
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, 2004

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.)*

2900 Eisenhower Avenue, Suite 300
Alexandria, Virginia 22314
(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 is an accelerated filer (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:

72,286,877 shares of common stock, par value \$0.01 per share, were outstanding as of October 29, 2004

**FORM 10-Q
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AVALONBAY COMMUNITIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

	9-30-04 (unaudited)	12-31-03
ASSETS		
Real estate:		
Land, including land held for development	\$1,009,196	\$ 914,085
Buildings and improvements	4,370,045	4,062,783
Furniture, fixtures and equipment	133,922	124,924
	5,513,163	5,101,792
Less accumulated depreciation	(816,193)	(682,210)
Net operating real estate	4,696,970	4,419,582
Construction in progress (including land)	201,098	253,158
Real estate assets held for sale, net	—	63,649
Total real estate, net	4,898,068	4,736,389
Cash and cash equivalents	33,577	7,165
Cash in escrow	13,216	11,825
Resident security deposits	24,164	20,891
Investments in unconsolidated real estate entities	25,211	19,735
Deferred financing costs, net	22,512	17,362
Deferred development costs	41,004	31,334
Participating mortgage note	—	21,483
Prepaid expenses and other assets	42,210	43,398
Total assets	\$5,099,962	\$4,909,582
LIABILITIES AND STOCKHOLDERS' EQUITY		
Unsecured notes	\$1,859,442	\$1,835,284
Variable rate unsecured credit facility	200,000	51,100
Mortgage notes payable	475,265	422,278
Dividends payable	52,663	51,831
Payables for construction	26,776	26,967
Accrued expenses and other liabilities	92,403	85,116
Accrued interest payable	29,418	38,883
Resident security deposits	36,333	31,928
Liabilities related to real estate assets held for sale	—	30,109
Total liabilities	2,772,300	2,573,496
Minority interest of unitholders in consolidated partnerships	22,976	24,752
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value; \$25 liquidation preference; 50,000,000 shares authorized at both September 30, 2004 and December 31, 2003; 4,000,000 shares issued and outstanding at both September 30, 2004 and December 31, 2003, respectively	40	40
Common stock, \$0.01 par value; 140,000,000 shares authorized at both September 30, 2004 and December 31, 2003; 72,125,003 and 70,937,526 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	722	709
Additional paid-in capital	2,371,880	2,322,581
Deferred compensation	(9,892)	(5,808)
Dividends less than (in excess of) accumulated earnings	(50,311)	2,024
Accumulated other comprehensive loss	(7,753)	(8,212)
Total stockholders' equity	2,304,686	2,311,334
Total liabilities and stockholders' equity	\$5,099,962	\$4,909,582

See accompanying notes to Condensed Consolidated Financial Statements.

AVALONBAY COMMUNITIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND OTHER COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands, except per share data)

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Revenue:				
Rental and other income	\$ 167,416	\$ 150,948	\$ 486,578	\$ 446,576
Management, development and other fees	157	234	463	744
Total revenue	<u>167,573</u>	<u>151,182</u>	<u>487,041</u>	<u>447,320</u>
Expenses:				
Operating expenses, excluding property taxes	49,570	46,013	143,651	130,531
Property taxes	15,962	14,252	46,734	42,256
Interest expense	33,240	33,272	98,006	101,313
Depreciation expense	42,451	37,325	121,886	110,906
General and administrative expense	3,729	3,382	11,771	10,636
Total expenses	<u>144,952</u>	<u>134,244</u>	<u>422,048</u>	<u>395,642</u>
Equity in income of unconsolidated entities	301	23,988	764	25,192
Interest income	42	852	99	2,634
Venture partner interest in profit-sharing	(252)	(420)	(930)	(1,268)
Minority interest in consolidated partnerships	(559)	(302)	(833)	(754)
Income from continuing operations before cumulative effect of change in accounting principle	<u>22,153</u>	<u>41,056</u>	<u>64,093</u>	<u>77,482</u>
Discontinued operations:				
Income from discontinued operations	451	2,756	1,899	11,602
Gain on sale of real estate assets	22,762	13,575	35,137	82,158
Total discontinued operations	<u>23,213</u>	<u>16,331</u>	<u>37,036</u>	<u>93,760</u>
Income before cumulative effect of change in accounting principle	45,366	57,387	101,129	171,242
Cumulative effect of change in accounting principle	—	—	4,547	—
Net income	<u>45,366</u>	<u>57,387</u>	<u>105,676</u>	<u>171,242</u>
Dividends attributable to preferred stock	(2,175)	(2,175)	(6,525)	(8,569)
Net income available to common stockholders	<u>\$ 43,191</u>	<u>\$ 55,212</u>	<u>\$ 99,151</u>	<u>\$ 162,673</u>
Other comprehensive income (loss):				
Unrealized gain (loss) on cash flow hedges	(476)	2,245	459	2,735
Comprehensive income	<u>\$ 42,715</u>	<u>\$ 57,457</u>	<u>\$ 99,610</u>	<u>\$ 165,408</u>
Dividends declared per common share	\$ 0.70	\$ 0.70	\$ 2.10	\$ 2.10
Earnings per common share - basic:				
Income from continuing operations (net of dividends attributable to preferred stock)	\$ 0.28	\$ 0.56	\$ 0.87	\$ 1.02
Discontinued operations	0.32	0.24	0.52	1.38
Net income available to common stockholders	<u>\$ 0.60</u>	<u>\$ 0.80</u>	<u>\$ 1.39</u>	<u>\$ 2.40</u>
Earnings per common share - diluted:				
Income from continuing operations (net of dividends attributable to preferred stock)	\$ 0.28	\$ 0.56	\$ 0.88	\$ 1.00
Discontinued operations	0.32	0.23	0.51	1.35
Net income available to common stockholders	<u>\$ 0.60</u>	<u>\$ 0.79</u>	<u>\$ 1.39</u>	<u>\$ 2.35</u>

See accompanying notes to Condensed Consolidated Financial Statements.

AVALONBAY COMMUNITIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	For the nine months ended	
	9-30-04	9-30-03
Cash flows from operating activities:		
Net income	\$ 105,676	\$ 171,242
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation expense	121,886	110,906
Depreciation expense from discontinued operations	435	3,551
Amortization of deferred financing costs and debt premium/discount	3,158	2,908
Amortization of deferred compensation	3,665	3,033
Income allocated to minority interest in consolidated partnerships including discontinued operations	833	1,143
Income allocated to venture partner interest in profit-sharing	930	1,268
Gain on sale of real estate assets	(35,137)	(82,158)
Gain on sale of joint venture community	—	(23,448)
Cumulative effect of change in accounting principle	(4,547)	—
Increase in cash in operating escrows	(2,251)	(1,519)
Decrease (increase) in resident security deposits, accrued interest receivable on participating mortgage notes, prepaid expenses and other assets	1,763	(13,136)
Decrease in accrued expenses, other liabilities and accrued interest payable	(787)	(9,250)
Net cash provided by operating activities	<u>195,624</u>	<u>164,540</u>
Cash flows from investing activities:		
Development/redevelopment of real estate assets including land acquisitions and deferred development costs	(257,731)	(278,227)
Acquisition of real estate assets	(53,846)	—
Capital expenditures - existing real estate assets	(10,761)	(7,422)
Capital expenditures - non-real estate assets	(589)	(383)
Proceeds from sale of communities and land, net of selling costs	88,913	252,528
Increase (decrease) in payables for construction	(191)	311
Decrease (increase) in cash in construction escrows	860	(8,935)
Decrease in investments in unconsolidated real estate entities	781	1,343
Net cash used in investing activities	<u>(232,564)</u>	<u>(40,785)</u>
Cash flows from financing activities:		
Issuance of common stock	37,774	143,461
Repurchase of common stock	—	(39,877)
Issuance of preferred stock, net of related costs	—	81,737
Redemption of preferred stock and related costs	—	(163,724)
Dividends paid	(156,463)	(150,754)
Net borrowings under unsecured credit facility	148,900	120,380
Issuance of mortgage notes payable	59,565	38,829
Repayments of mortgage notes payable	(38,455)	(3,230)
Issuance (repayment) of unsecured notes	25,000	(150,000)
Payment of deferred financing costs	(9,150)	(1,408)
Redemption of units for cash by minority partners	(163)	(295)
Distributions to DownREIT partnership unitholders	(1,100)	(1,740)
Distributions to joint venture and profit-sharing partners	(2,556)	(3,279)
Net cash provided by (used in) financing activities	<u>63,352</u>	<u>(129,900)</u>
Net increase (decrease) in cash and cash equivalents	26,412	(6,145)
Cash and cash equivalents, beginning of period	7,165	12,916
Cash and cash equivalents, end of period	<u>\$ 33,577</u>	<u>\$ 6,771</u>
Cash paid during period for interest, net of amount capitalized	<u>\$ 101,284</u>	<u>\$ 111,920</u>

See accompanying notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

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

During the nine months ended September 30, 2004:

- As described in Note 4, "Stockholders' Equity," 147,517 shares of common stock were issued in connection with stock grants, 48,255 shares were issued in connection with non-cash stock option exercises, 1,064 shares were issued through the Company's dividend reinvestment plan, 58,884 shares were withheld to satisfy employees' tax withholding and other liabilities and 2,518 shares were forfeited, for a net value of \$6,116.
- 68,660 units of limited partnership, valued at \$2,720, 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 sold one community with a mortgage note payable of \$18,755 that was assumed by the buyer as part of the total sales price.
- The Company assumed fixed rate debt of \$8,155 in connection with the acquisition of a community and \$13,322 in connection with the acquisition of two improved land parcels.
- The Company recorded a decrease to other liabilities and a corresponding gain to other comprehensive income of \$459 to adjust the Company's Hedged Derivatives (as defined in Note 5, "Derivative Instruments and Hedging Activities") to their fair value.
- Common and preferred dividends declared but not paid totaled \$52,663.

During the nine months ended September 30, 2003:

- 103,255 shares of common stock were issued in connection with stock grants, 33,047 shares were withheld to satisfy employees' tax withholding and other liabilities and 12,102 shares were forfeited, for a net value of \$10,030.
- The Company sold one community with a mortgage note payable of \$27,305 that was assumed by the buyer as part of the total sales price.
- 183,031 units of limited partnership, valued at \$7,266, 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 reduction to other liabilities and a corresponding gain to other comprehensive income of \$2,735 to adjust the Company's Hedged Derivatives to their fair value.
- Common and preferred dividends declared but not paid totaled \$51,662.

AVALONBAY COMMUNITIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

I. Organization and Significant Accounting Policies

Organization

AvalonBay Communities, Inc. (the "Company," which term, unless the context otherwise requires, refers to AvalonBay Communities, Inc. together with its 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, as amended. The Company focuses on the ownership and operation of apartment communities in high barrier-to-entry markets of the United States. These markets are located in the Northeast, Mid-Atlantic, Midwest, Pacific Northwest, and Northern and Southern California regions of the country.

At September 30, 2004, the Company owned or held a direct or indirect ownership interest in 135 operating apartment communities containing 39,349 apartment homes in ten states and the District of Columbia, of which two communities containing 890 apartment homes were under reconstruction. In addition, the Company owned or held a direct or indirect ownership interest in 13 communities under construction that are expected to contain an aggregate of 3,652 apartment homes when completed. The Company also owned a direct or indirect ownership interest in rights to develop an additional 44 communities that, if developed in the manner expected, will contain an estimated 11,515 apartment homes.

During the three months ended September 30, 2004:

- The Company acquired two communities, Briarcliffe Lakeside Apartments, located in the Chicago, Illinois area and Essex Place, located in the greater Boston, Massachusetts area. Briarcliffe Lakeside is a 204 apartment home community and was acquired for an acquisition price of \$14,200, which includes the assumption of \$8,155 of fixed rate mortgage debt. Essex Place is a 286 apartment home community and was acquired for an acquisition price of \$23,301. Essex Place was acquired upon exercise by the Company of a pre-existing purchase option entered into by the Company in 1998 at the same time as the acquisition, from the same seller, of an adjacent land parcel on which a community was subsequently developed and is still owned by the Company.
- The Company sold one community, Avalon at Fox Mill, located in the Washington, DC metropolitan area. This community, which contained 165 apartment homes, was sold for a sales price of \$38,500. The sale of this community resulted in a gain calculated in accordance with generally accepted accounting principles ("GAAP") of \$21,624.
- The Company sold one parcel of land located in Washington, DC, as well as certain transferable development rights acquired with an adjacent parcel of land on which a current operating community was developed, for a gross sales price of \$9,927. The sale of the land parcel and transferable development rights resulted in an aggregate gain in accordance with GAAP of \$1,138.
- The Company commenced the redevelopment of Avalon Towers, a 109 apartment home community acquired by the Company in 1995, located in the Long Island, New York area. This community, if redeveloped as expected, will be completed for a total capitalized cost of \$21,500, of which \$17,300 was incurred prior to redevelopment.
- The Company completed one development community, Avalon at Grosvenor Station, located in the Washington, DC metropolitan area. This community contains 497 apartment homes and was completed for a total capitalized cost of \$79,000.

The interim unaudited financial statements have been prepared in accordance with 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 Annual Report on Form 10-K for the

year ended December 31, 2003. The results of operations for the nine months ended September 30, 2004 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.

Principles of Consolidation

The Company assesses consolidation of variable interest entities under the guidance of FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," as revised in December 2003. The Company accounts for joint venture partnerships and subsidiary partnerships structured as DownREITs that are not variable interest entities in accordance with Statement of Position ("SOP") 78-9, "Accounting for Investments in Real Estate Ventures." Under SOP 78-9, the Company consolidates joint venture and DownREIT partnerships when the Company controls the major operating and financial policies of the partnership through majority ownership or in its capacity as general partner. The accompanying Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned partnerships, certain joint venture partnerships, subsidiary partnerships structured as DownREITs and one variable interest entity under FIN 46. All significant intercompany balances and transactions have been eliminated in consolidation.

In each of the partnerships structured as DownREITs, either the Company or one of the Company's wholly-owned subsidiaries is the general partner, and there are one or more limited partners whose interest in the partnership is represented by units of limited partnership interest. For each DownREIT partnership, limited partners are entitled to receive an initial distribution before any distribution is made to the general partner. Although the partnership agreements for each of the DownREITs are different, generally the distributions per unit paid to the holders of units of limited partnership interests have approximated the Company's current common stock dividend per share. Each DownREIT partnership has been structured so that it is unlikely the limited partners will be entitled to a distribution greater than the initial distribution provided for in the partnership agreement. The holders of units of limited partnership interest have the right to present each unit of limited partnership interest for redemption for cash equal to the fair market value of a share of the Company's common stock on the date of redemption. In lieu of a cash redemption by the partnership of a limited partner's unit, the Company may elect to acquire any unit presented for redemption for one share of common stock or for such cash amount.

The Company accounts for investments in unconsolidated entities that are not variable interest entities in accordance with SOP 78-9 and Accounting Principles Board ("APB") Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The Company uses the equity method to account for investments in which it owns greater than 20% of the equity value or has significant and disproportionate influence over that entity. Investments in which the Company owns 20% or less of the equity value and does not have significant and disproportionate influence are accounted for using the cost method. If there is an event or change in circumstance that indicates a loss in the value of an investment, the Company's policy is to record the loss and reduce the value of the investment to its fair value. A loss in value would be indicated if the Company could not recover the carrying value of the investment or if the investee could not sustain an earnings capacity that would justify the carrying amount of the investment.

Revenue Recognition

Rental income related to leases is recognized on an accrual basis when due from residents in accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition" and Statement of Financial Accounting Standards ("SFAS") No. 13, "Accounting for Leases." In accordance with the Company's standard lease terms, rental payments are generally due on a monthly basis. Any cash concessions given at the inception of the lease are amortized over the approximate life of the lease, which is generally one year.

Real Estate

Significant expenditures which improve or extend the life of an asset are capitalized. The operating real estate assets are stated at cost and consist of land, buildings and improvements, furniture, fixtures and equipment, and other costs incurred during their development, redevelopment and acquisition. Expenditures for maintenance and repairs are charged to operations as incurred.

The Company's policy with respect to capital expenditures is generally to capitalize only non-recurring expenditures. Improvements and upgrades are capitalized only if the item exceeds \$15, extends the useful life of the asset and is not related to making an apartment home ready for the next resident. Purchases of personal property, such as computers and furniture, are capitalized only if the item is a new addition and exceeds \$2.5. The Company generally expenses purchases of personal property made for replacement purposes.

The capitalization of costs during the development of assets (including interest and related loan fees, property taxes and other direct and indirect costs) begins when active development commences and ends when the asset, or a portion of an asset, is delivered and is ready for its intended use, which is generally indicated by the issuance of a certificate of occupancy. Cost capitalization during redevelopment of apartment homes (including interest and related loan fees, property taxes and other direct and indirect costs) begins when an apartment home is taken out-of-service for redevelopment and ends when the apartment home redevelopment is completed and the apartment home is available for a new resident. Rental income and operating costs incurred during the initial lease-up or post-redevelopment lease-up period are fully recognized as they accrue.

In accordance with SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects," 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 availability of capital. Pre-development costs incurred in the pursuit of Development Rights for which future development is not yet considered probable are expensed as incurred. In addition, if the status of a Development Right changes, deeming future development no longer probable, any capitalized pre-development costs are written-off with a charge to expense. The Company expensed costs related to Development Rights in the amounts of \$1,388 and \$1,109 for the nine months ended September 30, 2004 and 2003, respectively.

The Company currently owns two parcels of land improved with office buildings occupied by unrelated third-parties in connection with two Development Rights. The Company intends to manage the current improvements until such time as all tenant obligations have been satisfied or eliminated through negotiation, and construction of new apartment communities is ready to begin. As provided under the guidance of SFAS No. 67, the revenue from incidental operations received from the current improvements in excess of any incremental costs are being recorded as a reduction of total capitalized costs of the Development Right and not as part of net income.

Depreciation is calculated on buildings and improvements using the straight-line method over their estimated useful lives, which range from seven to thirty years. Furniture, fixtures and equipment are generally depreciated using the straight-line method over their estimated useful lives, which range from three years (primarily computer-related equipment) to seven years.

If there is an event or change in circumstance that indicates an impairment in the value of an operating community, the Company's policy is to assess any impairment in value by making a comparison of the current and projected operating cash flows of the community over its remaining useful life, on an undiscounted basis, to the carrying amount of the community. If the carrying amount is in excess of the estimated projected operating cash flows of the community, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value.

In connection with the acquisition of an operating community, the Company performs a valuation and allocation to each asset and liability acquired in such transaction, based on their estimated fair values at the date of acquisition in accordance with SFAS No. 141, "Business Combinations." The purchase price allocations to tangible assets, such as land, buildings and improvements, and furniture, fixtures and equipment, are reflected in real estate assets and depreciated over their estimated useful lives. Any purchase price allocation to intangible assets, such in-place leases, is included in prepaid expenses and other assets and amortized over the average remaining lease term of the acquired leases. The fair value of acquired in-place leases is determined based on the estimated cost to replace such leases, including foregone rents during an assumed re-lease period, as well as the impact on projected cash flows of acquired leases with leased rents above or below current market rents.

Deferred Financing Costs

Deferred financing costs include fees and costs incurred to obtain debt financing and are amortized on a straight-line basis, which approximates the effective interest method, over the shorter of the term of the loan or the related credit enhancement facility, if applicable. Unamortized financing costs are written-off when debt is retired before the maturity date. Accumulated amortization of deferred financing costs was \$22,424 at September 30, 2004 and \$19,266 at December 31, 2003.

Cash, Cash Equivalents and Cash in Escrow

Cash and cash equivalents include all cash and liquid investments with an original maturity of three months or less from the date acquired. The majority of the Company's cash, cash equivalents and cash in escrows is held at major commercial banks.

Interest Rate Contracts

The Company utilizes derivative financial instruments to manage interest rate risk and has designated these financial instruments as hedges under the guidance of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 138, "Accounting for Certain Instruments and Certain Hedging Activities, an Amendment of Statement No. 133." For fair value hedge transactions, changes in the fair value of the derivative instrument and changes in the fair value of the hedged item due to the risk being hedged are recognized in current period earnings. For cash flow hedge transactions, changes in the fair value of the derivative instrument are reported in other comprehensive income. For cash flow hedges where the changes in the fair value of the derivative exceed the change in fair value of the hedged item, the ineffective portion is recognized in current period earnings. Derivatives which are not part of a hedge relationship are recorded at fair value through earnings. As of September 30, 2004, the Company had approximately \$206,000 in variable rate debt subject to cash flow hedges. See Note 5, "Derivative Instruments and Hedging Activities."

Comprehensive Income

Comprehensive income, as reflected on the Condensed Consolidated Statements of Operations and Other Comprehensive Income, is defined as all changes in equity during each period except for those resulting from investments by or distributions to shareholders. Accumulated other comprehensive loss as reflected in Note 4, "Stockholders' Equity," reflects the changes in the fair value of effective cash flow hedges.

Earnings per Common Share

In accordance with the provisions of SFAS No. 128, "Earnings per Share," basic earnings per share is computed by dividing earnings available to common stockholders by the weighted average number of shares outstanding during the period. 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:

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Basic and diluted shares outstanding				
Weighted average common shares - basic	71,784,059	68,779,429	71,372,239	67,880,019
Weighted average DownREIT units outstanding	570,076	899,870	586,532	947,790
Effect of dilutive securities	1,229,589	852,621	1,115,337	696,419
Weighted average common shares - diluted	<u>73,583,724</u>	<u>70,531,920</u>	<u>73,074,108</u>	<u>69,524,228</u>
Calculation of Earnings per Share - basic				
Net income available to common stockholders	\$ 43,191	\$ 55,212	\$ 99,151	\$ 162,673
Weighted average common shares - basic	<u>71,784,059</u>	<u>68,779,429</u>	<u>71,372,239</u>	<u>67,880,019</u>
Earnings per common share - basic	<u>\$ 0.60</u>	<u>\$ 0.80</u>	<u>\$ 1.39</u>	<u>\$ 2.40</u>
Calculation of Earnings per Share - diluted				
Net income available to common stockholders	\$ 43,191	\$ 55,212	\$ 99,151	\$ 162,673
Add: Minority interest of DownREIT unitholders in consolidated partnerships, including discontinued operations	<u>882</u>	<u>285</u>	<u>2,121</u>	<u>1,047</u>
Adjusted net income available to common stockholders	<u>\$ 44,073</u>	<u>\$ 55,497</u>	<u>\$ 101,272</u>	<u>\$ 163,720</u>
Weighted average common shares - diluted	<u>73,583,724</u>	<u>70,531,920</u>	<u>73,074,108</u>	<u>69,524,228</u>
Earnings per common share - diluted	<u>\$ 0.60</u>	<u>\$ 0.79</u>	<u>\$ 1.39</u>	<u>\$ 2.35</u>

Certain employee options to purchase shares of common stock of 6,000 were outstanding during both the three and nine months ended September 30, 2004 and 688,834 and 1,384,115 were outstanding during the three and nine months ended September 30, 2003, respectively, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares for the period and therefore, are anti-dilutive.

Stock-Based Compensation

Effective January 1, 2003, the Company adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123," prospectively to all employee awards granted, modified, or settled on or after January 1, 2003. Awards under the Company's stock option plans vest over periods ranging from one to three years. Therefore, the cost related to stock-based employee compensation for employee stock options included in the determination of net income for the three and nine months ended September 30, 2004 and 2003, is less than that which would have been recognized if the fair value based method had been applied to all awards since the original effective date of SFAS No. 123.

The following table illustrates the effect on net income available to common stockholders and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in each period based on the fair market value as determined on the date of grant:

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Net income available to common stockholders, as reported	\$ 43,191	\$ 55,212	\$ 99,151	\$ 162,673
Add: Actual compensation expense recorded under fair value based method, net of related tax effects	223	72	627	172
Deduct: Total compensation expense determined under fair value based method, net of related tax effects	(433)	(550)	(1,384)	(1,785)
Pro forma net income available to common stockholders	<u>\$ 42,981</u>	<u>\$ 54,734</u>	<u>\$ 98,394</u>	<u>\$ 161,060</u>
Earnings per share:				
Basic - as reported	<u>\$ 0.60</u>	<u>\$ 0.80</u>	<u>\$ 1.39</u>	<u>\$ 2.40</u>
Basic - pro forma	<u>\$ 0.60</u>	<u>\$ 0.80</u>	<u>\$ 1.38</u>	<u>\$ 2.37</u>
Diluted - as reported	<u>\$ 0.60</u>	<u>\$ 0.79</u>	<u>\$ 1.39</u>	<u>\$ 2.35</u>
Diluted - pro forma	<u>\$ 0.60</u>	<u>\$ 0.78</u>	<u>\$ 1.38</u>	<u>\$ 2.33</u>

Variable Interest Entities under FIN 46

The Company has adopted FIN 46, resulting in the consolidation of one entity from which the Company holds a participating mortgage loan. This mortgage loan is with Arbor Commons Associates Limited Partnership ("Arbor Commons Associates"), which owns Avalon Arbor, a 302 apartment home community in Shrewsbury, Massachusetts. The mortgage loan accrues interest at a fixed rate of 10.2% per annum, payable at 9.0% per annum, matures in November 2005 and is secured by the interest in Avalon Arbor. Under the terms of the loan, the Company receives (as contingent interest) 50% of the cash flow after the 10.2% accrual rate is paid and 50% of the residual profits upon the sale of the community. As of December 31, 2003, the Company reported a note receivable of \$21,483 and accrued interest on the note of \$5,834. Related interest income for the three and nine months ended September 30, 2003 was \$823 and \$2,429, respectively. The consolidation of this entity effective January 1, 2004 resulted in an increase to net real estate assets of approximately \$33,000 and the elimination of the previously recorded mortgage note and accrued interest of approximately \$27,300. In addition, the Company recognized a cumulative effect of change in accounting principle during the nine months ended September 30, 2004 in the amount of \$4,547, which increased earnings per common share - diluted by \$0.06. The Company does not hold an equity interest in this entity, and therefore 100% of the entity's net income or loss is recognized by the Company as minority interest in consolidated partnerships on the Condensed Consolidated Statements of Operations and Other Comprehensive Income. The note receivable, related accrued interest and interest income as of and for the nine months ended September 30, 2004 have been eliminated in consolidation. During the nine months ended September 30, 2004, Arbor Commons Associates has been unable to make its full mortgage note payment on several occasions, resulting in a default on the mortgage loan. The Company negotiated to receive payment in full of the note in October 2004 prior to its scheduled maturity (see Note 10, "Subsequent Events"). Therefore, the Company believes that the assets related to Arbor Commons Associates as reflected on the Condensed Consolidated Balance Sheets were fully realizable as of September 30, 2004.

