AVALONBAY COMMUNITIES INC
Form 10-Q
August 03, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

Commission file number 1-12672

AVALONBAY COMMUNITIES, INC.

(Exact name of registrant as specified in its charter)

Maryland	**77-0404318**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Ballston Tower

671 N. Glebe Rd, Suite 800

Arlington, Virginia 22203

(Address of principal executive offices, including zip code)

(703) 329-6300

(Registrant s telephone number, including area code)

(Former name, if changed since last report)

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 twelve (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 ninety (90) days. Yes x No o

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

Indicate by check mark whether the Exchange 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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date:

96,909,747 shares of common stock, par value $0.01 per share, were outstanding as of July 31, 2012

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PART I - FINANCIAL INFORMATION

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AVALONBAY COMMUNITIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	6-30-12 (unaudited)	12-31-11
ASSETS		
Real estate:		
Land	$ 1,378,785	$ 1,336,225
Buildings and improvements	6,956,119	6,681,136
Furniture, fixtures and equipment	243,090	226,359
	8,577,994	8,243,720
Less accumulated depreciation	(1,947,431)	(1,820,381)
Net operating real estate	6,630,563	6,423,339
Construction in progress, including land	681,493	597,346
Land held for development	294,116	325,918
Operating real estate assets held for sale, net		78,427
Total real estate, net	7,606,172	7,425,030
Cash and cash equivalents	358,263	616,853
Cash in escrow	73,691	73,400
Resident security deposits	25,468	23,597
Investments in unconsolidated real estate entities	144,924	144,561
Deferred financing costs, net	29,470	33,653
Deferred development costs	27,677	24,770
Prepaid expenses and other assets	146,380	140,526
Total assets	$ 8,412,045	$ 8,482,390
LIABILITIES AND EQUITY		
Unsecured notes, net	$ 1,450,048	$ 1,629,210
Variable rate unsecured credit facility		
Mortgage notes payable	1,912,316	1,969,986
Dividends payable	93,698	84,953
Payables for construction	43,357	36,775
Accrued expenses and other liabilities	252,696	246,214
Accrued interest payable	30,672	34,210
Resident security deposits	39,702	36,620
Liabilities related to real estate assets held for sale		35,467
Total liabilities	3,822,489	4,073,435
Redeemable noncontrolling interests	7,316	7,063
Equity:		
Preferred stock, $0.01 par value; $25 liquidation preference; 50,000,000 shares authorized at both June 30, 2012 and December 31, 2011; zero shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively		
Common stock, $0.01 par value; 140,000,000 shares authorized at both June 30, 2012 and December 31, 2011; 96,586,916 and 95,175,677 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	966	952
Additional paid-in capital	4,827,330	4,652,457
Accumulated earnings less dividends	(145,921)	(171,648)
Accumulated other comprehensive loss	(103,809)	(87,020)

Total stockholders equity		4,578,566		4,394,741
Noncontrolling interest		3,674		7,151
Total equity		4,582,240		4,401,892
Total liabilities and equity	$	8,412,045	$	8,482,390

See accompanying notes to Condensed Consolidated Financial Statements.

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AVALONBAY COMMUNITIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(Dollars in thousands, except per share data)

	For the three months ended		For the six months ended	
	6-30-12	6-30-11	6-30-12	6-30-11
Revenue:				
Rental and other income	$ 256,035	$ 233,249	$ 504,052	$ 457,652
Management, development and other fees	2,770	2,332	5,319	4,652
Total revenue	258,805	235,581	509,371	462,304
Expenses:				
Operating expenses, excluding property taxes	68,972	63,951	134,471	127,274
Property taxes	25,182	23,266	49,457	47,167
Interest expense, net	33,193	44,544	66,819	87,515
Loss on extinguishment of debt, net			1,179	
Depreciation expense	64,875	60,836	127,436	120,059
General and administrative expense	8,316	8,145	18,026	15,437
Total expenses	200,538	200,742	397,388	397,452
Equity in income of unconsolidated entities	2,073	395	4,248	898
Gain on sale of land	280		280	
Income from continuing operations	60,620	35,234	116,511	65,750
Discontinued operations:				
Income from discontinued operations	1,152	283	2,870	303
Gain on sale of real estate assets	95,049	7,675	95,049	7,675
Total discontinued operations	96,201	7,958	97,919	7,978
Net income	156,821	43,192	214,430	73,728
Net (income) loss attributable to noncontrolling interests	88	181	237	(15)
Net income attributable to common stockholders	$ 156,909	$ 43,373	$ 214,667	$ 73,713
Other comprehensive income:				
Unrealized loss on cash flow hedges	(27,798)	(19,336)	(16,789)	(19,420)
Comprehensive income	$ 129,111	$ 24,037	$ 197,878	$ 54,293
Earnings per common share - basic:				
Income from continuing operations attributable to common stockholders	$ 0.63	$ 0.41	$ 1.22	$ 0.76
Discontinued operations attributable to common stockholders	1.01	0.09	1.03	0.09
	$ 1.64	$ 0.50	$ 2.25	$ 0.85

Net income attributable to common stockholders								
Earnings per common share - diluted:								
Income from continuing operations attributable to common stockholders	$	0.63	$	0.40	$	1.22	$	0.75
Discontinued operations attributable to common stockholders		1.00		0.09		1.02		0.09
Net income attributable to common stockholders	$	1.63	$	0.49	$	2.24	$	0.84
Dividends per common share:	$	0.9700	$	0.8925	$	1.9400	$	1.7850

See accompanying notes to Condensed Consolidated Financial Statements.

