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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 1998

Commission file number 1-12672

AVALONBAY COMMUNITIES, INC.  
(Exact name of registrant as specified in its charter)

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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)

Avalon Bay Communities, Inc.  
(Former name, if changed since last report)

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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

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:

63,843,927 shares outstanding as of November 3, 1998

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

<TABLE>  
<CAPTION>

	9-30-98 (unaudited)	12-31-97
	-----	-----
	<C>	<C>
<b>ASSETS</b>		
Real estate:		
Land	\$ 730,168	\$ 299,885
Buildings and improvements	2,620,882	839,638
Furniture, fixtures and equipment	105,872	63,631
	-----	-----
	3,456,922	1,203,154
Less accumulated depreciation	(120,448)	(79,031)
	-----	-----
Net operating real estate	3,336,474	1,124,123
Construction in progress (including land)	354,870	170,361
Communities held for sale	128,978	--
	-----	-----
Total real estate, net	3,820,322	1,294,484
Cash and cash equivalents	9,458	3,188
Cash in escrow	7,606	1,597
Resident security deposits	9,785	--
Investments in unconsolidated joint ventures	17,265	--
Deferred financing costs, net	12,661	8,174
Deferred development costs	13,132	--
Prepaid expenses and other assets	68,337	10,207
	-----	-----
TOTAL ASSETS	\$3,958,566	\$1,317,650
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Variable rate unsecured credit facility	\$ 327,600	\$ 224,200
Unsecured senior notes	710,000	--
Notes payable	496,258	263,284
Dividends payable	41,040	12,591
Payables for construction	28,134	3,853
Accrued expenses and other liabilities	43,158	5,598
Accrued interest payable	11,901	84
Resident security deposits	19,224	6,212
	-----	-----
TOTAL LIABILITIES	1,677,315	515,822

Minority interest of unitholders in consolidated operating partnerships	32,260	9,133
Stockholders' equity:		
Preferred stock, \$.01 par value; 50,000,000 shares authorized; 0 and 2,308,800 shares of Series A outstanding at September 30, 1998 and December 31, 1997, respectively; 0 and 405,022 shares of Series B outstanding at September 30, 1998 and December 31, 1997, respectively; 2,300,000 shares of Series C outstanding at both September 30, 1998 and December 31, 1997; 3,267,700 shares of Series D outstanding at both September 30, 1998 and December 31, 1997; 4,455,000 and 0 shares of Series F outstanding at September 30, 1998 and December 31, 1997, respectively; and 4,300,000 and 0 shares of Series G outstanding at September 30, 1998 and December 31, 1997, respectively	143	83
Common stock, \$.01 par value; 300,000,000 shares authorized; 63,683,676 and 26,077,518 shares outstanding at September 30, 1998 and December 31, 1997, respectively	637	261
Additional paid-in capital	2,321,891	823,520
Deferred compensation	(5,647)	--
Dividends in excess of accumulated earnings	(68,033)	(31,169)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	2,248,991	792,695
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$3,958,566	\$1,317,650
	=====	=====

</TABLE>

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

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AVALONBAY COMMUNITIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)  
(Dollars in thousands, except share data)

<TABLE>  
<CAPTION>

	For the three months ended		For the nine months ended	
	9-30-98	9-30-97	9-30-98	9-30-97
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Revenue:				
Rental income	\$117,693	\$33,164	\$233,794	\$89,805
Management fees	342	--	457	--
Other income	29	12	43	25
	-----	-----	-----	-----
Total revenue	118,064	33,176	234,294	89,830
	-----	-----	-----	-----
Expenses:				
Operating expenses	32,848	8,403	63,554	23,095
Property taxes	10,183	2,506	19,576	6,665
Interest expense	18,385	3,243	35,748	10,360
Depreciation and amortization	23,579	6,927	48,082	19,053
General and administrative	2,579	1,265	5,525	2,933
Provision for unrecoverable deferred development costs	350	140	750	670
	-----	-----	-----	-----
Total expenses	87,924	22,484	173,235	62,776
	-----	-----	-----	-----
Equity in income of unconsolidated joint ventures	608	--	846	--
Interest income	1,222	52	1,690	163
Minority interest	(470)	(91)	(874)	(315)
	-----	-----	-----	-----
Net income before gain on sale of communities	31,500	10,653	62,721	26,902
Gain on sale of communities	40	--	40	--
	-----	-----	-----	-----
Net income	31,540	10,653	62,761	26,902

Dividends attributable to preferred stock	(7,769)	(2,396)	(16,292)	(4,837)
	-----	-----	-----	-----
Net income available to common stockholders	\$ 23,771	\$ 8,257	\$ 46,469	\$22,065
	=====	=====	=====	=====
Per common share:				
Net income - basic	\$ 0.37	\$ 0.36	\$ 1.05	\$ 1.01
	=====	=====	=====	=====
Net income - diluted	\$ 0.37	\$ 0.36	\$ 1.03	\$ 1.01
	=====	=====	=====	=====

</TABLE>

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

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AVALONBAY COMMUNITIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(Dollars in thousands)