Discontinued Operations

On January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" which requires that the assets and liabilities and the results of operations of any communities which have been sold since January 1, 2002, or otherwise qualify as held for sale, be presented as discontinued operations in the Company's Condensed Consolidated Financial Statements in both current and prior periods presented. The community specific components of net income that are presented as discontinued operations include net operating income, depreciation expense, minority interest expense and interest expense. In addition, the net gain or loss (including any impairment loss) on the eventual disposal of communities held for sale will be presented as discontinued operations when recognized. A change in presentation for discontinued operations will not have any impact on the Company's financial condition or results of operations. Real estate assets held for sale are measured at

the lower of the carrying amount or the fair value less the cost to sell, and are presented separately in the accompanying Condensed Consolidated Balance Sheets. Subsequent to classification of a community as held for sale, no further depreciation is recorded on the assets.

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's financial statements to conform with current period presentations.

2. Interest Capitalized

Capitalized interest associated with communities under development or redevelopment totaled \$5,257 and \$6,360 for the three months ended September 30, 2004 and 2003, respectively, and \$15,335 and \$18,871 for the nine months ended September 30, 2004 and 2003, respectively.

3. Notes Payable, Unsecured Notes and Credit Facility

The Company's mortgage notes payable, unsecured notes and variable rate unsecured credit facility as of September 30, 2004 and December 31, 2003 are summarized as follows:

	<u>9-30-04</u>	<u>12-31-03</u>
Fixed rate unsecured notes (1)	\$1,859,442	\$1,835,284
Fixed rate mortgage notes payable - conventional and tax-exempt	257,894	334,028
Variable rate mortgage notes payable - conventional and tax-exempt (2)	<u>181,172</u>	<u>80,879</u>
Total notes payable and unsecured notes	2,298,508	2,250,191
Variable rate secured short-term debt	36,199	36,526
Variable rate unsecured credit facility	<u>200,000</u>	<u>51,100</u>
Total mortgage notes payable, unsecured notes and unsecured credit facility	<u>\$2,534,707</u>	<u>\$2,337,817</u>

(1) Balances at September 30, 2004 and December 31, 2003 include \$558 of debt discount and \$284 of debt premium, respectively, received at issuance of unsecured notes.

(2) Balance at December 31, 2003 includes \$29,155 related to real estate assets held for sale.

The following debt activity occurred during the nine months ended September 30, 2004:

- The Company repaid \$125,000 in previously issued unsecured notes, along with any unpaid interest, pursuant to their scheduled maturity, and no prepayment fees were incurred. In addition, the Company issued \$150,000 in unsecured notes under its existing shelf registration statement at an annual interest rate of 5.375%. Interest on these notes is payable semi-annually on April 15 and October 15, and they mature in April 2014;
- The Company repaid \$24,251 in fixed rate mortgage debt secured by two current communities, along with any unpaid interest, repaid \$10,400 in variable rate, tax-exempt debt related to the sale of a community and transferred \$18,755 in variable rate, tax-exempt debt related to the sale of a community to the purchaser;
- The Company issued \$42,800 in variable rate, conventional debt on two communities, including interest rate protection agreements that serve to effectively limit the level to which interest rates can rise. This debt has a weighted average variable interest rate of 3.2% as of September 30, 2004, and the Hedged Derivatives serve to effectively limit the level to which interest rates can rise on this debt to 10.0%;

- The Company obtained a \$50,000 secured construction loan for the construction of a development community that will be owned and operated in a joint venture entity upon completion (See Note 6, "Investments in Unconsolidated Real Estate Entities"). Outstanding draws will bear interest at a variable rate and will come due in March 2008, assuming the exercise of two one-year extension options;
- The Company issued \$16,765 in fixed rate, conventional mortgage debt on one community;
- The Company assumed \$8,155 in fixed rate, conventional mortgage debt in conjunction with the acquisition of a community;
- The Company assumed \$13,322 in fixed rate debt in connection with the acquisition of two parcels of improved land related to two Development Rights;
- The Company replaced the credit enhancements, including interest rate swaps, on approximately \$87,000 of its variable rate, tax-exempt debt when such credit enhancements expired. The Company put in place interest rate protection agreements that serve to effectively limit the level to which interest rates can rise to a range of 6.7% to 9.0%. This \$87,000 of variable rate, tax-exempt debt floats at an average coupon interest rate of 2.0% as of September 30, 2004; and
- The Company renegotiated the terms of a fixed rate, tax-exempt bond on one community in the amount of \$9,780 to decrease the annual interest rate from 7.0% to 4.9%.

In the aggregate, mortgage notes payable mature at various dates from April 2005 through April 2043 and are secured by certain apartment communities. As of September 30, 2004, the Company has guaranteed approximately \$112,000 of mortgage notes payable held by 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 6.7% at both September 30, 2004 and December 31, 2003. The weighted average interest rate of the Company's variable rate mortgage notes payable and its unsecured credit facility (as discussed below), including the effect of certain financing related fees, was 3.0% at September 30, 2004 and 3.5% at December 31, 2003.

Scheduled payments and maturities of mortgage notes payable and unsecured notes outstanding at September 30, 2004 are as follows:

Year	Secured notes payments	Secured notes maturities	Unsecured notes maturities	Stated interest rate of unsecured notes
2004	\$ 1,943	\$ —	\$ —	—
2005	6,291	36,087	100,000	6.625%
			50,000	6.500%
2006	6,720	—	150,000	6.800%
2007	7,176	—	110,000	6.875%
			150,000	5.000%
2008	7,469	12,044	50,000	6.625%
			150,000	8.250%
2009	6,874	36,160	150,000	7.500%
2010	5,999	29,388	200,000	7.500%
2011	6,360	7,204	300,000	6.625%
			50,000	6.625%
2012	5,948	12,095	250,000	6.125%
2013	6,140	—	—	—
Thereafter	151,186	130,181	150,000	5.375%
	<u>\$ 212,106</u>	<u>\$ 263,159</u>	<u>\$1,860,000</u>	

The Company has a \$500,000 revolving variable rate unsecured credit facility with JPMorgan Chase Bank and Wachovia Bank, N.A. serving as banks and syndication agents for a syndicate of commercial banks. The Company had \$200,000 outstanding under the facility and \$25,139 in letters of credit on September 30, 2004 and \$51,100 outstanding and \$19,901 in letters of credit on December 31, 2003. Under the terms of the credit facility, if the Company elects to increase the facility by up to an additional \$150,000, and one or more banks (from the syndicate or otherwise) voluntarily agree to provide the additional commitment, then the Company will be able to increase the facility up to \$650,000, and no member of the syndicate of banks can prohibit such increase; such an increase in the facility will only be effective to the extent banks (from the syndicate or otherwise) choose to commit to lend additional funds. The Company pays participating banks, in the aggregate, an annual facility fee of approximately \$750 in quarterly installments. The unsecured credit facility bears interest at varying levels based on the London Interbank Offered Rate ("LIBOR"), rating levels achieved on the Company's unsecured notes and on a maturity schedule selected by the Company. The current stated pricing is LIBOR plus 0.55% per annum (2.39% on September 30, 2004). The spread over LIBOR can vary from LIBOR plus 0.50% to LIBOR plus 1.15% based upon the rating of the Company's long-term unsecured debt. In addition, the unsecured credit facility includes a competitive bid option, which allows banks that are part of the lender consortium to bid to make loans to the Company at a rate that is lower than the stated rate provided by the unsecured credit facility for up to \$250,000. The competitive bid option may result in lower pricing if market conditions allow. The Company has \$150,000 outstanding under this competitive bid option as of September 30, 2004 priced at LIBOR plus 0.29%, or 2.0%. The Company is subject to (i) certain customary covenants under the unsecured credit facility, including, but not limited to, maintaining certain maximum leverage ratios, a minimum fixed charges coverage ratio and minimum unencumbered assets and equity levels and (ii) prohibitions on paying dividends in amounts that exceed 95% of the Company's Funds from Operations, as defined therein, except as may be required to maintain the Company's REIT status. The credit facility matures in May 2008, assuming exercise of a one-year renewal option by the Company.

4. Stockholders' Equity

The following summarizes the changes in stockholders' equity for the nine months ended September 30, 2004:

	Preferred stock	Common stock	Additional paid-in capital	Deferred compensation	Dividends less than (in excess of) accumulated earnings	Accumulated other comprehensive loss	Stockholders' equity
Balance at December 31, 2003	\$ 40	\$ 709	\$2,322,581	\$ (5,808)	\$ 2,024	\$ (8,212)	\$2,311,334
Net income	—	—	—	—	105,676	—	105,676
Unrealized gain on cash flow hedges	—	—	—	—	—	459	459
Dividends declared to common and preferred stockholders	—	—	—	—	(157,356)	—	(157,356)
Issuance of common stock, net of withholdings	—	13	47,252	(5,702)	(655)	—	40,908
Issuance of stock options	—	—	2,047	(2,047)	—	—	—
Amortization of deferred compensation	—	—	—	3,665	—	—	3,665
Balance at September 30, 2004	<u>\$ 40</u>	<u>\$ 722</u>	<u>\$2,371,880</u>	<u>\$ (9,892)</u>	<u>\$ (50,311)</u>	<u>\$ (7,753)</u>	<u>\$2,304,686</u>

During the nine months ended September 30, 2004, the Company (i) issued 1,031,638 shares of common stock in connection with stock options exercised, (ii) issued 68,660 shares of common stock in exchange for the redemption of an equal number of DownREIT limited partnership units, (iii) issued 1,064 shares through the Company's dividend reinvestment plan, (iv) issued 147,517 common shares in connection with stock grants to employees of which 80% are restricted, (v) had forfeitures of 2,518 shares of restricted stock grants to employees and (vi) withheld 58,884 shares to satisfy employees' tax withholding and other liabilities.

Dividends per common share for both the nine months ended September 30, 2004 and 2003 were \$2.10 per share. In the nine months ended September 30, 2004, average dividends for all non-redeemed preferred shares during the period were \$1.63 per share, and no preferred shares were redeemed. In the nine months ended September 30, 2003, average dividends for preferred shares redeemed during the period were \$0.31 per share and average dividends for all non-redeemed preferred shares were \$1.63 per share.

5. Derivative Instruments and Hedging Activities

The Company has historically used interest rate swap and cap agreements (collectively, the "Hedged Derivatives") to reduce the impact of interest rate fluctuations on its variable rate, tax-exempt bonds. The Company has not entered into any interest rate hedge agreements or treasury locks for its conventional unsecured debt and does not hold interest rate hedge agreements for trading or other speculative purposes. As of September 30, 2004, the Hedged Derivatives fix approximately \$69,000 of the Company's tax-exempt debt at a weighted average interest rate of 6.3% through interest rate swaps. In addition, as of September 30, 2004, the Company has Hedged Derivatives on \$137,000 of its variable rate debt, which floats at a weighted average coupon interest rate of 2.4% and has been capped at a weighted average interest rate of 8.2% through interest rate caps. These Hedged Derivatives have maturity dates ranging from 2007 to 2010. In addition, one of the Company's unconsolidated real estate investments (see Note 6, "Investments in Unconsolidated Real Estate Entities") has \$22,500 in variable rate debt outstanding as of September 30, 2004, which is subject to an interest rate swap. This debt is not recourse to or guaranteed by the Company. The Hedged Derivatives are accounted for in accordance with SFAS No. 133, which as amended, was adopted by the Company on January 1, 2001. SFAS No. 133 requires that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value, with changes in fair value recognized currently in earnings unless specific hedge accounting criteria are met.

The Company has determined that its Hedged Derivatives qualify as effective cash-flow hedges under SFAS No. 133, resulting in the Company recording all changes in the fair value of the Hedged Derivatives in other comprehensive income. Amounts recorded in other comprehensive income will be reclassified into earnings in the period in which earnings are affected by the hedged cash flows. To adjust the Hedged Derivatives to their fair value, the Company recorded unrealized gains to other comprehensive income of \$459 and \$2,735 during the nine months ended September 30, 2004 and 2003, respectively. The estimated amount, included in accumulated other comprehensive income as of September 30, 2004, expected to be reclassified into earnings within the next twelve months to offset the variability of cash flows during this period is not material.

The Company assesses, both at inception and on an on-going basis, the effectiveness of all hedges in offsetting cash flows of hedged items. Hedge ineffectiveness did not have a material impact on earnings and the Company does not anticipate that it will have a material effect in the future. The fair values of the obligations under the Hedged Derivatives are included in accrued expenses and other liabilities on the accompanying Condensed Consolidated Balance Sheets.

By using derivative financial instruments to hedge exposures to changes in interest rates, the Company exposes itself to credit risk and market risk. The credit risk is the risk of a counterparty not performing under the terms of the Hedged Derivatives. The counterparties to these Hedged Derivatives are major financial institutions which have an A+ or better credit rating by the Standard & Poor's Ratings Group. The Company monitors the credit ratings of counterparties and the amount of the Company's debt subject to Hedged Derivatives with any one party. Therefore, the Company believes the likelihood of realizing material losses from counterparty non-performance is remote. Market risk is the adverse effect of the value of financial instruments that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by the establishment and monitoring of parameters that limit the types and degree of market risk that may be undertaken. These risks are managed by the Company's Chief Financial Officer and Senior Vice President - Finance.

6. Investments in Unconsolidated Real Estate Entities

The Company accounts for investments in unconsolidated real estate entities that are not considered variable interest entities under FIN 46 in accordance with SOP 78-9 and APB Opinion No. 18. The Company applies the equity method of accounting to an investment in an entity if it owns greater than 20% of the equity value or has significant and disproportionate influence over that entity. At September 30, 2004 and December 31, 2003, the Company's investments in unconsolidated real estate entities accounted for under the equity method of accounting consisted of:

- a 49% general partnership interest in a partnership that owns the Avalon Run community;
- a 50% limited liability company membership interest in a limited liability company that owns the Avalon Grove community; and
- a 25% limited liability company membership interest (with a right to 50% of distributions after achievement of a threshold return) in a limited liability company that owns the Avalon Bedford community.

In addition, during the nine months ended September 30, 2004, the Company entered into the following joint venture agreements:

- *Avalon Chrystie Place* - In February 2004, the Company entered into a joint venture agreement with an unrelated third-party for the development of Avalon Chrystie Place I. In connection with the general contractor services that the Company provides to CVP I, LLC, the entity that owns and is developing Avalon Chrystie Place I, the Company has provided a construction completion guarantee to the lender of the joint venture entity's \$58,500 construction loan in order to fulfill their standard financing requirements related to the construction financing. The obligation of the Company under this guarantee will terminate following construction completion once all of the lender's standard completion requirements have been satisfied, which the Company expects to occur in the beginning of 2006. The Company holds a 20% equity interest in this joint venture entity (with a right to 50% of distributions after achievement of a threshold return), with the remaining 80% equity interest held by the third-party. The Company accounts for this investment under the equity method of accounting.
- *Avalon Del Rey* - In March 2004, the Company entered into an agreement with an unrelated third-party which provides that, after the Company completes construction of Avalon Del Rey, the community will be owned and operated by a joint venture between the Company and the third-party. Upon construction completion, the third-party venture partner will invest \$49,000 and will be granted a 70% ownership interest in the venture, with the Company retaining a 30% equity interest. In August 2004, the Company obtained a \$50,000 secured construction loan for the construction of Avalon Del Rey. The Company will consolidate this entity until the third-party venture partner contributes its investment to the venture at construction completion.
- *Avalon at Juanita Village* - In April 2004, the Company entered into an agreement to develop Avalon at Juanita Village through a wholly-owned taxable REIT subsidiary and, upon construction completion, contribute the community to a joint venture. Upon contribution of the community to the joint venture, the Company expects to be reimbursed for all costs incurred to develop the community. The third-party joint venture partner will receive a 100% equity interest in the joint venture and will manage the joint venture. The Company will receive a residual profits interest and will be engaged to manage the community for a property management fee. The Company will consolidate this community until it is contributed into the joint venture at construction completion.

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

	(Unaudited)	
	9-30-04	12-31-03
Assets:		
Real estate, net	\$ 180,917	\$ 119,339
Other assets	43,839	2,605
Total assets	<u>\$ 224,756</u>	<u>\$ 121,944</u>
Liabilities and partners' equity:		
Mortgage notes payable	\$ 81,000	\$ 22,500
Other liabilities	17,108	2,158
Partners' equity	126,648	97,286
Total liabilities and partners' equity	<u>\$ 224,756</u>	<u>\$ 121,944</u>

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

	For the three months ended (unaudited)		For the nine months ended (unaudited)	
	9-30-04	9-30-03	9-30-04	9-30-03
Rental income	\$ 5,362	\$ 5,291	\$ 15,812	\$ 15,692
Operating and other expenses	(2,086)	(2,099)	(6,189)	(5,928)
Interest expense, net	(447)	(442)	(1,340)	(1,247)
Depreciation expense	(1,006)	(993)	(3,008)	(2,993)
Net income	<u>\$ 1,823</u>	<u>\$ 1,757</u>	<u>\$ 5,275</u>	<u>\$ 5,524</u>

The Company also holds a 25% limited liability company membership interest in the limited liability company that owns Avalon on the Sound. The Company, which originally owned 100% of the limited liability company, sold a 75% controlling interest in the limited liability company to a third-party in 2000. As part of the sale, the Company retained an option to repurchase the 75% interest. In accordance with SFAS No. 66, "Accounting for Sales of Real Estate," the sale of the 75% interest is not recognized due to the existence of the repurchase option, and therefore the Company accounts for Avalon on the Sound as a profit-sharing arrangement. As a result, the revenues and expenses, and assets and liabilities of Avalon on the Sound are included in the Company's Condensed Consolidated Financial Statements, with the 75% interest presented as part of accrued expenses and other liabilities on the Company's Condensed Consolidated Balance Sheets. The income allocated to the controlling partner is shown as venture partner interest in profit-sharing on the Company's Condensed Consolidated Statements of Operations and Other Comprehensive Income. The Company believes it is unlikely that the repurchase option, which expires in December 2004, will be exercised. If the Company does not purchase the community under the repurchase option before its expiration, the sale of the 75% interest will be recognized and the Company will no longer account for Avalon on the Sound as a profit-sharing arrangement.

7. Discontinued Operations - Real Estate Assets Sold or Held for Sale

During the nine months ended September 30, 2004, the Company sold three communities, one located in Seattle, Washington, one located in Orange County, California and one located in the Washington, DC metropolitan area. These three communities, which contained a total of 762 apartment homes, were sold for an aggregate sales price of \$99,600, resulting in the transfer of debt of \$18,755, net proceeds of \$79,265 and a gain calculated in accordance with GAAP of \$33,999. During the nine months ended September 30, 2003, the Company sold eight communities, five comprising the entire Minneapolis, Minnesota portfolio, and three single asset sales, one in Los Angeles, California, one in Huntington Beach, California and one in Orange County, California. These eight communities, which contained a total of 2,363 apartment homes, were sold for an aggregate sales price of \$265,625, resulting in net proceeds of \$235,799 and a gain calculated in accordance with GAAP of \$82,158.

As of September 30, 2004, the Company did not have any communities that qualified as held for sale under the provisions of SFAS No. 144. However, as required under SFAS No. 144, the operations for any communities sold from January 1, 2003 through September 30, 2004 have been presented as discontinued operations in the accompanying Condensed Consolidated Financial Statements.

Accordingly, certain reclassifications have been made in prior periods to reflect discontinued operations consistent with current period presentation. The following is a summary of income from discontinued operations for the periods presented:

	For the three months ended (unaudited)		For the nine months ended (unaudited)	
	9-30-04	9-30-03	9-30-04	9-30-03
Rental income	\$ 688	\$ 6,220	\$ 4,418	\$ 28,643
Operating and other expenses	(237)	(2,409)	(1,870)	(11,548)
Interest expense, net	—	(384)	(214)	(1,553)
Minority interest expense	—	—	—	(389)
Depreciation expense	—	(671)	(435)	(3,551)
Income from discontinued operations	<u>\$ 451</u>	<u>\$ 2,756</u>	<u>\$ 1,899</u>	<u>\$ 11,602</u>

The Company's Condensed Consolidated Balance Sheets include other assets (excluding net real estate) of \$0 and \$1,239, other liabilities of \$0 and \$954 and mortgage notes payable of \$0 and \$29,155 as of September 30, 2004 and December 31, 2003, respectively, relating to real estate assets sold.

During the nine months ended September 30, 2004, the Company sold one parcel of land, as well as certain transferable development rights acquired with an adjacent parcel of land on which a current operating community was developed, for a gross sales price of \$9,927. The sale of the land parcel and transferable development rights resulted in an aggregate gain in accordance with GAAP of \$1,138 and net proceeds of \$9,648.

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 maintains that classification, unless disposition plans regarding a community change, throughout the year for the purpose of reporting segment operations.

- *Established Communities (also known as Same Store Communities)* are 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 year 2004, the Established Communities are communities that had stabilized occupancy and operating expenses as of January 1, 2003, 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. The number of Established Communities was adjusted during the three months ended September 30, 2004 to reflect changes in the Company's disposition program. All amounts for Established Communities have been adjusted from amounts previously reported to reflect this new classification.
- *Other Stabilized Communities* includes all other completed communities that have stabilized occupancy, as defined above. Other Stabilized Communities do not include communities that are conducting or planning to conduct substantial redevelopment activities within the current year.
- *Development/Redevelopment Communities* consists of communities that are under construction and have not received a final certificate of occupancy, communities where substantial redevelopment is in progress or is planned to begin during the current year and communities under lease-up, that had not reached stabilized occupancy, as defined above, as of January 1, 2004.

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

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," requires that segment disclosures present the measure(s) used by the chief operating decision maker for purposes of assessing such 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 and Other Stabilized Communities. NOI is defined by the Company as total revenue less direct property operating expenses, including property taxes, and excludes corporate-level property management and other indirect operating expenses, interest income and expense, general and administrative expense, equity in income of unconsolidated entities, minority interest in consolidated partnerships, venture partner interest in profit-sharing, depreciation expense, cumulative effect of change in accounting principle, gain on sale of real estate assets and income from 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.

A reconciliation of NOI to net income for the three and nine months ended September 30, 2004 and 2003 is as follows:

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Net income	\$ 45,366	\$ 57,387	\$ 105,676	\$ 171,242
Corporate-level property management and other indirect operating expenses	8,076	7,577	25,480	22,630
Interest income	(42)	(852)	(99)	(2,634)
Interest expense	33,240	33,272	98,006	101,313
General and administrative expense	3,729	3,382	11,771	10,636
Equity in income of unconsolidated entities	(301)	(23,988)	(764)	(25,192)
Minority interest in consolidated partnerships	559	302	833	754
Venture partner interest in profit-sharing	252	420	930	1,268
Depreciation expense	42,451	37,325	121,886	110,906
Cumulative effect of change in accounting principle	—	—	(4,547)	—
Gain on sale of real estate assets	(22,762)	(13,575)	(35,137)	(82,158)
Income from discontinued operations	(451)	(2,756)	(1,899)	(11,602)
Net operating income	<u>\$ 110,117</u>	<u>\$ 98,494</u>	<u>\$ 322,136</u>	<u>\$ 297,163</u>

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. 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. The accounting policies applicable to the operating segments described above are the same as those described in Note 1, "Organization and Significant Accounting Policies."

	For the three months ended				For the nine months ended			
	Total revenue	NOI	% NOI change from prior year	Gross real estate (1)	Total revenue	NOI	% NOI change from prior year	Gross real estate (1)
For the periods ended								
September 30, 2004								
Established								
Northeast	\$ 38,003	\$ 24,683	0.8%	\$ 932,252	\$ 112,722	\$ 74,458	(1.7%)	\$ 932,252
Mid-Atlantic	13,531	9,505	2.4%	287,289	40,323	28,335	2.8%	287,289
Midwest	2,735	1,579	13.9%	90,862	8,077	4,699	8.5%	90,862
Pacific Northwest	8,043	4,990	4.2%	347,299	23,819	14,891	1.9%	347,299
Northern California	34,178	23,403	(2.6%)	1,376,437	102,519	71,188	(6.4%)	1,376,437
Southern California	14,126	9,804	2.3%	400,956	41,847	29,454	1.4%	400,956
Total Established	110,616	73,964	0.6%	3,435,095	329,307	223,025	(1.9%)	3,435,095
Other Stabilized	31,827	20,857	n/a	1,125,239	91,921	60,189	n/a	1,125,239
Development / Redevelopment	25,031	15,197	n/a	1,014,959	65,400	38,509	n/a	1,014,959
Land Held for Future								
Development	n/a	n/a	n/a	117,960	n/a	n/a	n/a	117,960
Non-allocated (2)	99	99	n/a	21,008	413	413	n/a	21,008
Total	\$ 167,573	\$ 110,117	11.8%	\$5,714,261	\$ 487,041	\$ 322,136	8.4%	\$5,714,261
For the periods ended								
September 30, 2003								
Established								
Northeast	\$ 38,000	\$ 24,361	(8.6%)	\$ 884,519	\$ 114,389	\$ 75,494	(9.5%)	\$ 884,519
Mid-Atlantic	16,839	11,732	(2.7%)	368,857	49,905	34,960	(5.4%)	368,857
Midwest	4,048	2,028	(22.4%)	140,553	12,159	6,372	(19.1%)	140,553
Pacific Northwest	6,899	4,125	(7.9%)	297,401	20,556	12,623	(12.7%)	297,401
Northern California	34,413	23,724	(9.0%)	1,342,514	105,530	75,104	(11.6%)	1,342,514
Southern California	10,831	7,402	(1.4%)	304,355	32,315	22,435	(0.9%)	304,355
Total Established	111,030	73,372	(7.6%)	3,338,199	334,854	226,988	(9.3%)	3,338,199
Other Stabilized	19,591	13,659	n/a	713,593	57,849	39,068	n/a	713,593
Development / Redevelopment	20,382	11,284	n/a	1,092,790	53,981	30,471	n/a	1,092,790
Land Held for Future								
Development	n/a	n/a	n/a	116,556	n/a	n/a	n/a	116,556
Non-allocated (2)	179	179	n/a	20,228	636	636	n/a	20,228
Total	\$ 151,182	\$ 98,494	0.9%	\$5,281,366	\$ 447,320	\$ 297,163	(1.4%)	\$5,281,366

(1) Does not include gross real estate assets held for sale of \$168,735 as of September 30, 2003.