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AVALONBAY COMMUNITIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(Dollars in thousands)

	For the six months ended	
	6-30-12	**6-30-11**
Net income	$ 214,430	$ 73,728
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation expense	127,436	120,059
Depreciation expense from discontinued operations	895	4,160
Amortization of deferred financing costs and debt premium/discount	3,040	3,485
Amortization of stock-based compensation	4,268	3,262
Loss on extinguishment of debt	1,781	
Equity in (income) loss of unconsolidated entities and noncontrolling interests, net of eliminations	(3,182)	421
Gain on sale of real estate assets	(95,329)	(7,675)
Expensed acquisition costs	163	958
Increase in cash in operating escrows	(1,988)	(1,144)
Increase in resident security deposits, prepaid expenses and other assets	(20,895)	(9,943)
Increase (decrease) in accrued expenses, other liabilities and accrued interest payable	(8,151)	18,568
Net cash provided by operating activities	222,468	205,879
Cash flows from investing activities:		
Development/redevelopment of real estate assets including land acquisitions and deferred development costs	(341,144)	(266,374)
Acquisition of real estate assets	(37,105)	(46,275)
Capital expenditures - existing real estate assets	(6,606)	(7,765)
Capital expenditures - non-real estate assets	(588)	(7,748)
Proceeds from exchange/sale of real estate, net of selling costs	182,225	22,371
Increase (decrease) in payables for construction	6,582	(612)
Decrease in cash in construction escrows	1,697	10,917
Decrease in investments in unconsolidated real estate entities	2,188	2,458
Net cash used in investing activities	(192,751)	(293,028)
Cash flows from financing activities:		
Issuance of common stock	175,682	264,134
Dividends paid	(177,322)	(154,382)
Repayments of mortgage notes payable	(103,621)	(31,963)
Repayment of unsecured notes	(179,400)	
Payment of deferred financing costs	(123)	(252)
Acquisition of joint venture partner equity interest	(3,350)	(6,570)
Distributions to DownREIT partnership unitholders	(15)	(13)
Distributions to joint venture and profit-sharing partners	(158)	(127)
Net cash (used in) provided by financing activities	(288,307)	70,827
Net decrease in cash and cash equivalents	(258,590)	(16,322)
Cash and cash equivalents, beginning of period	616,853	306,426

Cash and cash equivalents, end of period	$	358,263	$	290,104
Cash paid during the period for interest, net of amount capitalized	$	62,012	$	76,315

See accompanying notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

Supplemental disclosures of non-cash investing and financing activities (amounts in whole dollars):

During the six months ended June 30, 2012:

- As described in Note 4, Equity, 95,941 shares of common stock valued at $12,786,000 were issued in connection with stock grants; 1,336 shares valued at $180,000 were issued through the Company s dividend reinvestment plan; 120,078 shares valued at $15,458,000 were withheld to satisfy employees tax withholding and other liabilities; and 7,558 shares and options valued at $393,000 previously issued in connection with employee compensation were cancelled upon forfeiture. In addition, the Company granted 113,804 options for common stock at a value of $3,306,000.

- The Company recorded an increase to other liabilities and a corresponding decrease to other comprehensive income of $16,789,000; and recorded a decrease to prepaid expenses and other assets of $11,000, with a corresponding offset to the basis of unsecured notes, net to record the impact of the Company s hedge accounting activity.

- Common dividends declared but not paid totaled $93,698,000.

- The Company recorded an increase of $521,000 in redeemable noncontrolling interests with a corresponding decrease to accumulated earnings less dividends to adjust the redemption value associated with the put option held by a joint venture partner and DownREIT partnership units. For further discussion of the nature and valuation of these items, see Note 10, Fair Value .

- The Company assumed a 4.61% coupon fixed rate mortgage loan with an outstanding balance of $11,958,000 in conjunction with the acquisition of The Mark Pasadena.

During the six months ended June 30, 2011:

- 498,810 shares of common stock valued at $63,061,000 were issued in connection with stock grants primarily associated with the Company s 2008 deferred stock performance plan; 1,809 shares valued at $212,000 were issued through the Company s dividend reinvestment plan; 126,928 shares valued at $14,825,000 were withheld to satisfy employees tax withholding and other liabilities; and 505 shares valued at $16,000 were forfeited. In addition, the Company granted 144,827 options for common stock at a value of $4,258,000.