<TABLE>  
<CAPTION>

	For the nine months ended	
	9-30-98	9-30-97
	-----	-----
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 62,761	\$ 26,902
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	48,082	19,053
Amortization of deferred compensation	574	--
Equity in income of unconsolidated joint ventures	(846)	--
Income allocated to minority interest	874	315
Gain on sale of communities	(40)	--
Decrease in cash in escrow, net	(1,902)	(471)
Increase (decrease) in prepaid expenses and other assets	1,377	(18,235)
Increase in accrued expenses, other liabilities and accrued interest payable	10,004	5,695
	-----	-----
Total adjustments	58,123	6,357
	-----	-----
Net cash provided by operating activities	120,884	33,259
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Investments in unconsolidated joint ventures	615	--
Increase in construction payables	10,119	1,820
Distributions from equity investments	351	--
Acquisition of participating mortgage note	(24,000)	--
Proceeds from sale of communities, net of selling costs	56,665	--
Purchase and development of real estate	(532,449)	(301,473)
	-----	-----
Net cash used in investing activities	(488,699)	(299,653)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock, net	59,294	262,391
Dividends paid	(71,176)	(29,912)
Proceeds from sale of unsecured senior notes	400,000	--
Payment of deferred financing costs	(5,590)	--
Repayments of notes payable	(1,836)	(739)
Borrowings under unsecured facilities	545,926	294,900
Repayments of unsecured facilities	(551,526)	(256,900)
Distributions to minority partners	(1,007)	(437)
	-----	-----
Net cash provided by financing activities	374,085	269,303
	-----	-----
Net increase in cash	6,270	2,909
Cash and cash equivalents, beginning of period	3,188	920

Cash and cash equivalents, end of period	\$ 9,458	\$ 3,829
	=====	=====
Cash paid during period for interest, net of amount capitalized	\$ 23,818	\$ 9,578
	=====	=====

</TABLE>

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Supplemental disclosures of non-cash investing and financing activities:

In connection with the merger of Avalon Properties, Inc. with and into the Company (the "Merger") in June 1998, the Company issued Common and Preferred Shares valued at \$1,433,513 in exchange for the net real estate assets of Avalon Properties, Inc. The Company also assumed \$643,410 in debt, \$6,221 in deferred compensation expense, \$25,866 in net other assets, \$1,013 in cash and cash equivalents and minority interest of \$19,409.

The Company assumed debt in connection with acquisitions totaling \$10,400 and \$25,603 during the nine months ended September 30, 1998 and 1997, respectively. The Company issued \$3,851 in operating partnership units for acquisitions during 1998.

During the nine months ended September 30, 1998, 2,308,800 shares of Series A Preferred Stock and 405,022 shares of Series B Preferred Stock totaling \$28 were converted into an aggregate of 2,713,822 shares of Common Stock.

Dividends declared but not paid as of September 30, 1998 and 1997 totaled \$41,040 and \$11,878, respectively.

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

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AVALONBAY COMMUNITIES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Recent Developments

AvalonBay Communities, Inc. (in conjunction with its partnerships and subsidiaries, the "Company"), is a real estate investment trust ("REIT") that is focused exclusively on the ownership of institutional-quality apartment communities in high barrier-to-entry markets of the United States. These markets include Northern and Southern California and selected states in the Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions of the country. The Company is the surviving corporation from the merger (the "Merger") of Avalon Properties, Inc. ("Avalon") with and into the Company (sometimes hereinafter referred to as "Bay" before the Merger) on June 4, 1998. The Merger was accounted for as a purchase of Avalon by Bay. Concurrently with the Merger, the Company changed its name from Bay Apartment Communities, Inc. to Avalon Bay Communities, Inc. On October 2, 1998, the Company changed its name from Avalon Bay Communities, Inc. to AvalonBay Communities, Inc.

At September 30, 1998, the Company owned or held an ownership interest in 130 operating apartment communities containing 38,132 apartment homes in sixteen states and the District of Columbia. The Company also owned 16 communities with an estimated 4,432 apartment homes under construction and rights to develop an additional 23 communities that will contain an estimated 6,377 apartment homes. Of the operating apartment communities, there were 13 communities containing 4,855 apartment homes under reconstruction.

During the third quarter of 1998, the Company's acquisition investments totaled \$154,000 comprised principally of the acquisition of the Prudential Center Apartments for \$130,000. The remaining \$24,000 related to the acquisition of a participating mortgage note secured by Fairlane Woods, a 288 apartment home community located in Dearborn, Michigan. Management is pursuing the purchase of a 100% equity interest in Fairlane Woods, but no assurance can be provided that

such an equity interest can be acquired. The Company also acquired land on which development of two new communities with 505 new apartment homes will begin in the fourth quarter of 1998. The total budgeted construction cost for these communities is approximately \$60,400.

Dispositions during the third quarter of 1998 consisted of the sale of three communities, two in suburban Detroit, Michigan and one in suburban Los Angeles, California. Proceeds from the sale of the Michigan communities, which contained a total of 758 apartment homes, were approximately \$44,000. Proceeds from the sale of the California community, which contained 260 apartment homes, were approximately \$12,500. The net proceeds were used to repay amounts outstanding under the Company's unsecured credit facility and to acquire the participating mortgage note secured by Fairlane Woods.

The interim unaudited financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and in conjunction with the rules and regulations of the Securities and Exchange Commission. 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 and Avalon's Annual Reports on Form 10-K for the year ended December 31, 1997. The results of operations for the three and nine months ended September 30, 1998 are not necessarily indicative of the operating results for the full year. Management believes the disclosures are adequate to make the information presented 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 accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned partnerships and subsidiaries and the operating partnerships structured as DownREITs. All significant intercompany balances and transactions have been eliminated in consolidation.

