AVALONBAY COMMUNITIES INC
Form 10-Q
May 04, 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 March 31, 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:

95,352,207 shares of common stock, par value $0.01 per share, were outstanding as of April 30, 2012

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AVALONBAY COMMUNITIES, INC.

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AVALONBAY COMMUNITIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	3-31-12 (unaudited)	12-31-11
ASSETS		
Real estate:		
Land	$ 1,375,068	$ 1,345,976
Buildings and improvements	6,803,724	6,726,634
Furniture, fixtures and equipment	235,556	228,451
	8,414,348	8,301,061
Less accumulated depreciation	(1,900,698)	(1,837,847)
Net operating real estate	6,513,650	6,463,214
Construction in progress, including land	688,617	597,546
Land held for development	297,127	325,918
Operating real estate assets held for sale, net	38,060	38,352
Total real estate, net	7,537,454	7,425,030
Cash and cash equivalents	248,242	616,853
Cash in escrow	72,894	73,400
Resident security deposits	24,269	23,597
Investments in unconsolidated real estate entities	151,565	144,561
Deferred financing costs, net	31,198	33,653
Deferred development costs	31,108	24,770
Prepaid expenses and other assets	144,329	140,526
Total assets	$ 8,241,059	$ 8,482,390
LIABILITIES AND EQUITY		
Unsecured notes, net	$ 1,449,929	$ 1,629,210
Variable rate unsecured credit facility		
Mortgage notes payable, net	1,930,386	1,969,986
Dividends payable	92,508	84,953
Payables for construction	43,789	36,775
Accrued expenses and other liabilities	233,743	247,599
Accrued interest payable	21,220	34,210
Resident security deposits	37,975	36,827
Liabilities related to real estate assets held for sale	34,042	33,875
Total liabilities	3,843,592	4,073,435
Redeemable noncontrolling interests	7,197	7,063
Equity:		
Preferred stock, $0.01 par value; $25 liquidation preference; 50,000,000 shares authorized at both March 31, 2012 and December 31, 2011; zero shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively		
Common stock, $0.01 par value; 140,000,000 shares authorized at both March 31, 2012 and December 31, 2011; 95,341,319 and 95,175,677 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively	953	952
Additional paid-in capital	4,666,536	4,652,457
Accumulated earnings less dividends	(208,304)	(171,648)
Accumulated other comprehensive loss	(76,012)	(87,020)

Total stockholders equity		4,383,173		4,394,741
Noncontrolling interests		7,097		7,151
Total equity		4,390,270		4,401,892
Total liabilities and equity	$	8,241,059	$	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			
	3-31-12		3-31-11	
Revenue:				
Rental and other income	$	249,905	$	226,210
Management, development and other fees		2,549		2,320
Total revenue		252,454		228,530
Expenses:				
Operating expenses, excluding property taxes		65,905		63,767
Property taxes		24,530		24,140
Interest expense, net		33,626		42,971
Loss on extinguishment of debt		1,179		
Depreciation expense		62,991		59,650
General and administrative expense		9,710		7,292
Total expenses		197,941		197,820
Equity in income of unconsolidated entities		2,175		503
Income from continuing operations		56,688		31,213
Discontinued operations:				
Income (loss) from discontinued operations		921		(676)
Total discontinued operations		921		(676)
Net income		57,609		30,537
Net (income) loss attributable to noncontrolling interests		149		(196)
Net income attributable to common stockholders	$	57,758	$	30,341
Other comprehensive income:				
Unrealized gain (loss) on cash flow hedges		11,008		(84)
Comprehensive income	$	68,766	$	30,257
Earnings per common share - basic:				
Income from continuing operations attributable to common stockholders	$	0.60	$	0.36
Discontinued operations attributable to common stockholders		0.01		(0.01)
Net income attributable to common stockholders	$	0.61	$	0.35
Earnings per common share - diluted:				
Income from continuing operations attributable to common stockholders	$	0.59	$	0.36
Discontinued operations attributable to common stockholders		0.01		(0.01)
Net income attributable to common stockholders	$	0.60	$	0.35