- 7,500 units of limited partnership, valued at $365,000 were presented for redemption to the DownREIT partnerships that issued such units and were acquired by the Company in exchange for an equal number of shares of the Company s common stock.

- The Company recorded an increase to other liabilities and a corresponding decrease to other comprehensive income of $19,420,000 and recorded an increase to prepaid expenses and other assets of $863,000, with a corresponding offset to the basis of unsecured notes, net to record the impact of the Company s hedge accounting activity.

- Common dividends declared but not paid totaled $79,157,000.

- The Company recorded an increase of $1,218,000 in redeemable noncontrolling interests with a corresponding decrease to accumulated earnings less dividends to adjust the redemption value associated with the put options held by joint venture partners and DownREIT partnership units.

- The Company repaid all amounts due under a $93,440,000 variable-rate, tax-exempt bond financing using the proceeds which were held in escrow.

- The Company assumed a 4.75% coupon fixed-rate mortgage loan with an outstanding balance of $44,044,000 in conjunction with the acquisition of Fairfax Towers.

- As part of an asset exchange in April 2011, the Company assumed a $55,400,000 fixed-rate mortgage loan with a 5.24% interest rate and relinquished a $55,800,000 mortgage loan with a 5.86% fixed rate.

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AVALONBAY COMMUNITIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Organization, Basis of Presentation and Significant Accounting Policies

Organization and Basis of Presentation

AvalonBay Communities, Inc. (the Company, which term, unless the context otherwise requires, refers to AvalonBay Communities, Inc. together with its consolidated subsidiaries), is a Maryland corporation that elected to be taxed as a real estate investment trust (REIT) under the Internal Revenue Code of 1986 (the Code). The Company focuses on the development, acquisition, ownership and operation of apartment communities in high barrier to entry markets of the United States. These markets are located in the New England, Metro New York/New Jersey, Mid-Atlantic, Pacific Northwest, and Northern and Southern California regions of the country.

At June 30, 2012, the Company owned or held a direct or indirect ownership interest in 181 operating apartment communities containing 53,144 apartment homes in nine states and the District of Columbia, of which 11 communities containing 2,721 apartment homes were under reconstruction. In addition, the Company owned or held a direct or indirect ownership interest in 20 communities under construction that are expected to contain an aggregate of 6,114 apartment homes when completed. The Company also owned or held a direct or indirect ownership interest in land or rights to land in which the Company expects to develop an additional 33 communities that, if developed as expected, will contain an estimated 9,036 apartment homes.

The interim unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and in conjunction with the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements required by GAAP have been condensed or omitted pursuant to such rules and regulations. These unaudited financial statements should be read in conjunction with the financial statements and notes included in the Company s 2011 Annual Report on Form 10-K. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the operating results for the full year. Management believes the disclosures are adequate to ensure the information presented is not misleading. In the opinion of management, all adjustments and eliminations, consisting only of normal, recurring adjustments necessary for a fair presentation of the financial statements for the interim periods, have been included.

Capitalized terms used without definition have the meaning as provided elsewhere in this Form 10-Q.

Earnings per Common Share

Basic earnings per share is computed by dividing net income attributable to common stockholders by the weighted average number of shares outstanding during the period. All outstanding unvested restricted share awards contain rights to non-forfeitable dividends and participate in undistributed earnings with common shareholders and, accordingly, are considered participating securities that are included in the two-class method of computing basic earnings per share (EPS). Both the unvested restricted shares and other potentially dilutive common shares, and the related impact to earnings, are considered when calculating earnings per share on a diluted basis. The Company s earnings per common share are determined as follows (dollars in thousands, except per share data):

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	For the three months ended		For the six months ended	
	6-30-12	6-30-11	6-30-12	6-30-11
Basic and diluted shares outstanding				
Weighted average common shares - basic	95,308,163	87,317,602	95,082,172	86,746,992
Weighted average DownREIT units outstanding	7,500	7,707	7,500	8,992
Effect of dilutive securities	677,162	871,129	730,531	841,997
Weighted average common shares - diluted	95,992,825	88,196,438	95,820,203	87,597,981
Calculation of Earnings per Share - basic				
Net income attributable to common stockholders	$ 156,909	$ 43,373	$ 214,667	$ 73,713
Net income allocated to unvested restricted shares	(547)	(123)	(845)	(206)
Net income attributable to common stockholders, adjusted	$ 156,362	$ 43,250	$ 213,822	$ 73,507
Weighted average common shares - basic	95,308,163	87,317,602	95,082,172	86,746,992
Earnings per common share - basic	$ 1.64	$ 0.50	$ 2.25	$ 0.85
Calculation of Earnings per Share - diluted				
Net income attributable to common stockholders	$ 156,909	$ 43,373	$ 214,667	$ 73,713
Add: noncontrolling interests of DownREIT unitholders in consolidated partnerships, including discontinued operations	7	7	13	13
Adjusted net income attributable to common stockholders	$ 156,916	$ 43,380	$ 214,680	$ 73,726
Weighted average common shares - diluted	95,992,825	88,196,438	95,820,203	87,597,981
Earnings per common share - diluted	$ 1.63	$ 0.49	$ 2.24	$ 0.84

Certain options to purchase shares of common stock in the amounts of 424,357 and 320,698 were outstanding at June 30, 2012 and 2011, respectively, but were not included in the computation of diluted earnings per share because such options were anti-dilutive.