#### Real Estate

Significant expenditures which improve or extend the life of the 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 development, redevelopment and acquisition. Expenditures for maintenance and repairs are charged to operations as incurred.

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 is delivered and a final certificate of occupancy is issued. Cost capitalization during redevelopment of assets (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 placed-in-service. The accompanying condensed consolidated financial statements include a charge to expense for unrecoverable deferred development costs related to pre-development communities that are unlikely to be developed.

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

Lease terms for apartment homes are generally one year or less. Rental income and operating costs incurred during the initial lease-up or post-redevelopment lease-up period are fully recognized as they accrue.

#### Income Taxes

The Company elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, for the year ended December 31, 1994 and has not revoked such election. A corporate REIT is a legal entity which holds real estate interests and, if certain conditions are met (including but not limited to the payment of a minimum level of dividends to stockholders), the payment of federal and state income taxes at the corporate level is avoided or reduced. Management believes that all such conditions for the avoidance of taxes have been met for the periods presented. Accordingly, no provision for federal and state income taxes has been made.

## Deferred Financing Costs

Deferred financing costs include fees and costs incurred to obtain debt financing and are amortized on a straight-line basis 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.

## Cash and Cash Equivalents

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.

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## Earnings per Common Share

The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." In accordance with the provisions of SFAS No. 128, basic earnings per share for the three and nine months ended September 30, 1998 and 1997 is computed by dividing earnings available to common shares (net income less preferred stock dividends) by the weighted average number of shares outstanding during the period. Additionally, other potentially dilutive common shares are considered when calculating earnings per share on a diluted basis. The Company's basic and diluted weighted average shares outstanding for the three and nine months ended September 30, 1998 and 1997 are as follows:

<TABLE>  
<CAPTION>

	Three Months Ended		Nine Months Ended	
	9-30-98	9-30-97	9-30-98	9-30-97
<S>	<C>	<C>	<C>	<C>
Weighted average common shares outstanding - basic	64,317,021	22,745,075	44,432,272	21,532,999
Shares issuable from assumed conversion of:				
Preferred stock	--	2,713,822	--	2,713,822
Common stock options	374,780	344,473	447,268	284,386
Unvested restricted stock grants	240,765	--	240,765	--
Weighted average common shares outstanding - diluted	64,932,566	25,803,370	45,120,305	24,531,207

</TABLE>

## Use of Estimates

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

## Reclassifications

Certain reclassifications have been made to amounts in prior years' financial statements to conform with current year presentations.

## Newly Issued Accounting Standards

In June 1997, the Financial Accounting Standards Board issued SFAS No. 130 "Reporting Comprehensive Income" and SFAS No. 131 "Disclosure of Segment Information." SFAS No. 130 establishes the disclosure requirements for reporting comprehensive income in an entity's annual and interim financial statements and becomes effective for the Company for the fiscal year ending December 31, 1998. Comprehensive income includes unrealized gains and losses on securities currently reported by the Company as a component of stockholders' equity which the Company would be required to include in a financial statement and display the accumulated balance of other comprehensive income separately in the equity section of the consolidated balance sheet. At September 30, 1998 this pronouncement has no material effect on the Company's results of operations.

SFAS No. 131 establishes standards for determining an entity's operating segments and the type and level of financial information to be disclosed. SFAS No. 131 becomes effective for the Company for the fiscal year ending December 31, 1998. The Company does not believe this pronouncement will have a material impact on the Company's consolidated financial statements.

In March 1998, the Emerging Issues Task Force of the Financial Accounting Standards Board issued Ruling 97-11 entitled "Accounting for Internal Costs Relating to Real Estate Property Acquisitions," which requires that internal costs of identifying and acquiring operating property be expensed as incurred. Costs associated with the acquisition of non-operating property may still be capitalized. The ruling is effective for acquisitions completed subsequent to March 19, 1998. This ruling does not have a material effect on the Company's condensed consolidated financial statements.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This pronouncement establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999 and cannot be applied retroactively. The Company currently plans to adopt this pronouncement effective January 1, 2000, and will determine both the method and impact of adoption prior to that date.

2. MERGER BETWEEN BAY AND AVALON

In June 1998, the Company completed its merger with Avalon. The Merger and related transactions were accounted for using the purchase method of accounting in accordance with GAAP. Accordingly, the assets and liabilities of Avalon were adjusted to fair value for financial accounting purposes and the results of operations of Avalon are included in the results of operations of the Company beginning June 4, 1998.

In connection with the Merger, the following related transactions occurred:

The Company issued .7683 of a share of Common Stock for each outstanding share of Avalon Common Stock;

The Company issued one share of Series F and G Preferred Stock for each outstanding share of Avalon Series A and B Preferred Stock, respectively.

The following unaudited pro forma information has been prepared as if the Merger and related transactions had occurred on January 1, 1997. The pro forma financial information is presented for informational purposes only and is not necessarily indicative of what actual results would have been nor does it purport to represent the results of operations for future periods had the Merger been consummated on January 1, 1997.

