

AVALONBAY COMMUNITIES INC

Form 10-Q

November 04, 2014

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 September 30, 2014

Commission file number 1-12672

AVALONBAY COMMUNITIES, INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

77-0404318

(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 ☒ No ☐

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 ☐ No ☐

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 ☒

Non-accelerated filer (Do not check if a smaller reporting company) ☐

Accelerated filer ☐

Smaller reporting company ☐

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ☐ No ☒

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:

132,008,021 shares of common stock, par value \$0.01 per share, were outstanding as of October 31, 2014

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AVALONBAY COMMUNITIES, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Dollars in thousands, except per share data)

	9/30/2014 (unaudited)	12/31/2013
ASSETS		
Real estate:		
Land	\$3,436,853	\$3,262,616
Buildings and improvements	12,098,294	11,059,001
Furniture, fixtures and equipment	388,566	340,461
	15,923,713	14,662,078
Less accumulated depreciation	(2,799,679)	(2,476,729)
Net operating real estate	13,124,034	12,185,349
Construction in progress, including land	1,343,157	1,582,906
Land held for development	176,484	300,364
Operating real estate assets held for sale, net	80,624	215,590
Total real estate, net	14,724,299	14,284,209
Cash and cash equivalents	440,028	281,355
Cash in escrow	95,664	98,564
Resident security deposits	29,604	26,672
Investments in unconsolidated real estate entities	304,795	367,866
Deferred financing costs, net	39,329	40,677
Deferred development costs	36,945	31,592
Prepaid expenses and other assets	210,514	197,208
Total assets	\$15,881,178	\$15,328,143
LIABILITIES AND EQUITY		
Unsecured notes, net	\$2,695,299	\$2,594,709
Variable rate unsecured credit facility	—	—
Mortgage notes payable	3,546,469	3,539,642
Dividends payable	153,125	138,476
Payables for construction	98,095	94,632
Accrued expenses and other liabilities	250,440	240,606
Accrued interest payable	28,857	43,175
Resident security deposits	49,425	44,823
Liabilities related to real estate assets held for sale	1,590	15,033
Total liabilities	6,823,300	6,711,096
Redeemable noncontrolling interests	12,596	17,320
Equity:		
Preferred stock, \$0.01 par value; \$25 liquidation preference; 50,000,000 shares authorized at both September 30, 2014 and December 31, 2013; zero shares issued and outstanding at both September 30, 2014 and December 31, 2013	—	—
Common stock, \$0.01 par value; 280,000,000 shares authorized at both September 30, 2014 and December 31, 2013; 132,006,835 and 129,416,695 shares issued and	1,320	1,294

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outstanding at September 30, 2014 and December 31, 2013, respectively

Additional paid-in capital	9,344,198	8,988,723
Accumulated earnings less dividends	(256,162	) (345,254)
Accumulated other comprehensive loss	(44,074	) (48,631)
Total stockholders' equity	9,045,282	8,596,132
Noncontrolling interests	—	3,595
Total equity	9,045,282	8,599,727
Total liabilities and equity	\$ 15,881,178	\$ 15,328,143

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 nine months ended	
	9/30/2014	9/30/2013	9/30/2014	9/30/2013
Revenue:				
Rental and other income	\$428,022	\$386,175	\$1,236,154	\$1,060,554
Management, development and other fees	2,503	3,014	8,253	8,198
Total revenue	430,525	389,189	1,244,407	1,068,752
Expenses:				
Operating expenses, excluding property taxes	105,212	96,857	304,812	256,549
Property taxes	44,996	42,184	131,920	115,096
Interest expense, net	46,376	43,945	132,631	127,772
Loss on extinguishment of debt, net	—	—	412	—
Loss on interest rate contract	—	53,484	—	51,000
Depreciation expense	111,836	159,873	328,598	455,410
General and administrative expense	11,290	9,878	30,745	31,262
Expensed acquisition, development and other pursuit costs	406	2,176	3,139	46,041
Total expenses	320,116	408,397	932,257	1,083,130
Equity in income (loss) of unconsolidated real estate entities	130,592	3,260	143,527	(16,244)
Gain on sale of land	—	—	—	240
Gain on sale of communities	—	—	60,945	—
Income (loss) from continuing operations	241,001	(15,948)	516,622	(30,382)
Discontinued operations:				
Income from discontinued operations	—	5,063	310	12,890
Gain on sale of discontinued operations	—	—	37,869	118,173
Total discontinued operations	—	5,063	38,179	131,063
Net income (loss)	241,001	(10,885)	554,801	100,681
Net loss (income) attributable to noncontrolling interests	99	170	(13,872)	248
Net income (loss) attributable to common stockholders	\$241,100	\$(10,715)	\$540,929	\$100,929
Other comprehensive income:				
Cash flow hedge losses reclassified to earnings	1,546	54,948	4,557	57,913
Comprehensive income	\$242,646	\$44,233	\$545,486	\$158,842
Earnings per common share - basic:				
Income (loss) from continuing operations attributable to common stockholders	\$1.83	\$(0.12)	\$3.86	\$(0.24)
	—	0.04	0.29	1.04

Discontinued operations attributable to common stockholders

Net income (loss) attributable to common stockholders	\$ 1.83	\$(0.08	) \$4.15	\$0.80
Earnings per common share - diluted:				
Income (loss) from continuing operations attributable to common stockholders	\$ 1.83	\$(0.12	) \$3.85	\$(0.24)
Discontinued operations attributable to common stockholders	—	0.04	0.29	1.04
Net income (loss) attributable to common stockholders	\$ 1.83	\$(0.08	) \$4.14	\$0.80
Dividends per common share	\$ 1.16	\$ 1.07	\$3.48	\$3.21

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 nine months ended	
	9/30/2014	9/30/2013
Cash flows from operating activities:		
Net income	\$554,801	\$ 100,681
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation expense	328,598	455,410
Depreciation expense from discontinued operations	—	13,154
Amortization of deferred financing costs	4,763	5,067
Amortization of debt premium	(26,271)	(20,898)
Loss on extinguishment of debt, net	412	—
Amortization of stock-based compensation	10,354	8,720
Equity in (income) loss of, and return on, unconsolidated real estate entities and noncontrolling interests, net of eliminations	2,911	45,215
Abandonment of development pursuits	1,455	—
Cash flow hedge losses reclassified to earnings	4,557	57,913
Gain on sale of real estate assets	(98,814)	(118,413)
Gain on sale of joint venture real estate assets	(130,386)	(12,667)
Decrease (increase) in cash in operating escrows	771	(12,883)
Increase in resident security deposits, prepaid expenses and other assets	(12,808)	(66,709)
Increase in accrued expenses, other liabilities and accrued interest payable	1,086	15,333
Net cash provided by operating activities	641,429	469,923
Cash flows from investing activities:		
Development/redevelopment of real estate assets including land acquisitions and deferred development costs	(861,466)	(908,215)
Acquisition of real estate assets, including partnership interest	—	(749,275)
Capital expenditures - existing real estate assets	(33,324)	(10,527)
Capital expenditures - non-real estate assets	(5,776)	(7,286)
Proceeds from sale of real estate, net of selling costs	186,651	432,380
Mortgage note receivable repayment	21,748	—
Increase in payables for construction	3,463	31,124
Decrease in investments in unconsolidated real estate entities	192,209	16,788
Net cash used in investing activities	(496,495)	(1,195,011)
Cash flows from financing activities:		
Issuance of common stock	340,091	2,874
Dividends paid	(440,632)	(387,658)
Issuance of mortgage notes payable	53,000	71,210
Repayments of mortgage notes payable, including prepayment penalties	(28,718)	(1,789,399)
Settlement of interest rate contract	—	(51,000)
Issuance of unsecured notes	250,000	400,000
Repayment of unsecured notes	(150,000)	(100,000)
Payment of deferred financing costs	(3,414)	(6,093)
Acquisition of joint venture partner equity interest	—	(1,965)
Distributions to DownREIT partnership unitholders	(26)	(24)