The Company is required to estimate the forfeiture of stock options and recognize compensation cost net of the estimated forfeitures. The estimated forfeitures included in compensation cost are adjusted to reflect actual forfeitures at the end of the vesting period. The forfeiture rate at June 30, 2012 is based on the average forfeiture activity over a period equal to the estimated life of the stock options, and was 0.3%. The application of estimated forfeitures did not materially impact compensation expense for the three and six months ended June 30, 2012 or 2011.

Derivative Instruments and Hedging Activities

The Company enters into interest rate swap and interest rate cap agreements (collectively, the Hedging Derivatives) for interest rate risk management purposes and in conjunction with certain variable rate secured debt to satisfy lender requirements. The Company does not enter into derivative transactions for trading or other speculative purposes. The Company assesses both at inception and on an on-going basis, the effectiveness of qualifying cash flow and fair value hedges. Hedge ineffectiveness is reported as a component of general and administrative expenses. The fair values of the Hedging Derivatives that are in an asset position are recorded in prepaid expenses and other assets. The fair value of the Hedging Derivatives that are in a liability position are included in accrued expenses and other liabilities. Fair value changes for derivatives that are not in qualifying hedge relationships are reported as a component of general and administrative expenses. For the derivative positions that the Company has determined qualify as effective cash flow hedges, the Company has recorded the effective portion of cumulative changes in the fair value of the Hedging Derivatives in other comprehensive income. Amounts recorded in other comprehensive income will be reclassified into earnings in the periods in which earnings are affected by the hedged cash flow. The effective portion of the change in fair value of the Hedging Derivatives that the Company has determined qualified as effective fair value hedges is reported as an adjustment to the carrying amount of the corresponding debt being hedged.

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Legal and Other Contingencies

The Company accounts for recoveries from legal matters as a reduction in the legal and related costs incurred associated with the matter, with recoveries in excess of these costs reported as a gain or, where appropriate, a reduction in the basis of a community to which the suit related.

The Company is involved in various claims and/or administrative proceedings that arise in the ordinary course of the Company s business. While no assurances can be given, the Company does not believe that any of these outstanding litigation matters, individually or in the aggregate, will have a material adverse effect on the Company s financial position or results of operations.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to amounts in prior period financial statements to conform to current period presentations.

2. Interest Capitalized

The Company capitalizes interest during the development and redevelopment of real estate assets. Capitalized interest associated with the Company s development or redevelopment activities totaled $12,625,000 and $7,673,000 for the three months ended June 30, 2012 and 2011, respectively, and $24,945,000 and $14,016,000 for the six months ended June 30, 2012 and 2011, respectively.

3. Notes Payable, Unsecured Notes and Credit Facility

The Company s mortgage notes payable, unsecured notes and Credit Facility, as defined below, as of June 30, 2012 and December 31, 2011, are summarized below (dollars in thousands). The following amounts and discussion do not include the mortgage notes related to the communities classified as held for sale, if any, as of June 30, 2012 and December 31, 2011, as shown in the Condensed Consolidated Balance Sheets (see Note 6, Real Estate Disposition Activities).

	6-30-12	12-31-11
Fixed rate unsecured notes (1)	$ 1,451,601	$ 1,556,001
Variable rate unsecured notes (1)		75,000
Fixed rate mortgage notes payable - conventional and tax-exempt (2)	1,534,037	1,528,783
Variable rate mortgage notes payable - conventional and tax-exempt	376,935	440,241
Total notes payable and unsecured notes	3,362,573	3,600,025
Credit Facility		
Total mortgage notes payable, unsecured notes and Credit Facility	$ 3,362,573	$ 3,600,025

(1) Balances at June 30, 2012 and December 31, 2011 exclude $1,553 and $1,802, respectively, of debt discount, and $0 and $11, respectively, for basis adjustments, as reflected in unsecured notes on the Company s Condensed Consolidated Balance Sheets.

(2) Balances at June 30, 2012 and December 31, 2011 exclude $1,344 and $962, respectively of debt premium as reflected in mortgage notes payable on the Company s Condensed Consolidated Balance Sheets.

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The following debt activity occurred during the six months ended June 30, 2012:

- In January 2012, the Company repaid $179,400,000 principal amount of its 5.5% coupon unsecured notes pursuant to their scheduled maturity.

- In February 2012, in conjunction with the acquisition of a community, the Company assumed the existing 4.61% mortgage note in the amount of $11,958,000 that matures in June 2018, and is secured by the community.