<TABLE>  
<CAPTION>

	FOR THE NINE MONTHS ENDED	
	9-30-98	9-30-97
	-----	-----
<S>	<C>	<C>
Pro forma total revenue	\$330,168	\$212,712
	=====	=====
Pro forma net income available to common stockholders	\$ 60,258	\$ 39,163
	=====	=====
Per common share:		
Pro forma net income-basic	\$ .95	\$ .78
	=====	=====
Pro forma net income-diluted	\$ .94	\$ .77
	=====	=====

</TABLE>

## 3. INTEREST CAPITALIZED

Capitalized interest associated with projects under development or redevelopment totaled \$4,847 and \$2,009 for the three months ended September 30, 1998 and 1997, respectively, and \$11,372 and \$4,430 for the nine months ended September 30, 1998 and 1997, respectively.

## 4. NOTES PAYABLE, UNSECURED SENIOR NOTES AND CREDIT FACILITY

The Company's notes payable, unsecured senior notes and credit facility are summarized as follows:

	9-30-98 -----	12-31-97 -----
<S>	<C>	<C>
Fixed rate notes payable (conventional and tax-exempt)	\$ 432,606	\$263,284
Variable rate notes payable (tax-exempt)	63,652	--
Fixed rate unsecured senior notes	710,000	--
Variable rate unsecured credit facility	327,600	224,200
	-----	-----
	\$1,533,858	\$487,484
	=====	=====

</TABLE>

Notes payable are collateralized by certain apartment communities and mature at various dates from July 1999 through December 2036. The weighted average interest rate of variable rate notes (tax-exempt) was 4.5% at September 30, 1998. The weighted average interest rate of fixed rate notes (conventional and tax-exempt) was 6.6% and 6.4% at September 30, 1998 and December 31, 1997, respectively.

The Company has a \$600,000 variable rate unsecured credit facility (the "Unsecured Facility") with Morgan Guaranty Trust Company of New York, Union Bank of Switzerland and Fleet National Bank, serving as co-agents for a syndicate of commercial banks. The Unsecured Facility bears interest at the London Interbank Offered Rate ("LIBOR") based on rating levels achieved on the Company's senior unsecured notes and on a maturity selected by the Company. The current pricing is LIBOR plus .60% per annum. The Unsecured Facility, which was put into place during June 1998, replaced three separate credit facilities previously available to the separate companies prior to the Merger. The terms of the retired facilities were similar to the Unsecured Facility. In addition, the Unsecured Facility includes a competitive bid option for up to \$400,000. The interest rate for borrowings under the Unsecured Facility as of September 30, 1998 was 6.1%. The Company is subject to certain customary covenants under the Unsecured Facility, including, but not limited to, maintaining certain maximum leverage ratios, a minimum fixed charge coverage ratio, minimum unencumbered assets and equity levels and restrictions on paying dividends in amounts that exceed 95% of the Company's Funds from Operations ("FFO"), as defined therein. The Unsecured Facility matures in July 2001 and has two, one-year extension options.

The Company's unsecured senior notes consist of the following:

Principal -----	Interest Rate -----	Maturity Date -----
\$100,000	7.375%	2002
\$ 50,000	6.25%	2003
\$100,000	6.5%	2003
\$100,000	6.625%	2005
\$ 50,000	6.5%	2005
\$150,000	6.8%	2006
\$110,000	6.875%	2007
\$ 50,000	6.625%	2008

The Company's unsecured senior notes contain a number of financial and other covenants with which the Company must comply, including, but not limited to,

limits on the aggregate amount of total and secured indebtedness the Company may have on a consolidated basis and limits on the Company's required debt service payments.

5. STOCKHOLDERS' EQUITY

The following summarizes the changes in stockholders' equity for the nine months ended September 30, 1998:

<TABLE>  
<CAPTION>

	Preferred stock	Common stock	Additional paid-in capital	Deferred compensation	Dividends in excess of accumulated earnings	
Total	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Stockholders' equity, December 31, 1997	\$ 83	\$261	\$ 823,520	\$ --	\$ (31,169)	\$
792,695						
Dividends declared (99,625)	--	--	--	--	(99,625)	
Issuance of common stock 59,294	--	17	59,277	--	--	
Merger of Avalon and the Company 1,433,292	88	331	1,439,094	(6,221)	--	
Conversion of preferred stock to common stock	(28)	28	--	--	--	
--						
Amortization of deferred compensation 574	--	--	--	574	--	
Net income 62,761	--	--	--	--	62,761	
-----	-----	-----	-----	-----	-----	-----
Stockholders' equity, September 30, 1998	\$143	\$637	\$2,321,891	\$ (5,647)	\$ (68,033)	
\$2,248,991	=====	=====	=====	=====	=====	

</TABLE>

6. INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES

At September 30, 1998, investments in unconsolidated joint ventures consist of a 50% general partnership interest in Falkland Partners, a 49% equity interest in Avalon Run and a 50% general partnership interest in Avalon Grove. The unconsolidated joint venture interests were obtained in connection with the Merger. The following is a combined summary of the financial position of these joint ventures for the periods presented:

	9-30-98	12-31-97
	-----	-----
Assets:		
Real estate, net	\$ 96,676	\$ 97,964
Other assets	4,694	10,790
	-----	-----
Total assets	\$101,370	\$108,754
	=====	=====
Liabilities and partners' equity:		
Mortgage notes payable	\$ 26,000	\$ 26,000
Other liabilities	4,752	4,164
Partners' equity	70,618	78,590
	-----	-----
Total liabilities and partners' equity	\$101,370	\$108,754
	=====	=====