Dividends per common share:	$	0.9700	$	0.8925

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 three months ended	
	3-31-12	**3-31-11**
Net income	$ 57,609	$ 30,537
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation expense	62,991	59,650
Depreciation expense from discontinued operations	321	1,649
Amortization of deferred financing costs and debt premium/discount	1,475	1,818
Amortization of stock-based compensation	1,984	1,733
Equity in income of unconsolidated entities, net of eliminations	(1,346)	(228)
Loss on extinguishment of debt	1,179	
Increase in cash in operating escrows	(1,225)	(4,217)
Increase in resident security deposits, prepaid expenses and other assets	(8,167)	(9,407)
Decrease in accrued expenses, other liabilities and accrued interest payable	(9,481)	(8,320)
Net cash provided by operating activities	105,340	73,215
Cash flows from investing activities:		
Development/redevelopment of real estate assets including land acquisitions and deferred development costs	(159,091)	(110,644)
Acquisition of communities	(7,442)	
Capital expenditures - existing real estate assets	(2,746)	(2,974)
Capital expenditures - non-real estate assets	(147)	(2,982)
Increase (decrease) in payables for construction	7,014	(1,736)
(Increase) decrease in cash in construction escrows	1,731	(7,572)
(Increase) decrease in investments in unconsolidated real estate entities	(5,659)	1,225
Net cash used in investing activities	(166,340)	(124,683)
Cash flows from financing activities:		
Issuance of common stock	8,956	150,157
Dividends paid	(84,926)	(76,557)
Repayments of mortgage notes payable	(52,038)	(30,119)
Repayment of unsecured notes	(179,400)	
Payment of deferred financing costs	(123)	
Acquisition of joint venture partner equity interest		(6,570)
Distributions to DownREIT partnership unitholders	(7)	(7)
Distributions to joint venture and profit-sharing partners	(73)	(62)
Net cash provided by (used in) financing activities	(307,611)	36,842
Net decrease in cash and cash equivalents	(368,611)	(14,626)
Cash and cash equivalents, beginning of the period	616,853	306,426
Cash and cash equivalents, end of the period	$ 248,242	$ 291,800

Cash paid during the year for interest, net of amount capitalized	$	42,684	$	47,462

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 three months ended March 31, 2012:

- As described in Note 4, Equity, 91,471 shares of common stock valued at $12,161,000 were issued in connection with stock grants; 735 shares valued at $95,000 were issued through the Company s dividend reinvestment plan; 39,054 shares valued at $5,119,000 were withheld to satisfy employees tax withholding and other liabilities; and 4,027 shares valued at $324,000 previously issued in connection with employee compensation were forfeited. In addition, the Company granted 113,804 options for common stock at a value of $3,306,000.

- The Company recorded a decrease to other liabilities and a corresponding increase to other comprehensive income of $11,008,000; 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 $92,508,000.

- The Company recorded an increase of $309,000 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 three months ended March 31, 2011:

- 88,124 shares of common stock valued at $10,207,000 were issued in connection with stock grants; 941 shares valued at $107,000 were issued through the Company s dividend reinvestment plan; 38,349 shares valued at $4,490,000 were withheld to satisfy employees tax withholding and other liabilities; 505 shares valued at $35,000 previously issued in connection with employee compensation 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 a decrease to prepaid expenses and other assets and a corresponding decrease to other comprehensive income of $84,000 and recorded a decrease to prepaid expenses and other assets of $456,000, 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 $77,941,000.

- The Company recorded an increase of $981,000 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.

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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, Midwest, Pacific Northwest, and Northern and Southern California regions of the country.

At March 31, 2012, the Company owned or held a direct or indirect ownership interest in 179 operating apartment communities containing 53,315 apartment homes in ten states and the District of Columbia, of which 10 communities containing 2,580 apartment homes were under reconstruction. In addition, the Company owned or held a direct ownership interest in 20 communities under construction that are expected to contain an aggregate of 5,775 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 34 communities that, if developed as expected, will contain an estimated 9,415 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 months ended March 31, 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			
		3-31-12		3-31-11
Basic and diluted shares outstanding				
Weighted average common shares - basic		94,855,266		86,168,732
Weighted average DownREIT units outstanding		7,500		10,291
Effect of dilutive securities		791,013		818,507
Weighted average common shares - diluted		95,653,779		86,997,530
Calculation of Earnings per Share - basic				
Net income attributable to common stockholders	$	57,758	$	30,341
Net income allocated to unvested restricted shares		(254)		(83)
Net income attributable to common stockholders, adjusted	$	57,504	$	30,258
Weighted average common shares - basic		94,855,266		86,168,732
Earnings per common share - basic	$	0.61	$	0.35
Calculation of Earnings per Share - diluted				
Net income attributable to common stockholders	$	57,758	$	30,341
Add: noncontrolling interests of DownREIT unitholders in consolidated partnerships, including discontinued operations		7		7
Adjusted net income attributable to common stockholders	$	57,765	$	30,348
Weighted average common shares - diluted		95,653,779		86,997,530
Earnings per common share - diluted	$	0.60	$	0.35

Certain options to purchase shares of common stock in the amounts of 427,288 and 469,647 were outstanding at March 31, 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 March 31, 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 months ended March 31, 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 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.