- Also in February 2012, the Company repaid a variable rate secured mortgage note in the amount of $48,500,000 in advance of its November 2039 scheduled maturity date. In conjunction with the early retirement the Company incurred a non-cash charge of $1,179,000 for the write off of deferred financing fees which was recognized as a loss on extinguishment of debt.

- In May 2012, the Company repaid a variable rate secured mortgage note in the amount of $14,566,000 in accordance with its scheduled maturity date.

- Also in May 2012 in conjunction with the disposition of an operating community, the Company repaid a variable rate secured mortgage note in the amount of $33,100,000 in advance of its scheduled maturity date. The Company incurred a charge of $602,000 for a prepayment penalty and the write off of deferred financing fees associated with the early repayment of this note.

The Company has a variable rate unsecured credit facility (the Credit Facility) with a syndicate of commercial banks, which has an available borrowing capacity of $750,000,000 and a 4-year term, plus a one year extension option. The Credit Facility was entered into in September 2011 and it bears interest at varying levels based on the London InterBank Offered Rate (LIBOR), rating levels achieved on the Company s unsecured notes and on a maturity schedule selected by the Company. The current stated pricing is LIBOR plus 1.075% per annum (1.32% at June 30, 2012). The Company did not have any borrowings outstanding under the Credit Facility and had $45,975,000 and $52,659,000 outstanding in letters of credit that reduced the borrowing capacity as of June 30, 2012 and December 31, 2011, respectively.

In the aggregate, secured notes payable mature at various dates from April 2013 through July 2066, and are secured by certain apartment communities and improved land parcels (with a net carrying value of $1,535,159,000 as of June 30, 2012).

As of June 30, 2012, the Company has guaranteed approximately $179,777,000 of mortgage notes payable held by wholly owned subsidiaries; all such mortgage notes payable are consolidated for financial reporting purposes. The weighted average interest rate of the Company s fixed rate mortgage notes payable (conventional and tax-exempt) was 5.7% both at June 30, 2012 and at December 31, 2011. The weighted average interest rate of the Company s variable rate mortgage notes payable and its Credit Facility, including the effect of certain financing related fees, was 2.6% at June 30, 2012 and 2.3% at December 31, 2011.

Scheduled payments and maturities of mortgage notes payable and unsecured notes outstanding at June 30, 2012 are as follows (dollars in thousands):

	Secured	Secured	Unsecured	Stated interest rate

Year	notes payments (1)	notes maturities	notes maturities	of unsecured notes
2012	$ 6,966	$	$ 201,601	6.125%
2013	13,376	223,473	100,000	4.950%
2014	14,284		150,000	5.375%
2015	12,170	406,019		
2016	12,807		250,000	5.750%
2017	13,709	18,300	250,000	5.700%
2018	14,330	11,073		
2019	2,597	610,813		
2020	2,768		250,000	6.100%
2021	2,952		250,000	3.950%
Thereafter	86,700	458,635		
	$ 182,659	$ 1,728,313	$ 1,451,601	

(1) Secured note payments are comprised of the principal pay downs for amortizing mortgage notes.

The Company was in compliance at June 30, 2012 with certain customary financial and other covenants under the Credit Facility and the Company s unsecured notes.

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4. Equity

The following summarizes the changes in stockholders equity for the six months ended June 30, 2012 (dollars in thousands):

	Common stock	Additional paid-in capital	Accumulated earnings less dividends	Accumulated other comprehensive loss	Total AvalonBay stockholders equity	Noncontrolling interests	Total equity
Balance at December 31, 2011	$ 952	$ 4,652,457	$ (171,648)	$ (87,020)	$ 4,394,741	$ 7,151	$ 4,401,892
Net income attributable to common stockholders			214,667		214,667		214,667
Unrealized loss on cash flow hedges				(16,789)	(16,789)		(16,789)
Change in redemption value of redeemable noncontrolling interest			(521)		(521)		(521)
Noncontrolling interests						(3,477)	(3,477)
Dividends declared to common stockholders			(186,170)		(186,170)		(186,170)
Issuance of common stock, net of withholdings	14	162,448	(2,249)		160,213		160,213
Amortization of deferred compensation		12,425			12,425		12,425
Balance at June 30, 2012	$ 966	$ 4,827,330	$ (145,921)	$ (103,809)	$ 4,578,566	$ 3,674	$ 4,582,240

During the six months ended June 30, 2012, the Company:

(i) issued 1,119,892 shares of common stock through public offerings under CEP II, discussed below;

(ii) issued 318,175 shares of common stock in connection with stock options exercised;

(iii) issued 1,336 common shares through the Company s dividend reinvestment plan;

(iv) issued 95,941 common shares in connection with stock grants;

(v) withheld 120,078 common shares to satisfy employees tax withholding and other liabilities; and

(vi) cancelled 4,027 shares of restricted common stock upon forfeiture.

In addition, the Company granted 113,804 options for common stock to employees. Any deferred compensation related to the Company s stock option and restricted stock grants during the six months ended June 30, 2012 is not reflected on the Company s Condensed Consolidated Balance Sheet as of June 30, 2012, and will not be reflected until earned as compensation cost.