(2) Revenue and NOI amounts represent third-party management, accounting and developer fees which are not allocated to a reportable segment.

Segment information for the periods ending September 30, 2004 and 2003 has been adjusted for the communities that were sold from January 1, 2003 through September 30, 2004 as described in Note 7, "Discontinued Operations – Real Estate Assets Sold or Held for Sale."

9. Related Party Arrangements

Unconsolidated Entities

The Company manages several unconsolidated real estate joint venture entities for which it receives management fee revenue. From these entities the Company received management fee revenue of \$182 and \$533 in the three and nine months ended September 30, 2004, respectively, and \$217 and \$682 in the three and nine months ended September 30, 2003, respectively.

Director Compensation

The Company's 1994 Plan provides that directors of the Company who are also employees receive no additional compensation for their services as a director. In accordance with the Company's 1994 Plan, as then in effect, on the fifth business day following the Company's May 2003 Annual Meeting of Stockholders, each of the Company's non-employee directors automatically received options to purchase 7,000 shares of common stock at the last reported sale price of the common stock on the NYSE on such date, and a restricted stock grant (or, in lieu thereof, a deferred stock award) of 2,500 shares of common stock. On May 14, 2003, the Company's Board of Directors approved an

amendment to the 1994 Plan pursuant to which, in lieu of the stock and option awards described above, each non-employee director would receive, following the 2004 Annual Meeting of Stockholders and each annual meeting thereafter, (i) a number of shares of restricted stock (or deferred stock awards) having a value of \$100 based on the last reported sale price of the common stock on the NYSE on the fifth business day following the prior year's annual meeting and (ii) \$30 cash, payable in quarterly installments of \$7.5. A non-employee director may elect to receive all or a portion of such cash payment in the form of a deferred stock award. In addition, the Lead Independent Director receives an annual fee of \$30 payable in equal monthly installments of \$2.5. The Company recorded compensation expense relating to the restricted stock grants, deferred stock awards and stock options in the amount of \$251 and \$719 in the three and nine months ended September 30, 2004, respectively, and \$228 and \$595 in the three and nine months ended September 30, 2003, respectively. Deferred compensation relating to these restricted stock grants, deferred stock awards and stock options was \$826 and \$722 on September 30, 2004 and December 31, 2003, respectively.

10. Subsequent Events

In October 2004, the Company received payment in full of the outstanding mortgage loan due from Arbor Commons Associates. The mortgage loan was repaid prior to its scheduled maturity, and therefore the total proceeds of \$33,994 included an early prepayment premium of approximately \$1,240 (net of related legal costs) along with the unpaid principal balance and accrued interest.

Subsequent to September 30, 2004, three communities previously held for operating purposes were classified as held for sale under SFAS No. 144. These communities have an aggregate net real estate carrying value of \$51,813 and aggregate outstanding debt of \$9,580 as of September 30, 2004. The Company is actively pursuing the disposition of these communities and expects to close by the end of 2004.

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

We are a real estate investment trust, or REIT, incorporated in the state of Maryland and focused on the ownership and operation of apartment communities in high barrier-to-entry markets of the United States. As of October 29, 2004, we had 134 current operating communities, which are the primary contributors to our overall operating performance. The net operating income of these communities, which is one of the financial measures that we use to evaluate community performance, is affected by the demand and supply dynamics within our markets, our rental rates and occupancy levels, and our ability to control operating costs. Our overall financial performance is also impacted by the general availability and cost of capital and the performance of our newly developed and acquired apartment communities. We seek to create long-term shareholder value by accessing capital on cost effective terms; deploying that capital to develop, redevelop and acquire apartment communities in high barrier-to-entry markets; operating apartments; and selling communities when they no longer meet our long-term investment strategy and when pricing is attractive.

This Form 10-Q, including the following discussion and analysis of our financial condition and results of operations, contains forward-looking statements that predict or indicate future events or trends and that do not report historical matters. Actual results or developments could differ materially from those projected in such statements as a result of the risk factors set forth on page 47 of this report. The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our Condensed Consolidated Financial Statements and notes included elsewhere in this report, as well as our Annual Report filed on Form 10-K for the year ended December 31, 2003.

Business Description and Community Information Overview

We believe that apartment communities present 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 intend to continue to pursue real estate investments in markets where constraints to new supply exist, and where new household formations are expected to out-pace multifamily permit activity over the course of the real estate cycle. 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. We regularly evaluate and monitor the allocation of our investments by the amount of invested capital and by product type within our individual markets, which are located in the Northeast, Mid-Atlantic, Midwest, Pacific Northwest, and Northern and Southern California regions of the United States. Our strategy is to more deeply penetrate these markets with a broad range of products and services that focus on our customer. A substantial majority of our current communities are upscale, which generally command among the highest rents in their markets. 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 believe that, over an entire business cycle, lower housing affordability and the limited new supply of apartment homes in our markets will result in a higher propensity to rent and larger increases in cash flows relative to other markets.

However, we believe we are at the end of a period of a business cycle where rents reset to lower levels, which resulted in a decline in cash flows in recent years. A number of our markets experienced economic contraction due to job losses in 2002 and 2003, particularly in the technology, telecom and financial services sectors. This resulted in a prolonged period of weak apartment market fundamentals as reflected in declining rental rates and demand. However, the rate of decline has diminished, and 2004 has been a year of transition where apartment fundamentals are becoming balanced in our markets, creating a platform for future growth. In 2004, the economy has shown signs of recovery as evidenced by modest job growth and declining unemployment claims. Continued improvement in the economic environment has resulted in the beginning of stabilization of apartment market fundamentals, and an improved demand and supply balance is expected as we begin to look forward to 2005. We have been experiencing the initial signs of improving apartment market fundamentals, as reflected in certain operating results and metrics during the three months ended September 30, 2004: (i) our Established Community portfolio achieved both sequential and year-over-year revenue growth, the first year-over-year increase that we have experienced since 2001; (ii) economic occupancy has stabilized and remained above 95% in each of our markets; (iii) availability of apartment homes continued to decrease; and (iv) concessions per move-in declined

sequentially. The improvements in these key metrics are important leading indicators that suggest pricing power is emerging. We expect these trends to continue throughout the remainder of 2004; however, due to the year-over-year declines experienced at the beginning of 2004, we anticipate that rental revenue for our Established Communities will decline modestly or remain flat for the full year 2004 as compared to 2003.

In response to transitioning apartment fundamentals, we are adjusting our business activity to position for the next expansionary cycle. We are continuing our disposition activity, although at a reduced level as compared to 2003, and we have increased our development and acquisition volume in anticipation of stronger apartment demand. However, the level of development and acquisition volume, or disposition activity, will be heavily influenced by capital and real estate market conditions, as well as apartment community demand.

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 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. We determine which of our communities fall into the Established Communities category as of January 1st of each year and maintain that classification throughout the year, unless disposition plans regarding a community change. For the year 2004, the Established Communities are communities that had stabilized occupancy and operating expenses as of January 1, 2003 and are not conducting or planning to conduct substantial redevelopment activities, as described below, and are not held for sale or planned for disposition within the current year. We consider a community 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. During the three months ended September 30, 2004, we changed the classification for certain communities to reflect changes in our disposition program for the remainder of 2004. All amounts for Established Communities have been adjusted from amounts previously reported to reflect this new classification.
- *Other Stabilized Communities* includes all other completed communities that have stabilized occupancy, as defined above. 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%.
- *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 exceeds the lesser of \$5,000,000 or 10% of the community’s acquisition cost. Throughout this report, the term “redevelopment” is used to refer to the entire redevelopment cycle, including planning and procurement of architectural and engineering

designs, budgeting and actual renovation work. The actual renovation work is referred to as “reconstruction,” which is only one element of the redevelopment cycle.

Development Communities are communities that are under construction and for which a final certificate of occupancy has not been received. These communities may be partially complete and operating. Throughout this report, the term “development” is used to refer to the entire property development cycle, including pursuit of zoning approvals, procurement of architectural and engineering designs and the construction process. References to “construction” refer only to the actual construction of the property, which is only one element of the development cycle.

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 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.

A more detailed description of our reportable segments and other related operating information can be found in Note 8, “Segment Reporting,” of our Condensed Consolidated Financial Statements. Although each of these categories is important to our business, we generally evaluate overall operating, industry and market trends based on the operating results of our Established Communities, for which a detailed discussion can be found in “Results of Operations” as part of our discussion of overall operating results. We evaluate our current and future cash needs and future operating potential based on acquisition, disposition, development, redevelopment and financing activities within Other Stabilized, Redevelopment and Development Communities, for which detailed discussions can be found in “Liquidity and Capital Resources.”

On September 30, 2004, we owned or had an ownership interest in these categories as follows:

	<u>Number of communities</u>	<u>Number of apartment homes</u>
<u>Current Communities</u>		
Established Communities:		
Northeast	29	7,350
Mid-Atlantic	13	3,537
Midwest	3	887
Pacific Northwest	11	2,738
Northern California	29	8,745
Southern California	11	3,870
Total Established	<u>96</u>	<u>27,127</u>
Other Stabilized Communities:		
Northeast	19	5,774
Mid-Atlantic	7	3,015
Midwest	2	613
Pacific Northwest	—	—
Northern California	4	823
Southern California	4	904
Total Other Stabilized	<u>36</u>	<u>11,129</u>
Lease-Up Communities	1	203
Redevelopment Communities	<u>2</u>	<u>890</u>
Total Current Communities	<u>135</u>	<u>39,349</u>
<u>Development Communities</u>	<u>13</u>	<u>3,652</u>
<u>Development Rights</u>	<u>44</u>	<u>11,515</u>

In October 2004, we received payment in full for our interest in a senior participating mortgage loan secured by a current community. As of October 29, 2004 our 134 current communities consisted of 39,047 apartment homes. Of those communities, we owned:

- a fee simple, or absolute, ownership interest in 110 operating communities, four of which are on land subject to land leases expiring in January 2062, April 2095, May 2099 and March 2142;
- a general partnership interest in three partnerships that each own a fee simple interest in an operating community;
- a general partnership interest in six partnerships structured as “DownREITs,” as described more fully below, that own an aggregate of 17 communities; and
- a membership interest in four limited liability companies that each hold a fee simple interest in an operating community, two of which are on land subject to land leases with one lease expiring in July 2029 and one lease expiring in November 2089.

We also hold a fee simple ownership interest in twelve of the Development Communities, two of which will be subject to joint venture ownership structures upon construction completion, in addition to a membership interest in a limited liability company that owns one Development Community subject to a land lease which expires in December 2026.

In each of our six partnerships structured as DownREITs, either AvalonBay or one of our wholly-owned subsidiaries is the general partner, and there are one or more limited partners whose interest in the partnership is represented by units of limited partnership interest. For each DownREIT partnership, limited partners are entitled to receive an initial distribution before any distribution is made to the general partner. Although the partnership agreements for each of the DownREITs are different, generally the distributions per unit paid to the holders of units of limited partnership interests have approximated our current common stock dividend amount. Each DownREIT partnership has been structured so that it is unlikely the limited partners will be entitled to a distribution greater than the initial distribution provided for in the applicable partnership agreement. The holders of units of limited partnership interest have the right to present each unit of limited partnership interest for redemption for cash equal to the fair market value of a share of our common stock on the date of redemption. In lieu of a cash redemption by the partnership, we may elect to acquire any unit presented for redemption for one share of our common stock or for such cash amount. As of October 29, 2004, there were 535,322 DownREIT partnership units outstanding. The DownREIT partnerships are consolidated for financial reporting purposes.

We elected to be taxed as a REIT for federal income tax purposes for the year ended December 31, 1994 and we have not revoked that election. We were incorporated under the laws of the State of California in 1978, and we were reincorporated in the State of Maryland in July 1995. Our principal executive offices are located at 2900 Eisenhower Avenue, Suite 300, Alexandria, Virginia, 22314, and our telephone number at that location is (703) 329-6300. We also maintain regional offices and administrative or specialty offices in or near the following cities:

- Boston, Massachusetts;
- Chicago, Illinois;
- New Canaan, Connecticut;
- New York, New York;
- Newport Beach, California;
- San Jose, California;
- Seattle, Washington; and
- Woodbridge, New Jersey.

Recent Developments

Development Activities. During the three months ended September 30, 2004, we completed the development of one community, Avalon at Grosvenor Station, located in the greater Washington, DC area. Avalon at Grosvenor Station is a garden-style community containing 497 apartment homes and was completed for a total capitalized cost of \$79,000,000. In addition, we commenced redevelopment on Avalon Towers, located in the Long Island, New York area, during the three months ended September 30, 2004. This community, which we acquired in 1995, contains 109 apartment homes and, if redeveloped as expected, will be completed for a total capitalized cost of \$21,500,000, of which \$17,300,000 was incurred prior to redevelopment.

The development and redevelopment of communities involves risks that the investment will fail to perform in accordance with our expectations. See “Risks of Development and Redevelopment” for our discussion of these and other risks inherent in developing or redeveloping communities.

Acquisition Activities. During the three months ended September 30, 2004, we acquired two communities, Briarcliffe Lakeside Apartments, located in the Chicago, Illinois area and Essex Place, located in the greater Boston metropolitan area. Briarcliffe Lakeside is a garden-style community containing 204 apartment homes and was acquired for an acquisition price of \$14,200,000, which includes the assumption of \$8,155,000 of fixed rate mortgage debt. Essex Place is a garden-style community containing 286 apartment homes and was acquired for an acquisition price of \$23,301,000. Essex Place was acquired upon exercise of a pre-existing purchase option that we entered into in 1998 at the same time as the acquisition, from the same seller, of an adjacent land parcel on which we subsequently developed and still own a community.

Disposition Activities. During the three months ended September 30, 2004, we sold one community, Avalon at Fox Mill, located in the greater Washington, DC metropolitan area. This community, which contained 165 apartment homes, was sold for a sales price of \$38,500,000. In addition, we sold a land parcel in Washington, DC, as well as certain transferable development rights acquired with an adjacent parcel of land on which a current operating community was developed, for a gross sales price of \$9,927,000.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”) requires management to use judgment in the application of accounting policies, including making estimates and assumptions. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, or different estimates or assumptions had been made, it is possible that different accounting policies would have been applied, resulting in different financial results or a different presentation of our financial statements. Below is a discussion of accounting policies that we consider critical, in that they may require complex judgment in their application or require estimates about matters which are inherently uncertain, and are critical to an understanding of our financial condition and operating results. As a REIT that owns, operates and develops apartment communities, our critical accounting policies relate to revenue recognition, cost capitalization, asset impairment evaluation and REIT status. A discussion of all of our accounting policies, including further discussion of the critical accounting policies described below, can be found in Note 1, “Organization and Significant Accounting Policies” of our Condensed Consolidated Financial Statements.

Revenue Recognition

Rental income related to leases is recognized on an accrual basis when due from residents in accordance with SEC Staff Accounting Bulletin No. 104, “Revenue Recognition” and Statement of Financial Accounting Standards No. 13, “Accounting for Leases.” In accordance with our standard lease terms, rental payments are generally due on a monthly basis. Any cash concessions given at the inception of the lease are amortized over the approximate life of the lease, which is generally one year. A discussion regarding the impact of cash concessions on rental revenue for Established Communities can be found in “Results of Operations.”

Cost Capitalization

We capitalize costs during the development of assets (including interest and related loan fees, property taxes and other direct and indirect costs) beginning when active development commences until the asset, or a portion of the asset, is delivered and is ready for its intended use, which is generally indicated by the issuance of a certificate of occupancy. We capitalize costs during redevelopment of apartment homes (including interest and related loan fees, property taxes and other direct and indirect costs) beginning when an apartment home is taken out-of-service for redevelopment until the apartment home redevelopment is completed and the apartment home is available for a new resident.

We capitalize pre-development costs incurred in pursuit of Development Rights for which we currently believe future development is probable. These costs include legal fees, design fees and related overhead costs. Future development of these Development Rights is dependent upon various factors, including zoning and regulatory approval, rental market conditions, construction costs and availability of capital. Pre-development costs incurred in the pursuit of Development Rights for which future development is not yet considered probable are expensed as incurred. In addition, if the status of a Development Right changes, deeming future development no longer probable, any capitalized pre-development costs are written-off with a charge to expense.

We generally capitalize only non-recurring expenditures. We capitalize improvements and upgrades only if the item: (i) exceeds \$15,000; (ii) extends the useful life of the asset; and (iii) is not related to making an apartment home ready for the next resident. Under this policy, virtually all capitalized costs are non-recurring, as recurring make-ready costs are expensed as incurred. Recurring make-ready costs include: (i) carpet and appliance replacements; (ii) floor coverings; (iii) interior painting; and (iv) other redecorating

costs. Because we expense carpet replacements, our expense levels and volatility are greatest in the third quarter of each year as this is when we experience our greatest amount of turnover. We capitalize purchases of personal property, such as computers and furniture, only if the item is a new addition and the item exceeds \$2,500. We generally expense replacements of personal property. For Established and Other Stabilized Communities, we recorded non-revenue generating capital expenditures of \$250 per apartment home in the nine months ended September 30, 2004 and \$252 per apartment home in the nine months ended September 30, 2003. The average maintenance costs charged to expense per apartment home, including carpet and appliance replacements, related to these communities was \$1,024 in the nine months ended September 30, 2004 and \$959 in the nine months ended September 30, 2003. Historically, we have experienced a gradual increase in capitalized costs and expensed maintenance costs per apartment home as the average age of our communities has increased, and expensed maintenance costs have fluctuated with turnover. We expect these trends to continue.

Asset Impairment Evaluation

If there is an event or change in circumstance that indicates an impairment in the value of a community, our policy is to assess the impairment by making a comparison of the current and projected operating cash flows of the community over its remaining useful life, on an undiscounted basis, to the carrying amount of the community. If the carrying amount is in excess of the estimated projected operating cash flows of the community, we would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value. Real estate assets held for sale are measured at the lower of the carrying amount or the fair value less the cost to sell.

We account for our investments in unconsolidated entities that are not variable interest entities in accordance with Statement of Position 78-9, "Accounting for Investments in Real Estate Ventures" and Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." If there is an event or change in circumstance that indicates a loss in the value of an investment, we record the loss and reduce the value of the investment to its fair value. A loss in value would be indicated if we could not recover the carrying value of the investment or if the investee could not sustain an earnings capacity that would justify the carrying amount of the investment.

REIT Status

A corporate REIT is a legal entity which holds real estate interests and must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its adjusted taxable income to stockholders. As a REIT, we generally will not be subject to corporate level federal income tax on taxable income we distribute currently to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may not be able to qualify as a REIT for four subsequent taxable years.

Results of Operations

Our year-over-year operating performance is primarily affected by changes in net operating income of our current operating apartment communities due to market conditions, net operating income derived from acquisitions and development completions, the loss of net operating income related to disposed communities and capital market, disposition and financing activity. A comparison of our operating results for the three and nine months ended September 30, 2004 and 2003 follows (dollars in thousands):

	For the three months ended				For the nine months ended			
	9-30-04	9-30-03	\$ Change	% Change	9-30-04	9-30-03	\$ Change	% Change
Revenue:								
Rental and other income	\$ 167,416	\$ 150,948	\$ 16,468	10.9%	\$ 486,578	\$ 446,576	\$ 40,002	9.0%
Management, development and other fees	157	234	(77)	(32.9%)	463	744	(281)	(37.8%)
Total revenue	167,573	151,182	16,391	10.8%	487,041	447,320	39,721	8.9%
Expenses:								
Direct property operating expenses, excluding property taxes	41,494	38,436	3,058	8.0%	118,171	107,901	10,270	9.5%
Property taxes	15,962	14,252	1,710	12.0%	46,734	42,256	4,478	10.6%
Total community operating expenses	57,456	52,688	4,768	9.0%	164,905	150,157	14,748	9.8%
Net operating income	110,117	98,494	11,623	11.8%	322,136	297,163	24,973	8.4%
Corporate-level property management and other indirect operating expenses	8,076	7,577	499	6.6%	25,480	22,630	2,850	12.6%
Interest expense	33,240	33,272	(32)	(0.1%)	98,006	101,313	(3,307)	(3.3%)
Depreciation expense	42,451	37,325	5,126	13.7%	121,886	110,906	10,980	9.9%
General and administrative expense	3,729	3,382	347	10.3%	11,771	10,636	1,135	10.7%
Total other expenses	87,496	81,556	5,940	7.3%	257,143	245,485	11,658	4.7%
Equity in income of unconsolidated entities	301	23,988	(23,687)	(98.7%)	764	25,192	(24,428)	(97.0%)
Interest income	42	852	(810)	(95.1%)	99	2,634	(2,535)	(96.2%)
Venture partner interest in profit-sharing	(252)	(420)	168	(40.0%)	(930)	(1,268)	338	(26.7%)
Minority interest in consolidated partnerships	(559)	(302)	(257)	85.1%	(833)	(754)	(79)	10.5%
Income from continuing operations before cumulative effect of change in accounting principle	22,153	41,056	(18,903)	(46.0%)	64,093	77,482	(13,389)	(17.3%)
Discontinued operations:								
Income from discontinued operations	451	2,756	(2,305)	(83.6%)	1,899	11,602	(9,703)	(83.6%)
Gain on sale of real estate assets	22,762	13,575	9,187	67.7%	35,137	82,158	(47,021)	(57.2%)
Total discontinued operations	23,213	16,331	6,882	42.1%	37,036	93,760	(56,724)	(60.5%)
Income before cumulative effect of change in accounting principle	45,366	57,387	(12,021)	(20.9%)	101,129	171,242	(70,113)	(40.9%)
Cumulative effect of change in accounting principle	—	—	—	—	4,547	—	4,547	100.0%
Net income	45,366	57,387	(12,021)	(20.9%)	105,676	171,242	(65,566)	(38.3%)
Dividends attributable to preferred stock	(2,175)	(2,175)	—	—	(6,525)	(8,569)	2,044	(23.9%)
Net income available to common stockholders	\$ 43,191	\$ 55,212	\$ (12,021)	(21.8%)	\$ 99,151	\$ 162,673	\$ (63,522)	(39.0%)

Net income available to common stockholders decreased \$12,021,000, or 21.8%, to \$43,191,000 for the three months ended September 30, 2004 and decreased by \$63,522,000 or 39.0% to \$99,151,000 for the nine months ended September 30, 2004 compared to the same periods in the preceding year. These decreases are primarily attributable to reduced disposition activity from the historically high levels experienced in 2003.

Net operating income ("NOI") is defined by us as total revenue less direct property operating expenses, including property taxes, and excludes corporate-level property management and other indirect operating expenses, interest income and expense, general and administrative expense, equity in income of unconsolidated entities, minority interest in consolidated partnerships, venture partner interest in profit-sharing, depreciation expense, gain on sale of real estate assets, cumulative effect of change in accounting principle and income from discontinued operations. We believe that NOI is an important and appropriate supplemental measure to net income of the operating performance of our communities because it helps both investors and management to understand the core operations of a community or communities prior to the allocation of any corporate-level or financing-related costs. This is more reflective of the operating performance of a community, and allows for an easier comparison of the operating performance of individual assets or groups of assets. In addition, because prospective buyers of real estate have different

overhead structures, with varying marginal impact to overhead by acquiring real estate, NOI is considered by many in the real estate industry to be a useful measure for determining the value of a real estate asset or group of assets. NOI does not represent cash generated from operating activities in accordance with GAAP. Therefore, NOI should not be considered an alternative to net income as an indication of our performance. NOI should also not be considered an alternative to net cash flows from operating activities, as determined by GAAP, as a measure of liquidity, nor is NOI necessarily indicative of cash available to fund cash needs. A calculation of NOI for the three and nine months ending September 30, 2004 and 2003, along with a reconciliation to net income, is provided in the preceding table.

The NOI increases of \$11,623,000 and \$24,973,000 for the three and nine months ended September 30, 2004, respectively, as compared to the prior year periods consists of changes in the following categories:

	2004 NOI Increase (Decrease)	
	For the three months ended 9-30-04	For the nine months ended 9-30-04
Established Communities	\$ 430,000	\$ (4,360,000)
Other Stabilized Communities	3,956,000	14,264,000
Development and Redevelopment Communities	7,315,000	15,290,000
Non-allocated	(78,000)	(221,000)
Total	\$ 11,623,000	\$ 24,973,000

The NOI decrease in Established Communities during the nine months ended September 30, 2004 as compared to the same period of 2003 was largely due to the effects of the weakened economy in many of our markets during the first half of the year. The impact of historical job losses in many of our markets, in addition to strong single-family home sales, aggravated a weak demand environment, which caused market rental rates to decline. However, we have experienced modest job growth and declining unemployment claims in our markets in 2004, suggesting the beginning of an economic recovery. Strengthening apartment fundamentals, along with strong on-site execution, resulted in an increase in NOI from Established Communities during the three months ended September 30, 2004 as compared to the same period of 2003, the first increase in NOI that we have experienced in two and a half years. Although the recent job growth appears to be stabilizing apartment fundamentals, we still expect modest year-over-year declines in our Established Communities NOI for the full year 2004. We have reached 95% occupancy, a point at which we generally regain pricing power, and we are therefore beginning to test revenue growth through modest rental rate increases and/or reductions in concessions. This, combined with aggressively managing operating expenses, should allow us to mitigate declines in NOI during the remainder of 2004 and to position for growth in 2005.

Rental and other income increased in the three and nine months ended September 30, 2004 as compared to the prior year periods due to rental income generated from newly developed and acquired communities and increased occupancy, partially offset by declines in effective rental rates.

Overall Portfolio – The weighted average number of occupied apartment homes increased to 35,979 apartment homes for the nine months ended September 30, 2004 as compared to 32,794 apartment homes for the nine months ended September 30, 2003. This change is primarily the result of increased homes available from newly developed communities and an increase in the overall occupancy rate, partially offset by communities sold in 2003 and 2004. The weighted average monthly revenue per occupied apartment home decreased to \$1,500 in the nine months ended September 30, 2004 as compared to \$1,512 in the nine months ended September 30, 2003, primarily due to the high concessionary environment experienced in certain of our markets.