Recently Adopted Accounting Standards

In May 2011, The Financial Accounting Standards Board (FASB) issued guidance on fair value measurement and disclosure requirements, which became effective for interim and annual periods beginning after December 15, 2011. The adoption of this guidance resulted in the tabular disclosure of fair value of the Company s financial assets and liabilities, classified by level in the fair value hierarchy, and did not impact the Company s 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 $12,320,000 and $6,343,000 for the three months ended March 31, 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 March 31, 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 March 31, 2012 and December 31, 2011, as shown in the Condensed Consolidated Balance Sheets (see Note 6, Real Estate Disposition Activities).

		3-31-12		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)		1,537,343		1,528,783
Variable rate mortgage notes payable - conventional and tax-exempt		391,601		440,241
Total notes payable and unsecured notes		3,380,545		3,600,025
Credit Facility				
Total mortgage notes payable, unsecured notes and Credit Facility	$	3,380,545	$	3,600,025

(1) Balances at March 31, 2012 and December 31, 2011 exclude $1,672 and $1,802, respectively, of debt discount, and $0 and $11, respectively, for basis adjustments, as reflected in unsecured notes, net on the Company s Condensed Consolidated Balance Sheets.

(2) Balances at March 31, 2012 and December 31, 2011 exclude $1,442 and $962, respectively of debt premium as reflected in mortgage notes payable, net on the Company s Condensed Consolidated Balance Sheets.

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The following debt activity occurred during the three months ended March 31, 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% fixed-rate 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.

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 selected by the Company. The current stated pricing is LIBOR plus 1.075% per annum (1.32% at March 31, 2012). The Company did not have any borrowings outstanding under the Credit Facility and had $46,135,000 and $52,659,000 outstanding in letters of credit that reduced the borrowing capacity as of March 31, 2012 and December 31, 2011, respectively.

In the aggregate, secured notes payable mature at various dates from May 2012 through July 2066, and are secured by certain apartment communities and improved land parcels (with a net carrying value of $1,567,946,000, excluding communities classified as held for sale, as of March 31, 2012).

As of March 31, 2012, the Company has guaranteed approximately $179,918,000 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% at March 31, 2012 and 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 2.3% at March 31, 2012 and December 31, 2011.

Scheduled payments and maturities of mortgage notes payable and unsecured notes outstanding at March 31, 2012, excluding mortgage notes secured by communities classified as held for sale, are as follows (dollars in thousands):

Year	Secured notes payments (1)	Secured notes maturities	Unsecured notes maturities	Stated interest rate of unsecured notes
2012	$ 10,274	$ 14,666	$ 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	86,698	458,635		
	$ 185,965	$ 1,742,979	$ 1,451,601	

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

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The Company was in compliance at March 31, 2012 with certain customary financial and other covenants under the Credit Facility and the Company s unsecured notes.

4. Equity

The following summarizes the changes in equity for the three months ended March 31, 2012 (dollars in thousands):

	Common stock	Additional paid-in capital	Accumulated earnings less dividends	Accumulated other comprehensive gain (loss)	Total 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			57,758		57,758	(54)	57,704
Unrealized gain on cash flow hedges				11,008	11,008		11,008
Change in redemption value of redeemable noncontrolling interest			(309)		(309)		(309)
Dividends declared to common stockholders			(92,481)		(92,481)		(92,481)
Issuance of common stock, net of withholdings	1	5,231	(1,624)		3,608		3,608
Amortization of deferred compensation		8,848			8,848		8,848
Balance at March 31, 2012	$ 953	$ 4,666,536	$ (208,304)	$ (76,012)	$ 4,383,173	$ 7,097	$ 4,390,270

During the three months ended March 31, 2012, the Company:

(i) issued 116,517 shares of common stock in connection with stock options exercised;

(ii) issued 735 common shares through the Company s dividend reinvestment plan;

(iii) issued 91,471 common shares in connection with stock grants;

(iv) withheld 39,054 common shares to satisfy employees tax withholding and other liabilities; and

(v) 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 three months ended March 31, 2012 is not reflected on the Company s Condensed Consolidated Balance Sheet as of March 31, 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 may sell up to $500,000,000 of its common stock from time to time during a 36-month period. The Company did not sell any shares under CEP II during the three months ended March 31, 2012. From program inception in November 2010 through March 31, 2012, the Company sold 2,490,765 shares at an average price of $119.84 per share for aggregate net proceeds of $294,000,000.

5. Investments in Real Estate Entities

Investments in consolidated entities

In February 2012, the Company acquired The Mark Pasadena, located in Pasadena, CA. The Mark Pasadena contains 84 apartment homes and was acquired for a purchase price of $19,400,000. In conjunction with this acquisition, the Company assumed the existing 4.61% fixed-rate mortgage loan with an outstanding principal amount of $11,958,000 which matures in June 2018, and is secured by the community.

The Company accounted for the acquisition of The Mark Pasadena as a business combination and recorded 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, in place leases and mortgage loan. 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. The Company used a discounted cash flow analysis on the

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expected cash flows of the mortgage note to determine its fair value, considering the contractual terms of the instrument and observable market-based inputs. The fair value of the mortgage loan is considered a Level 2 price as the majority of the inputs used fall within Level 2 of the fair value hierarchy.