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Distributions to joint venture and profit-sharing partners	(262) (238)
Redemption of preferred interest obligation	(6,300) (33,327)
Net cash provided by (used in) financing activities	13,739	(1,895,620)
Net increase (decrease) in cash and cash equivalents	158,673	(2,620,708)
Cash and cash equivalents, beginning of period	281,355	2,733,618	
Cash and cash equivalents, end of period	\$440,028	\$112,910	
Cash paid during the period for interest, net of amount capitalized	\$154,653	\$137,081	

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:

During the nine months ended September 30, 2014:

As described in Note 4, "Equity," 113,822 shares of common stock were issued as part of the Company's stock based compensation plan, of which 16,209 shares related to the conversion of restricted stock units to restricted shares, and the remaining 97,613 shares valued at \$12,605,000 were issued in connection with new stock grants; 1,868 shares valued at \$250,000 were issued through the Company's dividend reinvestment plan; 53,983 shares valued at \$4,701,000 were withheld to satisfy employees' tax withholding and other liabilities; and 200 restricted shares as well as restricted stock units with an aggregate value of \$1,826,000 previously issued in connection with employee compensation were canceled upon forfeiture.

Common dividends declared but not paid totaled \$153,125,000.

The Company recorded a decrease of \$4,088,000 in redeemable noncontrolling interest with a corresponding increase to accumulated earnings less dividends to adjust the redemption value associated with the put options held by joint venture partners and DownREIT partnership units. For further discussion of the nature and valuation of these items, see Note 11, "Fair Value."

The Company reclassified \$4,557,000 of cash flow hedge losses from other comprehensive income to interest expense, net, to record the impact of the Company's derivative and hedge accounting activity.

The Company derecognized \$17,816,000 in noncontrolling interest in conjunction with the deconsolidation of a Fund I subsidiary.

During the nine months ended September 30, 2013:

The Company issued 14,889,706 shares of common stock valued at \$1,875,210,000 as partial consideration for the Archstone Acquisition (as defined in this Form 10-Q); 123,977 shares of common stock valued at \$16,019,000 were issued in connection with stock grants; 1,465 shares valued at \$200,000 were issued through the Company's dividend reinvestment plan; 44,750 shares valued at \$5,706,000 were withheld to satisfy employees' tax withholding and other liabilities; and 5,214 shares and options valued at \$780,000 previously issued in connection with employee compensation were forfeited. In addition, the Company granted 215,230 options for common stock at a value of \$5,768,000.

The Company reclassified \$4,429,000 of deferred cash flow hedge losses from other comprehensive income to interest expense, net, and \$53,484,000 to loss on interest rate contract, to record the impact of the Company's derivative and hedge accounting activity.

Common dividends declared but not paid totaled \$138,459,000.

The Company recorded \$13,262,000 in redeemable noncontrolling interests associated with the acquisition of consolidated joint ventures as part of the Archstone Acquisition. The Company also recorded an increase of \$441,000 in redeemable noncontrolling interest 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.

- The Company assumed secured indebtedness with a principal amount of \$3,512,202,000 in conjunction with the Archstone Acquisition. The Company also assumed an obligation related to outstanding preferred interests of approximately \$67,500,000, included in accrued expenses and other liabilities.

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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 has 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 primarily in high barrier to entry markets of the United States. The Company’s primary markets are located in New England, the New York/New Jersey Metro area, the Mid-Atlantic, the Pacific Northwest and the Northern and Southern California regions of the United States.

At September 30, 2014, the Company owned or held a direct or indirect ownership interest in 247 operating apartment communities containing 73,182 apartment homes in 11 states and the District of Columbia, of which six communities containing 2,094 apartment homes were under reconstruction. In addition, the Company owned or held a direct or indirect ownership interest in 27 communities under construction that are expected to contain an aggregate of 9,151 apartment homes when completed. The Company also owned or held a direct or indirect ownership interest in land or rights to land on which the Company expects to develop an additional 39 communities that, if developed as expected, will contain an estimated 10,707 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 2013 Annual Report on Form 10-K. The results of operations for the three and nine months ended September 30, 2014 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 meanings 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 nine months ended	
	9/30/2014	9/30/2013	9/30/2014	9/30/2013
Basic and diluted shares outstanding				
Weighted average common shares - basic	131,330,078	129,208,839	130,165,873	126,057,793
Weighted average DownREIT units outstanding	7,500	7,500	7,500	7,500
Effect of dilutive securities (1)	568,417	—	554,627	411,821
Weighted average common shares - diluted	131,905,995	129,216,339	130,728,000	126,477,114
Calculation of Earnings per Share - basic				
Net income (loss) attributable to common stockholders	\$241,100	\$(10,715)	\$540,929	\$100,929
Net income (loss) allocated to unvested restricted shares	(366)	16	(858)	(166)
Net income (loss) attributable to common stockholders, adjusted	\$240,734	\$(10,699)	\$540,071	\$100,763
Weighted average common shares - basic	131,330,078	129,208,839	130,165,873	126,057,793
Earnings (loss) per common share - basic	\$1.83	\$(0.08)	\$4.15	\$0.80
Calculation of Earnings per Share - diluted				
Net income (loss) attributable to common stockholders	\$241,100	\$(10,715)	\$540,929	\$100,929
Add: noncontrolling interests of DownREIT unitholders in consolidated partnerships, including discontinued operations	9	8	26	24
Adjusted net income (loss) available to common stockholders	\$241,109	\$(10,707)	\$540,955	\$100,953
Weighted average common shares - diluted	131,905,995	129,216,339	130,728,000	126,477,114
Earnings (loss) per common share - diluted	\$1.83	\$(0.08)	\$4.14	\$0.80

(1) Securities considered antidilutive for the three months ended September 30, 2013 due to the Company's recognition of a net loss.

Certain options to purchase shares of common stock in the amounts of 1,499 and 605,899 were outstanding at September 30, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per share because such options were anti-dilutive for the respective quarters.

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 September 30, 2014 is based on the average forfeiture activity over a period equal to the estimated life of the stock options, and was 1.4%. The application of estimated forfeitures did not materially impact compensation expense for the three and nine months ended September 30, 2014 or 2013.