Established Communities – Rental revenue increased \$510,000, or 0.5%, in the three months ended September 30, 2004 as compared to the same period of 2003. This increase is due to an increase in economic occupancy, partially offset by declining rental rates during 2004. However, rental revenue decreased \$3,189,000, or 1.0%, in the nine months ended September 30, 2004 as

compared to the same period of 2003, as the increase in economic occupancy was not large enough to offset the declining rental rates during that period. For the nine months ended September 30, 2004, the weighted average monthly revenue per occupied apartment home decreased 2.3% to \$1,418 compared to \$1,452 for the nine months ended September 30, 2003, partially due to increased concessions granted throughout 2003 and into 2004. The average economic occupancy increased from 93.8% in the nine months ended September 30, 2003 to 95.1% in the nine months ended September 30, 2004. Economic occupancy takes into account the fact that apartment homes of different sizes and locations within a community have different economic impacts on a community's gross revenue. Economic occupancy is defined as gross potential revenue less vacancy loss, as a percentage of gross potential revenue. Gross potential revenue is determined by valuing occupied homes at leased rates and vacant homes at market rents. We expect our Established Communities' operating performance to remain at current levels for the remainder of 2004, which when combined with the operating results from the beginning of 2004, will result in rental income for Established Communities that is modestly down or flat for the full year 2004 as compared to 2003.

Although rental revenue from the Established Community portfolio as a whole decreased in the nine months ended September 30, 2004 as compared to the same period of 2003, we had increases in Established Communities' rental revenue in four of our six regions. The largest increase was in the Mid-Atlantic with an increase in rental revenue of 2.6% between periods, reflecting an increase in both economic occupancy and average rental rates. In addition, in Southern California, we were able to increase average rental rates by 1.2%, while maintaining an economic occupancy in excess of 95%, resulting in an increase in rental revenue of 1.5% between periods. The Midwest and Pacific Northwest experienced increases in rental revenue of 2.1% and 0.9%, respectively, during the nine months ended September 30, 2004 as compared to the same period of 2003, reflecting increased economic occupancy partially offset by declining average rental rates.

However, our total rental revenue from Established Communities was impacted by the continued declines in average rental rates in certain Northern California and Northeast markets. Northern California, which accounted for approximately 31.1% of Established Community rental revenue during the nine months ended September 30, 2004, experienced a decline in rental revenue of 4.0% in the nine months ended September 30, 2004 as compared to the same period in 2003, partially related to the continued impact of historical job losses in the technology sector. Although economic occupancy in Northern California increased to 95.5% in the nine months ended September 30, 2004, average rental rates dropped 4.4% to \$1,363 from \$1,426 during 2003. We expect year-over-year rental revenue to decline slightly in Northern California for the remainder of the year as the region continues to stabilize.

The Northeast region accounted for approximately 34.2% of Established Community rental revenue during the nine months ended September 30, 2004 and experienced a year-over-year decline in rental revenue of 0.8%, primarily due to the continued impact of historical job losses in the financial services sector. Although economic occupancy increased to 94.4% during the nine months ended September 30, 2004, average rental rates dropped 2.5% to \$1,803 from \$1,850 in 2003. The Northeast region appears to be stabilizing, as reflected in year-over-year rental revenue growth in the three months ended September 30, 2004 as compared to the same period of 2003. However, we expect pressure on rental rates to continue in the Northeast region, resulting in year-over-year rental revenue declines for the remainder of 2004 as compared to 2003. We expect these year-over-year rental revenue declines to diminish as compared to those experienced in prior periods.

In accordance with GAAP, cash concessions are amortized as an offset to rental revenue over the approximate lease term, which is generally one year. However, we consider rental revenue with concessions stated on a cash basis to be a supplemental measure to rental revenue in conformity with GAAP in helping investors to evaluate the impact of both current and historical concessions on GAAP based rental revenue and to more readily enable comparisons to revenue as reported by other companies. In addition, rental revenue with concessions stated on a cash basis allows an investor to understand the historical trend in cash concessions, which is an indicator of current rental market conditions.

The following table reconciles total rental revenue in conformity with GAAP to total rental revenue adjusted to state concessions on a cash basis for our Established Communities for the three and nine months ended September 30, 2004 and 2003 (dollars in thousands).

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Rental revenue (GAAP basis)	\$ 110,559	\$ 110,049	\$ 329,124	\$ 332,313
Concessions amortized	4,289	3,345	12,093	8,912
Concessions granted	(5,252)	(4,634)	(13,020)	(10,357)
Rental revenue adjusted to state concessions on a cash basis	\$ 109,596	\$ 108,760	\$ 328,197	\$ 330,868
Year-over-year % change — GAAP revenue	0.5%	n/a	(1.0%)	n/a
Year-over-year % change — cash concession based revenue	0.8%	n/a	(0.8%)	n/a

Concessions granted per move-in for Established Communities averaged \$912 during the three months ended September 30, 2004, an increase of 6.7% from \$855 in the three months ended September 30, 2003. This increase was primarily a result of our efforts to increase occupancy during 2004 to offset the continued impact of the weakened demand/supply fundamentals in many of our markets from 2003. Concessions granted per move-in have begun to decrease in recent months and are expected to continue to decrease in the future as occupancy remains at stabilized levels and we regain pricing power. However, because we amortize concessions over the lease term, these historically high concessions will continue to impact our operating results in future periods.

Direct property operating expenses, excluding property taxes increased in the three and nine months ended September 30, 2004 due to the addition of recently developed and redeveloped apartment homes, coupled with increased expenses due to salary increases and leasing bonuses, as well as increased make-ready costs associated with increasing occupancy.

For Established Communities, direct property operating expenses, excluding property taxes, increased \$228,000, or 0.9%, for the three months ended September 30, 2004 and \$1,427,000, or 1.9%, for the nine months ended September 30, 2004 as compared to the same periods of 2003 due to increased salaries and leasing bonuses, as well as increased make-ready costs associated with increasing occupancy. We expect expense growth to continue to moderate in 2004 as we experience declines in the historical high levels of property insurance costs and bad debt expenses with changes in the insurance markets and the overall economy.

Property taxes increased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 due to overall higher assessments and the addition of newly developed and redeveloped apartment homes, partially offset by property tax refunds.

For Established Communities, property taxes decreased by \$125,000 and \$221,000 in the three and nine months ended September 30, 2004, respectively, as compared to the same periods of 2003, due to successful tax appeals, partially offset by overall higher assessments throughout all regions. We expect property taxes to increase for the remainder of 2004 as local jurisdictions continue to look for additional revenue sources to offset budget deficits. We manage property tax increases internally, as well as engage third-party consultants, and appeal increases when appropriate.

Corporate-level property management and other indirect operating expenses increased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 as a result of construction litigation relating to a community that has completed development, litigation and settlement costs associated with Proposition 65 signage requirements at our California communities, increased compensation costs, and increased abandoned pursuit costs. Abandoned pursuit costs increased \$279,000 from \$1,109,000 in the nine months ended September 30, 2003 to \$1,388,000 in the nine months ended September 30, 2004.

Abandoned pursuit costs can be volatile, and the increases reflected during the nine months ended September 30, 2004 compared to the same period of 2003 may not be experienced in future periods. We expect corporate-level property management and other indirect operating expenses to continue to increase during the year due to the costs associated with a potential discretionary investment management fund and increased legal costs relating to ongoing lawsuits.

Interest expense decreased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 primarily due to the repayment of certain unsecured notes and overall lower interest rates on both short-term and long-term borrowings, partially offset by higher average outstanding balances on our unsecured credit facility.

Depreciation expense increased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 primarily due to the completion of development and redevelopment activities, as well as the acquisition of new communities in 2004.

General and administrative expense (“G&A”) increased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 as a result of higher compensation expense and additional corporate governance costs, including costs relating to compliance with Sarbanes-Oxley. We expect G&A to continue to reflect year-over-year increases in 2004 due to increased corporate governance (primarily Sarbanes-Oxley compliance) and compensation costs, partially offset by a decrease in our directors and officers (“D&O”) insurance resulting from our March 2004 renewal at a lower premium.

Equity in income of unconsolidated entities decreased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 primarily due to absence of the gain received on a community sold in 2003 which was accounted for under the equity method in which we held a 50% interest.

Interest income decreased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 due to lower average cash balances invested and lower interest rates. In addition, effective January 1, 2004, we consolidated an entity in which we held a participating mortgage note due to the implementation of FASB Interpretation No. 46 (“FIN 46”), “Consolidation of Variable Interest Entities, and Interpretation of ARB No. 51,” as revised in December 2003. Therefore, interest income that we recognized during the three and nine months ended September 30, 2003 is not reflected during the three and nine months ended September 30, 2004 as such amounts were eliminated in consolidation. (See Note 1, “Organization and Significant Accounting Policies,” of the Condensed Consolidated Financial Statements.) On October 15, 2004, we received payment in full of the outstanding mortgage loan due from this entity. The mortgage loan was repaid prior to its scheduled maturity, and therefore the total proceeds of \$33,994,000 included an early prepayment premium of approximately \$1,240,000 (net of related legal costs) along with the unpaid principal balance and accrued interest.

Income from discontinued operations represents the net income generated by communities sold during the period from January 1, 2003 through September 30, 2004. The decreases in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 are due to the sale of eleven communities in 2003 and three communities in 2004.

Gain on sale of communities decreased in the three and nine months ended September 30, 2004 as compared to the same periods of 2003 due to the reduced disposition activity in 2004 as compared to the prior year. The amount of gains realized depends on many factors, including the number of communities sold, the size and carrying value of those communities and the market conditions in the local area. We expect to sell fewer assets in 2004 as compared to 2003, which will result in less aggregate gains on assets sold.

Cumulative effect of change in accounting principle during the nine months ended September 30, 2004 is a result of the implementation of FIN 46, discussed above, and represents the difference between the net assets consolidated under FIN 46 and the previously recorded net assets.

Dividends attributable to preferred stock decreased during the nine months ended September 30, 2004 as compared to the same periods of 2003 primarily as a result of two preferred stock redemptions during the nine months ended September 30, 2003.

Funds from Operations attributable to common stockholders ("FFO") is considered by management an appropriate supplemental measure of our operating and financial performance because, by excluding gains or losses related to dispositions of previously depreciated property and excluding real estate depreciation, which can vary among owners of identical assets in similar condition based on historical cost accounting and useful life estimates, FFO can help one compare the operating performance of a real estate company between periods or as compared to different companies. We believe that in order to understand our operating results, FFO should be examined with net income as presented in the Condensed Consolidated Statements of Operations and Other Comprehensive Income included elsewhere in this report.

Consistent with the definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts[®] ("NAREIT"), we calculate FFO as net income or loss computed in accordance with GAAP, adjusted for:

- gains or losses on sales of previously depreciated operating communities;
- extraordinary gains or losses (as defined by GAAP);
- cumulative effect of a change in accounting principle;
- depreciation of real estate assets; and
- adjustments for unconsolidated partnerships and joint ventures.

During the three months ended September 30, 2004, we changed our methodology for the calculation of FFO to include gains or losses on undepreciated property (i.e. land). The inclusion of these gains or losses is acceptable, but not required, under the definition of FFO adopted by NAREIT. The treatment of these gains and losses varies within the REIT industry; however, we believe that inclusion of these gains and losses allows for a better comparison of our reported FFO to FFO as reported by our peers in the apartment REIT industry.

FFO does not represent net income in accordance with GAAP, and therefore it should not be considered an alternative to net income, which remains the primary measure, as an indication of our performance. In addition, FFO as calculated by other REITs may not be comparable to our calculation of FFO. The following is a reconciliation of net income to FFO (dollars in thousands, except per share data):

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Net income	\$ 45,366	\$ 57,387	\$ 105,676	\$ 171,242
Dividends attributable to preferred stock	(2,175)	(2,175)	(6,525)	(8,569)
Depreciation - - real estate assets, including discontinued operations and joint venture adjustments	41,152	14,237	118,704	89,306
Minority interest expense, including discontinued operations	882	285	2,121	1,047
Cumulative effect of change in accounting principle	—	—	(4,547)	—
Gain on sale of operating communities	(21,624)	(13,575)	(33,999)	(82,158)
Funds from operations attributable to common stockholders	<u>\$ 63,601</u>	<u>\$ 56,159</u>	<u>\$ 181,430</u>	<u>\$ 170,868</u>
Weighted average common shares outstanding - diluted	73,583,724	70,531,920	73,074,108	69,524,228
EPS per common share - diluted	<u>\$ 0.60</u>	<u>\$ 0.79</u>	<u>\$ 1.39</u>	<u>\$ 2.35</u>
FFO per common share - diluted	<u>\$ 0.86</u>	<u>\$ 0.80</u>	<u>\$ 2.48</u>	<u>\$ 2.46</u>

FFO also does not represent cash generated from operating activities in accordance with GAAP, and therefore should not be considered an alternative to net cash flows from operating activities, as determined by GAAP, as a measure of liquidity. Additionally, it is not necessarily indicative of cash available to fund cash needs. A presentation of GAAP based cash flow metrics is as follows (dollars in thousands) and a discussion of “Liquidity and Capital Resources” can be found below.

	For the three months ended		For the nine months ended	
	9-30-04	9-30-03	9-30-04	9-30-03
Net cash provided by operating activities	\$ 59,715	\$ 34,859	\$ 195,624	\$ 164,540
Net cash used in investing activities	\$ (70,140)	\$ (20,903)	\$(232,564)	\$ (40,785)
Net cash provided by (used in) financing activities	\$ 41,501	\$ (28,635)	\$ 63,352	\$(129,900)

Liquidity and Capital Resources

An important source of liquidity is our cash flows from operations. Operating cash flows have historically been determined by: (i) the number of apartment homes currently owned, (ii) rental rates, (iii) occupancy levels and (iv) operating expenses with respect to apartment homes. The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, particularly to changes in interest rates. Changes in the capital markets environment, such as changes in interest rates or the availability of cost-effective capital, affect our plans for development, redevelopment, acquisition and disposition activity.

We regularly review our liquidity needs, the adequacy of cash flow from operations, and other expected liquidity sources to meet these needs. We believe our principal short-term liquidity needs are to fund:

- normal recurring operating expenses;
- debt service and maturity payments;
- preferred stock dividends and DownREIT partnership unit distributions;
- the minimum dividend payments required to maintain our REIT qualification under the Internal Revenue Code of 1986;
- development and redevelopment activity in which we are currently engaged; and
- opportunities for the acquisition of improved property.

We anticipate that we can fully satisfy these needs from a combination of cash flows provided by operating activities, proceeds from asset dispositions and borrowing capacity under our variable rate unsecured credit facility.

Cash and cash equivalents totaled \$33,577,000 at September 30, 2004, an increase of \$26,412,000 from \$7,165,000 on December 31, 2003. The following discussion relates to changes in cash due to operating, investing and financing activities, which are presented in our Condensed Consolidated Statements of Cash Flows included elsewhere in this report.

Operating Activities – Net cash provided by operating activities increased to \$195,624,000 for the nine months ended September 30, 2004 from \$164,540,000 for the nine months ended September 30, 2003, primarily due to additional NOI from recently acquired and developed communities, partially offset by the loss of NOI from the fourteen communities sold in 2003 and 2004, as discussed earlier in this report.

Investing Activities – Net cash used in investing activities of \$232,564,000 in the nine months ended September 30, 2004 related to investments in assets through development, redevelopment and acquisition of apartment communities. During the nine months ended September 30, 2004, we invested \$322,927,000 in the purchase and development of real estate and capital expenditures:

- We began the development of five new communities. These communities, if developed as expected, will contain a total of 1,171 apartment homes, and the total capitalized cost, including

land acquisition costs, is projected to be approximately \$216,200,000. We completed the development of three communities containing a total of 1,012 apartment homes for a total capitalized cost, including land acquisition cost, of \$175,000,000.

- We began the redevelopment of one new community which we acquired in 1995. This community contains 109 apartment homes and, if redeveloped as expected, will be completed for a total capitalized cost of \$21,500,000, of which \$17,300,000 was incurred prior to redevelopment. We completed the redevelopment of one community containing 308 apartment homes for a total capitalized cost of \$44,000,000, of which \$35,700,000 was incurred prior to redevelopment.
- We acquired three communities containing 595 apartment homes for an aggregate purchase price of \$61,566,000.
- We acquired seven parcels of land in connection with Development Rights for an aggregate purchase price of \$76,525,000.
- We had capital expenditures relating to current communities' real estate assets of \$10,761,000 and non-real estate capital expenditures of \$589,000.

Financing Activities – Net cash provided by financing activities totaled \$63,352,000 for the nine months ended September 30, 2004, primarily due to an increase in borrowings under our unsecured credit facility, issuance of mortgage notes payable, issuance of common stock for option exercises and issuance of unsecured notes, partially offset by dividends paid and certain debt repayments. See Note 3, “Notes Payable, Unsecured Notes and Credit Facility,” and Note 4, “Stockholders’ Equity,” of our Condensed Consolidated Financial Statements, for additional information.

Variable Rate Unsecured Credit Facility

We have a \$500,000,000 revolving variable rate unsecured credit facility with JPMorgan Chase Bank and Wachovia Bank, N.A. serving as banks and syndication agents for a syndicate of commercial banks. Under the terms of the credit facility, if we elect to increase the facility by up to an additional \$150,000,000, and one or more banks (from the syndicate or otherwise) voluntarily agree to provide the additional commitment, then we will be able to increase the facility up to \$650,000,000, and no member of the syndicate of banks can prohibit such increase; such an increase in the facility will only be effective to the extent banks (from the syndicate or otherwise) choose to commit to lend additional funds. We pay participating banks, in the aggregate, an annual facility fee of approximately \$750,000 in quarterly installments. The unsecured credit facility bears interest at varying levels based on the London Interbank Offered Rate (“LIBOR”), rating levels achieved on our unsecured notes and on a maturity schedule selected by us. The current stated pricing is LIBOR plus 0.55% per annum (2.55% on October 29, 2004). The spread over LIBOR can vary from LIBOR plus 0.50% to LIBOR plus 1.15% based upon the rating of our long-term unsecured debt. In addition, a competitive bid option is available for borrowings of up to \$250,000,000. This option allows banks that are part of the lender consortium to bid to provide us loans at a rate that is lower than the stated pricing provided by the unsecured credit facility. The competitive bid option may result in lower pricing if market conditions allow. We had \$150,000,000 outstanding under this competitive bid option at October 29, 2004 priced at LIBOR plus 0.29%, or 2.16%. We are subject to (i) certain customary covenants under the unsecured credit facility, including, but not limited to, maintaining certain maximum leverage ratios, a minimum fixed charges coverage ratio and minimum unencumbered assets and equity levels, and (ii) prohibitions on paying dividends in amounts that exceed 95% of our FFO, except as may be required to maintain our REIT status. The credit facility matures in May 2008, assuming our exercise of a one-year renewal option. At October 29, 2004, \$168,000,000 was outstanding, \$25,874,000 was used to provide letters of credit and \$306,126,000 was available for borrowing under the unsecured credit facility.

Future Financing and Capital Needs – Debt Maturities

One of our principal long-term liquidity needs is the repayment of medium and long-term debt at the time that such debt matures. For unsecured notes, we anticipate that no significant portion of the principal of these notes will be repaid prior to maturity. If we do not have funds on hand sufficient to repay our indebtedness as it becomes due, it will be necessary for us to refinance the debt. This refinancing may be

accomplished by uncollateralized private or public debt offerings, additional debt financing that is collateralized by mortgages on individual communities or groups of communities, draws on our unsecured credit facility or by additional equity offerings. Although we believe we will have the capacity to meet our long-term liquidity needs, we cannot assure you that additional debt financing or debt or equity offerings will be available or, if available, that they will be on terms we consider satisfactory.

As of October 29, 2004, the following current year debt activity occurred:

- We repaid \$125,000,000 in previously issued unsecured notes, along with any unpaid interest, pursuant to their scheduled maturity, and no prepayment penalties were incurred. In addition, we issued \$150,000,000 in unsecured notes under our existing shelf registration statement at an annual interest rate of 5.375%. Interest on these notes is payable semi-annually on April 15 and October 15, and they mature in April 2014;
- We repaid \$24,251,000 in fixed rate mortgage debt secured by two current communities, along with any unpaid interest, repaid \$10,400,000 in variable rate, tax-exempt debt related to the sale of a community and transferred \$18,755,000 in variable rate, tax-exempt debt related to the sale of a community to the purchaser;
- We issued \$42,800,000 in variable rate, conventional debt on two communities, including interest rate protection agreements that serve to effectively limit the level to which interest rates can rise to a rate of 10.0%;
- We obtained a \$50,000,000 secured construction loan for the construction of a development community that will be owned and operated in a joint venture entity upon completion. Outstanding draws will bear interest at a variable rate and will come due in March 2008, assuming the exercise of two one-year extension options;
- We issued \$16,765,000 in variable rate, conventional debt on one community;
- We assumed \$8,155,000 in fixed rate, conventional mortgage debt in conjunction with the acquisition of a community;
- We assumed \$13,322,000 in fixed rate debt in connection with the acquisition of two parcels of improved land related to two Development Rights;
- We replaced the credit enhancements, including interest rate swaps, on approximately \$87,000,000 of our variable rate, tax-exempt debt when such credit enhancements expired. We put in place interest rate protection agreements that serve to effectively limit the level to which interest rates can rise to a range of 6.7% to 9.0%; and
- We renegotiated the terms of a fixed rate, tax-exempt bond on one community in the amount of \$9,780,000 to decrease the annual interest rate from 7.0% to 4.9%.

The following table details debt maturities for the next five years, excluding our unsecured credit facility, for debt outstanding at September 30, 2004 (dollars in thousands):

Community	All-In interest rate (1)	Principal maturity date	Balance outstanding		Scheduled maturities					
			12-31-03	9-30-04	2004	2005	2006	2007	2008	Thereafter
Tax-exempt bonds										
<i>Fixed rate</i>										
CountryBrook	6.30%	Mar-2012	\$ 17,628	\$ 17,280	\$ 180	\$ 562	\$ 599	\$ 638	\$ 679	\$ 14,622
Avalon at Symphony Glen	4.90%	Jul-2024	9,780	9,780	—	—	—	—	—	9,780
Avalon View	7.55%	Aug-2024	17,345	17,030	110	455	485	518	555	14,907
Avalon at Lexington	6.56%	Feb-2025	13,477	13,234	83	347	368	391	415	11,630
Avalon at Nob Hill	5.80%	Jun-2025	19,149	18,931(2)	113	355	380	408	437	17,238
Avalon Campbell	6.48%	Jun-2025	35,065	34,582(2)	250	786	843	904	969	30,830
Avalon Pacifica	6.48%	Jun-2025	15,906	15,687(2)	113	356	382	410	440	13,986
Avalon Knoll	6.95%	Jun-2026	12,748	12,565	63	263	282	302	324	11,331
Avalon Landing	6.85%	Jun-2026	6,301	6,209	32	132	142	152	162	5,589
Avalon Fields	7.55%	May-2027	11,106	10,962	49	207	222	239	256	9,989
Avalon West	7.73%	Dec-2036	8,396	8,345	19	75	80	85	91	7,995
Avalon Oaks	7.45%	Jul-2041	17,530	17,453	27	112	120	128	138	16,928
Avalon Oaks West	7.48%	Apr-2043	17,336	17,264	24	103	110	117	125	16,785
			201,767	199,322	1,063	3,753	4,013	4,292	4,591	181,610
<i>Variable rate (4)</i>										
Avalon at Laguna Niguel (5)	—	Mar-2009	10,400	—	—	—	—	—	—	—
The Promenade	2.56%	Oct-2010	33,185	32,929	266	562	605	652	701	30,143
Waterford	2.02%	Jul-2014	33,100	33,100(3)	—	—	—	—	—	33,100
Avalon at Mountain View	2.02%	Feb-2017	18,300	18,300(3)	—	—	—	—	—	18,300
Avalon at Foxchase I	2.02%	Nov-2017	16,800	16,800(3)	—	—	—	—	—	16,800
Avalon at Foxchase II	2.02%	Nov-2017	9,600	9,600(3)	—	—	—	—	—	9,600
Fairway Glen	2.02%	Nov-2017	9,580	9,580(3)	—	—	—	—	—	9,580
Avalon at Mission Viejo	2.57%	Jun-2025	7,039	6,959(6)	41	129	139	149	160	6,341
Avalon Greenbriar (5)	—	May-2026	18,755	—	—	—	—	—	—	—
Avalon at Fairway Hills I	2.51%	Jun-2026	11,500	11,500	—	—	—	—	—	11,500
			168,259	138,768	307	691	744	801	861	135,364
Conventional loans (7)										
<i>Fixed rate</i>										
\$125 Million unsecured notes	6.733%	Feb-2004	125,000	—	—	—	—	—	—	—
\$100 Million unsecured notes	6.750%	Jan-2005	100,000	100,000	—	100,000	—	—	—	—
\$50 Million unsecured notes	6.500%	Jan-2005	50,000	50,000	—	50,000	—	—	—	—
\$150 Million unsecured notes	6.926%	Jul-2006	150,000	150,000	—	—	150,000	—	—	—
\$150 Million unsecured notes	5.178%	Aug-2007	150,000	150,000	—	—	—	150,000	—	—
\$110 Million unsecured notes	7.128%	Dec-2007	110,000	110,000	—	—	—	110,000	—	—
\$50 Million unsecured notes	6.625%	Jan-2008	50,000	50,000	—	—	—	—	50,000	—
\$150 Million unsecured notes	8.374%	Jul-2008	150,000	150,000	—	—	—	—	150,000	—
\$150 Million unsecured notes	7.634%	Aug-2009	150,000	150,000	—	—	—	—	—	150,000
\$200 Million unsecured notes	7.665%	Dec-2010	200,000	200,000	—	—	—	—	—	200,000
\$300 Million unsecured notes	6.792%	Sep-2011	300,000	300,000	—	—	—	—	—	300,000
\$50 Million unsecured notes	6.314%	Sep-2011	50,000	50,000	—	—	—	—	—	50,000
\$250 Million unsecured notes	6.261%	Nov-2012	250,000	250,000	—	—	—	—	—	250,000
\$150 Million unsecured notes	5.508%	Apr-2014	—	150,000	—	—	—	—	—	150,000
Avalon at Pruneyard	7.250%	May-2004	12,870	—	—	—	—	—	—	—
Avalon Walk II	8.930%	Aug-2004	11,437	—	—	—	—	—	—	—
Briarcliffe Lakeside	6.900%	Feb-2008	—	8,136	32	133	142	153	7,676	—
Wheaton Development Right	6.990%	Oct-2008	—	4,677	22	71	77	82	4,425	—
Twinbrook Development Right	7.250%	Oct-2011	—	8,585	49	158	171	183	196	7,828
Avalon Redondo Beach	4.840%	Oct-2011	—	16,765	—	—	—	—	—	16,765
Avalon Orchards	7.650%	Jul-2033	20,574	20,409	57	237	254	272	292	19,297
			1,879,881	1,918,572	160	150,599	150,644	260,690	212,589	1,143,890
<i>Variable rate (4)</i>										
Avalon on the Sound (8)	3.20%	Apr-2005	36,526	36,199	112	36,087	—	—	—	—
Avalon Ledges	3.21%	May-2009	—	19,815(6)	141	583	616	651	688	17,136
Avalon at Flanders Hill	3.21%	May-2009	—	22,589(6)	160	665	703	742	784	19,535
			36,526	78,603	413	37,335	1,319	1,393	1,472	36,671
Total indebtedness - excluding unsecured credit facility			<u>\$2,286,433</u>	<u>\$2,335,265</u>	<u>\$1,943</u>	<u>\$192,378</u>	<u>\$156,720</u>	<u>\$267,176</u>	<u>\$219,513</u>	<u>\$1,497,535</u>

(1) Includes credit enhancement fees, facility fees, trustees' fees and other fees.