Investment in unconsolidated entities

As of March 31, 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. 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 March 31, 2012, AvalonBay Value Added Fund, LP (Fund I) sold two communities located in Chicago, IL: Avalon Lakeside, containing 204 apartment homes, was sold for $20,500,000 and Avalon Poplar Creek, containing 196 apartment homes, was sold for $27,200,000. The Company s proportionate share of the aggregate gain in accordance with GAAP for these dispositions was $1,086,000.

During the three months ended March 31, 2012, AvalonBay Value Added Fund II, LP (Fund II) acquired Avalon Watchung, a 334 apartment home community located in Watchung, NJ, for $63,000,000. This is the final asset acquisition for Fund II.

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 March 31, 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):

		3-31-12 (unaudited)		**12-31-11 (unaudited)**
Assets:				
Real estate, net	$	1,597,083	$	1,583,397
Other assets		108,057		70,233
Total assets	$	1,705,140	$	1,653,630
Liabilities and partners capital:				
Mortgage notes payable	$	1,097,846	$	1,074,429
Other liabilities		29,994		27,335
Partners capital		577,300		551,866
Total liabilities and partners capital	$	1,705,140	$	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	
	3-31-12 (unaudited)	3-31-11 (unaudited)
Rental and other income	$ 42,627	$ 37,823
Operating and other expenses	(18,669)	(17,554)
Gain on sale of communities	8,909	
Interest expense, net	(13,066)	(12,301)
Depreciation expense	(12,700)	(11,603)
Net income (loss)	$ 7,101	$ (3,635)

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In conjunction with the formation of Fund I and 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 $8,671,000 at March 31, 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 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 March 31, 2012). As of March 31, 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 March 31, 2012, was not significant and therefore the Company has not recorded any obligation for either of these guarantees as of March 31, 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 disposition of assets for which the disposition did not occur, in the amounts of $147,000 and $651,000 for the three months ended March 31, 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 months ended March 31, 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 months ended March 31, 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 months ended March 31, 2012 and 2011.

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6. Real Estate Disposition Activities

The Company did not sell any communities during the three months ended March 31, 2012. As of March 31, 2012, the Company had one real estate asset that qualified as held for sale.

The operations for any real estate assets sold from January 1, 2011 through March 31, 2012, as well as for assets classified as held for sale at March 31, 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 (loss) from discontinued operations for the periods presented (dollars in thousands):

	For the three months ended	
	3-31-12 (unaudited)	**3-31-11 (unaudited)**
Rental income	$ 2,033	$ 7,278
Operating and other expenses	(711)	(5,005)
Interest expense, net	(80)	(1,300)
Depreciation expense	(321)	(1,649)
Income (loss) from discontinued operations	$ 921	$ (676)

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 maintains that classification, unless disposition plans regarding a community change, 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 months ended March 31, 2012 and 2011 is as follows (dollars in thousands):

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	For the three months ended	
	3-31-12 (unaudited)	3-31-11 (unaudited)
Net income	$ 57,609	$ 30,537
Indirect operating expenses, net of corporate income	8,036	7,037
Investments and investment management expense	1,446	1,191
Expensed acquisition, development and other pursuit costs	239	651
Interest expense, net	33,626	42,971
Loss on extinguishment of debt	1,179	
General and administrative expense	9,710	7,292
Equity in income of unconsolidated entities	(2,175)	(503)
Depreciation expense	62,991	59,650
(Income) loss from discontinued operations	(921)	676
Net operating income	$ 171,740	$ 149,502

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 months ended March 31, 2012 and 2011 have been adjusted for the real estate assets that were sold from January 1, 2011 through March 31, 2012, or otherwise qualify as discontinued operations as of March 31, 2012, as described in Note 6, Real Estate Disposition Activities.

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	Total revenue	NOI	% NOI change from prior year	Gross real estate (1)
For the three months ended March 31, 2012				
Established				
New England	$ 33,881	$ 22,065	7.5%	$ 1,100,828
Metro NY/NJ	57,218	39,591	9.8%	1,962,197
Mid-Atlantic	25,696	18,816	6.4%	591,140
Pacific Northwest	7,905	5,572	11.9%	301,793
Northern California	31,112	22,793	15.5%	1,180,070
Southern California	23,747	16,559	11.9%	931,512
Total Established	179,559	125,396	10.2%	6,067,540
Other Stabilized	36,674	23,932	N/A	1,289,507
Development / Redevelopment	33,672	22,412	N/A	1,641,636
Land Held for Future Development	N/A	N/A	N/A	297,127
Non-allocated (2)	2,549	N/A	N/A	104,282
Total	$ 252,454	$ 171,740	14.9%	$ 9,400,092
For the three months ended March 31, 2011				
Established				
New England	$ 41,027	$ 25,482	6.7%	$ 1,293,907
Metro NY/NJ	47,691	31,559	5.5%	1,527,764
Mid-Atlantic	26,852	19,242	8.8%	658,249
Pacific Northwest	9,129	6,140	0.8%	361,623
Northern California	22,826	16,208	5.4%	866,694
Southern California	18,394	11,955	1.9%	695,067
Total Established	165,919	110,586	5.6%	5,403,304
Other Stabilized	31,570	20,027	N/A	1,557,988
Development / Redevelopment	28,721	18,889	N/A	1,324,743
Land Held for Future Development	N/A	N/A	N/A	193,593
Non-allocated (2)	2,320	N/A	N/A	79,037
Total	$ 228,530	$ 149,502	11.3%	$ 8,558,665