Derivative Instruments and Hedging Activities

The Company enters into interest rate swap and interest rate cap agreements (collectively, "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 Hedging Derivatives 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 Hedging Derivatives that are in an asset position are recorded in prepaid expenses and other assets. The fair value of 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 interest expense, net. For Hedging Derivatives that the Company has determined qualify as effective

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cash flow hedges, the Company has recorded the effective portion of cumulative changes in the fair value of 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 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.

Legal and Other Contingencies

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.

Acquisitions of Investments in Real Estate

The Company accounts for acquisitions of investments in real estate in accordance with the authoritative guidance for the initial measurement, which requires the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree to be recognized at fair value. Typical assets and liabilities acquired include land, building, furniture, fixtures, and equipment, and identified intangible assets and liabilities, consisting of the value of above or below market leases and in-place leases. In making estimates of fair values for purposes of allocating purchase price, the Company utilizes various sources, including its own analysis of recently acquired and existing comparable properties in its portfolio and other market data.

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 years' financial statements to conform to current year presentations as a result of discontinued operations and changes in held for sale classification as described in Note 7, "Real Estate Disposition Activities."

Recently Adopted Accounting Standards

In April 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-08, guidance updating the accounting and reporting for discontinued operations. Under the recently issued guidance, only disposals representing a strategic shift in operations (e.g., a disposal of a major geographic area, a major line of business or a major equity method investment) will be presented as discontinued operations. Additionally, the final standard requires expanded disclosures about dispositions that will provide financial statement users with more information about the assets, liabilities, income and expenses of discontinued operations, as well as disposals of a significant part of an entity that does not qualify for discontinued operations reporting. The final standard is effective in the first quarter of 2015 and allows for early adoption. The Company adopted the guidance as of January 1, 2014, as discussed in Note 7, "Real Estate Disposition Activities."

In May 2014, the Financial Accounting Standards Board issued a revenue recognition standard that will result in companies recognizing revenue from contracts when control for the service or product that is the subject of the contract is transferred from the seller to the buyer. The Company will be required to apply the new standard in the first quarter of 2017 and is assessing whether the new standard will have a material effect on its financial position or results of operations.

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 \$15,989,000 and \$17,205,000 for the three months ended September 30, 2014 and 2013, respectively, and \$54,294,000 and \$47,168,000 for the nine months ended September 30, 2014 and 2013, respectively.

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3. Notes Payable, Unsecured Notes and Credit Facility

The Company's mortgage notes payable, unsecured notes, Term Loan and Credit Facility, both as defined below, as of September 30, 2014 and December 31, 2013, 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 September 30, 2014 and December 31, 2013, as shown in the Condensed Consolidated Balance Sheets (dollars in thousands) (see Note 7, "Real Estate Disposition Activities").

	9/30/2014	12/31/2013
Fixed rate unsecured notes (1)	\$2,450,000	\$2,600,000
Term Loan	250,000	—
Fixed rate mortgage notes payable - conventional and tax-exempt (2)	2,405,000	2,418,389
Variable rate mortgage notes payable - conventional and tax-exempt	1,048,118	1,011,609
Total mortgage notes payable and unsecured notes	6,153,118	6,029,998
Credit Facility	—	—
Total mortgage notes payable, unsecured notes and Credit Facility	\$6,153,118	\$6,029,998

(1) Balances at September 30, 2014 and December 31, 2013 exclude \$4,701 and \$5,291 of debt discount, respectively, as reflected in unsecured notes, net on the Company's Condensed Consolidated Balance Sheets.

(2) Balances at September 30, 2014 and December 31, 2013 exclude \$93,351 and \$120,684 of debt premium, respectively, as reflected in mortgage notes payable on the Company's Condensed Consolidated Balance Sheets.

The following debt activity occurred during the nine months ended September 30, 2014:

In March 2014, the Company entered into a \$300,000,000 variable rate unsecured term loan that matures in March 2021 (the "Term Loan"). At September 30, 2014, the Company had drawn \$250,000,000 of the available \$300,000,000, with the option to draw the additional \$50,000,000 until March 2015.

In April 2014, in conjunction with certain requirements associated with the development of an apartment community, the Company entered into a \$53,000,000 secured mortgage loan maturing in 2019, with an option to extend the maturity to 2024. The mortgage is comprised of a \$15,000,000 fixed rate note with an interest rate of 2.99% and a \$38,000,000 variable rate note at the London Interbank Offered Rate ("LIBOR") plus 2.00%.

Pursuant to its scheduled maturity in April 2014, the Company repaid \$150,000,000 principal amount of unsecured notes with a stated coupon of 5.375%.

In June 2014, in conjunction with the disposition of an operating community, the Company repaid a fixed rate secured mortgage loan in the amount of \$10,427,000 with an interest rate of 6.19% in advance of its November 2015 maturity date. In accordance with the requirements of the master credit agreement governing this and certain other secured borrowings, the Company repaid an additional \$5,914,000 principal amount of secured borrowings for eight other operating communities. The Company incurred a charge for early debt extinguishment of \$412,000.

The Company has a \$1,300,000,000 revolving variable rate unsecured credit facility with a syndicate of banks (the "Credit Facility") which matures in April 2017. The Company has the option to extend the maturity by up to one year under two, six month extension options for an aggregate fee of \$1,950,000. The Credit Facility bears interest at varying levels based on the LIBOR rating levels achieved on the unsecured notes and on a maturity schedule selected by the Company. The current stated pricing is LIBOR plus 1.05% (1.20% at September 30, 2014), assuming a one month borrowing rate. The annual facility fee is approximately \$1,950,000 based on the \$1,300,000,000 facility size and based on the Company's current credit rating.

The Company had no borrowings outstanding under the Credit Facility and had \$52,347,000 and \$65,018,000 outstanding in letters of credit that reduced the borrowing capacity as of September 30, 2014 and December 31, 2013, respectively.

In the aggregate, secured notes payable mature at various dates from November 2015 through July 2066, and are secured by certain apartment communities and improved land parcels (with a net carrying value of \$4,440,175,000 excluding communities classified as held for sale, as of September 30, 2014).

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As of September 30, 2014, the Company has guaranteed approximately \$257,970,000 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 4.5% at both September 30, 2014 and December 31, 2013. The weighted average interest rate of the Company's variable rate mortgage notes payable (conventional and tax exempt), the Term Loan and its Credit Facility, including the effect of certain financing related fees, was 1.8% at both September 30, 2014 and December 31, 2013.