In November 2010, the Company commenced a second continuous equity program (CEP II), under which the Company was authorized to sell up to $500,000,000 of its common stock from time to time during a 36-month period. During the three and six months ended June 30, 2012, the Company sold 1,119,892 shares at an average sales price of $140.14 per share, for net proceeds of $154,588,000. The Company completed CEP II in July 2012, see Note 11, Subsequent Events .

5. Investments in Real Estate Entities

Investments in consolidated entities

In June 2012, the Company acquired Eaves Cerritos, located in Artesia, CA. Eaves Cerritos contains 151 apartment homes and was acquired for a purchase price of $29,500,000.

The Company accounted for the acquisition of Eaves Cerritos as a business combination and allocated the purchase price to the acquired assets and assumed liabilities, including identifiable intangibles, based on their fair values. The Company looked to third party pricing for the value of the land, and an internal model to determine the fair value of the real estate assets and in place leases. Given the heterogeneous nature of multi-family real estate, the fair values for the land, real estate assets and in place leases incorporated significant unobservable inputs and therefore are considered to be Level 3 prices within the fair value hierarchy.

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Investment in unconsolidated entities

As of June 30, 2012, the Company had investments in five unconsolidated real estate entities with ownership interest percentages ranging from 15.2% to 31.3%. The Company accounts for its investments in unconsolidated real estate entities under the equity method of accounting, except as otherwise noted below. The significant accounting policies of the Company s unconsolidated real estate entities are consistent with those of the Company in all material respects.

During the three months ended June 30, 2012, AvalonBay Value Added Fund I, LP (Fund I) sold Avalon Lombard, located in Chicago, IL, containing 256 apartment homes for $35,450,000. The Company s proportionate share of the aggregate gain in accordance with GAAP was $385,000.

There were no other changes in the Company s ownership interest in, or presentation of, its investments in unconsolidated real estate entities during the three months ended June 30, 2012.

The following is a combined summary of the financial position of the entities accounted for using the equity method, as of the dates presented (dollars in thousands):

	6-30-12 (unaudited)	12-31-11 (unaudited)
Assets:		
Real estate, net	$ 1,544,617	$ 1,583,397
Other assets	84,127	70,233
Total assets	$ 1,628,744	$ 1,653,630
Liabilities and partners capital:		
Mortgage notes payable and credit facility	$ 1,077,716	$ 1,074,429
Other liabilities	22,320	27,335
Partners capital	528,708	551,866
Total liabilities and partners capital	$ 1,628,744	$ 1,653,630

The following is a combined summary of the operating results of the entities accounted for using the equity method, for the periods presented (dollars in thousands):

	For the three months ended (unaudited)		For the six months ended (unaudited)	
	6-30-12	6-30-11	6-30-12	6-30-11
Rental and other income	$ 44,505	$ 38,632	$ 87,132	$ 76,454
	(19,131)	(17,090)	(37,800)	(34,644)

Operating and other expenses								
Gain on sale of communities		3,825				12,735		
Interest expense, net		(12,659)		(12,478)		(25,726)		(24,779)
Depreciation expense		(12,597)		(11,737)		(25,297)		(23,339)
Net income (loss)	$	3,943	$	(2,673)	$	11,044	$	(6,308)

In conjunction with the formation of Fund I and AvalonBay Value Added Fund II, L.P. (Fund II), as well as the acquisition and development of certain other investments in unconsolidated entities, the Company incurred costs in excess of its equity in the underlying net assets of the respective investments. These costs represent $8,389,000 at June 30, 2012 and $9,167,000 at December 31, 2011 of the respective investment balances.

As part of the formation of Fund I and Fund II, the Company provided separate and distinct guarantees to one of the limited partners in each of the ventures. These guarantees are specific to the respective fund and any impacts or obligation of the Company to perform under one of the guarantees has no impact on the Company s obligations with respect to the other guarantee. The guarantees provide that, if, upon final liquidation of Fund I or Fund II, the total amount of all distributions to the guaranteed partner during the life of the respective fund (whether from operating cash flow or property sales) does not equal the total capital contributions made by that partner, then the Company will pay

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the guaranteed partner an amount equal to the shortfall, but in no event more than 10% of the total capital contributions made by the guaranteed partner (maximum of approximately $7,500,000 for Fund I and approximately $8,910,000 for Fund II as of June 30, 2012). As of June 30, 2012, the expected realizable values of the real estate assets owned by Fund I and Fund II are considered adequate to cover such potential payments under a liquidation scenario. The estimated fair value of, and the Company s obligation under these guarantees, both at inception and as of June 30, 2012, was not significant and therefore the Company has not recorded any obligation for either of these guarantees as of June 30, 2012.