(1) Does not include gross real estate assets held for sale of $64,000 and $62,230 as of March 31, 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 under the AvalonBay Communities, Inc. 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 shares	Weighted average exercise price per share	1994 Plan shares	Weighted average exercise price per share
Options Outstanding, December 31, 2011	247,403	$ 98.42	1,112,959	$ 94.10
Exercised	(15,640)	95.80	(100,877)	73.57
Granted	113,804	132.95		
Forfeited	(2,396)	99.69	(1,135)	48.60
Options Outstanding, March 31, 2012	343,171	$ 109.98	1,010,947	$ 96.20
Options Exercisable March 31, 2012	102,243	$ 92.48	1,010,947	$ 96.20

The weighted average fair value of the options granted under the 2009 Plan during the three months ended March 31, 2012 is estimated at $29.05 per share on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: dividend yield of 3.5% over the expected life of the option, volatility of 35.00%, risk-free interest rate of 0.9% and an expected life of approximately five years.

At March 31, 2012, the Company had 394,868 outstanding unvested shares granted under restricted stock awards. Restricted stock vesting during the three months ended March 31, 2012 totaled 126,169 shares and had fair values at the grant date ranging from $48.60 to $132.95 per share. The total grant date fair value of shares vested was $11,727,000 and $8,647,000 for the three months ended March 31, 2012 and 2011, respectively.

Total employee stock-based compensation cost recognized in income was $2,974,000 and $2,834,000 for the three months ended March 31, 2012 and 2011, respectively, and total capitalized stock-based compensation cost was $1,276,000 and $1,341,000 for the three months ended March 31, 2012 and 2011, respectively. At March 31, 2012, there was a total of $4,356,000 and $12,222,000 in unrecognized compensation cost for unvested stock options and unvested restricted stock, respectively, which does not include estimated forfeitures. The unrecognized compensation cost for unvested stock options and restricted stock is expected to be recognized over a weighted average period of 2.42 years and 2.96 years, respectively.

9. 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 received fees of $2,549,000 and $2,320,000 in the three months ended March 31, 2012 and 2011, 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 $3,623,000 and $4,294,000 as of March 31, 2012 and December 31, 2011, respectively.

Director Compensation

The Company recorded non-employee director compensation expense relating to restricted stock grants and deferred stock awards in the amount of $209,000 and $187,000 for the three months ended March 31, 2012 and 2011, respectively, as a component of general and administrative expense. Deferred compensation relating to these restricted stock grants and deferred stock awards was $161,000 and $370,000 on March 31, 2012 and December 31, 2011, respectively.

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10. Fair Value

Financial Instruments Carried at Fair Value

Derivative Financial Instruments

Currently, the Company uses interest rate swap and 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 minimizing credit risk concentration. The Company believes the likelihood of realizing losses from counterparty non-performance 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 March 31, 2012, 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 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 March 31, 2012, excluding derivatives executed to hedge debt on communities classified as held for sale (dollars in thousands):

	Non-designated Hedges Interest Rate Caps	**Cash Flow Hedges Interest Rate Caps**	**Cash Flow Hedges Interest Rate Swaps**
Notional balance	$ 42,747	$ 194,881	$ 430,000
Weighted average interest rate (1)	1.2%	2.3%	4.5%
Weighted average capped interest rate	7.3%	5.3%	N/A
Earliest maturity date	Aug-12	Jun-12	Sep-12
Latest maturity date	Mar-14	Jun-15	May-13

(1) For interest rate caps, this represents the weighted average interest rate on the debt.