Scheduled payments and maturities of mortgage notes payable and unsecured notes outstanding at September 30, 2014 are as follows (dollars in thousands):

Year	Secured notes payments	Secured notes maturities	Unsecured notes maturities	Stated interest rate of unsecured notes
2014	\$4,641	\$—	\$—	—
2015	17,871	586,703	—	—
2016	19,036	16,255	250,000	5.750 %
2017	20,257	710,491	250,000	5.700 %
2018	19,646	76,930	—	—
2019	7,145	658,475	—	—
2020	6,205	50,824	250,000	6.100 %
			400,000	3.625 %
2021	5,985	27,844	250,000	3.950 %
			250,000	LIBOR + 1.45%
2022	6,352	—	450,000	2.950 %
2023	6,596	—	350,000	4.200 %
			250,000	2.850 %
Thereafter	85,973	1,125,889	—	—
	\$199,707	\$3,253,411	\$2,700,000	

The Company was in compliance at September 30, 2014 with certain customary financial and other covenants under the Credit Facility, the Term Loan, and the Company's fixed-rate unsecured notes.

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4. Equity

The following summarizes the changes in equity for the nine months ended September 30, 2014 (dollars in thousands):

	Common stock	Additional paid-in capital	Accumulated earnings less dividends	Accumulated other comprehensivestockholders' loss	Total AvalonBay stockholders' equity	Noncontrolling interests	Total equity
Balance at December 31, 2013	\$1,294	\$8,988,723	\$ (345,254)	\$ (48,631)	\$8,596,132	\$ 3,595	\$8,599,727
Net income attributable to common stockholders	—	—	540,929	—	540,929	—	540,929
Cash flow hedge loss reclassified to earnings	—	—	—	4,557	4,557	—	4,557
Change in redemption value of redeemable noncontrolling interest	—	—	4,088	—	4,088	—	4,088
Noncontrolling interests income allocation	—	—	—	—	—	14,221	14,221
Noncontrolling interests derecognition	—	—	—	—	—	(17,816)	(17,816)
Dividends declared to common stockholders	—	—	(455,531)	—	(455,531)	—	(455,531)
Issuance of common stock, net of withholdings	26	334,207	(394)	—	333,839	—	333,839
Amortization of deferred compensation	—	21,268	—	—	21,268	—	21,268
Balance at September 30, 2014	\$1,320	\$9,344,198	\$ (256,162)	\$ (44,074)	\$9,045,282	\$ —	\$9,045,282

As of September 30, 2014 and December 31, 2013, the Company's charter had authorized for issuance a total of 280,000,000 shares of common stock and 50,000,000 shares of preferred stock.

During the nine months ended September 30, 2014, the Company:

- (i) issued 2,069,538 common shares through public offerings under CEP III, discussed below;
- (ii) issued 454,728 common shares in connection with stock options exercised;
- (iii) issued 1,868 common shares through the Company's dividend reinvestment plan;
- (iv) issued 113,822 common shares in connection with stock grants and the conversion of restricted stock units to restricted shares;
- (v) issued 4,367 common shares through the Employee Stock Purchase Program;
- (vi) withheld 53,983 common shares to satisfy employees' tax withholding and other liabilities; and
- (vii) canceled 200 shares of restricted stock upon forfeiture.

Any deferred compensation related to the Company's stock option and restricted stock grants during the nine months ended September 30, 2014 is not reflected on the Company's Condensed Consolidated Balance Sheet as of

September 30, 2014, and will not be reflected until earned as compensation cost.

In August 2012, the Company commenced a third continuous equity program ("CEP III"), under which the Company may sell up to \$750,000,000 of shares of its common stock from time to time during a 36-month period. Actual sales will depend on a variety of factors to be determined by the Company, including market conditions, the trading price of the Company's common stock and determinations by the Company of the appropriate sources of funding for the Company. In conjunction with CEP III, the Company engaged sales agents who receive compensation of approximately 1.5% of the gross sales price for shares sold. During the three and nine months ended September 30, 2014, the Company sold 650,579 and 2,069,538 shares at an average sales price of \$153.68 and \$144.95 per share, for net proceeds of \$98,481,000 and \$295,465,000, respectively. As of September 30, 2014, the Company had \$346,304,000 of shares remaining authorized for issuance under this program.

On September 9, 2014, based on a market closing price of \$155.83 per share on that date, the Company entered into a forward contract to sell 4,500,000 shares of common stock for an initial forward price of \$151.74 per share, net of offering fees and discounts. The sales price and proceeds achieved by the Company will be determined on the date or dates of settlement, with adjustments during the term of the contract for the Company's dividends as well as for a daily interest factor that varies with changes in the Fed Funds rate. The Company generally has the ability to determine the date(s) and method of settlement, subject

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to certain conditions and the right of the forward counterparty to accelerate settlement under certain circumstances. Settlement may be (i) physical sale of shares of our common stock for cash, (ii) net cash settlement, whereby the Company will either pay or receive the difference between the forward contract price and the weighted average market price for its common stock at the time of settlement, or (iii) net share settlement, whereby the Company will either receive or issue shares of its common stock, with the number of shares issued or received determined by the difference between the forward contract price and the weighted average market price for its common stock at the time of settlement. The forward contract price and the weighted average market price would in both cases be determined under the applicable terms of the forward contract. Under either of the net settlement provisions, the Company will pay to the counterparty either cash or shares of its common stock when the weighted average market price of its common stock at the time of settlement exceeds the forward contract price, and will receive either cash or issue shares of its common stock to the extent that the weighted average market price of its common stock at the time of settlement is less than the price under the forward contract. Settlement of the forward contract will occur on one or more dates not later than September 8, 2015.

5. Archstone Acquisition

On February 27, 2013, pursuant to an asset purchase agreement (the "Purchase Agreement") dated November 26, 2012, by and among the Company, Equity Residential and its operating partnership, ERP Operating Limited Partnership (together, "Equity Residential"), Lehman Brothers Holdings, Inc. ("Lehman," which term is sometimes used in this report to refer to Lehman Brothers Holdings, Inc., and/or its relevant subsidiary or subsidiaries), and Archstone Enterprise LP ("Archstone," which has since changed its name to Jupiter Enterprise LP), the Company, together with Equity Residential, acquired, directly or indirectly, all of Archstone's assets, including all of the ownership interests in joint ventures and other entities owned by Archstone, and assumed Archstone's liabilities, both known and unknown, with certain limited exceptions.

Under the terms of the Purchase Agreement, the Company acquired approximately 40% of Archstone's assets and liabilities and Equity Residential acquired approximately 60% of Archstone's assets and liabilities (the "Archstone Acquisition"). The Company accounted for the acquisition as a business combination and recorded the purchase price to acquired tangible assets consisting primarily of direct and indirect interests in land and related improvements, buildings and improvements and construction in progress and identified intangible assets and liabilities, consisting primarily of the value of above and below market leases, the value of in-place leases, and acquired management fees, at their fair values.

During the nine months ended September 30, 2013, the Company recognized \$82,544,000 in acquisition related expenses associated with the Archstone Acquisition, with \$37,295,000 reported as a component of equity in income (loss) of unconsolidated real estate entities, and the balance in expensed acquisition, development, and other pursuit costs on the accompanying Condensed Consolidated Statements of Comprehensive Income.