The following is a combined summary of the operating results of these joint ventures for the periods presented:

<TABLE>  
<CAPTION>

Three months ended		Nine months ended	
-----	-----	-----	-----
9-30-98	9-30-97	9-30-98	9-30-97

<S>	<C>	<C>	<C>	<C>
Rental income	\$ 5,019	\$ 4,505	\$14,719	\$11,794
Other income	8	11	20	36
Operating expenses	(1,500)	(1,384)	(4,156)	(3,793)
Mortgage interest expense	(205)	(222)	(628)	(661)
Depreciation and amortization	(764)	(735)	(2,279)	(1,991)
	\$ 2,558	\$ 2,175	\$ 7,676	\$ 5,385
	=====	=====	=====	=====

</TABLE>

#### 7. COMMUNITIES HELD FOR SALE

During the third quarter of 1998, the Company determined that it would pursue a disposition strategy for certain assets in markets that were in primarily outlying locations. In connection with this decision, the Company's Board of Directors authorized management to pursue the disposition of select communities within specific markets. The Company will solicit competing bids from unrelated parties for these individual assets, and will consider the sales price and tax ramifications of each proposal. Management anticipates these assets will be sold during the upcoming twelve months. One of these communities authorized for sale, Arbor Park, was disposed during September 1998, resulting in a net gain of \$40.

The assets to be disposed include land, buildings and improvements and furniture, fixtures and equipment, and are recorded at the lower of carrying amount or fair value less selling costs. At September 30, 1998, total real estate, net of accumulated depreciation, subject to sale totaled \$128,978. Certain individual assets are secured by mortgage indebtedness which may be assumed by the purchaser or repaid by the Company from the net sales proceeds.

The Company's condensed consolidated statements of operations includes net income of the communities held for sale of \$1,463 and \$546 for the three months ended September 30, 1998 and 1997, respectively and \$2,994 and \$1,558 for the nine months ended September 30, 1998 and 1997, respectively.

#### 8. SUBSEQUENT EVENTS

On October 2, 1998, the Company held a Special Meeting of Stockholders at which stockholders approved (i) amendments to the charter reducing the number of authorized shares of the Company's Common Stock from 300,000,000 to 140,000,000, and (ii) an amendment to the charter changing the Company's name from "Avalon Bay Communities, Inc." to "AvalonBay Communities, Inc."

On October 15, 1998, the Company completed the sale of 4,000,000 shares of 8.7% Series H Cumulative Redeemable Preferred Stock at a public price of \$25 per share (the "Offering"). The net proceeds from the Offering of approximately \$96,600 were used to reduce borrowings under the Company's Unsecured Facility.

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As disclosed in Footnote 7 of these financial statements, during the third quarter of 1998 the Company's Board of Directors authorized management to pursue the disposition of select communities within specific markets. During October 1998, the Board of Directors authorized additional communities to be disposed.

The additional assets to be disposed include land, buildings and improvements and furniture, fixtures and equipment and are recorded at the lower of carrying amount or fair value less selling costs. At September 30, 1998, total real estate, net of accumulated depreciation, subject to sale totaled \$105,444 for these assets. Certain individual assets are secured by mortgage indebtedness which may be assumed by the purchaser or repaid by the Company from the net sales proceeds.

The Company's condensed consolidated statements of operations include net income of the communities held for sale of \$762 and \$249 for the three months ended September 30, 1998 and 1997, respectively and \$1,347 and \$703 for the nine months ended September 30, 1998 and 1997, respectively.

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PART I. FINANCIAL INFORMATION (CONTINUED)

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

FORWARD-LOOKING STATEMENTS

Certain statements in this Form 10-Q constitute "forward-looking statements" as that term is defined under the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). The words "believe," "expect," "anticipate," "intend," "estimate," "assume" and other similar expressions which are predictions of or indicate future events and trends and which do not relate to historical matters identify forward-looking statements. In addition, information concerning construction, occupancy and completion of Development Communities and Development Rights (as each term is hereinafter defined) and related cost and EBITDA estimates, as well as the cost, timing and effectiveness of Year 2000 compliance, are forward-looking statements. Reliance should not be placed on forward-looking statements as they involve known and unknown risks, uncertainties and other factors, which are in some cases beyond the control of the Company and may cause the actual results, performance or achievements of the Company to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements.

Certain factors that might cause such differences include, but are not limited to, the following: the Company may not be successful in managing its current growth in the number of apartment communities and the related growth of its business operations; the Company's expansion into new geographic market areas may not produce financial results that are consistent with its historical performance; acquisitions of portfolios of apartment communities may result in the Company acquiring communities that are more expensive to manage and portfolio acquisitions may not be successfully completed, resulting in charges to earnings; the Company may fail to secure or may abandon development opportunities; construction costs of a community may exceed original estimates; construction and lease-up may not be completed on schedule, resulting in increased debt service expense and construction costs and reduced rental revenues; occupancy rates and market rents may be adversely affected by local economic and market conditions which are beyond management's control; financing may not be available on favorable terms; the Company's cash flow may be insufficient to meet required payments of principal and interest; existing indebtedness may not be able to be refinanced or the terms of such refinancing may not be as favorable as the terms of existing indebtedness; and the Company and its suppliers may experience unanticipated delays or expenses in achieving Year 2000 compliance.