Excluding derivatives executed to hedge debt on communities classified as held for sale, the Company had seven derivatives designated as cash flow hedges and three derivatives not designated as hedges at March 31, 2012. Fair value changes for derivatives not in qualifying hedge relationships for the three months ended March 31, 2012, were not material. To adjust the Hedging Derivatives in qualifying cash flow hedges to their fair value and recognize the impact of hedge accounting, the Company recorded an increase in other comprehensive income of $11,008,000 and a decrease in other comprehensive income of $84,000 during the three months ended March 31, 2012 and 2011, respectively. The amount reclassified from accumulated other comprehensive loss into earnings for the three months ended March 31, 2012, as well as the estimated amount included in accumulated other comprehensive loss as of March 31, 2012, expected to be reclassified into earnings within the next twelve months to offset the variability of cash flows of the hedged items during this period are not material. The Company had two derivatives designated as fair value hedges as of December 31, 2011 which matured prior to March 31, 2012. The Company recorded a decrease in the fair value of these fair value hedges of $456,000 for the three months ended March 31, 2011.

Redeemable Noncontrolling Interests

The Company provided a redemption option (the Put) that allows a joint venture partner of the Company to require the Company to purchase its interest in the investment at a guaranteed minimum amount. The Put is payable in cash. The Company determines the fair value of the Put based on unobservable inputs considering the assumptions that market participants would make in pricing the obligation, applying a guaranteed rate of return to

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the joint venture partner s net capital contribution balance as of period end. Given the significance of the unobservable inputs, the valuation is 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 agreement, 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 in the Company s common stock. The limited partnership units in the DownREIT 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.

Other Financial Instruments

Rents receivable, accounts and construction payable and accrued expenses and other liabilities are carried at their face amounts, which reasonably approximate their fair values.

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 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 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 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 at fair value on a recurring basis (dollars in thousands):

Description	3/31/2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivatives:				
Cash Flow Hedges				
Interest Rate Caps	$ 40	$	$ 40	$
Interest Rate Swaps	(74,437)		(74,437)	
Put	(5,702)			(5,702)
DownREIT units	(1,060)	(1,060)		
Indebtedness	(3,597,917)	(1,596,631)	(2,001,286)	
Total	$ (3,679,076)	$ (1,597,691)	$ (2,075,683)	$ (5,702)

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11. Subsequent Events

The Company has evaluated subsequent events through the date on which this Form 10-Q was filed, the date on which these financial statements were issued.

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

Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to help provide an understanding of our business and results of operations. This MD&A should be read in conjunction with our Condensed Consolidated Financial Statements and the accompanying Notes to Condensed Consolidated Financial Statements included elsewhere in this report. This report, including the following MD&A, contains forward-looking statements regarding future events or trends as described more fully under Forward-Looking Statements included in this report. Actual results or developments could differ materially from those projected in such statements as a result of the factors described under Forward-Looking Statements below and the risk factors described in Item 1a, Risk Factors, of our Form 10-K for the year ended December 31, 2011 (our Form 10-K).

All capitalized terms have the meaning as provided elsewhere in this Form 10-Q.

Executive Overview

Business Description

We are primarily engaged in developing, acquiring, owning and operating apartment communities in high barrier to entry markets of the United States. We believe that apartment communities are an attractive long-term investment opportunity compared to other real estate investments because a broad potential resident base should help reduce demand volatility over a real estate cycle. We seek to create long-term shareholder value by accessing capital at cost effective terms; deploying that capital to develop, redevelop and acquire apartment communities in high barrier to entry markets; operating apartment communities; and selling communities when they no longer meet our long-term investment strategy or when pricing is attractive. Barriers to entry in our markets generally include a difficult and lengthy entitlement process with local jurisdictions and dense urban or suburban areas where zoned and entitled land is in limited supply.

Our strategy is to be leaders in market research and capital allocation, delivering a range of multifamily offerings tailored to serve the needs of the most attractive customer segments in the best-performing submarkets of the United States. Our communities are predominately upscale, which generally command among the highest rents in their markets. However, we also pursue the ownership and operation of apartment communities that target a variety of customer segments and price points, consistent with our goal of offering a broad range of products and services.

We regularly evaluate the allocation of our investments by the amount of invested capital and by product type within our individual markets, which are currently located in New England, the New York/New Jersey metro area, the Mid-Atlantic, the Midwest, the Pacific Northwest, and the Northern and Southern California regions of the United States. At the present time, we are no longer pursuing development or acquisition opportunities in the Midwest region, and we are currently marketing for sale, or have executed a sales contract, for two apartment communities, which includes one for Fund I, and a land parcel located in that region. Should these assets sell during 2012, we would no longer have an investment interest in the Midwest region.

First Quarter 2012 Highlights

The Company experienced strong operating performance in the first quarter of 2012.

- Net income attributable to common stockholders for the quarter ended March 31, 2012 was $57,758,000, an increase of $27,417,000 or 90.4% from the prior year period. The increase is attributable primarily to an increase in NOI from our existing and newly developed and acquired communities, as well as a decrease in interest expense, as discussed below.