Abandoned Pursuit Costs and Impairment of Long-Lived Assets

The Company capitalizes pre-development costs incurred in pursuit of new development opportunities for which the Company currently believes future development is probable (Development Rights). Future development of these Development Rights is dependent upon various factors, including zoning and regulatory approval, rental market conditions, construction costs and the availability of capital. Initial pre-development costs incurred for pursuits for which future development is not yet considered probable are expensed as incurred. In addition, if the status of a Development Right changes, making future development by the Company no longer probable, any capitalized pre-development costs are written off with a charge to expense. The Company expensed costs related to abandoned pursuits, which includes the abandonment of Development Rights as well as costs incurred in pursuing the acquisition or disposition of assets for which such transactional activity did not occur, in the amounts of $820,000 and $395,000 for the three months ended June 30, 2012 and 2011, respectively, and $968,000 and $1,045,000 for the six months ended June 30, 2012 and 2011, respectively. These costs are included in operating expenses, excluding property taxes on the accompanying Condensed Consolidated Statements of Comprehensive Income. Abandoned pursuit costs can vary greatly, and the costs incurred in any given period may be significantly different in future periods.

The Company evaluates its real estate and other long-lived assets for impairment when potential indicators of impairment exist. Such assets are stated at cost, less accumulated depreciation and amortization, unless the carrying amount of the asset is not recoverable. If events or circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the Company assesses its recoverability by comparing the carrying amount of the long-lived asset to its estimated undiscounted future cash flows. If the carrying amount exceeds the aggregate undiscounted future cash flows, the Company recognizes an impairment loss to the extent the carrying amount exceeds the estimated fair value of the long-lived asset. Based on periodic tests of recoverability of long-lived assets, the Company did not record any impairment losses for the three and six months ended June 30, 2012 and 2011.

The Company assesses its portfolio of land held for development and for investment for impairment if the intent of the Company changes with respect to either the development of, or the expected holding period for the land. The Company did not recognize any impairment charges on its investment in land for the three and six months ended June 30, 2012 and 2011.

The Company also evaluates its unconsolidated investments for impairment, considering both its carrying value of the investment, estimated as the expected proceeds that it would receive if the entity were dissolved and the net assets were liquidated at their current GAAP basis, as well as the Company s proportionate share of any impairment of assets held by unconsolidated investments. There were no impairment losses recognized by any of the Company s investments in unconsolidated entities during the three and six months ended June 30, 2012 and 2011.

6. Real Estate Disposition Activities

During the three months ended June 30, 2012, the Company sold two communities: Waterford, located in Oakland, CA and Arlington Heights, located in Chicago, IL. These communities, containing a total of 953 apartment homes, were sold for an aggregate price of $173,750,000. The dispositions resulted in an aggregate gain in accordance with GAAP of $95,049,000.

The Company sold one unimproved land parcel in Chicago, IL, for $12,300,000, resulting in an aggregate gain in accordance with GAAP of $280,000. The Company recorded impairment charges of approximately $16,363,000 related to this asset in prior years when it was determined that the site would not be developed.

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As of June 30, 2012, the Company did not have any real estate assets that qualified as held for sale.

The operations for any real estate assets sold from January 1, 2011 through June 30, 2012 have been presented as income from discontinued operations in the accompanying Condensed Consolidated Statements of Comprehensive Income. Accordingly, certain reclassifications have been made to prior years to reflect discontinued operations consistent with current year presentation.

The following is a summary of income from discontinued operations for the periods presented (dollars in thousands):

	For the three months ended (unaudited)		For the six months ended (unaudited)	
	6-30-12	6-30-11	6-30-12	6-30-11
Rental income	$ 3,065	$ 9,278	$ 6,986	$ 18,363
Operating and other expenses	(1,114)	(5,600)	(2,486)	(11,289)
Interest expense, net	(53)	(1,311)	(133)	(2,611)
Loss on extinguishment of debt	(602)		(602)	
Depreciation expense	(144)	(2,084)	(895)	(4,160)
Income from discontinued operations	$ 1,152	$ 283	$ 2,870	$ 303

7. Segment Reporting

The Company s reportable operating segments include Established Communities, Other Stabilized Communities, and Development/Redevelopment Communities. Annually as of January 1st, the Company determines which of its communities fall into each of these categories and unless disposition or redevelopment plans regarding a community change, maintains that classification throughout the year for the purpose of reporting segment operations.

In addition, the Company owns land for future development and has other corporate assets that are not allocated to an operating segment.

The Company s segment disclosures present the measure(s) used by the chief operating decision maker for purposes of assessing each segments performance. The Company s chief operating decision maker is comprised of several members of its executive management team who use net operating income (NOI) as the primary financial measure for Established Communities and Other Stabilized Communities. NOI is defined by the Company as total revenue less direct property operating expenses. Although the Company considers NOI a useful measure of a community s or communities operating performance, NOI should not be considered an alternative to net income or net cash flow from operating activities, as determined in accordance with GAAP. NOI excludes a number of income and expense categories as detailed in the reconciliation of NOI to net income.