The following discussion should be read in conjunction with the consolidated financial statements and notes included in this report.

GENERAL

The Company is a real estate investment trust ("REIT") that is focused exclusively on the ownership of institutional-quality apartment communities in high barrier-to-entry markets of the United States. These markets include Northern and Southern California and selected states in the Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions of the country. The Company is the surviving corporation from the merger (the "Merger") of Avalon Properties, Inc. ("Avalon") with and into the Company (sometimes hereinafter referred to as "Bay" before the Merger) on June 4, 1998. The Merger was accounted for as a purchase of Avalon by Bay. Concurrently with the Merger, the Company changed its name from Bay Apartment Communities, Inc. to Avalon Bay Communities, Inc. On October 2, 1998, the Company changed its name from Avalon Bay Communities, Inc. to AvalonBay Communities, Inc.

The Company is a fully-integrated real estate organization with in-house acquisition, development, redevelopment, construction, reconstruction, financing, marketing, leasing and management expertise. With its experience and in-house capabilities, the Company believes it is well-positioned to continue to

pursue opportunities to develop and acquire upscale apartment homes in its target markets.

The Company's real estate investments as of November 6, 1998 consist primarily of apartment communities in various stages of the development cycle and land or land options held for development and can be divided into three categories:

Number of Communities	Number of Apartment Homes
-----	-----

Current Communities	130	38,132
Development Communities	16	4,432(*)
Development Rights	23	6,377(*)

(\*) Represents an estimate

"Current Communities" are apartment communities where construction is complete and the community has either reached stabilized occupancy or is in the initial lease-up process. A "Stabilized Community" is a Current Community that has completed its initial lease-up and has attained a physical occupancy level of at least 95% or has been completed for one year, whichever occurs earlier. An "Established Community" is a Current Community that has been a Stabilized Community with stabilized operating costs during the current and as of the beginning of the previous calendar year such that its year-to-date operating results are comparable between periods. Included in the Current Communities are "Redevelopment Communities," which are communities for which substantial redevelopment has either begun or is scheduled to begin. Redevelopment is considered substantial when additional capital invested during the reconstruction effort exceeds the lesser of \$5 million or 10% of the community's acquisition cost. There are currently 13 Redevelopment Communities containing 4,855 apartment homes.

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

"Development Rights" are development opportunities in the very earliest phase of the development process for which the Company has an option to acquire land or owns land to develop a new community and where related pre-development costs have been incurred and capitalized in pursuit of these new developments.

Of the Current Communities, the Company held a fee simple ownership interest in 112 operating communities (one of which is on land subject to a 149 year land lease), a general partnership interest in four other operating communities, a general partnership interest in partnerships structured as DownREITs, which own 13 communities, and a 100% interest in a senior participating mortgage note secured by another operating community. The Company holds a fee simple ownership interest in each of the Development Communities except for two communities for which the Company holds a general partnership interest. The existing DownREITs have been structured so that substantially all of the economic interests of these partnerships accrue to the benefit of the Company. The Company believes that it is unlikely that the limited partners in these partnerships will receive any financial return on their limited partnership interests other than the stated distributions on their units of the operating partnerships ("Units") or as a result of the possible future conversion of their Units into shares of common stock. The DownREIT partnerships are consolidated for financial reporting purposes.

Management believes apartment communities present an attractive investment opportunity compared to other real estate investments because a broad potential resident base results in relatively stable demand during all phases of a real estate cycle. The Company intends to pursue appropriate new investments (both acquisitions of communities and new developments) where constraints to new supply exist and where new household formations have out-paced multifamily permit activity in recent years.

At September 30, 1998, the Company's management ("Management") had positioned the Company's portfolio of Stabilized Communities, excluding communities owned by joint ventures, to a physical occupancy level of 96.5% and achieved an average economic occupancy of 96.7% and 96.5% for the three and nine months ended September 30, 1998, respectively. Average economic occupancy for the portfolio for the three and nine months ended September 30, 1997 was 95.8% and 95.6%, respectively. This continued high occupancy was achieved through aggressive marketing efforts combined with limited and targeted pricing adjustments. This positioning has resulted in overall growth in rental revenue from Established Communities between periods. It is Management's strategy to maximize total rental revenue through management of rental rates and occupancy levels. If market and economic conditions change, Management's strategy of maximizing total rental revenue could lead to lower occupancy levels. Given the high occupancy level of the portfolio, Management anticipates that any rental revenue and net income gains from the Company's Established Communities would be achieved primarily through higher rental rates and enhanced operating cost leverage provided by high occupancy.

The Company elected to be taxed as a REIT for federal income tax purposes for the year ended December 31, 1994 and has not revoked that election. The Company was incorporated under the laws of the State of California in 1978 and was reincorporated in the State of Maryland in July 1995. Its principal executive offices are located at 2900 Eisenhower Avenue, Suite 300, Alexandria, Virginia 22314, and its telephone number at that location is (703) 329-6300. The Company also maintains super-regional offices in San Jose, California and Wilton, Connecticut and acquisition, development, redevelopment, construction, reconstruction or administrative offices in Boston, Massachusetts; Chicago, Illinois; Minneapolis, Minnesota; New York, New York; Newport Beach, California; Princeton, New Jersey; Richmond, Virginia; and Seattle, Washington.