Consideration

Pursuant to the Purchase Agreement and separate arrangements between the Company and Equity Residential governing the allocation of liabilities assumed under the Purchase Agreement, the Company's portion of consideration under the Purchase Agreement consisted of the following:

- the issuance of 14,889,706 shares of the Company's common stock, valued at \$1,875,210,000 as of the market's close on the closing date, February 27, 2013;
- cash payment of approximately \$760,000,000;
- the assumption of consolidated indebtedness with a fair value of approximately \$3,732,980,000, as of February 27, 2013, consisting of \$3,512,202,000 principal amount of consolidated indebtedness and \$220,777,000 representing the amount by which fair value of the aforementioned debt exceeded the principal face value, \$70,479,000 of which excess related to debt the Company repaid concurrent with the Archstone Acquisition;
- the acquisition with Equity Residential of interests in entities that have preferred units outstanding, some of which may be presented for redemption from time to time. The Company's 40% share of the fair value of the collective obligations, including accrued dividends on these outstanding Archstone preferred units as of February 27, 2013, was approximately \$67,500,000; and

the assumption with Equity Residential of all other liabilities, known or unknown, of Archstone, other than certain excluded liabilities. The Company shares 40% of the responsibility for these liabilities.

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The following table presents information for assets acquired in the Archstone Acquisition that are included in the Company's Condensed Consolidated Statement of Comprehensive Income from the closing date of the acquisition, February 27, 2013, through September 30, 2013 (in thousands):

	For the period including February 28, 2013 through September 30, 2013
Revenues	\$246,969
Loss attributable to common shareholders (1)	\$(128,542)

(1) Amounts exclude acquisition costs for the Archstone Acquisition.

Pro Forma Information

The following table presents the Company's supplemental consolidated pro forma information for the nine months ended September 30, 2013, as if the acquisition had occurred on January 1, 2012 (unaudited) (in thousands):

	For the nine months ended September 30, 2013
Revenues	\$1,152,418
Income from continuing operations	\$242,647
Earnings per common share - diluted (from continuing operations)	\$1.87

The pro forma consolidated results are prepared for informational purposes only, and are based on assumptions and estimates considered appropriate by the Company's management. However, they are not necessarily indicative of what the Company's consolidated financial condition or results of operations actually would have been assuming the Archstone Acquisition had occurred on January 1, 2012, nor do they purport to represent the consolidated financial position or results of operations for future periods.

6. Investments in Real Estate EntitiesInvestment in unconsolidated real estate entities

As of September 30, 2014, the Company had investments in seven unconsolidated real estate entities, excluding an interest in the Residual JV (as defined in this Form 10-Q), with ownership interest percentages ranging from 15.2% to 31.3%. As discussed below, two of these entities disposed of their investments in real estate during the nine months ended September 30, 2014. The Company accounts for its investments in unconsolidated real estate entities under the equity method of accounting. 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 nine months ended September 30, 2014, AvalonBay Value Added Fund I, L.P. ("Fund I") sold its four final apartment communities.

Weymouth Place, located in Weymouth, MA, containing 211 apartment homes was sold for \$25,750,000. The Company's share of the gain in accordance with GAAP for the disposition was \$545,000.

South Hills Apartments, located in West Covina, CA, containing 85 apartment homes was sold for \$21,800,000. The Company's share of the gain in accordance with GAAP for the disposition was \$54,000.

The Springs, located in Corona, CA, containing 320 apartment homes was sold for \$43,200,000. The Company's share of the gain in accordance with GAAP for the disposition was \$2,373,000.

Avalon Rutherford Station, located in East Rutherford, NJ, containing 108 homes was sold for \$34,250,000. The Company's share of the gain in accordance with GAAP for the disposition was \$345,000.

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The net assets and results of operations of The Springs were consolidated for financial reporting purposes. As a result, 100% of the gain recognized of \$16,656,000 is included in gain on sale of communities in the Condensed Consolidated Statements of Comprehensive Income, and the Company's joint venture partners' 84.8% interest in this gain of \$14,132,000 is reported as a component of net (income) loss attributable to noncontrolling interests.

Concurrent with the disposition of The Springs, Fund I repaid its obligation to the Company under a fixed rate secured mortgage loan in the amount of \$21,748,000 with an interest rate of 6.06% in advance of its October 2014 maturity date. Upon repayment the Company deconsolidated the net assets of The Springs.

Fund I has a term that expires in March 2015.

During the nine months ended September 30, 2014, AvalonBay Value Added Fund II, L.P. ("Fund II") sold two communities.

Avalon Bellevue Park, located in Bellevue, WA, containing 220 apartment homes was sold for \$58,750,000. The Company's share of the gain in accordance with GAAP for the disposition was \$8,450,000.

Avalon Fair Oaks, located in Fairfax, VA, containing 491 apartment homes was sold for \$108,200,000. The Company's share of the gain in accordance with GAAP for the disposition was \$13,174,000.

During the three months ended September 30, 2014, CVP I, LLC, the entity that owned Avalon Chrystie Place, located in New York, NY containing 361 apartment homes and approximately 71,000 square feet of retail space, sold the community for \$365,000,000. The Company owned a 20.0% interest in the entity, and its share of the gain in accordance with GAAP for the disposition was \$50,478,000. In addition, the Company earned \$57,489,000 for its promoted interest in CVP I, LLC, reported in equity in income (loss) of unconsolidated real estate entities on the accompanying Condensed Consolidated Statements of Comprehensive Income.

In conjunction with the disposition of these communities, the respective ventures repaid \$198,961,000 of related secured indebtedness in advance of the scheduled maturity dates. This resulted in charges for prepayment penalties and a write off of deferred financing costs, of which the Company's portion was approximately \$2,339,000 and was reported as a reduction of equity in income (loss) of unconsolidated real estate entities on the accompanying Condensed Consolidated Statements of Comprehensive Income. In addition, during the three months ended September 30, 2014, Fund II repaid an outstanding mortgage note at par in the amount of \$42,023,000, in advance of its November 2014 maturity date.

As of September 30, 2014, the Residual JV completed the disposition of substantially all of its direct and indirect interests in German multifamily real estate assets and the associated property management company. The Company's proportionate share of income from the Residual JV (including from gains from dispositions) from its interests in German multifamily real estate assets was \$7,548,000 for the nine months ended September 30, 2014, recorded as a component of equity in income (loss) of unconsolidated real estate entities in the Condensed Consolidated Statements of Comprehensive Income. The Company received proceeds of \$8,249,000 and \$51,361,000, respectively, during the three and nine months ended September 30, 2014 from the Residual JV, for its proportionate share of the proceeds from operations and the dispositions of the venture's interest in German multifamily real estate assets.