(2) Financed by variable rate, tax-exempt debt, but interest rate is effectively fixed at September 30, 2004 at the rate indicated through a swap agreement.

(3) Financed by variable rate, tax-exempt debt, that was effectively fixed through a swap agreement at December 31, 2003 and was reported as fixed rate debt at that time. The debt was restructured in February 2004 such that the interest rate was capped through an interest rate protection agreement and is currently included as variable rate debt for financial reporting purposes.

(4) Variable rates are given as of September 30, 2004.

(5) Included in liabilities related to real estate assets held for sale on our Condensed Consolidated Balance Sheets as of December 31, 2003 included elsewhere in this report.

(6) Financed by variable rate debt, but interest rate is capped through an interest rate protection agreement.

- (7) Balances outstanding do not include \$558 of debt discount and \$284 of debt premium as of September 30, 2004 and December 31, 2003, respectively, reflected in unsecured notes on our Condensed Consolidated Balance Sheets included elsewhere in this report.
- (8) Variable rate construction loan was refinanced in March 2004, extending the maturity date to April 2005.

Future Financing and Capital Needs – Portfolio and Other Activity

As of September 30, 2004, we had thirteen new communities under construction, for which a total estimated cost of \$181,844,000 remained to be invested. In addition, we had two communities under reconstruction, for which a total estimated cost of \$7,132,000 remained to be invested. Substantially all of the capital expenditures necessary to complete the communities currently under construction and reconstruction, as well as development costs related to pursuing Development Rights, will be funded from:

- the remaining capacity under our current \$500,000,000 unsecured credit facility;
- the net proceeds from sales of existing communities;
- retained operating cash;
- the issuance of debt or equity securities; and/or
- private equity funding.

Before planned reconstruction activity or the construction of a Development Right begins, we intend to arrange adequate financing to complete these undertakings, although we cannot assure you that we will be able to obtain such financing. In the event that financing cannot be obtained, we may have to abandon Development Rights, write-off associated pre-development costs that were capitalized and/or forego reconstruction activity. In such instances, we will not realize the increased revenues and earnings that we expected from such Development Rights.

We sell assets that do not meet our long-term investment criteria or when capital and real estate markets allow us to realize a portion of the value created over the past business cycle and redeploy the proceeds from those sales to develop and redevelop communities. In response to real estate and capital markets conditions, including strong institutional demand for product in our markets, we have sold and plan to continue selling communities in 2004, although at reduced levels as compared to past disposition activity. However, we cannot assure you that assets can continue to be sold on terms that we consider satisfactory or that market conditions will continue to make the sale of assets an appealing strategy. Because the proceeds from the sale of communities may not be immediately redeployed into revenue generating assets, the immediate effect of a sale of a community for a gain is to increase net income, but reduce future total revenues, total expenses, NOI and FFO. As of October 29, 2004, we have three communities classified as held for sale under GAAP. We are actively pursuing the disposition of these communities and expect to close on these dispositions in 2004. However, we cannot assure you that these communities will be sold as planned.

We are engaging in discussions with a limited number of institutional investors regarding the possible formation of a discretionary fund that would acquire and operate apartment communities. This fund would serve, for a period of three years from the date of its final closing or until a significant portion of its committed capital is invested, as the exclusive vehicle through which we would acquire apartment communities, subject to certain exceptions including, among others, significant individual asset and portfolio acquisitions, properties acquired in tax-deferred transactions and acquisitions that are inadvisable or inappropriate for the fund, if any. The fund would not restrict our development activities, which would not be a part of the fund, and would terminate after a term of eight years (subject to two one-year extensions). We may also acquire certain assets and transfer our interests in those assets to the fund upon its formation. As of October 29, 2004, we have acquired two communities which we intend to transfer to the fund upon its formation, but which are currently consolidated and included in our operating results. We have preliminarily targeted that the fund would have approximately \$715,000,000 available for investment (consisting of approximately \$250,000,000 of fund equity, of which we would commit approximately 20% of the total, and approximately \$465,000,000 of debt financing). We have identified a lead investor for the fund and anticipate closing on the first round of equity funding by the end of 2004 or the beginning of 2005. We intend to actively pursue the formation of the fund, but there can be no assurance as to when or if such a fund will be formed or, if formed, what its size, terms or investment performance will be.

We have also recently increased our use of joint ventures, pursuant to which certain developments will be held upon completion through partnership vehicles. We generally employ joint ventures primarily to mitigate asset concentration or market risk and secondarily as a source of liquidity. Each joint venture or partnership agreement has been and will continue to be individually negotiated, and our ability to operate and/or dispose of a community in our sole discretion may be limited to varying degrees depending on the terms of the joint venture or partnership agreement. However, we cannot assure you that we will enter into joint ventures in the future, or that, if we do, we will achieve our objectives.

As of October 29, 2004, the following current year joint venture activity occurred:

- We entered into a joint venture agreement with an unrelated third-party for the development of Avalon Chrystie Place I. We hold a 20% equity interest in this joint venture entity (with a right to 50% of distributions after achievement of a threshold return), with the remaining 80% equity interest held by the third-party;
- We entered into an agreement with an unrelated third-party which provides that, after we complete construction of Avalon Del Rey, the community will be owned and operated by a joint venture between us and the third-party. Upon construction completion, the third-party venture partner will invest \$49,000,000 and will be granted a 70% ownership interest in the venture, while we retain a 30% equity interest; and
- We entered into an agreement to develop Avalon at Juanita Village through a wholly-owned taxable REIT subsidiary and, upon construction completion, contribute the community to a joint venture. Upon contribution of the community to the joint venture, we expect to be reimbursed for all costs incurred to develop the community. The third-party joint venture partner will receive a 100% equity interest in the joint venture and will manage the joint venture. We will receive a residual profits interest and will be engaged to manage the community for a property management fee.

Off Balance Sheet Arrangements

We own interests in unconsolidated real estate entities, with ownership interests up to 50%. Two of these unconsolidated real estate entities, Avalon Terrace, LLC and CVP I, LLC, have debt outstanding as of September 30, 2004. Avalon Terrace LLC has \$22,500,000 of variable rate debt which matures in 2005 and is payable by the unconsolidated real estate entity with operating cash flow from the underlying real estate. CVP I, LLC has a \$58,500,000 construction loan which matures in February 2009, assuming exercise of two one-year renewal options, and is payable by the unconsolidated real estate entity. We have not guaranteed the debt on Avalon Terrace LLC, nor do we have any obligation to fund this debt should the unconsolidated real estate entity be unable to do so. However, in connection with the general contractor services that we provide to CVP I, LLC, the entity that owns and is developing Avalon Chrystie Place I, we have provided a construction completion guarantee to the lender in order to fulfill their standard financing requirements related to the construction financing. Our obligations under this guarantee will terminate following construction completion once all of the lender's standard completion requirements have been satisfied. We currently expect this to occur in the beginning of 2006. There are no lines of credit, side agreements, financial guarantees or any other derivative financial instruments related to or between us and our unconsolidated real estate entities. In evaluating our capital structure and overall leverage, management takes into consideration our proportionate share of this unconsolidated debt. For more information regarding the operations of our unconsolidated entities see Note 6, "Investments in Unconsolidated Real Estate Entities," of our Condensed Consolidated Financial Statements.

Contractual Obligations

We currently have contractual obligations consisting primarily of long-term debt obligations and lease obligations for certain land parcels and office space. There have not been any material changes outside the ordinary course of business to our contractual obligations during the nine months ended September 30, 2004.

Development Communities

As of October 29, 2004, we had thirteen Development Communities under construction. We expect these Development Communities, when completed, to add a total of 3,652 apartment homes to our portfolio for a total capitalized cost, including land acquisition costs, of approximately \$710,800,000. Statements regarding the future development or performance of the Development Communities are forward-looking statements. We cannot assure you that:

- we will complete the Development Communities;
- our budgeted costs or estimates of occupancy rates will be realized;
- our schedule of leasing start dates, construction completion dates or stabilization dates will be achieved; or
- future developments will realize returns comparable to our past developments.

You should carefully review the discussion under “Risks of Development and Redevelopment” included elsewhere in this report.

The following table presents a summary of the Development Communities. We hold a direct or indirect fee simple ownership interest in these communities except where noted.

		Number of apartment homes	Total capitalized cost (1) (\$ millions)	Construction start	Initial occupancy (2)	Estimated completion	Estimated stabilization (3)
1.	Avalon at Glen Cove South <i>Glen Cove, NY</i>	256	\$ 65.5	Q3 2002	Q1 2004	Q4 2004	Q1 2005
2.	Avalon at Traville (4) <i>North Potomac, MD</i>	520	71.5	Q4 2002	Q3 2003	Q4 2004	Q1 2005
3.	Avalon Run East II <i>Lawrenceville, NJ</i>	312	49.3	Q2 2003	Q2 2004	Q1 2005	Q3 2005
4.	Avalon at Crane Brook <i>Danvers & Peabody, MA</i>	387	56.2	Q3 2003	Q2 2004	Q2 2005	Q4 2005
5.	Avalon Milford I <i>Milford, CT</i>	246	31.8	Q3 2003	Q2 2004	Q4 2004	Q2 2005
6.	Avalon Chrystie Place I (5) <i>New York, NY</i>	361	151.7	Q4 2003	Q3 2005	Q4 2005	Q2 2006
7.	Avalon at The Pinehills I <i>Plymouth, MA</i>	101	19.9	Q4 2003	Q3 2004	Q4 2004	Q2 2005
8.	Avalon Pines I <i>Coram, NY</i>	298	48.7	Q4 2003	Q4 2004	Q3 2005	Q1 2006
9.	Avalon Orange <i>Orange, CT</i>	168	22.4	Q1 2004	Q1 2005	Q3 2005	Q1 2006
10.	Avalon Danbury <i>Danbury, CT</i>	234	35.6	Q1 2004	Q2 2005	Q4 2005	Q2 2006
11.	Avalon Del Rey (6) <i>Los Angeles, CA</i>	309	70.0	Q2 2004	Q2 2005	Q4 2005	Q2 2006
12.	Avalon at Juanita Village (7) <i>Kirkland, WA</i>	211	45.5	Q2 2004	Q3 2005	Q4 2005	Q2 2006
13.	Avalon Camarillo <i>Camarillo, CA</i>	249	42.7	Q2 2004	Q3 2005	Q1 2006	Q3 2006
	Total	<u>3,652</u>	<u>\$ 710.8</u>				

- (1) Total capitalized cost includes all capitalized costs projected to be or actually incurred to develop the respective Development Community, determined in accordance with GAAP, including land acquisition costs, construction costs, real estate taxes, capitalized interest and loan fees, permits, professional fees, allocated development overhead and other regulatory fees. Total capitalized cost for communities identified as having joint venture ownership, either during construction or upon construction completion, represents the total projected joint venture contribution amount.
- (2) Future initial occupancy dates are estimates.
- (3) Stabilized operations is defined as the earlier of (i) attainment of 95% or greater physical occupancy or (ii) the one-year anniversary of completion of development.
- (4) This is a two-phase community for which construction of the second phase commenced in the second quarter of 2003.
- (5) This community is being financed under a joint venture structure with third-party financing, in which the community is owned by a limited liability company managed by one of our wholly-owned subsidiaries. The total capitalized cost for this community includes costs associated with the construction of 89,000 square feet of retail space and 30,000 square feet for a community facility. Our portion of the total capitalized cost of this joint venture is projected to be \$30.3 million including community-based tax-exempt debt.
- (6) The community is currently owned by one of our wholly-owned subsidiaries, will be financed, in part or in whole, by a construction loan, and is subject to a joint venture agreement that allows for a 70% joint venture partner to be admitted upon construction completion.
- (7) The community is being developed by one of our wholly-owned, taxable REIT subsidiaries, and is subject to a venture agreement that provides for the transfer of 100% of the ownership interests to the joint venture upon its completion.

Redevelopment Communities

As of October 29, 2004, we had two communities under redevelopment. We expect the total capitalized cost to complete these communities, including the cost of acquisition, capital expenditures subsequent to acquisition and redevelopment, to be approximately \$181,500,000, of which approximately \$30,300,000 is the additional capital invested or expected to be invested during redevelopment and \$151,200,000 was incurred prior to redevelopment. Statements regarding the future redevelopment or performance of the Redevelopment Communities are forward-looking statements. We have found that the cost to redevelop an existing apartment community is more difficult to budget and estimate than the cost to develop a new community. Accordingly, we expect that actual costs may vary from our budget by a wider range than for a new development community. We cannot assure you that we will meet our schedule for reconstruction completion or restabilized operations, or that we will meet our budgeted costs, either individually or in the aggregate. See the discussion under "Risks of Development and Redevelopment" included elsewhere in this report.

The following presents a summary of these Redevelopment Communities:

	Number of apartment homes	Total cost (\$ millions)		Reconstruction start	Estimated Reconstruction completion	Estimated restabilized operations (2)
		Pre-redevelopment cost	Total capitalized cost (1)			
1. Avalon at Prudential Center <i>Boston, MA</i>	781	\$ 133.9	\$ 160.0	Q4 2000	Q2 2006	Q4 2006
2. Avalon Towers <i>Long Beach, NY</i>	109	17.3	21.5	Q3 2004	Q3 2005	Q3 2005
Total	<u>890</u>	<u>\$ 151.2</u>	<u>\$ 181.5</u>			

(1) Total capitalized cost includes all capitalized costs projected to be incurred to redevelop the respective Redevelopment Community, including costs to acquire the community, reconstruction costs, real estate taxes, capitalized interest and loan fees, permits, professional fees, allocated redevelopment overhead and other regulatory fees determined in accordance with GAAP.

(2) Restabilized operations is defined as the earlier of (i) attainment of 95% or greater physical occupancy or (ii) the one-year anniversary of completion of redevelopment.

Development Rights

As of October 29, 2004, we are considering the development of 44 new apartment communities on land that is either owned by us, under contract, subject to a leasehold interest or for which we hold a purchase option. We generally hold Development Rights through options to acquire land, although for twelve of the Development Rights we currently own the land on which a community would be built if we proceeded with development. The Development Rights range from those beginning design and architectural planning to those that have completed site plans and drawings and can begin construction almost immediately. We estimate that the successful completion of all of these communities would ultimately add 11,515 apartment homes to our portfolio. Substantially all of these apartment homes will offer features like those offered by the communities we currently own. At September 30, 2004, there were cumulative capitalized costs (including legal fees, design fees and related overhead costs, but excluding land costs) of \$41,004,000 relating to Development Rights. In addition, land costs related to the pursuit of Development Rights (consisting of original land and additional carrying costs) of \$117,960,000 are reflected as land held for development on the accompanying Condensed Consolidated Balance Sheets as of September 30, 2004.

The properties comprising the Development Rights are in different stages of the due diligence and regulatory approval process. The decisions as to which of the Development Rights to pursue, if any, or to continue to pursue once an investment in a Development Right is made, are business judgments that we make after we perform financial, demographic and other analyses. In the event that we do not proceed with a Development Right, we generally would not recover capitalized costs incurred in the pursuit of those communities, unless we were to recover amounts in connection with the sale of land; however, we cannot

guarantee a recovery. Pre-development costs incurred in the pursuit of Development Rights for which future development is not yet considered probable are expensed as incurred. In addition, if the status of a Development Right changes, deeming future development no longer probable, any capitalized pre-development costs are written-off with a charge to expense.

Although the development of any particular Development Right cannot be assured, we believe that the Development Rights, in the aggregate, present attractive potential opportunities for future development and growth of long-term stockholder value.

Statements regarding the future development of the Development Rights are forward-looking statements. We cannot assure you that:

- we will succeed in obtaining zoning and other necessary governmental approvals or the financing required to develop these communities, or that we will decide to develop any particular community; or
- if we undertake construction of any particular community, that we will complete construction at the total capitalized cost assumed in the financial projections in the following table.

The following presents a summary of the 44 Development Rights we are currently pursuing:

	Location		Estimated number of homes	Total capitalized cost (\$ millions) (1)
1.	Lyndhurst, NJ	(2)	316	\$ 69
2.	Bedford, MA	(2)	139	24
3.	Los Angeles, CA	(2)	123	40
4.	San Francisco, CA	(4)	313	124
5.	Newton, MA		204	56
6.	Glen Cove, NY	(2)	111	32
7.	Long Island City, NY Phase II and III		613	176
8.	Rockville, MD Phase II		196	28
9.	Hingham, MA		236	44
10.	Quincy, MA	(2)	148	24
11.	New Rochelle, NY Phase II and III		588	156
12.	Norwalk, CT		312	63
13.	New York, NY Phase II and III	(2)	308	134
14.	Shrewsbury, MA		264	40
15.	Stratford, CT		146	23
16.	Bellevue, WA		368	71
17.	Danvers, MA		428	80
18.	Coram, NY Phase II	(2)	152	26
19.	Dublin, CA Phase I		305	72
20.	Wilton, CT		100	24
21.	Encino, CA	(2)	131	46
22.	Plymouth, MA Phase II		69	13
23.	Lexington, MA		387	76
24.	Andover, MA		115	21
25.	Greenburgh, NY Phase II		766	120
26.	West Haven, CT		170	23
27.	Dublin, CA Phase II		200	52
28.	Seattle, WA	(2)	194	54
29.	Canoga Park, CA		200	47
30.	Sharon, MA		156	26
31.	Oyster Bay, NY		273	69
32.	Union City, CA Phase I		230	58
33.	Yaphank, NY		254	43
34.	College Park, MD		320	44
35.	Irvine, CA		290	63
36.	Gaithersburg, MD		254	41
37.	Cohasset, MA		200	38
38.	Dublin, CA Phase III		205	53
39.	Milford, CT	(2)	284	45
40.	Shelton, CT		302	49
41.	Wheaton, MD	(2) (3)	320	56
42.	Union City, CA Phase II		209	54
43.	Camarillo, CA		376	55
44.	Rockville, MD	(2) (3)	240	46
	Total		11,515	\$ 2,498

- (1) Total capitalized cost includes all capitalized costs incurred to date (if any) and projected to be incurred to develop the respective community, determined in accordance with GAAP, including land acquisition costs, construction costs, real estate taxes, capitalized interest and loan fees, permits, professional fees, allocated development overhead and other regulatory fees.
- (2) We own the land parcel, but construction has not yet begun.
- (3) Represents improved land encumbered with debt. The improved land consists of occupied office buildings. NOI from incidental operations from the current improvements will be recorded as a reduction in cost basis as described in the Notes to the Condensed Consolidated Financial Statements included elsewhere in this report.
- (4) In October 2004, we entered into an agreement with an unrelated third-party which provides that, if we decide to commence construction of Avalon at Mission Bay II, the community will be developed, owned and operated by a joint venture between us and the third-party, in which we will hold a 25% interest.

Risks of Development and Redevelopment

We intend to continue to pursue the development and redevelopment of apartment home communities. Our development and redevelopment activities may be exposed to the following:

- we may abandon opportunities we have already begun to explore based on further review of, or changes in, financial, demographic, environmental or other factors;
- we may encounter liquidity constraints, including the unavailability of financing on favorable terms for the development or redevelopment of a community;
- we may be unable to obtain, or we may experience delays in obtaining, all necessary zoning, land-use, building, occupancy, and other required governmental permits and authorizations;
- we may incur construction or reconstruction costs for a community that exceed our original estimates due to increased materials, labor or other expenses, which could make completion of development or redevelopment of the community uneconomical;
- occupancy rates and rents at a newly completed development or redevelopment community may fluctuate depending on a number of factors, including competition and market and general economic conditions, and may not be sufficient to make the community profitable; and
- we may be unable to complete construction and lease-up on schedule, resulting in increased debt service expense and construction costs.

The occurrence of any of the events described above could adversely affect results of operations and our payment of distributions to our stockholders.

Construction costs are projected by us based on market conditions prevailing in the community's market at the time our budgets are prepared and reflect changes to those market conditions that we anticipated at that time. Although we attempt to anticipate changes in market conditions, we cannot predict those changes with certainty. Construction costs have been increasing, particularly for materials such as steel, concrete and lumber, and, for some of our Development Communities and Development Rights, the total construction costs may be higher than the original budget. We do not expect that these price increases will materially affect our current Development Communities. However, these increases may materially affect Development Rights where construction has not yet begun. Total capitalized cost includes all capitalized costs projected to be incurred to develop the respective Development or Redevelopment Community, determined in accordance with GAAP, including:

- land and/or property acquisition costs;
- construction or reconstruction costs;
- real estate taxes;
- capitalized interest;
- loan fees;
- permits;
- professional fees;
- allocated development or redevelopment overhead; and
- other regulatory fees.

Costs to redevelop communities that have been acquired have, in some cases, exceeded our original estimates and similar increases in costs may be experienced in the future. We cannot assure you that market rents in effect at the time new development communities or redevelopment communities complete lease-up will be sufficient to fully offset the effects of any increased construction or reconstruction costs.

Insurance and Risk of Uninsured Losses

We carry commercial general liability insurance and property insurance with respect to all of our communities. These policies, and other insurance policies we carry, have policy specifications, insured limits and deductibles that we consider commercially reasonable. There are, however, certain types of losses (such as losses arising from acts of war) that are not insured, in full or in part, because they are either uninsurable or the cost of insurance makes it, in management's view, economically impractical. If an uninsured property loss or a property loss in excess of insured limits were to occur, we could lose our capital invested in a community, as well as the anticipated future revenues from such community. We would also continue to be obligated to repay any mortgage indebtedness or other obligations related to the community. If an uninsured liability to a third-party were to occur, we would incur the cost of defense and settlement with, or court ordered damages to, that third-party. A significant uninsured property or liability loss could materially and adversely affect our financial condition and results of operations.

Many of our West Coast communities are located in the general vicinity of active earthquake faults. A large concentration of our communities lie near, and thus are susceptible to, the major fault lines in the San Francisco Bay Area, including the San Andreas fault and the Hayward fault. We cannot assure you that an earthquake would not cause damage or losses greater than insured levels. In June 2004, we renewed our earthquake insurance. We have in place with respect to communities located in California, for any single occurrence and in the aggregate, \$75,000,000 of coverage with a deductible per building equal to five percent of the insured value of that building. The five percent deductible is subject to a minimum of \$100,000 per occurrence. Earthquake coverage outside of California is subject to a \$75,000,000 limit, except with respect to the state of Washington, for which the limit is \$65,000,000. Our earthquake insurance outside of California provides for a \$100,000 deductible per occurrence. In addition, up to a policy aggregate of \$3,000,000, the next \$400,000 of loss per occurrence outside California will be treated as an additional deductible.

Our annual general liability policy and workman's compensation coverage was renewed on August 1, 2004 and the insurance coverage provided for in these renewal policies did not materially change from the preceding year. Including the costs we estimate that we may incur as a result of deductibles, we expect the cost related to these insurance categories for the policy period from August 1, 2004 to July 31, 2005 to remain flat as compared to the prior period.

Our property insurance policy was scheduled to renew on February 1, 2005; however, in an effort to capitalize on declining insurance rates we elected to cancel the prior policy and rewrite the policy effective June 1, 2004 with a new expiration date of December 1, 2005. Based on this renewal, we have seen a decline in insurance premiums for property coverage, which combined with the cost we may incur as a result of deductibles, we expect will result in declining overall insurance costs as compared to prior periods.

Just as with office buildings, transportation systems and government buildings, there have been reports that apartment communities could become targets of terrorism. In November 2002, Congress passed the Terrorism Risk Insurance Act ("TRIA") which is designed to make terrorism insurance available. In connection with this legislation, we have purchased insurance for property damage due to terrorism up to \$200,000,000. Additionally, we have purchased insurance for certain terrorist acts, not covered under TRIA, such as domestic-based terrorism. This insurance, often referred to as "non-certified" terrorism insurance, is subject to deductibles, limits and exclusions. Our general liability policy provides TRIA coverage (subject to deductibles and insured limits) for liability to third parties that result from terrorist acts at our communities.

Mold growth may occur when excessive moisture accumulates in buildings or on building materials, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Although the occurrence of mold at multifamily and other structures, and the need to remediate such mold, is not a new phenomenon, there has been increased awareness in recent years that certain molds may in some instances lead to adverse health effects, including allergic or other reactions. To help limit mold growth, we educate residents about the importance of adequate ventilation and request or require that they notify us when they see mold or excessive moisture. We have established procedures for promptly addressing and remediating mold or excessive moisture from apartment homes when we become aware of its presence regardless of whether we or the resident believe a health risk is present. However, we cannot

assure that mold or excessive moisture will be detected and remediated in a timely manner. If a significant mold problem arises at one of our communities, we could be required to undertake a costly remediation program to contain or remove the mold from the affected community and could be exposed to other liabilities. We cannot assure that we will have coverage under our existing policies for property damage or liability to third parties arising as a result of exposure to mold or a claim of exposure to mold at one of our communities.

In March 2004, we renewed our D&O insurance. In the past year, we have noted an increase in competition from new carriers entering the market and expanded capital capacity of existing carriers, resulting in a partial reversal of the significant premium increases experienced in recent years. Our premium for this insurance decreased as compared to the prior coverage period at renewal.