RECENT DEVELOPMENTS

Acquisitions of Existing Communities. Since June 30, 1998, the Company has acquired the following community and land held for development communities (dollars in millions):

<TABLE>  
<CAPTION>

Current Communities	Location	Period Acquired	Purchase Price	Apartment Homes
1. Avalon at Prudential Center	Boston, MA	3Q98	\$130.0	781

<CAPTION>

Development Communities	Location	Period Acquired	Budgeted Cost (1)	Apartment Homes
1. Avalon Corners	Stamford, CT	3Q98	\$ 32.5	195
2. Avalon Fox Mill	Herndon, VA	3Q98	\$ 20.1	165
3. Avalon Court North	Melville, NY	3Q98	\$ 40.3	340

</TABLE>

(1) Budgeted Cost includes all capitalized costs projected to be incurred to develop the respective Development Community, including land acquisition costs, construction costs, real estate taxes, capitalized interest and loan fees, permits, professional fees, allocated development overhead and other regulatory fees determined in accordance with GAAP.

Acquisitions entail risks that investments will fail to perform in accordance with expectations and that judgments with respect to the cost of improvements to bring an acquired community up to standards established for the market position intended for that community will prove inaccurate, as well as general investment risks associated with any new real estate investment. Although the Company undertakes an evaluation of the physical condition of each new community before it is acquired, certain defects or necessary repairs may not be detected until after the community is acquired, which could significantly increase the Company's total acquisition costs and decrease the Company's percentage return on that investment.

Historically, construction costs and the costs to reposition communities that have been acquired have, in some cases, exceeded management's original estimates. Management believes that it may experience similar increases in the future. There can be no assurance that the Company will be able to charge rents upon completing either the development or redevelopment of the communities that will be sufficient to offset the effects of increases in construction costs in order to achieve the original projected yield on the investment.

Sale of Existing Communities and Re-Investment of Proceeds. In connection with an agreement executed by Avalon in March 1998 which provided for the buyout of certain limited partners in DownREIT V Limited Partnership, the Company sold two communities, Village Park of Troy and Aspen Meadows, located in suburban Detroit, Michigan, in July 1998. Gross proceeds from the sale of the two communities, containing an aggregate of 758 apartment homes, were approximately \$44 million and were used to acquire the participating mortgage note secured by the Fairlane Woods community in Dearborn, Michigan, with the balance used to repay amounts outstanding under the Company's \$600 million variable rate unsecured credit facility (the "Unsecured Facility"). The Company also sold

Arbor Park, a 260 apartment home community located in suburban Los Angeles, California. The gross proceeds of approximately \$12.5 million were used to repay amounts outstanding under the Unsecured Facility.

#### RESULTS OF OPERATIONS

The changes in operating results from period-to-period are primarily the result of increases in the number of apartment homes owned due to the Merger as well as the development and acquisition of additional communities. Where appropriate, comparisons are made on a weighted average basis for the number of occupied apartment homes in order to adjust for such changes in the number of apartment homes. For Stabilized Communities (excluding communities owned by joint ventures), all occupied apartment homes are included in the calculation of weighted average occupied apartment homes for each reporting period. For communities in the initial lease-up phase, only apartment homes of communities that are completed and occupied are included in the weighted average number of occupied apartment homes calculation for each reporting period.

The analysis that follows compares the operating results of the Company for the three and nine months ended September 30, 1998 and 1997.

Net income increased \$20,887,000 (196.1%) to \$31,540,000 for the three months ended September 30, 1998 compared to \$10,653,000 for the comparable period of the preceding year. Net income increased \$35,859,000 (133.3%) to \$62,761,000 for the nine months ended September 30, 1998 compared to \$26,902,000 for the comparable period of the preceding year. The primary reasons for these increases are additional operating income from the former Avalon communities, communities developed or acquired during 1998 and 1997, as well as growth in operating income from Established Communities.

Rental income increased \$84,529,000 (254.9%) to \$117,693,000 for the three months ended September 30, 1998 compared to \$33,164,000 for the comparable period of the preceding year. Rental income increased \$143,989,000 (160.3%) to \$233,794,000 for the nine months ended September 30, 1998 compared to \$89,805,000 for the comparable period of the preceding year. Of the increase for the nine month period, \$4,118,000 relates to rental revenue increases from Established Communities, \$86,046,000 relates to rental revenue attributable to the former Avalon communities, and \$53,825,000 is attributable to the addition of newly completed or acquired apartment homes.

Overall Portfolio - The \$143,989,000 increase in rental income for the nine month period is primarily due to increases in the weighted average number of occupied apartment homes as well as an increase in the weighted average monthly rental income per occupied apartment home. The weighted average number of occupied apartment homes increased from 9,535 apartment homes for the nine months ended September 30, 1997 to 24,034 apartment homes for the nine months ended September 30, 1998 as a result of additional apartment homes from the former Avalon communities and the development and acquisition of new communities. For the three months ended September 30, 1998, the weighted average monthly revenue per occupied apartment home increased \$46 (4.4%) to \$1,100 compared to \$1,054 for the comparable period of the preceding year. For the nine months ended September 30, 1998, the weighted average monthly revenue per occupied apartment home increased \$34 (3.3%) to \$1,070 compared to \$1,036 for the comparable period of the preceding year.