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

	9/30/2014 (unaudited)	12/31/2013 (unaudited)
Assets:		
Real estate, net	\$1,624,119	\$1,905,005
Other assets	92,521	164,183
Total assets	\$1,716,640	\$2,069,188
Liabilities and partners' capital:		
Mortgage notes payable and credit facility	\$982,246	\$1,251,067
Other liabilities	34,846	32,257

Partners' capital	699,548	785,864
Total liabilities and partners' capital	\$1,716,640	\$2,069,188

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

	For the three months ended		For the nine months ended	
	9/30/2014	9/30/2013	9/30/2014	9/30/2013
	(unaudited)		(unaudited)	
Rental and other income	\$49,388	\$56,613	\$154,034	\$157,938
Operating and other expenses	(19,989)	(22,915)	(61,680)	(63,731)
Gain on sale of communities	327,539	5,395	333,221	70,662
Interest expense, net	(22,922)	(15,376)	(50,335)	(46,474)
Depreciation expense	(11,934)	(15,668)	(40,214)	(46,602)
Net income	\$322,082	\$8,049	\$335,026	\$71,793

In conjunction with the formation of Fund I and Fund II, the Company incurred costs in excess of its equity in the underlying net assets of the respective investments. These costs represent \$4,108,000 at September 30, 2014 and \$5,439,000 at December 31, 2013 of the respective investment balances.

As part of the formation of Fund II, the Company provided a guarantee to one of the limited partners that provides if, upon final liquidation of Fund II, the total amount of all distributions to the guaranteed partner during the life of Fund II (whether from operating cash flow or property sales) does not equal the total capital contributions made by that partner, then the Company will pay 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 \$8,910,000 for Fund II as of September 30, 2014). As of September 30, 2014, the expected realizable value of the real estate assets owned by Fund II is considered adequate to cover the guaranteed distribution amount under a liquidation scenario. The estimated fair value of, and the Company's obligation under, this guarantee, both at inception and as of September 30, 2014, was not significant and therefore the Company has not recorded any obligation for this guarantee as of September 30, 2014.

Expensed Acquisition, Development and Other 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 the abandonment of Development Rights as well as costs incurred in pursuing the acquisition of assets or costs incurred pursuing the disposition of assets for which such disposition activity did not occur, in the amounts of \$407,000 and \$351,000 for the three months ended September 30, 2014 and 2013, respectively, and \$3,138,000 and \$792,000 for the nine months ended September 30, 2014 and 2013. Amounts for the three and nine months ended September 30, 2013 do not include costs associated with the Archstone Acquisition. For further discussion of these costs, see Note 5, "Archstone Acquisition." These costs are included in expensed acquisition, development, and other pursuit costs on the accompanying Condensed Consolidated Statements of Comprehensive Income. These 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 nine months ended September 30, 2014 and 2013.

The Company assesses its portfolio of land held for both development and 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 nine months ended September 30, 2014 and 2013.

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The Company also evaluates its unconsolidated investments for impairment, considering both the 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 nine months ended September 30, 2014 and 2013, respectively.

7. Real Estate Disposition Activities

During the nine months ended September 30, 2014, the Company sold three wholly-owned operating communities. Avalon Valley, located in Danbury, CT containing 268 homes, was sold for \$53,325,000. The Company's gain in accordance with GAAP for the disposition was \$37,869,000, reported in gain on sale of discontinued operations on the accompanying Condensed Consolidated Statements of Comprehensive Income.

Oakwood Philadelphia, acquired as part of the Archstone Acquisition and located in Philadelphia, PA containing 80 homes, was sold for \$28,875,000. The Company's gain in accordance with GAAP for the disposition was \$3,268,000, reported in gain on sale of communities on the accompanying Condensed Consolidated Statements of Comprehensive Income.

Avalon Danvers, located in Danvers, MA containing 433 homes, was sold for \$108,500,000. The Company's gain in accordance with GAAP for the disposition was \$41,021,000, reported in gain on sale of communities on the accompanying Condensed Consolidated Statements of Comprehensive Income.

The results of operations for Oakwood Philadelphia and Avalon Danvers are included in income (loss) from continuing operations on the accompanying Condensed Consolidated Statements of Comprehensive Income.

The operations for any real estate assets sold from January 1, 2013 through September 30, 2014 (which includes Avalon Valley) and which were classified as held for sale and discontinued operations as of and for the period ended December 31, 2013, and thus not subject to the new guidance for discontinued operations presentation and disclosure, as discussed in Note 1, "Organization, Basis of Presentation and Significant Accounting Policies," 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		For the nine months ended	
	9/30/2014	9/30/2013	9/30/2014	9/30/2013
	(unaudited)		(unaudited)	
Rental income	\$—	\$11,114	\$579	\$37,040
Operating and other expenses	—	(3,516)	(269)	(10,996)
Depreciation expense	—	(2,535)	—	(13,154)
Income from discontinued operations	\$—	\$5,063	\$310	\$12,890

During the nine months ended September 30, 2014, Fund I sold The Springs, which was consolidated for financial reporting purposes, as discussed in Note 6, "Investments in Real Estate Entities."

At September 30, 2014, the Company had one real estate asset that qualified as held for sale.

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8. 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 generally maintains that classification throughout the year for the purpose of reporting segment operations, unless disposition or redevelopment plans regarding a community change. At April 1, 2014, the Company updated its reportable operating segments, primarily to include communities acquired as part of the Archstone Acquisition, as described in Note 5, "Archstone Acquisition," in its Established Community portfolio.

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 segment's 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 property revenue less direct property operating expenses, including property taxes, and excluding corporate-level income (including management, development and other fees), corporate-level property management and other indirect operating expenses, investments and investment management expenses, expensed acquisition, development and other pursuit costs, net interest expense, gain (loss) on extinguishment of debt, general and administrative expense, joint venture income (loss), depreciation expense, impairment loss on land holdings, gain on sale of real estate assets, income from discontinued operations and net operating income from real estate assets sold or held for sale, not classified as discontinued operations. 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 nine months ended September 30, 2014 and 2013 is as follows (dollars in thousands):

	For the three months ended		For the nine months ended	
	9/30/2014	9/30/2013	9/30/2014	9/30/2013
Net income	\$241,001	\$(10,885)	\$554,801	\$100,681
Indirect operating expenses, net of corporate income	13,173	10,780	36,333	30,673
Investments and investment management expense	1,079	1,043	3,195	3,154
Expensed acquisition, development and other pursuit costs	406	2,176	3,139	46,041
Interest expense, net (1)	46,376	43,945	132,631	127,772
Loss on extinguishment of debt, net	—	—	412	—
Loss on interest rate contract	—	53,484	—	51,000
General and administrative expense	11,290	9,878	30,745	31,262
Equity in (income) loss of unconsolidated real estate entities	(130,592)	(3,260)	(143,527)	16,244
Depreciation expense (1)	111,836	159,873	328,598	455,410
Gain on sale of real estate assets	—	—	(60,945)	(240)
Gain on sale of discontinued operations	—	—	(37,869)	(118,173)
Income from discontinued operations	—	(5,063)	(310)	(12,890)
Net operating income from real estate assets sold or held for sale, not classified as discontinued operations	(1,216)	(3,535)	(8,373)	(9,587)
Net operating income	\$293,353	\$258,436	\$838,830	\$721,347

(1) Includes amounts associated with assets sold or held for sale, not classified as discontinued operations. The following is a summary of NOI from real estate assets sold or held for sale, not classified as discontinued operations, for the periods presented (dollars in thousands):

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	For the three months ended		For the nine months ended	
	9/30/2014	9/30/2013	9/30/2014	9/30/2013
Rental income from real estate assets sold or held for sale, not classified as discontinued operations	\$2,238	\$5,871	\$13,809	\$15,659
Operating expenses real estate assets sold or held for sale, not classified as discontinued operations	(1,022	) (2,336	) (5,436	) (6,072
Net operating income from real estate assets sold or held for sale, not classified as discontinued operations	\$1,216	\$3,535	\$8,373	\$9,587

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 at either the beginning of the given calendar year, or April 1, 2014, when the Company updated its operating segments. 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 nine months ended September 30, 2014 and 2013 has been adjusted to exclude amounts for the real estate assets that were both sold between January 1, 2013 and September 30, 2014, or qualified as held for sale as of September 30, 2014, as described in Note 7, "Real Estate Disposition Activities."