Inflation and Deflation

Substantially all of our apartment leases are for a term of one year or less. In an inflationary environment, this may allow us to realize increased rents upon renewal of existing leases or the beginning of new leases. Short-term leases generally minimize our risk from the adverse effects of inflation, although these leases generally permit residents to leave at the end of the lease term and therefore expose us to the effect of a decline in market rents. In a deflationary rent environment, we may be exposed to declining rents more quickly under these shorter-term leases.

Forward-Looking Statements

This Form 10-Q contains “forward-looking statements” as that term is defined under the Private Securities Litigation Reform Act of 1995. You can identify forward-looking statements by our use of the words “believe,” “expect,” “anticipate,” “intend,” “estimate,” “assume,” “project,” “plan,” “may,” “shall,” “will” and other similar expressions in this Form 10-Q, that predict or indicate future events and trends or that do not report historical matters. These statements include, among other things, statements regarding our intent, belief or expectations with respect to:

- our potential development, redevelopment, acquisition or disposition of communities;
- the timing and cost of completion of apartment communities under construction, reconstruction, development or redevelopment;
- the timing of lease-up, occupancy and stabilization of apartment communities;
- the pursuit of land on which we are considering future development;
- the anticipated operating performance of our communities;
- cost, yield and earnings estimates;
- our declaration or payment of distributions;
- our joint venture and discretionary fund activities;
- our policies regarding investments, indebtedness, acquisitions, dispositions, financings and other matters;
- our qualification as a REIT under the Internal Revenue Code;
- the real estate markets in Northern and Southern California and markets in selected states in the Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions of the United States and in general;
- the availability of debt and equity financing;
- interest rates;
- general economic conditions; and
- trends affecting our financial condition or results of operations.

We cannot assure the future results or outcome of the matters described in these statements; rather, these statements merely reflect our current expectations of the approximate outcomes of the matters discussed. You should not rely on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, some of which are beyond our control. These risks, uncertainties and other factors may cause our actual results, performance or achievements to differ materially from the anticipated future results, performance or achievements expressed or implied by these forward-looking statements.

Some of the factors that could cause our actual results, performance or achievements to differ materially from those expressed or implied by these forward-looking statements include, but are not limited to, the following:

- we may fail to secure development opportunities due to an inability to reach agreements with third parties or to obtain desired zoning and other local approvals;
- we may abandon or defer development opportunities for a number of reasons, including changes in local market conditions which make development less desirable, increases in costs of development and increases in the cost of capital;
- construction costs of a community may exceed our original estimates;
- we may not complete construction and lease-up of communities under development or redevelopment on schedule, resulting in increased interest expense and construction costs and a decrease in our expected rental revenues;
- occupancy rates and market rents may be adversely affected by competition and local economic and market conditions which are beyond our control;
- financing may not be available on favorable terms or at all, and our cash flow from operations and access to cost effective capital may be insufficient for the development of our pipeline which could limit our pursuit of opportunities;
- our cash flow may be insufficient to meet required payments of principal and interest, and we may be unable to refinance existing indebtedness or the terms of such refinancing may not be as favorable as the terms of existing indebtedness; and
- we may be unsuccessful in managing changes in our portfolio composition.

These forward-looking statements represent our estimates and assumptions only as of the date of this report. We do not undertake to update these forward-looking statements, and you should not rely upon them after the date of this report.

Part I. FINANCIAL INFORMATION (continued)

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our exposures to market risk since December 31, 2003.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2004. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. We continue to review and document our disclosure controls and procedures, including our internal controls and procedures for financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

(b) Changes in internal controls over financial reporting.

None.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

As reported most recently in our Form 10-Q for the quarter ended June 30, 2004, we are currently involved in litigation with York Hunter Construction, Inc. and National Union Fire Insurance Company. A non-jury trial ended in April 2004 and on May 20, 2004, the court issued a ruling, finding that (i) York Hunter breached the Construction Management Agreement between it and the Company in failing to complete the project and abandoning the construction site and is therefore liable to the Company for consequential damages, and (ii) National Union, having failed to exercise its various rights to perform and complete, is liable to the Company for consequential damages. The court issued a ruling dated October 6, 2004, awarding the Company approximately \$1.25 million plus interest. The defendants have filed a motion seeking to reduce the damage award to approximately \$370,000 plus interest. The Company is considering filing an appeal to seek an increase in the damage award.

Also as reported in our Form 10-Q for the quarter ended June 30, 2004, on June 6, 2003, a purported California class action lawsuit, *Julie E. Ko v. AvalonBay Communities, Inc. and Does 1 through 100*, was filed against the Company in California's Los Angeles County Superior Court. The suit purports to be brought on behalf of all of the Company's former California residents who, during the four-year period prior to the filing of the suit, paid a security deposit to the Company for the rental of residential property in California and had a portion of the deposit withheld by the Company in excess of the damages actually sustained by the Company. The plaintiff seeks compensatory and statutory damages in unspecified amounts as well as injunctive relief, restitution, and an award of attorneys' fees, expenses and costs of suit. The complaint seeking class certification was amended in March 2004 and the Company responded to the amended complaint on May 3, 2004. Due

to the uncertainty of many critical factual and legal issues, including the viability of the case as a class action, it is not possible to determine or predict the outcome.

We are involved in various other claims and/or administrative proceedings that arise in the ordinary course of our 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.

Item 2. Unregistered Sales of Securities and Use of Proceeds

During the three months ended September 30, 2004, AvalonBay issued 19,269 shares of common stock in exchange for 19,269 units of limited partnership held by certain limited partners of Avalon DownREIT V, L.P. and Avalon Grosvenor, L.P. The shares were issued in reliance on an exemption from registration under Section 4(2) of the Securities Act of 1933. AvalonBay is relying on the exemption based on factual representations received from the limited partners who received these shares.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
3(i).1	– Articles of Amendment and Restatement of Articles of Incorporation of AvalonBay Communities (the “Company”), dated as of June 4, 1998. (Incorporated by reference to Exhibit 3(i).1 to Form 10-Q of the Company filed August 14, 1998.)
3(i).2	– Articles of Amendment, dated as of October 2, 1998. (Incorporated by reference to Exhibit 3.1(ii) to Form 8-K of the Company filed on October 6, 1998.)
3(i).3	– Articles Supplementary, dated as of October 13, 1998, relating to the 8.70% Series H Cumulative Redeemable Preferred Stock. (Incorporated by reference to Exhibit 1 to Form 8-A of the Company filed October 14, 1998.)
3(ii).1	– Amended and Restated Bylaws of the Company, as adopted by the Board of Directors on February 13, 2003. (Incorporated by reference to Exhibit 3(ii) to Form 10-K of the Company filed March 11, 2003.)
4.1	– Indenture of Avalon Properties, Inc. (hereinafter referred to as “Avalon Properties”) dated as of September 18, 1995. (Incorporated by reference to Form 8-K of Avalon Properties dated September 18, 1995.)
4.2	– First Supplemental Indenture of Avalon Properties dated as of September 18, 1995. (Incorporated by reference to Exhibit 4.2 to Form 10-K of the Company filed March 26, 2002.)
4.3	– Second Supplemental Indenture of Avalon Properties dated as of December 16, 1997. (Incorporated by reference to Exhibit 4.3 to Form 10-K of the Company filed March 11, 2003.)

- 4.4 – Third Supplemental Indenture of Avalon Properties dated as of January 22, 1998. (Incorporated by reference to Exhibit 4.4 to Form 10-K of the Company filed March 11, 2003.)
- 4.5 – Indenture, dated as of January 16, 1998, between the Company and State Street Bank and Trust Company, as Trustee. (Incorporated by reference to Exhibit 4.5 to Form 10-K of the Company filed on March 11, 2003.)
- 4.6 – First Supplemental Indenture, dated as of January 20, 1998, between the Company and the Trustee. (Incorporated by reference to Exhibit 4.6 to Form 10-K of the Company filed on March 11, 2003.)
- 4.7 – Second Supplemental Indenture, dated as of July 7, 1998, between the Company and the Trustee. (Incorporated by reference to Exhibit 4.2 to Form 8-K of the Company filed on July 9, 1998.)
- 4.8 – Amended and Restated Third Supplemental Indenture, dated as of July 10, 2000 between the Company and the Trustee, including forms of Floating Rate Note and Fixed Rate Note. (Incorporated by reference to Exhibit 4.4 to the Company’s Current Report on Form 8-K filed on July 11, 2000.)
- 4.9 – Dividend Reinvestment and Stock Purchase Plan of the Company filed on September 14, 1999. (Incorporated by reference to Form S-3 of the Company, File No. 333-87063.)
- 4.10 – Amendment to the Company’s Dividend Reinvestment and Stock Purchase Plan filed on December 17, 1999. (Incorporated by reference to the Prospectus Supplement filed pursuant to Rule 424(b)(2) of the Securities Act of 1933 on December 17, 1999.)
- 4.11 – Amendment to the Company’s Dividend Reinvestment and Stock Purchase Plan filed on March 26, 2004. (Incorporated by reference to the Prospectus Supplement filed pursuant to Rule 424(b)(3) of the Securities Act of 1933 on March 26, 2004.)
- 10.1 – Form of AvalonBay Communities, Inc. Employee Non-Qualified Stock Option Agreement (1994 Stock Incentive Plan, as Amended and Restated), including Form of Executive Officer Addendum. (Filed herewith.)
- 10.2 – Form of AvalonBay Communities, Inc. Employee Incentive Stock Option Agreement (1994 Stock Incentive Plan, as Amended and Restated), including Form of Executive Officer Addendum. (Filed herewith.)
- 10.3 – Form of AvalonBay Communities, Inc. Employee Stock Grant and Restricted Stock Agreement. (Filed herewith.)
- 10.4 – Form of AvalonBay Communities, Inc. Director Restricted Unit Agreement. (Filed herewith.)
- 10.5 – Form of AvalonBay Communities, Inc. Director Restricted Stock Agreement. (Filed herewith.)
- 12.1 – Statements re: Computation of Ratios. (Filed herewith.)
- 31.1 – Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer.) (Filed herewith.)
- 31.2 – Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer.) (Filed herewith.)
- 32 – Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer and Chief Financial Officer). (Furnished herewith.)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AVALONBAY COMMUNITIES, INC.

Date: November 4, 2004

/s/ Bryce Blair

Bryce Blair
Chief Executive Officer and President

Date: November 4, 2004

/s/ Thomas J. Sargeant

Thomas J. Sargeant
Chief Financial Officer

[Form of Employee Non-Qualified Stock Option Agreement]

**AVALONBAY COMMUNITIES, INC.
NON-QUALIFIED STOCK OPTION AGREEMENT
(1994 STOCK INCENTIVE PLAN, AS AMENDED AND RESTATED)**

Pursuant to the AvalonBay Communities, Inc. 1994 Stock Incentive Plan, as amended and restated (the "Plan"), AvalonBay Communities, Inc. (the "Company") hereby grants to the Optionee named below an Option to purchase up to the number of shares of the Company's Common Stock, par value \$.01 per share ("Common Stock") set forth below. This option is subject to all of the terms and conditions as set forth herein, in the Non-Qualified Stock Option Agreement Terms (the "Terms") which are attached hereto and incorporated herein in their entirety, and in the Plan. Capitalized terms used but not defined herein or in the Terms shall have the respective meanings ascribed thereto in the Plan.

Optionee: _____
Date of Grant: _____
Number of Shares Subject to Option ("Option Shares"): _____
Exercise Price (Per Share): _____
Total Exercise Price: _____
Expiration Date: _____

Non-Qualified Stock Option:

This Option does not qualify as an incentive stock option under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), and consequently shall be treated as a non-qualified stock option for tax purposes.

Vesting Schedule:

Subject to the provisions of Section 4 and 6 of the Terms and the discretion of the Company to accelerate the vesting schedule, this option shall become vested and exercisable with respect to the following number of Option Shares at the expiration of the following periods from the Date of Grant set out above:

<u>Vesting Event</u>	<u>Option Shares Vested</u>
[First Anniversary of Grant Date]	[One-Third]
[Second Anniversary of Grant Date]	[One-Third]
[Third Anniversary of Grant Date]	[One-Third]

In any event this Option shall become fully vested and exercisable with respect to all of the Option Shares three years after the date hereof.

Additional Terms/Acknowledgements: The undersigned Optionee acknowledges receipt of, and understands and agrees to, this Non-Qualified Stock Option Agreement, including, without limitation, the Terms. Optionee further acknowledges receipt of a copy of the Plan. Optionee further acknowledges that as of the Date of Grant, this Non-Qualified Stock Option Agreement, including, without limitation, the Terms, and the Plan set forth the entire understanding between Optionee and the Company regarding the Options described herein and supersede all prior oral and written agreements on that subject.

AVALONBAY COMMUNITIES, INC.

OPTIONHOLDER:

By: _____
Signature

Signature

Title: _____

Name (Print): _____

Date: _____

Date: _____

ATTACHMENT: Non-qualified Stock Option Agreement Terms

AVALONBAY COMMUNITIES, INC.
1994 STOCK INCENTIVE PLAN, AS AMENDED AND RESTATED

NON-QUALIFIED STOCK OPTION AGREEMENT TERMS

1. Vested Option Shares. Subject to Section 4, when this Option is vested with respect to any of the Option Shares, this Option shall continue to be exercisable with respect to such Option Shares ("Vested Option Shares") at any time or times prior to the Expiration Date.

2. Manner of Exercise. The Optionee may exercise this Option only in the following manner: from time to time on or prior to the Expiration Date, the Optionee may give written notice to the Company of his election to purchase some or all of the Vested Option Shares purchasable at the time of such notice, which this notice shall specify the number of Option Shares to be purchased.

Payment of the purchase price for the Option Shares to be purchased may be made by one or more of the following methods: (a) in cash, by certified bank check or other instrument acceptable to the Company; (b) through the delivery (or attestation to the ownership) of shares of Common Stock that have been beneficially owned by the Optionee for at least six (6) months and are not then subject to restrictions under any Company plan and were not used in a "stock swap" within the six (6) months preceding the option exercise, such surrendered shares to be valued at the closing price of the Common Stock on the principal exchange on which the Common Stock is listed on the date the Company receives the exercise notice; (c) by the Optionee delivering to the Company a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company cash or a check payable and acceptable to the Company to pay the purchase price; provided that in the event the Optionee chooses to pay the purchase price as provided in this subsection (c), the Optionee and the broker shall comply with such procedures and enter into such agreements of indemnity and other agreements as the Company shall prescribe as a condition of such payment procedure; or (d) with the consent of the Company, a combination of (a), (b) and (c) above. Payment instruments will be received subject to collection.

The delivery of certificates representing the Option Shares will be contingent upon (i) the Company's receipt from the Optionee of full payment for the Option Shares, (ii) the satisfaction of section 10 hereof, and (iii) any agreement, statement or other evidence that the Company may require to satisfy itself that the issuance of Option Shares to be purchased pursuant to the exercise of Options under the Plan and any subsequent resale of the shares will be in compliance with applicable laws and regulations.

If requested upon the exercise of this Option, certificates for Option Shares may be issued in the name of the Optionee jointly with another person or in the name of the executor or administrator of the Optionee's estate. The Optionee shall not have the rights of a stockholder with respect to any Option Shares prior to his acquisition of such Option Shares upon the exercise of this Option.

Notwithstanding any other provision hereof or of the Plan, no portion of this Option shall be exercisable after the Expiration Date hereof.

3. Non-transferability of Option. This Option shall not be transferable by the Optionee otherwise than by will or by the laws of descent and distribution and this Option shall be exercisable, during the Optionee's lifetime, only by the Optionee.

4. Termination of Employment. If the Optionee's employment (or other business relationship) by the Company or a Subsidiary (as defined in the Plan) is terminated, the period within which to exercise the Option may be subject to earlier termination as set forth below.

(a) Termination Due to Death. If the Optionee's employment (or other business relationship) terminates by reason of death, any Option held by the Optionee may be exercised, to the extent exercisable at the date of death, by the Optionee's legal representative or legatee for a period of six (6) months from the date of death, or until the Expiration Date, if earlier. For clarification, it is noted that this means that the remaining unvested portion of the Option shall terminate immediately and be of no further force or effect.

(b) Termination Due to Disability. If the Optionee's employment (or other business relationship) terminates by reason of Disability (as defined in the Plan), any Option held by the Optionee may be exercised, to the extent exercisable on the date of termination, for a period of twelve (12) months from the date of termination, or until the Expiration Date, if earlier. The death of the Optionee during the twelve (12) month period provided in this Section 4(b) shall extend such period for six (6) months from the date of death or until the Expiration Date, if earlier. For clarification, it is noted that this means that the remaining unvested portion of the Option shall terminate immediately and be of no further force or effect.

(c) Termination by Reason of Retirement. If the Optionee's employment terminates by reason of Retirement (as defined in the Plan), any Option held by the Optionee shall be automatically vested on the date of termination, and shall be exercisable for a period of twelve (12) months from the date of termination, or until the Expiration Date, if earlier. The death of the Optionee during the twelve (12) month period provided in this Section 4(c) shall extend such period for six (6) months from the date of death, or until the Expiration Date, if earlier.

Retirement, as defined in the Plan, means:

the Optionee's termination of employment with the Company and its Subsidiaries, other than for Cause, following the date on which the sum of (i) the number of full months the Optionee has been employed by the Company and any Predecessor Company (as defined in the Plan) and (ii) the Optionee's age on the date of termination, equals or exceeds 70 years, provided that:

(x) the Optionee has been employed by the Company and any Predecessor Company for a period of at least 120 contiguous full months at the time of termination;

(y) the Optionee gives at least six months' prior written notice to the Company of his intention to retire; and

(z) upon termination of employment, the Optionee enters into a "Non-Compete and Non-Solicitation Agreement" (as defined in the Plan) and a general release of all claims in a form reasonably satisfactory to the Company.

(d) Termination for Cause. If the Optionee's employment (or other business relationship) terminates for Cause (as defined in the Plan), any Option held by the Optionee shall immediately terminate and be of no further force and effect.

(e) Other Termination. If the Optionee's employment (or other business relationship) terminates for any reason other than death, Disability, Retirement or Cause, and unless otherwise determined by the Company, any Option held by the Optionee may be exercised, to the extent exercisable on the date of termination, for a period of three (3) months from the date of termination, or until the Expiration Date, if earlier. For clarification, it is noted that this means that the remaining unvested portion of the Option shall terminate immediately and be of no further force or effect.

For this purpose, neither a transfer of employment from the Company to a Subsidiary (or from a Subsidiary to the Company) nor an approved leave of absence shall be deemed a "termination of employment."

5. Option Shares. The Option Shares are shares of the Common Stock of the Company as constituted on the date of this Option, subject to adjustment as provided in the Plan.

6. Effect of Change of Control. Upon the occurrence of a Change of Control, as defined in the Plan, this Option shall automatically become fully exercisable.

7. No Special Employment Rights. This Option will not confer upon the Optionee any right with respect to continuance of employment by the Company or a Subsidiary, nor will it interfere in any way with any right of the Optionee's employer to terminate the Optionee's employment at any time.

8. Rights as a Shareholder. The Optionee shall have no rights as a shareholder with respect to any shares of Common Stock that may be purchased upon exercise of this Option unless and until a certificate or certificates representing such shares are duly issued and delivered to the Optionee. Except as otherwise expressly provided in the Plan, no adjustment shall be made for dividends or other rights for which the record date is prior to the date such stock certificate is issued.

9. The Plan. In the event of any discrepancy or inconsistency between this Agreement and the Plan, the terms and conditions of the Plan shall control.

10. Withholding Taxes. The Optionee shall, not later than the date as of which the exercise of this Option becomes a taxable event for federal income tax purposes, pay to the Company (or make arrangements satisfactory to the Company for payment of) any federal, state and local taxes required by law to be withheld on account of such taxable event. The Optionee acknowledges and agrees that the Company has the right to deduct from payments of any kind otherwise due to the Optionee, or from the Option Shares to be issued in respect of an exercise of this Option, any federal, state or local taxes of any kind required by law to be withheld with respect to the issuance of shares of Stock to the Optionee.

11. Miscellaneous. Notices hereunder shall be mailed or delivered to the Company at its principal place of business, 2900 Eisenhower Avenue, Suite 300, Alexandria, Virginia 22314, Attention: Jenny Bercik, and shall be mailed or delivered to Optionee at his address set forth in the Company's records, or in either case at such other address as one party may subsequently furnish to the other party in writing. This Option shall be governed by the laws of the State of Maryland, except to the extent such law is preempted by federal law.

[End of Text]

[In accordance with the employment agreements of Messrs. Blair, Naughton, Sargeant, Fuller and Horey, the Company enters into the following addendum to all Non-Qualified Stock Option Agreements with such individuals.]

**Addendum to NQSO Stock Option Agreement
with**

This Addendum to Stock Option Agreement is dated as of ____.

Reference is made to the following agreement (the "Unmodified Stock Option Agreement"):

Non-Qualified Stock Option Agreement between ____ ("Employee") and AvalonBay Communities, Inc. ("AvalonBay"), dated ____, with respect to ____ stock options (the "Options") having an exercise price of \$ ____.

Capitalized terms used herein and not defined herein have the meanings set forth in the Unmodified Stock Option Agreement.

For the convenience of AvalonBay, the Unmodified Stock Option Agreement is in a standard format commonly used by AvalonBay. However, this Addendum to Stock Option Agreement (the "Addendum") contains one or more provisions (the "Modifications") approved by the Board of Directors of AvalonBay (the "Board") that are inconsistent with the terms of the Unmodified Stock Option Agreement. The Board approved the Modifications at the time it approved the grant of the Options to Employee, and for ease of administration the Company is documenting the grant of the Options with the Modifications by entering into the Unmodified Stock Option Agreement and this Addendum.

NOW, THEREFORE, intending to be legally bound and for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, AvalonBay and Employee agree as follows:

If, pursuant to the terms of the Employment Agreement between the Company and Employee dated ____, as amended, or pursuant to the terms of a successor agreement or arrangement (other than the Unmodified Stock Option Agreement), the vesting of Employee's stock options is accelerated upon the termination of his employment, then the following shall apply: any Option then held by Employee may be exercised, to the extent exercisable on the date of termination (after giving effect to accelerated vesting), for a period of one (1) year from the date of termination, or until the Expiration Date, if earlier.

For clarification it is noted that the terms of the preceding paragraph will not apply if vesting of Employee's stock options is not accelerated upon a termination of employment (e.g., if he voluntarily resigns without a Constructive Termination without Cause, as defined in the Employment Agreement). In such cases, the period of time following termination in which the Options must be exercised will be

determined by the Unmodified Stock Option Agreement, which generally provides that the Options will terminate earlier than one year from the date of termination.

Except as stated above, the terms of the Unmodified Stock Option Agreement apply in full to the Options.

AVALONBAY COMMUNITIES, INC.

By: _____

Name:

Title:

By: _____

Name:

Title:

Receipt is hereby acknowledged of a copy of the Company's Plan, the Unmodified Stock Option Agreement and this Addendum. The undersigned agrees to be bound by the terms and conditions of the Plan, the Unmodified Stock Option Agreement and this Addendum.

Optionee:

Address:

[Form of Employee Incentive Stock Option Agreement]

**AVALONBAY COMMUNITIES, INC.
INCENTIVE STOCK OPTION AGREEMENT
(1994 STOCK INCENTIVE PLAN, AS AMENDED AND RESTATED)**

Pursuant to the AvalonBay Communities, Inc. 1994 Stock Incentive Plan, as amended and restated (the "Plan"), AvalonBay Communities, Inc. (the "Company") hereby grants to the Optionee named below an Option to purchase up to the number of shares of the Company's Common Stock, par value \$.01 per share ("Common Stock") set forth below. This option is subject to all of the terms and conditions as set forth herein, in the Incentive Stock Option Agreement Terms (the "Terms") which are attached hereto and incorporated herein in their entirety, and in the Plan. Capitalized terms used but not defined herein or in the Terms shall have the respective meanings ascribed thereto in the Plan.

Optionee: _____
Date of Grant: _____
Number of Shares Subject to Option ("Option Shares"): _____
Exercise Price (Per Share): _____
Total Exercise Price: _____
Expiration Date: _____

Incentive Stock Option: This Option shall be construed in a manner to qualify it as an "incentive stock option" under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code").

Vesting Schedule: Subject to the provisions of Section 4 and 6 of the Terms and the discretion of the Company to accelerate the vesting schedule, this option shall become vested and exercisable with respect to the following number of Option Shares at the expiration of the following periods from the Date of Grant set out above:

<u>Vesting Event</u>	<u>Option Shares Vested</u>
[First Anniversary of Grant Date]	[One-Third]
[Second Anniversary of Grant Date]	[One-Third]
[Third Anniversary of Grant Date]	[One-Third]

In any event this Option shall become fully vested and exercisable with respect to all of the Option Shares three years after the date hereof.

Additional Terms/Acknowledgements: The undersigned Optionee acknowledges receipt of, and understands and agrees to, this Incentive Stock Option Agreement, including, without limitation, the Terms. Optionee further acknowledges receipt of a copy of the Plan. Optionee further acknowledges that as of the Date of Grant, this Incentive Stock Option Agreement, including, without limitation, the Terms, and the Plan set forth the entire understanding between Optionee and the Company regarding the Options described herein and supersede all prior oral and written agreements on that subject.

AVALONBAY COMMUNITIES, INC.

OPTIONHOLDER:

By: _____
Signature

Signature

Title: _____

Name (Print): _____

Date: _____

Date: _____

ATTACHMENT: Incentive Stock Option Agreement Terms

AVALON BAY COMMUNITIES, INC.
1994 STOCK INCENTIVE PLAN, AS AMENDED AND RESTATED

INCENTIVE STOCK OPTION AGREEMENT TERMS

1. **Vested Option Shares.** Subject to Section 4, when this Option is vested with respect to any of the Option Shares, this Option shall continue to be exercisable with respect to such Option Shares ("Vested Option Shares") at any time or times prior to the Expiration Date.

2. **Manner of Exercise.** The Optionee may exercise this Option only in the following manner: from time to time on or prior to the Expiration Date, the Optionee may give written notice to the Company of his election to purchase some or all of the Vested Option Shares purchasable at the time of such notice, which notice shall specify the number of Option Shares to be purchased.