A reconciliation of NOI to net income for the three and six months ended June 30, 2012 and 2011 is as follows (dollars in thousands):

	For the three months ended		For the six months ended	
	6-30-12	6-30-11	6-30-12	6-30-11
Net income	$ 156,821	$ 43,192	$ 214,430	$ 73,728
Indirect operating expenses, net of corporate income	8,617	7,701	16,653	14,729
Investments and investment management expense	1,499	1,341	2,945	2,532
Expensed development and other pursuit costs	901	1,353	1,141	2,003
Interest expense, net	33,193	44,544	66,819	87,515
Loss on extinguishment of debt, net			1,179	
General and administrative expense	8,316	8,145	18,026	15,437
Equity in income of unconsolidated entities	(2,073)	(395)	(4,248)	(898)
Depreciation expense	64,875	60,836	127,436	120,059
Gain on sale of real estate assets	(95,329)	(7,675)	(95,329)	(7,675)
Income from discontinued operations	(1,152)	(283)	(2,870)	(303)
Net operating income	$ 175,668	$ 158,759	$ 346,182	$ 307,127

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The primary performance measure for communities under development or redevelopment depends on the stage of completion. While under development, management monitors actual construction costs against budgeted costs as well as lease-up pace and rent levels compared to budget.

The following table provides details of the Company s segment information as of the dates specified (dollars in thousands). The segments are classified based on the individual community s status as of the beginning of the given calendar year. Therefore, each year the composition of communities within each business segment is adjusted. Accordingly, the amounts between years are not directly comparable. Segment information for the three and six months ended June 30, 2012 and 2011 have been adjusted for the real estate assets that were sold from January 1, 2011 through June 30, 2012, or otherwise qualify as discontinued operations as of June 30, 2012, as described in Note 6, Real Estate Disposition Activities.

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	For the three months ended			For the six months ended			
	Total revenue	NOI	% NOI change from prior year	Total revenue	NOI	% NOI change from prior year	Gross real estate (1)
For the period ended June 30, 2012							
Established							
New England	$ 41,736	$ 27,263	5.7%	$ 82,812	$ 53,894	7.2%	$ 1,285,318
Metro NY/NJ	58,169	40,637	6.3%	115,388	80,228	8.0%	1,962,950
Mid-Atlantic	25,829	18,722	2.4%	51,525	37,538	4.4%	591,284
Pacific Northwest	8,119	5,651	9.5%	16,024	11,223	10.7%	303,343
Northern California	31,918	23,235	12.8%	63,030	46,028	14.1%	1,180,167
Southern California	24,508	17,023	8.5%	48,869	34,002	10.2%	946,376
Total Established	190,279	132,531	7.1%	377,648	262,913	8.7%	6,269,438
Other Stabilized	36,194	23,244	N/A	70,979	45,949	N/A	1,274,461
Development / Redevelopment	29,562	19,893	N/A	55,425	37,320	N/A	1,656,545
Land Held for Future Development	N/A	N/A	N/A	N/A	N/A	N/A	294,116
Non-allocated (2)	2,770	N/A	N/A	5,319	N/A	N/A	59,043
Total	$ 258,805	$ 175,668	10.7%	$ 509,371	$ 346,182	12.7%	$ 9,553,603
For the period ended June 30, 2011							
Established							
New England	$ 42,083	$ 27,006	10.5%	$ 83,110	$ 52,488	8.6%	$ 1,297,280
Metro NY/NJ	48,501	33,153	6.4%	96,191	64,712	5.9%	1,530,426
Mid-Atlantic	25,600	18,711	6.3%	50,645	36,821	7.3%	601,967
Pacific Northwest	9,346	6,349	6.4%	18,475	12,489	3.6%	360,995
Northern California	23,451	16,993	10.0%	46,277	33,201	7.7%	867,520
Southern California	18,568	12,393	8.7%	36,962	24,348	5.2%	695,220
Total Established	167,549	114,605	8.1%	331,660	224,059	6.8%	5,353,408
Other Stabilized	34,461	22,272	N/A	66,032	42,296	N/A	1,578,605
Development / Redevelopment	31,239	21,882	N/A	59,960	40,772	N/A	1,459,969
Land Held for Future Development	N/A	N/A	N/A	N/A	N/A	N/A	225,896
Non-allocated (2)	2,332	N/A	N/A	4,652	N/A	N/A	68,827
Total	$ 235,581	$ 158,759	15.4%	$ 462,304	$ 307,127	13.4%	$ 8,686,705

(1) Does not include gross real estate assets held for sale of $0 and $269,542 as of June 30, 2012 and 2011, respectively.

(2) Revenue represents third party management, asset management and developer fees and miscellaneous income which are not allocated to a reportable segment.

8. Stock-Based Compensation Plans

Information with respect to stock options granted under the Company s 1994 Stock Option and Incentive Plan (the 1994 Plan) and its 2009 Stock Option and Incentive Plan (the 2009 Plan) are as follows (dollars in thousands, other than per share amounts):

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	2009 Plan	Weighted average exercise price	1994 Plan	Weighted average