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	For the three months ended				For the nine 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 September 30, 2014 (2)								
Established								
New England	\$49,227	\$31,858	4.6	%	\$140,891	\$89,693	0.7	% \$1,427,605
Metro NY/NJ	96,112	67,255	3.9	%	237,732	165,867	2.4	% 2,376,493
Mid-Atlantic	47,122	32,284	(2.2)	)%	73,964	51,947	(3.3)	)% 645,872
Pacific Northwest	16,744	11,668	9.4	%	40,437	28,104	6.3	% 499,611
Northern California	64,120	48,805	12.2	%	129,560	99,030	7.8	% 1,401,286
Southern California	63,126	41,655	6.8	%	103,919	71,054	4.5	% 1,224,729
Total Established	336,451	233,525	5.5	%	726,503	505,695	3.0	% 7,575,596
Other Stabilized	45,023	31,838	N/A		370,627	255,085	N/A	6,008,289
Development / Redevelopment	44,310	27,990	N/A		125,215	78,050	N/A	3,639,770
Land Held for Future Development	N/A	N/A	N/A		N/A	N/A	N/A	176,484
Non-allocated (3)	2,503	N/A	N/A		8,253	N/A	N/A	43,215
Total	\$428,287	\$293,353	13.5	%	\$1,230,598	\$838,830	16.3	% \$17,443,354
For the period ended September 30, 2013								
Established								
New England	\$42,853	\$27,221	(0.6)	)%	\$126,239	\$81,882	2.1	% \$1,286,876
Metro NY/NJ	63,103	43,327	3.4	%	186,897	129,215	4.6	% 1,919,151
Mid-Atlantic	25,262	17,652	(1.0)	)%	75,608	54,169	1.1	% 632,102
Pacific Northwest	11,773	7,752	1.7	%	34,752	23,539	7.4	% 443,812
Northern California	35,850	28,009	15.3	%	104,794	79,914	13.1	% 1,232,724
Southern California	30,001	20,165	4.7	%	88,873	60,640	5.7	% 1,057,512
Total Established	208,842	144,126	4.2	%	617,163	429,359	5.4	% 6,572,177
Other Stabilized	139,093	92,856	N/A		348,028	237,846	N/A	6,539,176
Development / Redevelopment	32,369	21,454	N/A		79,704	54,142	N/A	2,676,384
Land Held for Future Development	N/A	N/A	N/A		N/A	N/A	N/A	282,285
Non-allocated (3)	3,014	N/A	N/A		8,198	N/A	N/A	47,921
Total	\$383,318	\$258,436	49.3	%	\$1,053,093	\$721,347	45.4	% \$16,117,943

(1) Does not include gross real estate assets held for sale of \$87,393 and \$654,729 as of September 30, 2014 and 2013, respectively.

(2)

Results for the three months ended September 30, 2014 reflect the operating segments updated as of April 1, 2014, which include most stabilized communities acquired as part of the Archstone Acquisition in the Established Communities segment. Results for the nine months ended September 30, 2014 reflect the operating segments determined as of January 1, 2014, which include stabilized communities acquired as part of the Archstone Acquisition in the Other Stabilized segment.

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

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9. 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):

	2009 Plan shares	Weighted average exercise price per share	1994 Plan shares	Weighted average exercise price per share
Options Outstanding, December 31, 2013	501,568	\$ 120.77	691,526	\$ 106.19
Exercised	(144,750)	) 116.06	(309,978)	) 97.00
Forfeited	(4,052)	) 131.05	(76,381)	) 142.66
Options Outstanding, September 30, 2014	352,766	\$ 122.58	305,167	\$ 106.39
Options Exercisable September 30, 2014	197,931	\$ 116.93	305,167	\$ 106.39

The Company granted 131,980 restricted stock units net of forfeitures, with an estimated aggregate compensation cost of \$15,522,000, as part of its stock-based compensation plan, during the nine months ended September 30, 2014. The amount of restricted stock ultimately earned is based on the total shareholder return metrics related to the Company's common stock for 58,206 restricted stock units and financial metrics related to operating performance and leverage metrics of the Company for 73,774 restricted stock units. For the portion of the grant for which the award is determined by the total shareholder return of the Company's common stock, the Company used a Monte Carlo model to assess the compensation cost associated with the restricted stock units. The estimated compensation cost was derived using the following assumptions: baseline share value of \$128.97; dividend yield of approximately 3.6%; estimated volatility figures ranging from 17.6% to 18.6% over the life of the plan for the Company using 50% historical volatility and 50% implied volatility; and risk free rates over the life of the plan ranging from 0.04% to 0.72%, resulting in an average estimated fair value per restricted stock unit of \$103.20. For the portion of the grant for which the award is determined by financial metrics, the estimated compensation cost was based on the baseline share value of \$128.97 and the Company's estimate of corporate achievement for the financial metrics.

During the nine months ended September 30, 2014, the Company also issued 113,822 shares of restricted stock, of which 16,209 shares related to the conversion of restricted stock units to restricted shares, and the remaining 97,613 shares were new grants with a fair value of \$12,605,000.

At September 30, 2014, the Company had 190,589 outstanding unvested restricted shares granted under the Company's equity compensation plans. Restricted stock vesting during the nine months ended September 30, 2014 totaled 97,346 shares of which 4,622 shares related to the conversion of restricted stock units and 92,724 shares related to restricted stock awards which had fair values at the grant date ranging from \$74.20 to \$149.05 per share. The total grant date fair value of shares vested under restricted stock awards was \$11,143,000 and \$13,857,000 for the nine months ended September 30, 2014 and 2013, respectively.

Total employee stock-based compensation cost recognized in income was \$9,897,000 and \$16,768,000 for the nine months ended September 30, 2014 and 2013, respectively, and total capitalized stock-based compensation cost was \$4,635,000 and \$5,911,000 for the nine months ended September 30, 2014 and 2013, respectively. At September 30, 2014, there was a total unrecognized compensation cost of \$1,483,000 for unvested stock options and \$22,681,000 for unvested restricted stock and restricted stock units, which does not include estimated forfeitures. The unrecognized compensation cost for unvested stock options, and restricted stock and restricted stock units is expected to be recognized over a weighted average period of 1.2 years and 3.7 years, respectively.