- For the quarter ended March 31, 2012, Established Communities NOI increased by $11,626,000 or 10.2% over the prior year period. This year-over-year increase was driven by an increase in rental revenue of 6.6% due to increases in both rental rates and economic occupancy and a decrease in operating expenses of 1.1% as compared to the prior year period.

- At March 31, 2012, we had approximately $321,136,000 in unrestricted cash and cash in escrow.

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Financial Outlook

Our portfolio results for the quarter ended March 31, 2012 reflect year-over-year revenue growth, as well as continued sequential rental revenue growth. The increase in revenues was driven by our portfolio growth and leasing activity for new development as well as an increase in rental rates and occupancy for our Established Communities, partially offset by dispositions. We expect year-over-year revenue growth to continue for the balance of 2012, supported by a combination of a decline in the homeownership rate, disproportionately greater employment growth in the population segments with the highest propensity to rent, and limited supply of new multifamily rental product. We believe continued favorable apartment fundamentals, combined with a capital markets environment that provides for cost effective access to capital, supports our expanded investment activity as further discussed below.

During the quarter ended March 31, 2012, we started construction of one community containing 531 apartment homes for an estimated total capitalized cost of $120,900,000. At March 31, 2012, 20 communities were under construction with a total projected capitalized cost of approximately $1,584,200,000. As of March 31, 2012, approximately $808,805,000 of the capital for this development was invested, with $775,395,000 remaining to invest. At March 31, 2012 the expected total capitalized cost of communities under construction and in planning is $4,388,200,000, providing us the ability to deliver assets into expected favorable market conditions in 2012 and 2013.

At March 31, 2012, there were 10 communities under redevelopment, with an expected investment of approximately $93,100,000, excluding costs incurred prior to the start of redevelopment, with $67,657,000 remaining to be invested. During the first quarter of 2012, we completed the redevelopment of two communities, one of which was redeveloped under our *Eaves by Avalon* brand and the second under our *Avalon* brand. These communities contain 758 apartment homes and were redeveloped for $32,500,000, excluding costs incurred prior to redevelopment.

We expect to maintain or increase our current level of redevelopment activity through the end of 2012 and into 2013, taking the opportunity to reinvest and reposition our assets to meet the needs of our residents and to try to position our assets to outperform as the economy fully recovers.

At present, cash on hand and available capital from our Credit Facility are sufficient to provide the capital necessary to fund our committed development and redevelopment activities as of March 31, 2012. We believe that our balance sheet, as measured by our current level of indebtedness, our current ability to service interest and other fixed charges and our current limited use of financial encumbrances (such as secured financing), provides adequate access to liquidity from the capital markets through the issuance of corporate securities (which could include unsecured debt and/or common and preferred equity) and secured debt, as well as other sources of liquidity such as from joint ventures or from our retained cash, to meet any reasonably foreseeable liquidity needs as they arise. See the discussion under *Liquidity and Capital Resources.*

While we continue to grow principally through our demonstrated core competency of developing wholly owned assets, we also acquire interests in additional operating assets, either directly by us or through joint ventures.

During the three months ended March 31, 2012, we acquired The Mark Pasadena, located in Pasadena, CA, for our wholly-owned portfolio. The Mark Pasadena contains 84 apartment homes and was acquired for $19,400,000.

We established Fund I and Fund II (collectively the Funds) to engage in acquisition programs through discretionary investment funds. We believe this investment format provided the following attributes: (i) third-party joint venture equity as an additional source of financing to expand and diversify our portfolio; (ii) additional sources of income in the form of property management and asset management fees and, potentially, incentive distributions if the performance of the Funds exceeds certain thresholds; and (iii) visibility into the transactions occurring in multi-family assets that helps us with other investment decisions related to our wholly-owned portfolio.

Fund I has nine institutional investors, including us. One of our wholly owned subsidiaries is the general partner of Fund I and we have made an equity investment of approximately $42,000,000 in Fund I (net of distributions and excluding the purchase by us of a mortgage note secured by a Fund I community), representing a 15.2% combined general partner and limited partner equity interest. Fund I was our principal vehicle for acquiring apartment communities through the close of its investment period in March 2008. Fund I has a term that expires in March 2015, subject to two, one-year extension options. Subsidiaries of Fund I have 17 loans, including one held by us,

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secured by individual assets with amounts outstanding in the aggregate of $361,311,000 with varying maturity dates (and, in some cases, dates after which the loans can be prepaid without penalty), ranging from August 2013 to September 2016. These mortgage loans are secured by the underlying real estate.

During the quarter ended March 31, 2012, Fund I sold two communities located in Chicago, IL: Avalon Lakeside, containing 204 apartment homes, was sold for $20,500,000 and Avalon Poplar Creek, containing 196 apartment homes was sold $27,200,000. The Company s proportionate share of the aggregate gain in accordance with GAAP for these dispositions was $1,086,000.

