, Melanie and Kyle Kopp commenced an action against us in the Franklin County, Ohio Court of Common Pleas seeking undetermined damages, injunctive relief and class action certification. This case arose out of our Suredeposit program. This program allowed cash short prospective residents to purchase a bond in lieu of paying a security deposit. The bond serves as a fund to pay those resident obligations that would otherwise have been funded by the security deposit. Plaintiffs allege that the nonrefundable premium paid for the bond is a disguised form of security deposit, which is otherwise required to be refundable in accordance with Ohio's Landlord-Tenant Act. Plaintiffs further allege that certain pet deposits and other nonrefundable deposits required by us are similarly security deposits that must be refundable in accordance with Ohio's Landlord-Tenant Act. On or about January 15, 2004, the Plaintiffs filed a motion for class certification. We subsequently filed a motion for summary judgment. Both motions are pending before the Court. We intend to vigorously defend ourselves against these claims.

12. SUBSEQUENT EVENTS

Dividends. On August 1, 2008, we paid a dividend of $0.17 per common share to shareholders of record on July 11, 2008, which had been declared on June 18, 2008.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Part I, Item 1 of this report on Form 10-Q. This discussion may 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, including but not limited to, expectations regarding our 2008 performance, which are based on certain assumptions. Accordingly, readers are cautioned not to place undue reliance on forward-looking statements which speak only as of the dates of the document. 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", "anticipates", and similar expressions are intended to identify forward-looking statements. Investors are cautioned that these forward-looking statements involve risks and uncertainty that could cause actual results to differ from estimates or projections contained in these forward-looking statements, including without limitation the following:

- changes in the economic climate in the markets in which we own and manage properties, including interest rates, our ability to consummate the sale of properties pursuant to our current plan, the overall level of economic activity, the availability of consumer credit and mortgage financing, unemployment rates and other factors;
- our ability to refinance debt on favorable terms at maturity;
- our ability to defease or prepay debt pursuant to our current plan;
- risks of a lessening of demand for the multifamily units that we own or manage;
- competition from other available multifamily units and change in market rental rates;
- increases in property and liability insurance costs;
- unanticipated increases in real estate taxes and other operating expenses (e.g., cleaning, utilities, repairs and maintenance costs, insurance and administrative costs, security, landscaping, staffing and other general costs);
- 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 or millage rate increases;
- our inability to control operating expenses or achieve increases in revenue;
- the results of litigation filed or to be filed against us;
- changes in tax legislation;
- risks of personal injury claims and property damage related to mold claims because of diminished insurance coverage;
- catastrophic property damage losses that are not covered by our insurance;
- our ability to acquire properties at prices consistent with our investment criteria;
- risks associated with property acquisitions such as environmental liabilities, among others;
- changes in or termination of contracts relating to third party management and advisory business;
- risks related to our joint venture; and
- risks related to the perception of residents and prospective residents as to the attractiveness, convenience and safety of our properties or the neighborhoods in which they are located.

Overview. We are engaged primarily in the ownership and operation of multifamily residential units. We also provide asset and property management services to third party owners of multifamily residential units for which we are paid fees. Our primary source of cash and revenue from operations is rents from the leasing of owned apartment units, which represented 98.1% of our consolidated revenue for the six months ended June 30, 2008.

The operating performance of our properties is affected by factors such as interest rates, unemployment rates, job growth, household formation and the supply and demand of rental apartment communities and in certain markets other housing alternatives, such as condominiums, single and multifamily rental homes and owner occupied single and multifamily homes. Rental revenue collections are a combination of rental rates, occupancy levels and rent concessions. We attempt to adjust these factors from time to time, based on market conditions, in order to maximize rental revenue. Indicators that we use in measuring these factors include physical occupancy and net collected rent. These indicators are more fully described in the Results of Operations comparison. Additionally, we consider property net operating income ("NOI") to be an important indicator of our overall performance. Property NOI (property operating revenue less property operating and maintenance expenses) is a measure of the profitability of our properties, which has the largest impact of all of our sources of income and expense on our financi