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10. Related Party Arrangements

Unconsolidated Entities

The Company manages unconsolidated real estate entities for which it receives asset management, property management, development and redevelopment fee revenue. From these entities, the Company earned fees of \$2,503,000 and \$3,014,000 during the three months ended September 30, 2014 and 2013, respectively, and \$8,253,000 and \$8,198,000 during the nine months ended September 30, 2014 and 2013, respectively. These fees are included in management, development and other fees on the accompanying Condensed Consolidated Statements of Comprehensive Income. In addition, the Company has outstanding receivables associated with its management role of \$5,458,000 and \$7,004,000 as of September 30, 2014 and December 31, 2013, respectively.

Director Compensation

The Company recorded non-employee director compensation expense relating to restricted stock grants and deferred stock awards in the amount of \$250,000 in both the three months ended September 30, 2014 and 2013, and \$750,000 and \$743,000, in the nine months ended September 30, 2014 and 2013, respectively, as a component of general and administrative expense. Deferred compensation relating to restricted stock grants and deferred stock awards to non-employee directors was \$667,000 and \$417,000 on September 30, 2014 and December 31, 2013, respectively.

11. Fair Value

Financial Instruments Carried at Fair Value

Derivative Financial Instruments

Currently, the Company uses interest rate cap agreements to manage its interest rate risk. These instruments are carried at fair value in the Company's financial statements. In adjusting the fair value of its derivative contracts for the effect of counterparty nonperformance risk, the Company has considered the impact of its net position with a given counterparty, as well as any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees. The Company minimizes its credit risk on these transactions by dealing with major, creditworthy financial institutions which have an A or better credit rating by the Standard & Poor's Ratings Group. As part of its on-going control procedures, the Company monitors the credit ratings of counterparties and the exposure of the Company to any single entity, thus reducing credit risk concentration. The Company believes the likelihood of realizing losses from counterparty nonperformance is remote. Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives use Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by itself and its counterparties. As of September 30, 2014, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined it is not significant. As a result, the Company has determined that its derivative valuations are classified in Level 2 of the fair value hierarchy.

Hedge ineffectiveness did not have a material impact on earnings of the Company for the three months ended September 30, 2014, or any prior period, and the Company does not anticipate that it will have a material effect in the future.

The following table summarizes the consolidated Hedging Derivatives at September 30, 2014, excluding derivatives executed to hedge debt on communities classified as held for sale (dollars in thousands):

	Non-designated Hedges	Cash Flow Hedges	
Notional balance	\$606,274	\$171,302	
Weighted average interest rate (1)	1.7	% 2.5	%
Weighted average capped interest rate	5.9	% 5.1	%
Earliest maturity date	Jan 2015	Apr 2015	
Latest maturity date	Aug 2018	Apr 2019	

(1) Represents the weighted average interest rate on the hedged debt.

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Excluding derivatives executed to hedge secured debt on communities classified as held for sale, the Company had four derivatives designated as cash flow hedges and 14 derivatives not designated as hedges at September 30, 2014. Fair value changes for derivatives not in qualifying hedge relationships for the three and nine months ended at September 30, 2014 were not material. Excluding the forward interest rate protection agreement discussed further below, fair value changes for derivatives not in qualifying hedge relationships for the three and nine months ended September 30, 2013 were not material. During the three and nine months ended September 30, 2014, the Company reclassified \$1,546,000 and \$4,557,000, respectively, of deferred losses from accumulated other comprehensive income as a component of interest expense, net. During the three and nine months ended September 30, 2013, the Company reclassified \$54,948,000 and \$57,913,000 of deferred losses from accumulated other comprehensive income as a charge to earnings, primarily associated with the forward interest rate protection agreement discussed below. The Company anticipates reclassifying approximately \$5,493,000 of hedging losses from accumulated other comprehensive income into earnings within the next 12 months to offset the variability of cash flows of the hedged items during this period.

In 2013, the Company was party to a \$215,000,000 forward interest rate protection agreement, which was entered into in 2011 to reduce the impact of variability in interest rates on a portion of its expected debt issuance activity in 2013. The Company settled this position at its maturity in May 2013 with a payment to the counterparty of \$51,000,000, the fair value at the time of settlement. Based on changes in the Company's capital markets outlook for 2013, the Company deemed it was probable that it would not issue the anticipated debt for which the interest rate protection agreement was transacted. During the three and nine months ended September 30, 2013, the Company recognized the deferred losses of \$53,484,000 and \$51,000,000, respectively, for the forward interest rate protection agreement in loss on interest rate contract on the accompanying Condensed Consolidated Statements of Comprehensive Income.

Redeemable Noncontrolling Interests

The Company provided redemption options (the "Puts") that allow joint venture partners of the Company to require the Company to purchase their interests in the investment at a guaranteed minimum amount related to three ventures. The Puts are payable in cash. The Company determines the fair value of the Puts based on unobservable inputs considering the assumptions that market participants would make in pricing the obligations, applying a guaranteed rate of return to the joint venture partners' net capital contribution balances as of period end. Given the significance of the unobservable inputs, the valuations are classified in Level 3 of the fair value hierarchy.

The Company issued units of limited partnership interest in DownREITs which provide the DownREIT limited partners the ability to present all or some of their units for redemption for cash as determined by the partnership agreement. Under the DownREIT agreements, for each limited partnership unit, the limited partner is entitled to receive cash in the amount equal to the fair value of the Company's common stock on or about the date of redemption. In lieu of cash redemption, the Company may elect to exchange such units for an equal number of shares of the Company's common stock. The limited partnership units in the DownREITs are valued using the market price of the Company's common stock, a Level 1 price under the fair value hierarchy.

Financial Instruments Not Carried at Fair Value

Cash and Cash Equivalents

Cash and cash equivalent balances are held with various financial institutions within principal protected accounts. The Company monitors credit ratings of these financial institutions and the concentration of cash and cash equivalent balances with any one financial institution and believes the likelihood of realizing material losses related to cash and cash equivalent balances is remote. Cash and cash equivalents are carried at their face amounts, which reasonably approximate their fair values and are Level 1 within the fair value hierarchy.

Other Financial Instruments

The Company values its unsecured notes using quoted market prices, a Level 1 price within the fair value hierarchy. The Company values its notes payable and outstanding amounts under the Credit Facility and Term Loan using a discounted cash flow analysis on the expected cash flows of each instrument. This analysis reflects the contractual terms of the instrument, including the period to maturity, and uses observable market-based inputs, including interest rate curves. The process also considers credit valuation adjustments to appropriately reflect the Company's

nonperformance risk. The Company has concluded that the value of its notes payable and amounts outstanding under its Credit Facility and Term Loan are Level 2 prices as the majority of the inputs used to value its positions fall within Level 2 of the fair value hierarchy.

Financial Instruments Measured/Disclosed at Fair Value on a Recurring Basis

The following table summarizes the classification between the three levels of the fair value hierarchy of the Company's financial instruments measured/disclosed at fair value on a recurring basis (dollars in thousands):

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Total Fair Value	Quoted Prices in Active Markets for	Significant Other Observable
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