Payment of the purchase price for the Option Shares to be purchased may be made by one or more of the following methods: (a) in cash, by certified bank check or other instrument acceptable to the Company; (b) through the delivery (or attestation to the ownership) of shares of Common Stock that have been beneficially owned by the Optionee for at least six (6) months and are not then subject to restrictions under any Company plan and were not used in a "stock swap" within the six (6) months preceding the option exercise, such surrendered shares to be valued at the closing price of the Common Stock on the principal exchange on which the Common Stock is listed on the date the Company receives the exercise notice; (c) by the Optionee delivering to the Company a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company cash or a check payable and acceptable to the Company to pay the purchase price; provided that in the event the Optionee chooses to pay the purchase price as provided in this subsection(c), the Optionee and the broker shall comply with such procedures and enter into such agreements of indemnity and other agreements as the Company shall prescribe as a condition of such payment procedure; or (d) with the consent of the Company, a combination of (a), (b) and (c) above. Payment instruments will be received subject to collection.

The delivery of certificates representing the Option Shares will be contingent upon (i) the Company's receipt from the Optionee of full payment for the Option Shares, as set forth above, (ii) the satisfaction of section 11 hereof, and (iii) any agreement, statement or other evidence that the Company may require to satisfy itself that the issuance of Option Shares to be purchased pursuant to the exercise of Options under the Plan and any subsequent resale of the shares will be in compliance with applicable laws and regulations.

If requested upon the exercise of the Option, certificates for Option Shares may be issued in the name of the Optionee jointly with another person or in the name of the executor or administrator of the Optionee's estate, and the foregoing representations shall be modified accordingly. The Optionee shall not have the rights of a stockholder with respect to any Option Shares prior to his acquisition of such Option Shares upon the exercise of this Option.

Notwithstanding any other provision hereof or of the Plan, no portion of this Option shall be exercisable after the Expiration Date hereof.

3. **Non-transferability of Option.** This Option shall not be transferable by the Optionee otherwise than by will or by the laws of descent and distribution. This Option shall be exercisable during the Optionee's lifetime only by the Optionee.

4. **Termination of Employment.** If the Optionee's employment (or other business relationship) by the Company or a Subsidiary (as defined in the Plan) is terminated, the period within which to exercise the Option may be subject to earlier termination as set forth below.

(a) **Termination Due to Death.** If the Optionee's employment (or other business relationship) terminates by reason of death, any Option held by the Optionee may be exercised, to the extent exercisable at the date of death, by the Optionee's legal representative or legatee for a period of six (6) months from the date of death, or until the Expiration Date, if earlier. For clarification, it is noted that this means that the remaining unvested portion of the Option shall terminate immediately and be of no further force or effect.

(b) Termination Due to Disability. If the Optionee's employment (or other business relationship) terminates by reason of Disability (as defined in the Plan), any Option held by the Optionee may be exercised, to the extent exercisable on the date of termination, for a period of twelve (12) months from the date of termination, or until the Expiration Date, if earlier. The death of the Optionee during the twelve (12) month period provided in this Section 4(b) shall extend such period for six (6) months from the date of death or until the Expiration Date, if earlier. For clarification, it is noted that this means that the remaining unvested portion of the Option shall terminate immediately and be of no further force or effect.

(c) Termination by Reason of Retirement. If the Optionee's employment terminates by reason of Retirement (as defined in the Plan), any Option held by the Optionee shall be automatically vested on the date of termination, and shall be exercisable for a period of twelve (12) months from the date of termination, or until the Expiration Date, if earlier. The death of the Optionee during the twelve (12) month period provided in this Section 4(c) shall extend such period for six (6) months from the date of death, or until the Expiration Date, if earlier.

Retirement, as defined in the Plan, means:

the Optionee's termination of employment with the Company and its Subsidiaries, other than for Cause, following the date on which the sum of (i) the number of full months the Optionee has been employed by the Company and any Predecessor Company (as defined in the Plan) and (ii) the Optionee's age on the date of termination, equals or exceeds 70 years, provided that:

- (x) the Optionee has been employed by the Company and any Predecessor Company for a period of at least 120 contiguous full months at the time of termination;
- (y) the Optionee gives at least six months' prior written notice to the Company of his intention to retire; and
- (z) upon termination of employment, the Optionee enters into a "Non-Compete and Non-Solicitation Agreement" (as defined in the Plan") and a general release of all claims in a form reasonably satisfactory to the Company.

(d) Termination for Cause. If the Optionee's employment (or other business relationship) terminates for Cause (as defined in the Plan), any Option held by the Optionee shall immediately terminate and be of no further force and effect.

(e) Other Termination. If the Optionee's employment terminates for any reason other than death, Disability, Retirement or Cause, and unless otherwise determined by the Company, any Option held by the Optionee may be exercised, to the extent exercisable on the date of termination, for a period of three (3) months from the date of termination, or until the Expiration Date, if earlier. For clarification, it is noted that this means that the remaining unvested portion of the Option shall terminate immediately and be of no further force or effect.

For this purpose, neither a transfer of employment from the Company to a Subsidiary (or from a Subsidiary to the Company) nor an approved leave of absence shall be deemed a "termination of employment."

5. Option Shares. The Option Shares are shares of the Common Stock of the Company as constituted on the date of this Option, subject to adjustment as provided in the Plan.

6. Effect of Change of Control. Upon the occurrence of a Change of Control, as defined in the Plan, this Option shall automatically become fully exercisable.

7. No Special Employment Rights. This Option will not confer upon the Optionee any right with respect to continuance of employment by the Company or a Subsidiary, nor will it interfere in any way with any right of the Optionee's employer to terminate the Optionee's employment at any time.

8. Rights as a Shareholder. The Optionee shall have no rights as a shareholder with respect to any shares of Common Stock that may be purchased upon exercise of this Option unless and until a certificate or certificates representing such shares are duly issued and delivered to the Optionee. Except as otherwise expressly provided in the Plan, no adjustment shall be made for dividends or other rights for which the record date is prior to the date such stock certificate is issued.

9. Qualification under Section 422. It is understood and intended that the Option granted hereunder shall qualify as an “incentive stock option” as defined in Section 422 of the Code. Accordingly, the Optionee understands that in order to obtain the benefits of an incentive stock option under Section 422 of the Code, no sale or other disposition may be made of any Option Shares acquired upon exercise of the Option within the one-year period beginning on the day after the day of the transfer of such Option Shares to him or her, nor within the two-year period beginning on the day after the grant of the Option. If the Optionee intends to dispose or does dispose (whether by sale, gift, transfer or otherwise) of any such Option Shares within these periods, he or she will notify the Company within thirty (30) days after such disposition. In addition, no more than \$100,000 of the aggregate fair market value of Stock Options granted under the Plan may become exercisable for the first time by the Optionee during any calendar year and be treated as incentive stock options under Section 422 of the Code.

10. The Plan. In the event of any discrepancy or inconsistency between this Agreement and the Plan, the terms and conditions of the Plan shall control.

11. Withholding Taxes. The Optionee shall, not later than the date as of which the exercise of this Option becomes a taxable event for federal income tax purposes, pay to the Company (or make arrangements satisfactory to the Company for payment of) any federal, state and local taxes required by law to be withheld on account of such taxable event. The Optionee acknowledges and agrees that the Company has the right to deduct from payments of any kind otherwise due to the Optionee, or from the Option Shares to be issued in respect of an exercise of this Option, any federal, state or local taxes of any kind required by law to be withheld with respect to the issuance of shares of Stock to the Optionee.

12. Miscellaneous. Notices hereunder shall be mailed or delivered to the Company at its principal place of business, 2900 Eisenhower Avenue, Suite 300, Alexandria, Virginia 22314, Attention: Jenny Bercik, and shall be mailed or delivered to Optionee at his address set forth in the Company’s records, or in either case at such other address as one party may subsequently furnish to the other party in writing. This Option shall be governed by the laws of the State of Maryland, except to the extent such law is preempted by federal law.

[End of Text]

[In accordance with the employment agreements of Messrs. Blair, Naughton, Sargeant, Fuller and Horey, the Company enters into the following addendum to all Incentive Stock Option Agreements with such individuals.]

**Addendum to ISO Stock Option Agreement
with**

This Addendum to Stock Option Agreement is dated as of ____.

Reference is made to the following agreement (the "Unmodified Stock Option Agreement"):

Incentive Stock Option Agreement between ____ ("Employee") and AvalonBay Communities, Inc. ("AvalonBay"), dated ____, with respect to ____ stock options (the "Options") having an exercise price of \$ ____.

Capitalized terms used herein and not defined herein have the meanings set forth in the Unmodified Stock Option Agreement.

For the convenience of AvalonBay, the Unmodified Stock Option Agreement is in a standard format commonly used by AvalonBay. However, this Addendum to Stock Option Agreement (the "Addendum") contains one or more provisions (the "Modifications") approved by the Board of Directors of AvalonBay (the "Board") that are inconsistent with the terms of the Unmodified Stock Option Agreement. The Board approved the Modifications at the time it approved the grant of the Options to Employee, and for ease of administration the Company is documenting the grant of the Options with the Modifications by entering into the Unmodified Stock Option Agreement and this Addendum.

NOW, THEREFORE, intending to be legally bound and for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, AvalonBay and Employee agree as follows:

If, pursuant to the terms of the Employment Agreement between the Company and Employee dated ____, as amended, or pursuant to the terms of a successor agreement or arrangement (other than the Unmodified Stock Option Agreement), the vesting of Employee's stock options is accelerated upon the termination of his employment, then the following shall apply: any Option then held by Employee may be exercised, to the extent exercisable on the date of termination (after giving effect to accelerated vesting), for a period of one (1) year from the date of termination, or until the Expiration Date, if earlier.

For clarification it is noted that the terms of the preceding paragraph will not apply if vesting of Employee's stock options is not accelerated upon a termination of employment (e.g., if he voluntarily resigns without a Constructive Termination Without Cause, as defined in the Employment Agreement). In such cases, the period of time following termination in which the Options must be exercised will be determined by the Unmodified Stock Option Agreement, which generally provides that the Options will terminate earlier than one year from the date of termination.

Except as stated above, the terms of the Unmodified Stock Option Agreement apply in full to the Options.

AVALONBAY COMMUNITIES, INC.

By: _____

Name:

Title:

By: _____

Name:

Title:

Receipt is hereby acknowledged of a copy of the Company's Plan, the Unmodified Stock Option Agreement and this Addendum. The undersigned agrees to be bound by the terms and conditions of the Plan, the Unmodified Stock Option Agreement and this Addendum.

Optionee:

Address:

[Form of Employee Stock Grant and Restricted Stock Agreement]

**AVALONBAY COMMUNITIES, INC.
STOCK GRANT AND RESTRICTED STOCK AGREEMENT**

In consideration for services rendered and to be rendered to AvalonBay Communities, Inc. (the "Company") and for other good and valuable consideration, which the Company has determined to be equal to the fair market value of the Shares, as defined below, the Company is issuing to the Employee named below contemporaneously herewith the Shares, upon the terms and conditions set forth herein and in the Restricted Stock Agreement Terms (the "Terms") which are attached hereto and incorporated herein in their entirety. Capitalized terms used but not defined herein shall have the respective meanings ascribed thereto in the Terms.

Employee: _____
Award Date: _____
Vesting Commencement Date: _____
Number of Shares Granted ("Shares"): _____

Vesting Schedule: Subject to the provisions of the Terms and the discretion of the Company to accelerate the vesting schedule, the Employee's ownership interest in the Shares shall vest, and the status of the Shares as Restricted Stock and all Restrictions with respect to the Shares shall terminate, in accordance with the following schedule of events:

<u>Vesting Event</u>	<u>Shares Vested</u>
March 1, 200_ [Year of Grant]	[20%]
March 1, 200_ [Second Year]	[20%]
March 1, 200_ [Third Year]	[20%]
March 1, 200_ [Fourth Year]	[20%]
March 1, 200_ [Fifth Year]	[20%]
Termination of the Employee's Employment by the Company, other than for Cause	[Total RSA]*
The death or disability of the Employee	[Total RSA]*
The Retirement of the Employee	[Total RSA]*
If earlier than any of the above events, a Change of Control	[Total RSA]*

*or, if fewer, all Restricted Shares

Additional Terms/Acknowledgements: The undersigned Employee acknowledges receipt of, and understands and agrees to, this Stock Grant and Restricted Stock Agreement, including, without limitation, the Terms. Employee further acknowledges that as of the Award Date, this Stock Grant and Restricted Stock Agreement, including, without limitation, the Terms, sets forth the entire understanding between Employee and the Company regarding the stock grant described herein and supersedes all prior oral and written agreements on that subject.

AVALONBAY COMMUNITIES, INC.

EMPLOYEE:

By: _____
Signature

Signature

Title: _____

Name (Print): _____

Date: _____

Date: _____

ATTACHMENT: Restricted Stock Agreement Terms

AVALONBAY COMMUNITIES, INC.

RESTRICTED STOCK AGREEMENT TERMS

ARTICLE I

DEFINITIONS

Section 1.1 - Cause

“Cause” means and shall be limited to a vote of the Board of Directors resolving that the Employee should be dismissed as a result of (i) any material breach by the Employee of any agreement to which the Employee and the Company are parties, (ii) any act (other than retirement) or omission to act by the Employee which may have a material and adverse effect on the business of the Company or any Subsidiary (as hereinafter defined) or on the Employee’s ability to perform services for the Company or any Subsidiary, including, without limitation, the Employee being convicted of any crime (other than ordinary traffic violations) or (iii) any material misconduct or neglect of duties by the Employee in connection with the business or affairs of the Company or any Subsidiary.

Section 1.2 - Change of Control

“Change of Control” means the occurrence of any one of the following events:

(i) any “person,” as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the “Act”) (other than the Company, any of its Subsidiaries, or any trustee, fiduciary or other person or entity holding securities under any employee benefit plan or trust of the Company or any of its Subsidiaries), together with all “affiliates” and “associates” (as such terms are defined in Rule 12b-2 under the Act) of such person, shall become the “beneficial owner” (as such term is defined in Rule 13d-3 under the Act), directly or indirectly, of securities of the Company representing 30% or more of either (A) the combined voting power of the Company’s then outstanding securities having the right to vote in an election of the Company’s Board of Directors (“Voting Securities”) or (B) the then outstanding shares of Common Stock (as hereinafter defined), in either such case other than as a result of an acquisition of securities directly from the Company; or

(ii) persons who, as of the Award Date, constitute the Company’s Board of Directors (the “Incumbent Directors”) cease for any reason, including, without limitation, as a result of a tender offer, proxy contest, merger, acquisition of Voting Securities or similar transaction, to constitute at least a majority of the Board of Directors, provided that any person becoming a director of the Company subsequent to the Award Date whose election or nomination for election was approved by a vote of at least a majority of the Incumbent Directors shall, for purposes of this Agreement, be considered an Incumbent Director; or

(iii) the stockholders of the Company shall approve (A) any consolidation or merger of the Company or any Subsidiary where the stockholders of the Company, immediately prior to the consolidation or merger, would not, immediately after the consolidation or merger, beneficially own (as such term is defined in Rule 13d-3 under the Act), directly or indirectly, shares representing in the aggregate 30% of the voting shares of the corporation or other entity issuing cash or securities in the consolidation or merger (or of its ultimate parent corporation or other entity, if any), (B) any sale, lease, exchange or other transfer (in one transaction or a series of transactions contemplated or arranged by any party as a single plan) of all or substantially all of the assets of the Company or (C) any plan or proposal for the liquidation or dissolution of the Company.

Notwithstanding the foregoing, a “Change of Control” shall not be deemed to have occurred for purposes of the foregoing clause (i) solely as the result of an acquisition of securities by the Company which, by reducing the number of shares of Common Stock or other Voting Securities outstanding, increases (x) the proportionate number of shares of Common Stock beneficially owned by any person to 30% or more of the shares of Common Stock then outstanding or (y) the proportionate voting power represented by the Voting Securities beneficially owned by any

person to 30% or more of the combined voting power of all then outstanding Voting Securities; provided, however, that if any person referred to in clause (x) or (y) of this sentence shall thereafter become the beneficial owner of any additional shares of Common Stock or other Voting Securities (other than pursuant to a stock split, stock dividend, or similar transaction), then a “Change of Control” shall be deemed to have occurred for purposes of the foregoing clause (i).

Section 1.3 - Common Stock

“Common Stock” shall mean the common stock of the Company, \$.01 par value.

Section 1.4 - Fair Market Value

“Fair Market Value” on any given date means the last reported sale price at which the Common Stock is traded on such date or, if no Common Stock is traded on such date, the most recent date on which Common Stock was traded, as reflected on the New York Stock Exchange or, if applicable, any other national stock exchange on which the Common Stock is traded.

Section 1.5 - Restricted Stock

“Restricted Stock” shall mean the Shares issued under this Agreement for as long as such shares are subject to the Restrictions (as hereinafter defined) imposed by this Agreement.

Section 1.6 - Restrictions

“Restrictions” shall mean the restrictions set forth in Article III of this Agreement.

Section 1.7 – Retirement

“Retirement” in accordance with the Plan shall mean:

the Employee’s termination of employment with the Company and its Subsidiaries, other than for Cause, following the date on which the sum of (i) the number of full months the Employee has been employed by the Company and any Predecessor Company (as defined in the Plan) and (ii) the Employee’s age on the date of termination, equals or exceeds 70 years, provided that:

- (x) the Employee has been employed by the Company and any Predecessor Company for a period of at least 120 contiguous full months at the time of termination;
- (y) the Employee gives at least six months’ prior written notice to the Company of his intention to retire; and
- (z) upon termination of employment, the Employee enters into a “Non-Compete and Non-Solicitation Agreement” (as defined in the Plan) and a general release of all claims in a form reasonably satisfactory to the Company.

Section 1.7 - Secretary

“Secretary” shall mean the secretary of the Company.

Section 1.8 - Subsidiary

“Subsidiary” means any corporation or other entity (other than the Company) in any unbroken chain of corporations or other entities, beginning with the Company if each of the corporations or entities (other than the last corporation or entity in the unbroken chain) owns stock or other interests possessing 50% or more of the economic interest or the total combined voting power of all classes of stock or other interests in one of the other corporations or entities in the chain.

ARTICLE II

RESTRICTED STOCK

Section 2.1 - Restricted Stock

Any shares of Common Stock granted pursuant to this Agreement which vest on a date other than the Award Date shall be considered Restricted Stock for purposes of this Agreement and shall be subject to the Restrictions until such time or times and except to the extent that the Employee's ownership interest in Shares vests in accordance with the Vesting Schedule set forth on the first page of this Agreement.

Section 2.2 - Escrow

The Secretary or such other escrow holder as the Company may from time to time appoint shall retain physical custody of the certificates representing Restricted Stock, including shares of Restricted Stock issued pursuant to Section 3.5, until all of the Restrictions expire or shall have been removed; provided, however, that in no event shall the Employee retain physical custody of any certificates representing Restricted Stock issued to him.

Section 2.3 - Rights as Stockholder

From and after the Award Date, the Employee shall have all the rights of a stockholder with respect to the Shares, subject to the Restrictions herein (including the provisions of Article IV), including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares unless and to the extent that the Employee's interest in Restricted Stock shall have terminated and the Restricted Stock reverts to the Company as provided in Section 3.1 of this Agreement.

ARTICLE III

RESTRICTIONS

Section 3.1 - Reversion of Restricted Stock

Except as provided in Section 2.3, this Section 3.1, and the Vesting Schedule set forth on the first page of this Agreement, the Restricted Stock shall be the property of the Company for as long as and to the extent that the Shares are Restricted Stock pursuant to Section 2.1. In the event that the Employee's employment by the Company terminates for any reason other than (a) death, (b) disability or (c) termination of the Employee's employment by the Company other than for Cause, any interest of the Employee in Shares that are Restricted Stock shall thereupon immediately terminate and all rights with respect to the Restricted Stock shall immediately revert to and unconditionally be the property of the Company; provided, however, that the Employee shall be entitled to retain any cash dividends paid before the date of such event on the Restricted Stock.

Section 3.2 - Restricted Stock Not Transferable

No Restricted Stock or any interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Employee or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law or judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that the Employee may designate one or more trusts or other similar arrangements for the benefit of the Employee or members of his immediate family as the registered holders of Restricted Stock if and as long as the Employee acts as trustee or in a similar capacity with respect to such trust or arrangement. Any Restricted Stock so registered shall for all purposes hereunder be deemed to be held of record by the Employee and shall be subject to all of the terms and conditions of this Agreement, including but not limited to the Restrictions and the provisions of Article III of this Agreement.

Section 3.3 - Legend

(a) Certificates representing shares of Restricted Stock issued pursuant to this Agreement shall, until all Restrictions lapse and new certificates are issued pursuant to Section 3.4, bear the following legend:

“THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN VESTING REQUIREMENTS AND MAY BE SUBJECT TO FORFEITURE TO AVALONBAY COMMUNITIES, INC. (THE “COMPANY”) UNDER THE TERMS OF THAT CERTAIN RESTRICTED STOCK AGREEMENT BY AND BETWEEN THE COMPANY AND THE HOLDER OF THE SECURITIES. PRIOR TO VESTING OF OWNERSHIP IN THE SECURITIES, THEY MAY NOT BE, DIRECTLY OR INDIRECTLY, OFFERED, TRANSFERRED, SOLD, ASSIGNED, PLEDGED, HYPOTHECATED OR OTHERWISE DISPOSED OF UNDER ANY CIRCUMSTANCES. COPIES OF THE ABOVE REFERENCED AGREEMENT ARE ON FILE AT AND MAY BE OBTAINED ON REQUEST AND WITHOUT CHARGE FROM THE OFFICES OF THE COMPANY AT 2900 EISENHOWER AVENUE, SUITE 300, ALEXANDRIA, VA 22314.”

(b) Certificates representing any shares of Common Stock issued pursuant to this Agreement shall bear the following or substantially similar legend:

“THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”). NO SALE, HYPOTHECATION, TRANSFER OR OTHER DISPOSITION OF THESE SECURITIES MAY BE MADE UNLESS EITHER (A) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR (B) PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.”

Section 3.4 - Lapse of Restrictions

Upon the vesting of some or all of the Restricted Stock as provided in the Vesting Schedule set forth on the first page of this Agreement, and subject to the conditions to issuance set forth in Article IV, the Company shall cause new certificates to be issued with respect to such vested Shares and delivered to the Employee or his legal representative, free from the legend provided for in Section 3.3(a).

Section 3.5 - Restrictions on New Shares

In the event that the outstanding shares of the Company’s Common Stock are changed into or exchanged for a different number or kind of shares or other securities of the Company, or a stock split-up or stock dividend, such new, additional or different shares or securities which are held or received by the Employee (or his designee) in his capacity as a holder of Restricted Stock shall be considered to be Restricted Stock and shall be subject to all of the terms and conditions of this Agreement, including but not limited to the Restrictions.

ARTICLE IV

MISCELLANEOUS

Section 4.1 - - Conditions to Issuance of Stock Certificates

The Company shall not be required to issue or deliver any certificate or certificates for shares of stock pursuant to this Agreement prior to fulfillment of all of the following conditions:

- (a) The admission of such shares to listing on all stock exchanges on which such class of stock is then listed; and
- (b) The completion of any registration or other qualification of such shares under any state or Federal law or under rulings or regulations of the Securities and Exchange Commission or of any other governmental regulatory body, which the Company shall deem necessary or advisable; and
- (c) The obtaining of any approval or other clearance from any state or Federal governmental agency which the Company shall, in its absolute discretion, determine to be necessary or advisable; and
- (d) The payment by the Employee of all amounts required to be withheld under federal, state and local tax laws, with respect to the issuance of Restricted Stock and/or the lapse or removal of any of the Restrictions; and

Section 4.2 - Notices

Any notice to be given under the terms of this Agreement to the Company shall be addressed to the Company in care of its Secretary, and any notice to be given to the Employee shall be addressed to him at his address as set forth in the Company's records. By a notice given pursuant to this Section 4.2, either party may hereafter designate a different address for notices to be given to it or him. Any notice which is required to be given to the Employee shall, if the Employee is then deceased, be given to the Employee's personal representative if such representative has previously informed the Company of his status and address by written notice under this Section 4.2. Any notice shall have been deemed duly given when enclosed in a properly sealed envelope or wrapper addressed as aforesaid and deposited (with postage prepaid) in a post office or branch post office regularly maintained by the United States Postal Service.

Section 4.3 - Titles

Titles and captions are provided herein for convenience only and are not to serve as a basis for interpretation or construction of this Agreement.

Section 4.4 - Amendment

This Agreement may be amended only by a writing executed by the parties hereto which specifically states that it is amending this Agreement.

Section 4.5 - Tax Withholding

The Company's obligation (i) to issue or deliver to the Employee any certificate or certificates for unrestricted shares of stock or (ii) to pay to the Employee any dividends or make any distributions with respect to the Common Stock issued under this Agreement is expressly conditioned on the Company's satisfaction of its obligation, if any, to withhold taxes. The Company may, if the employee so elects in writing, withhold from any distribution made to the Employee under this Agreement shares of Common Stock valued at Fair Market Value on the date of such withholding to cover any applicable withholding and employment taxes. In lieu of withholding shares of Common Stock, the Employee may elect to pay to the Company any amounts required to be withheld in cash.

Section 4.6 - Governing Law

The laws of the State of Maryland shall govern the interpretation, validity, administration, enforcement and performance of the terms of this Agreement regardless of the law that might be applied under principles of conflicts of laws.

Section 4.7 - Counterparts

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

Section 4.8 - No Special Employment Rights

This Agreement does not, and shall not be interpreted to, create any right on the part of the Employee to continue in the employ of the Company or any subsidiary or affiliate thereof, nor to any continued compensation, prerequisites or other current or future benefits or other incidents of employment.