Fund II has six institutional investors, including us. One of our wholly owned subsidiaries is the general partner of Fund II and we have total equity commitments of $125,000,000, representing a 31.3% combined general partner and limited partner equity interest. At March 31, 2012, we had invested $111,375,000 in Fund II. Fund II has a term that expires in August 2018, plus two one-year extension options. Fund II served as the exclusive vehicle, with some exceptions, through which we acquired investment interests in apartment communities through August 2011.

During the three months ended March 31, 2012, a subsidiary of Fund II acquired Avalon Watchung, consisting of 334 apartment homes, located in Watchung, NJ for a purchase price of $63,000,000. This is the final acquisition for Fund II. At March 31, 2012, Fund II had invested an aggregate of $836,236,000.

Subsidiaries of Fund II have 14 loans secured by individual assets with amounts outstanding in the aggregate of $492,238,000 with varying maturity dates (and, in some cases, dates after which the loans can be prepaid without penalty), ranging from November 2014 to September 2019. These mortgage loans are secured by the underlying real estate.

We are not presently pursuing the formation of a new, third fund.

Communities Overview

Our real estate investments consist primarily of current operating apartment communities, communities in various stages of development (Development Communities) and Development Rights as defined below. Our current operating communities are further distinguished as Established Communities, Other Stabilized Communities, Lease-Up Communities and Redevelopment Communities. The following is a description of each category:

Current Communities are categorized as Established, Other Stabilized, Lease-Up, or Redevelopment according to the following attributes:

- *Established Communities (also known as Same Store Communities)* are consolidated communities where a comparison of operating results from the prior year to the current year is meaningful, as these communities were owned and had stabilized occupancy and

operating expenses as of the beginning of the prior year. For the period ended March 31, 2012, the Established Communities are communities that are consolidated for financial reporting purposes, had stabilized occupancy and operating expenses as of January 1, 2011, are not conducting or planning to conduct substantial redevelopment activities and are not held for sale or planned for disposition within the current year. A community is considered to have stabilized occupancy at the earlier of (i) attainment of 95% physical occupancy or (ii) the one-year anniversary of completion of development or redevelopment.

- *Other Stabilized Communities* are all other completed communities that we own or have a direct or indirect ownership interest in, and that attained stabilized occupancy, as defined above, subsequent to January 1, 2011, such that they have stabilized occupancy as of January 1, 2012. Other Stabilized Communities do not include communities that are conducting or planning to conduct substantial redevelopment activities within the current year.

- *Lease-Up Communities* are communities where construction has been complete for less than one year and where physical occupancy has not reached 95%.

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- *Redevelopment Communities* are communities where substantial redevelopment is in progress or is planned to begin during the current year. Redevelopment is considered substantial when capital invested during the reconstruction effort is expected to exceed either $5,000,000 or 10% of the community s pre-redevelopment basis and is expected to have a material impact on the operations of the community, including occupancy levels and future rental rates.

Development Communities are communities that are under construction and for which a certificate of occupancy has not been received. These communities may be partially or fully complete and operating.

Development Rights are development opportunities in the early phase of the development process for which we either have an option to acquire land or enter into a leasehold interest, for which we are the buyer under a long-term conditional contract to purchase land or where we control the land through a ground lease or own land to develop a new community. We capitalize related pre-development costs incurred in pursuit of new developments for which we currently believe future development is probable.

We currently lease our corporate headquarters located in Arlington, Virginia under an operating lease. The lease term ends in 2020, subject to two five year renewal options. All other regional and administrative offices are leased under operating leases.

As of March 31, 2012, communities that we owned or held a direct or indirect interest in were classified as follows:

	Number of communities	**Number of apartment homes**
Current Communities		
Established Communities:		
New England	27	6,286
Metro NY/NJ	23	7,893
Mid-Atlantic	11	4,748
Pacific Northwest	8	1,908
Northern California	18	5,220
Southern California	15	4,733
Total Established	102	30,788
Other Stabilized Communities:		
New England	7	2,112
Metro NY/NJ	12	3,872
Mid-Atlantic/Midwest	12	4,270
Pacific Northwest	6	1,535
Northern California	10	3,160
Southern California	18	4,807
Total Other Stabilized	65	19,756
Lease-Up Communities	2	191
Redevelopment Communities	10	2,580

Total Current Communities	179	53,315
Development Communities	20	5,775
Development Rights	34	9,415

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Results of Operations

Our year-over-year operating performance is primarily affected by both overall and individual geographic market conditions and apartment fundamentals and is reflected in changes in NOI of our Established Communities; NOI derived from acquisitions and development completions; the loss of NOI related to disposed communities; and capital market and financing activity. A comparison of our operating results for the three months ended March 31, 2012 and 2011 follows (dollars in thousands):

	For the three months ended			
	3-31-12	**3-31-11**	**$ Change**	**% Change**
Revenue:				
Rental and other income				