[End of Text]

[Form of Director Restricted Unit Agreement]

**AVALONBAY COMMUNITIES, INC.
RESTRICTED UNIT AGREEMENT**

Pursuant to the terms of the AvalonBay Communities, Inc. Amended and Restated 1994 Stock Incentive Plan (as amended from time to time, the "Plan"), in consideration for services rendered and to be rendered to AvalonBay Communities, Inc. (the "Company"), in order to advance the interests of the Company and its stockholders and effect the intended purposes of the Plan, and for other good and valuable consideration, which the Company has determined to be equal to the fair market value of the Units, as defined below, the Company is awarding to the Director named below contemporaneously herewith the Units, upon the terms and conditions set forth herein and in the Restricted Unit Agreement Terms (the "Terms") which are attached hereto and incorporated herein in their entirety. Capitalized terms used but not defined herein shall have the respective meanings ascribed thereto in the Terms

Director: _____
Award Date: _____
Number of Shares of Deferred Stock ("Units") Awarded: _____
Conversion Date or Event for Units
(previously elected by Director) **[Specify date or 30 days after ceasing to be a director
of the Company for any reason]**

Vesting Schedule: Subject to the provisions of the Terms, the Director's ownership interest in the Units shall vest, and the status of the Units as Unvested Units and all Restrictions with respect to the Units shall terminate, in accordance with the following schedule of events:

<u>Vesting Event</u>	<u>Shares Vested</u>
Award Date	20%
First Anniversary of Award Date	40%
Second Anniversary of Award Date	60%
Third Anniversary of Award Date	80%
Fourth Anniversary of Award Date	100%
Termination of the Director's service as a director by vote of the Company's stockholders for any reason other than Cause	100%
Failure by the Board of Directors or any authorized committee thereof to nominate the Director for re-election for any reason other than for Cause	100%
Failure of the Company's stockholders to re-elect the Director	100%
Death or Disability of the Director	100%
If earlier than any of the above events, a Change of Control	100%

Additional Terms/Acknowledgements: The undersigned Director acknowledges receipt of, and understands and agrees to, this Restricted Unit Agreement, including, without limitation, the Terms. The Director further acknowledges that as of the Award Date, this Restricted Unit Agreement, including, without limitation, the Terms, sets forth the entire understanding between the Director and the Company regarding the grant of Units described herein and supersedes all prior oral and written agreements on that subject.

AVALONBAY COMMUNITIES, INC.

DIRECTOR:

By: _____
Signature

Signature

Title: _____

Name (Print): _____

Date: _____

Date: _____

ATTACHMENT: Restricted Unit Agreement Terms

AVALONBAY COMMUNITIES, INC.
RESTRICTED UNIT AGREEMENT TERMS

ARTICLE I
DEFINITIONS

The following terms used below in this Agreement shall have the meaning specified below unless the context clearly indicates to the contrary. Capitalized terms not otherwise defined herein shall have the meanings set forth in the Plan.

Section 1.1 - Cause

“Cause” means and shall be limited to (a) an affirmative vote of the holders of at least 75 percent of the shares entitled to vote at a meeting of stockholders called for the purpose, resolving that the Director should be removed from office or (b) a vote of the Board of Directors, the Nominating Committee, if any, or any other authorized committee of the Board of Directors resolving that the Director should not be nominated for re-election as a director, in either case, as a result of (i) conviction of a felony, (ii) declaration of unsound mind by order of a court, (iii) gross dereliction of duty, (iv) commission of any act involving moral turpitude or (v) commission of an act that constitutes intentional misconduct or a knowing violation of law if such action in either event results in both an improper substantial personal benefit to such Director and a material injury to the Company.

Section 1.2 - Common Stock

“Common Stock” shall mean the common stock of the Company, \$.01 par value.

Section 1.3 – Deferred Stock

“Deferred Stock” shall mean phantom stock of the Company. Each share of Deferred Stock shall have the same value as each share of Common Stock and shall be ultimately distributed to the Director in the form of Common Stock.

Section 1.4 - Restrictions

“Restrictions” shall mean the restrictions set forth in Article III of this Agreement.

Section 1.5 - Secretary

“Secretary” shall mean the secretary of the Company.

Section 1.6 - Unvested Units

“Unvested Units” shall mean the Units (as defined in the Restricted Unit Agreement)

issued under this Agreement for as long as such Units are subject to the Restrictions (as hereinafter defined) imposed by this Agreement.

ARTICLE II
RESTRICTED UNITS

Section 2.1 - Unvested Units

Any Units granted on the Award Date pursuant to this Agreement shall be considered Unvested Units for purposes of this Agreement and shall be subject to the Restrictions until such time or times and except to the extent that the Director's ownership interest in Units vests in accordance with the Vesting Schedule set forth on the first page of this Agreement.

Section 2.2 - Rights as Stockholder

From and after the Award Date, the Director shall not have any of the rights of a stockholder with respect to the Units until the Units are distributed to the Director in the form of Common Stock, except with respect to Dividend Equivalent Rights as set forth on Section 2.3.

Section 2.3 - Dividend Equivalent Rights

All Units granted hereunder shall carry Dividend Equivalent Rights which shall entitle the Director to receive additional Units, based on the amount of actual dividends payable by the Company with respect to the Common Stock. The amount of dividend equivalents credited to the Director's Units following each calendar quarter shall be converted to additional Units based on the Fair Market Value of the Common Stock on the last day of such calendar quarter. Such additional Units shall also carry Dividend Equivalent Rights. All additional Units credited to a Director's account pursuant to this Section 2.3 shall be fully vested at all times.

ARTICLE III
RESTRICTIONS

Section 3.1 - Reversion of Unvested Units

Except as provided in clauses (a) through (e) of this sentence or in the following paragraph, any interest of the Director in Units that are Unvested Units shall immediately terminate if the Director's service as a director of the Company terminates for any reason, unless such termination of service results from (a) death of the Director, (b) Disability of the Director, (c) removal of the Director from office by vote of the Company's stockholders for any reason other than for Cause, (d) failure by the Board of Directors or any authorized committee thereof to nominate the Director for re-election for any reason other than for Cause or (e) failure of the Company's stockholders to re-elect the Director.

In the event that the Director resigns or declines to accept nomination for re-election, any Units that are Unvested Units shall continue to vest on the dates provided in this Agreement as if

the Director continued to serve on the Board of Directors unless the Board of Directors or any authorized committee thereof determines in good faith that there exist reasonable grounds on which the stockholders of the Company could remove the Director for Cause (in which case any interest of the Director in Units that are Unvested Units shall immediately upon such determination terminate).

Notwithstanding the provisions of the preceding two paragraphs, in the event that any Unvested Units are forfeited, the Director shall be entitled to retain any Units credited to his account pursuant to the Dividend Equivalent Rights accrued on the Unvested Units in accordance with Section 2.3 before the date of such event.

Section 3.2 – Units Not Transferable

No Units, whether vested or unvested, or any interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Director or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law or judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that this Section 3.2 shall not prevent transfers by will or by applicable laws of descent and distribution until the Units are distributed to the Director in shares of Common Stock. Until such time when the shares of Common Stock are distributed to the Director, the Director's rights under this Agreement shall be similar to that of an unsecured creditor of the Company.

Section 3.3 – Adjustments; Restrictions on New Units

In the event that the outstanding shares of the Company's Common Stock are changed into or exchanged for a different number or kind of shares or other securities of the Company, or a stock split-up or stock dividend, the Committee shall make an appropriate adjustment to the number of Units credited to the Director. Any such additional Units attributable to Unvested Units shall be considered to be Unvested Units and shall be subject to all of the terms and conditions of this Agreement, including but not limited to the Restrictions.

Section 3.4 – Timing and Form of Distribution

The Units shall be exchanged into shares of Common Stock on a one-for-one basis and shall be distributed to the Director at such time as the Director may have previously elected in writing to the Company. Any fractional Unit shall be distributed in cash at the same time.

ARTICLE IV
MISCELLANEOUS

Section 4.1 - Conditions to Issuance of Stock Certificates

The Company shall not be required to issue or deliver any certificate or certificates for shares of stock pursuant to this Agreement prior to fulfillment of all of the following conditions:

- (a) The admission of such shares to listing on all stock exchanges on which such class of stock is then listed; and
- (b) The completion of any registration or other qualification of such shares under any state or Federal law or under rulings or regulations of the Securities and Exchange Commission or of any other governmental regulatory body, which the Company shall deem necessary or advisable; and
- (c) The obtaining of any approval or other clearance from any state or Federal governmental agency which the Company shall, in its absolute discretion, determine to be necessary or advisable.

Section 4.2 - Administration

The Committee shall have the power to interpret the Plan, this Agreement and all other documents relating to Unvested Stock and to adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith and to interpret, amend or revoke any such rules. All actions taken and all interpretations and determinations made by the Committee in good faith shall be final and binding upon the Director, the Company and all other interested person. No member of the Committee shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or Unvested Stock and all members of the Committee shall be fully protected by the Company in respect to any such action, determination or interpretation. The Board shall have no right to exercise any of the rights or duties of the Committee under the Plan and this Agreement.

Section 4.3 - Notices

Any notice to be given under the terms of this Agreement to the Company shall be addressed to the Company in care of its Secretary, and any notice to be given to the Director shall be addressed to him at the address maintained in the Company's records. By a notice given pursuant to this Section 4.3, either party may hereafter designate a different address for notices to be given to it or him. Any notice which is required to be given to the Director shall, if the Director is then deceased, be given to the Director's personal representative if such representative has previously informed the Company of his status and address by written notice under this Section 4.3. Any notice shall have been deemed duly given when enclosed in a properly sealed envelope or wrapper addressed as aforesaid and deposited (with postage prepaid) in a post office or branch post office regularly maintained by the United States Postal Service.

Section 4.4 - Titles

Titles and captions are provided herein for convenience only and are not to serve as a basis for interpretation or construction of this Agreement.

Section 4.5 - Amendment

This Agreement may be amended only by a writing executed by the parties hereto which specifically states that it is amending this Agreement.

Section 4.6 - Governing Law

The laws of the State of Maryland shall govern the interpretation, validity, administration, enforcement and performance of the terms of this Agreement regardless of the law that might be applied under principles of conflicts of laws.

Section 4.7 - Counterparts

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

Section 4.8 - No Special Rights

This Agreement does not, and shall not be interpreted to, create any right on the part of the Director to nomination, election or continued service as a director of the Company or any subsidiary or affiliate thereof, nor to any continued compensation, prerequisites or other current or future benefits or other incidents of such service nor shall it interfere with or restrict in any way any right or power, which is hereby expressly reserved, to remove or not to renominate the Director at any time for any reason whatsoever, with or without cause.

[End of Text]

[Form of Director Restricted Stock Agreement]

**AVALONBAY COMMUNITIES, INC.
RESTRICTED STOCK AGREEMENT**

Pursuant to the terms of the AvalonBay Communities, Inc. Amended and Restated 1994 Stock Incentive Plan (as amended from time to time, the "Plan"), in consideration for services rendered and to be rendered to AvalonBay Communities, Inc. (the "Company"), in order to advance the interests of the Company and its stockholders and effect the intended purposes of the Plan, and for other good and valuable consideration, which the Company has determined to be equal to the fair market value of the Shares, as defined below, the Company is issuing to the Director named below contemporaneously herewith the Shares, upon the terms and conditions set forth herein and in the Restricted Stock Agreement Terms (the "Terms") which are attached hereto and incorporated herein in their entirety. Capitalized terms used but not defined herein shall have the respective meanings ascribed thereto in the Terms.

Director: _____
Award Date: _____
Number of Shares Granted ("Shares"): _____

Vesting Schedule: Subject to the provisions of the Terms, the Director's ownership interest in the Shares shall vest, and the status of the Shares as Unvested Stock and all Restrictions with respect to the Shares shall terminate, in accordance with the following schedule of events:

<u>Vesting Event</u>	<u>Shares Vested</u>
Award Date	20%
First Anniversary of Award Date	40%
Second Anniversary of Award Date	60%
Third Anniversary of Award Date	80%
Fourth Anniversary of Award Date	100%
Termination of the Director's service as a director by vote of the Company's stockholders for any reason other than Cause	100%
Failure by the Board of Directors or any authorized committee thereof to nominate the Director for re-election for any reason other than for Cause	100%
Failure of the Company's stockholders to re-elect the Director	100%
Death or Disability of the Director	100%
If earlier than any of the above events, a Change of Control	100%

Additional Terms/Acknowledgements: The undersigned Director acknowledges receipt of, and understands and agrees to, this Restricted Stock Agreement, including, without limitation, the Terms. The Director further acknowledges that as of the Award Date, this Restricted Stock Agreement, including, without limitation, the Terms, sets forth the entire understanding between the Director and the Company regarding the stock grant described herein and supersedes all prior oral and written agreements on that subject.

AVALONBAY COMMUNITIES, INC.

DIRECTOR:

By: _____
Signature

Signature

Title: _____

Name (Print): _____

Date: _____

Date: _____

ATTACHMENT: Restricted Stock Agreement Terms

AVALONBAY COMMUNITIES, INC.

RESTRICTED STOCK AGREEMENT TERMS

ARTICLE I
DEFINITIONS

The following terms used below in this Agreement shall have the meaning specified below unless the context clearly indicates to the contrary. Capitalized terms not otherwise defined herein shall have the meanings set forth in the Restricted Stock Agreement and in the Plan.

Section 1.1 – Cause

“Cause” means and shall be limited to (a) an affirmative vote of the holders of at least 75 percent of the shares entitled to vote at a meeting of stockholders called for the purpose, resolving that the Director should be removed from office or (b) a vote of the Board of Directors, the Nominating Committee, if any, or any other authorized committee of the Board of Directors resolving that the Director should not be nominated for re-election as a director, in either case, as a result of (i) conviction of a felony, (ii) declaration of unsound mind by order of a court, (iii) gross dereliction of duty, (iv) commission of any act involving moral turpitude or (v) commission of an act that constitutes intentional misconduct or a knowing violation of law if such action in either event results in both an improper substantial personal benefit to such Director and a material injury to the Company.

Section 1.2 – Common Stock

“Common Stock” shall mean the common stock of the Company, \$.01 par value.

Section 1.3 – Restrictions

“Restrictions” shall mean the restrictions set forth in Article III of this Agreement.

Section 1.4 – Secretary

“Secretary” shall mean the secretary of the Company.

Section 1.5 – Unvested Stock

“Unvested Stock” shall mean the Shares issued under this Agreement for as long as such shares are subject to the Restrictions (as hereinafter defined) imposed by this Agreement, without regard to whether the issuance to and/or resale by the Director has been registered under the Securities Act of 1933, as amended.

ARTICLE II
ISSUANCE OF STOCK

Section 2.1 – Unvested Stock

Any shares of Common Stock granted on the Award Date pursuant to this Agreement shall be considered Unvested Stock for purposes of this Agreement and shall be subject to the Restrictions until such time or times and except to the extent that the Director's ownership interest in Shares vests in accordance with the Vesting Schedule set forth on the first page of this Agreement.

Section 2.2 – Escrow

The Secretary or such other escrow holder as the Company may from time to time appoint shall retain physical custody of the certificates representing Unvested Stock, including shares of Unvested Stock issued pursuant to Section 3.5, until all of the Restrictions expire or shall have been removed; provided, however, that in no event shall the Director retain physical custody of any certificates representing Unvested Stock issued to the Director.

Section 2.3 – Rights as Stockholder

From and after the Award Date, the Director shall have all the rights of a stockholder with respect to the Shares, subject to the Restrictions herein (including the provisions of Article IV), including the right to vote the Shares and to receive all dividends or other distributions paid or made with respect to the Shares unless and to the extent that the Director's interest in Unvested Stock shall have terminated and the Unvested Stock reverts to the Company as provided in Section 3.1 of this Agreement.

ARTICLE III
RESTRICTIONS

Section 3.1 – Reversion of Unvested Stock

Except as provided in Section 2.3 and this Section 3.1 and the Vesting Schedule set forth on the first page of this Agreement, it is expressly understood and agreed that the Unvested Stock is and at all times shall be the property of the Company for as long as and to the extent that the Shares are Unvested Stock pursuant to Section 2.1. Except as provided in clauses (a) through (e) of this sentence or in the following paragraph, any interest of the Director in Shares that are Unvested Stock shall immediately terminate and all rights with respect to the Unvested Stock shall immediately revert to and unconditionally be the property of the Company if the Director's service as a director of the Company terminates for any reason, unless such termination of service results from (a) death of the Director, (b) Disability of the Director, (c) removal of the Director from office by vote of the Company's stockholders for any reason other than for Cause, (d) failure by the Board of Directors or any authorized committee thereof to nominate the

Director for re-election for any reason other than for Cause or (e) failure of the Company's stockholders to re-elect the Director.

In the event that the Director resigns or declines to accept nomination for re-election, any Shares that are Unvested Stock shall continue to vest on the dates provided in this Agreement as if the Director continued to serve on the Board of Directors unless the Board of Directors or any authorized committee thereof determines in good faith that there exist reasonable grounds on which the stockholders of the Company could remove the Director for Cause (in which case any interest of the Director in Shares that are Unvested Stock shall immediately upon such determination terminate and all rights with respect thereto revert to and unconditionally be the property of the Company).

Notwithstanding the provisions of the preceding two paragraphs, in the event that any Unvested Stock reverts to the Company, the Director shall be entitled to retain any cash dividends paid on the Unvested Stock before the date of such event.

Section 3.2 – Unvested Stock Not Transferable

No Unvested Stock or any interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Director or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law or judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that this Section 3.2 shall not prevent transfers by will or by applicable laws of descent and distribution. Any Unvested Stock registered in the name of any person, trust, or other nominee shall for all purposes hereunder be deemed to be held of record by the Director and shall be subject to all of the terms and conditions of this Agreement, including but not limited to the Restrictions and the provisions of Article III of this Agreement.

Section 3.3 – Legend

Certificates representing shares of Unvested Stock issued pursuant to this Agreement shall, until all Restrictions lapse and new certificates are issued pursuant to Section 3.4, bear the following legend:

“THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO THE TERMS OF THAT CERTAIN RESTRICTED STOCK AGREEMENT BY AND BETWEEN THE HOLDER OF THE SECURITIES AND AVALON BAY COMMUNITIES, INC. (THE “COMPANY”), INCLUDING CERTAIN VESTING REQUIREMENTS, AND ARE THE PROPERTY OF, AND MAY BE SUBJECT TO FORFEITURE TO, THE COMPANY. PRIOR TO VESTING OF OWNERSHIP IN THE SECURITIES, THEY MAY NOT BE, DIRECTLY OR

INDIRECTLY, OFFERED, TRANSFERRED, SOLD, ASSIGNED, PLEDGED, HYPOTHECATED OR OTHERWISE DISPOSED OF UNDER ANY CIRCUMSTANCES. COPIES OF THE ABOVE REFERENCED AGREEMENT ARE ON FILE AT AND MAY BE OBTAINED ON REQUEST AND WITHOUT CHARGE FROM THE OFFICES OF THE COMPANY AT 2900 EISENHOWER AVENUE, SUITE 300, ALEXANDRIA, VA 22314.”

Section 3.4 – Lapse of Restrictions

Upon the vesting of some or all of the Unvested Stock as provided in the Vesting Schedule set forth on the first page of this Agreement, and subject to the conditions to issuance set forth in Article IV, the Company shall cause new certificates to be issued with respect to such vested Shares and delivered to the Director or his legal representative, free from the legend provided for in Section 3.3.

Section 3.5 – Restrictions on New Shares

In the event that the outstanding shares of the Company’s Common Stock are changed into or exchanged for a different number or kind of shares or other securities of the Company, or a stock split-up or stock dividend, such new, additional or different shares or securities which are held or received by the Director in his capacity as a holder of Unvested Stock shall be considered to be Unvested Stock and shall be subject to all of the terms and conditions of this Agreement, including but not limited to the Restrictions.

ARTICLE IV
MISCELLANEOUS

Section 4.1 – Conditions to Issuance of Stock Certificates

The Company shall not be required to issue or deliver any certificate or certificates for shares of stock pursuant to this Agreement prior to fulfillment of all of the following conditions:

- (a) The admission of such shares to listing on all stock exchanges on which such class of stock is then listed; and
- (b) The completion of any registration or other qualification of such shares under any state or Federal law or under rulings or regulations of the Securities and Exchange Commission or of any other governmental regulatory body, which the Company shall deem necessary or advisable; and
- (c) The obtaining of any approval or other clearance from any state or Federal governmental agency which the Company shall, in its absolute discretion, determine to be necessary or advisable.

Section 4.2 – Administration

The Committee shall have the power to interpret the Plan, this Agreement and all other documents relating to Unvested Stock and to adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith and to interpret, amend or revoke any such rules. All actions taken and all interpretations and determinations made by the Committee in good faith shall be final and binding upon the Director, the Company and all other interested person. No member of the Committee shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or Unvested Stock and all members of the Committee shall be fully protected by the Company in respect to any such action, determination or interpretation. The Board shall have no right to exercise any of the rights or duties of the Committee under the Plan and this Agreement.

Section 4.3 – Notices

Any notice to be given under the terms of this Agreement to the Company shall be addressed to the Company in care of its Secretary, and any notice to be given to the Director shall be addressed to him at the address maintained in the Company's records. By a notice given pursuant to this Section 4.3, either party may hereafter designate a different address for notices to be given to it or him. Any notice which is required to be given to the Director shall, if the Director is then deceased, be given to the Director's personal representative if such representative has previously informed the Company of his status and address by written notice under this Section 4.3. Any notice shall have been deemed duly given when enclosed in a properly sealed envelope or wrapper addressed as aforesaid and deposited (with postage prepaid) in a post office or branch post office regularly maintained by the United States Postal Service.

Section 4.4 – Titles

Titles and captions are provided herein for convenience only and are not to serve as a basis for interpretation or construction of this Agreement.

Section 4.5 – Amendment

This Agreement may be amended only by a writing executed by the parties hereto which specifically states that it is amending this Agreement.

Section 4.6 – Governing Law

The laws of the State of Maryland shall govern the interpretation, validity, administration, enforcement and performance of the terms of this Agreement regardless of the law that might be applied under principles of conflicts of laws.

Section 4.7 – Counterparts

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

Section 4.8 – No Special Rights

This Agreement does not, and shall not be interpreted to, create any right on the part of the Director to nomination, election or continued service as a director of the Company or any subsidiary or affiliate thereof, nor to any continued compensation, prerequisites or other current or future benefits or other incidents of such service nor shall it interfere with or restrict in any way any right or power, which is hereby expressly reserved, to remove or not to renominate the Director at any time for any reason whatsoever, with or without cause.

[End of Text]

Exhibit 12.1

AVALONBAY COMMUNITIES, INC.
RATIOS OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED STOCK DIVIDENDS

	Nine Months Ended September 30, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002	Year Ended December 31, 2001	Year Ended December 31, 2000	Year Ended December 31, 1999
Income before gain on sale of communities and cumulative effect of change in accounting principle	\$ 64,093	\$ 100,471	\$ 103,825	\$ 163,146	\$ 149,502	\$ 110,575
(Plus) Minority interest in consolidated partnerships	833	999	914	997	1,086	1,231
Earnings before fixed charges	<u>\$ 64,926</u>	<u>\$ 101,470</u>	<u>\$ 104,739</u>	<u>\$ 164,143</u>	<u>\$ 150,588</u>	<u>\$ 111,806</u>
(Plus) Fixed charges:						
Portion of rents representative of the interest factor	\$ 240	\$ 503	\$ 527	\$ 472	\$ 461	\$ 526
Interest expense	98,006	134,911	119,666	101,170	81,071	72,461
Interest capitalized	15,335	24,709	29,937	27,635	18,328	21,888
Preferred dividend	6,525	10,744	17,896	40,035	39,779	39,779
Total fixed charges (1)	<u>\$ 120,106</u>	<u>\$ 170,867</u>	<u>\$ 168,026</u>	<u>\$ 169,312</u>	<u>\$ 139,639</u>	<u>\$ 134,654</u>
(Less):						
Interest capitalized	15,335	24,709	29,937	27,635	18,328	21,888
Preferred dividend	6,525	10,744	17,896	32,497	39,779	39,779
Earnings (2)	<u>\$ 163,172</u>	<u>\$ 236,884</u>	<u>\$ 224,932</u>	<u>\$ 273,323</u>	<u>\$ 232,120</u>	<u>\$ 184,793</u>
Ratio (2 divided by 1)	<u>1.36</u>	<u>1.39</u>	<u>1.34</u>	<u>1.61</u>	<u>1.66</u>	<u>1.37</u>

Exhibit 12.1 (continued)

AVALONBAY COMMUNITIES, INC.
RATIOS OF EARNINGS TO FIXED CHARGES

	Nine Months Ended September 30, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002	Year Ended December 31, 2001	Year Ended December 31, 2000	Year Ended December 31, 1999
Income before gain on sale of communities and extraordinary item	\$ 64,093	\$ 100,471	\$ 103,825	\$ 163,146	\$ 149,502	\$ 110,575
(Plus) Minority interest in consolidated partnerships	833	999	914	997	1,086	1,231
Earnings before fixed charges	<u>\$ 64,926</u>	<u>\$ 101,470</u>	<u>\$ 104,739</u>	<u>\$ 164,143</u>	<u>\$ 150,588</u>	<u>\$ 111,806</u>
(Plus) Fixed charges:						
Portion of rents representative of the interest factor	\$ 240	\$ 503	\$ 527	\$ 472	\$ 461	\$ 526
Interest expense	98,006	134,911	119,666	101,170	81,071	72,461
Interest capitalized	15,335	24,709	29,937	27,635	18,328	21,888
Total fixed charges (1)	<u>\$ 113,581</u>	<u>\$ 160,123</u>	<u>\$ 150,130</u>	<u>\$ 129,277</u>	<u>\$ 99,860</u>	<u>\$ 94,875</u>
(Less):						
Interest capitalized	15,335	24,709	29,937	27,635	18,328	21,888
Earnings (2)	<u>\$ 163,172</u>	<u>\$ 236,884</u>	<u>\$ 224,932</u>	<u>\$ 265,785</u>	<u>\$ 232,120</u>	<u>\$ 184,793</u>
Ratio (2 divided by 1)	<u>1.44</u>	<u>1.48</u>	<u>1.50</u>	<u>2.06</u>	<u>2.32</u>	<u>1.95</u>

CERTIFICATION

I, Bryce Blair, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AvalonBay Communities, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2004

/s/ Bryce Blair

Bryce Blair
Chief Executive Officer and President

CERTIFICATION

I, Thomas J. Sargeant, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AvalonBay Communities, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2004

/s/ Thomas J. Sargeant

Thomas J. Sargeant
Chief Financial Officer

CERTIFICATION

The undersigned officers of AvalonBay Communities, Inc. (the "Company") hereby certify that the Company's quarterly report on Form 10-Q to which this certification is attached (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 4, 2004

/s/ Bryce Blair

Bryce Blair
Chief Executive Officer and President

Date: November 4, 2004

/s/ Thomas J. Sargeant

Thomas J. Sargeant
Chief Financial Officer

This certification is being furnished and not filed, and shall not be incorporated into any document for any purpose, under the Securities Exchange Act of 1934 or the Securities Act of 1933.