Established Communities - Rental revenue increased \$1,107,000 and \$4,118,000 for the three and nine months ended September 30, 1998, respectively, compared to the comparable periods of the preceding year due to market conditions that allowed for higher average rents at relatively stable occupancy. For the three months ended September 30, 1998, weighted average monthly revenue per occupied apartment home increased \$67 (6.3%) to \$1,131 compared to \$1,064 for the comparable period of the preceding year. The average economic occupancy decreased 0.7% from 98.0% for the three months ended September 30, 1997 to 97.3% for the three months ended September 30, 1998. For the nine months ended September 30, 1998, weighted average monthly revenue per occupied apartment home increased \$73 (7.0%) to \$1,111 compared to \$1,038 for the comparable period of the preceding year. The average economic occupancy increased 0.1% from 97.6% for the nine months ended September 30, 1997 to 97.7% for the nine months ended September 30, 1998.

The Company's Established Communities consist entirely of communities located within the Northern California market. Compared to the prior year, most of the sub-markets within Northern California have maintained a strong economic environment that has allowed for high occupancy levels and rent

growth. However, Management has seen in recent periods that certain Northern California sub-markets, that are dependent on Silicon Valley employment markets are being negatively impacted by tightening employment conditions caused by recent Asian economic difficulties. These impacted sub-markets have not experienced the same rent growth or occupancy levels that are prevalent in other Northern California sub-markets.

Management fees totaling \$342,000 and \$457,000 for the three and nine months ended September 30, 1998, respectively, represent revenue from certain third-party contracts obtained from the Merger with Avalon.

Operating expenses increased \$24,445,000 (290.9%) to \$32,848,000 for the three months ended September 30, 1998 compared to \$8,403,000 for the comparable period of the preceding year. These expenses increased \$40,459,000 (175.2%) to \$63,554,000 for the nine months ended September 30, 1998 compared to \$23,095,000 for the comparable period of the preceding year.

Overall Portfolio - The increases for the three and nine months ended September 30, 1998 are primarily due to additional expense from the former Avalon communities, the acquisition of new communities as well as the completion of Development Communities for which maintenance, insurance and other costs are expensed as communities move from the initial construction and lease-up phase to the stabilized operating phase.

Established Communities - Operating expenses increased \$41,000 (0.9%) to \$4,428,000 for the three months ended September 30, 1998 compared to \$4,387,000 for the comparable period of the preceding year. These expenses decreased \$69,000 (0.5%) to \$12,948,000 for the nine months ended September 30, 1998 compared to \$13,017,000 for the comparable period of the preceding year. The net changes are the result of higher maintenance costs, offset by lower insurance costs.

Property taxes increased \$7,677,000 (306.3%) to \$10,183,000 for the three months ended September 30, 1998 compared to \$2,506,000 for the comparable period of the preceding year. Property taxes increased \$12,911,000 (193.7%) to \$19,576,000 for the nine months ended September 30, 1998 compared to \$6,665,000 for the comparable period of the preceding year.

Overall Portfolio - The increases for the three and nine months ended September 30, 1998 are primarily due to additional expense from the former Avalon communities, the acquisition of new communities as well as the completion of Development Communities for which property taxes are expensed as communities move from the initial construction and lease-up phase to the stabilized operating phase.

Established Communities - Property taxes increased \$42,000 (3.1%) to \$1,395,000 for the three months ended September 30, 1998 compared to \$1,353,000 for the comparable period of the preceding year. Property taxes increased \$163,000 (4.1%) to \$4,132,000 for the nine months ended September 30, 1998 compared to \$3,969,000 for the comparable period of the preceding year. These increases are primarily the result of increased assessments of property values.

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Interest expense increased \$15,142,000 (466.9%) to \$18,385,000 for the three months ended September 30, 1998 compared to \$3,243,000 for the comparable period of the preceding year. Interest expense increased \$25,388,000 (245.1%) to \$35,748,000 for the nine months ended September 30, 1998 compared to \$10,360,000 for the comparable period of the preceding year. These increases are primarily attributable to \$643,410,000 of debt assumed in connection with the Merger as well as increased borrowings under the Unsecured Facility offset in part by higher capitalization of interest from increased development, redevelopment, construction and reconstruction activity.

Depreciation and amortization increased \$16,652,000 (240.4%) to \$23,579,000 for the three months ended September 30, 1998 compared to \$6,927,000 for the comparable period of the preceding year. Depreciation and amortization increased \$29,029,000 (152.4%) to \$48,082,000 for the nine months ended September 30, 1998 compared to \$19,053,000 for the comparable period of the preceding year. These increases reflect additional expense from the former Avalon communities, as well as acquisitions and development of communities in 1998 and 1997.

General and administrative expenses increased \$1,314,000 (103.9%) to \$2,579,000 for the three months ended September 30, 1998 compared to \$1,265,000 for the comparable period of the preceding year. General and administrative expenses increased \$2,592,000 (88.4%) to \$5,525,000 for the nine months ended September 30, 1998 compared to \$2,933,000 for the comparable period of the preceding year. These increases are primarily due to the Merger and staff additions related to the growth of the Company's portfolio.

Provision for unrecoverable deferred development costs increased \$210,000 (150.0%) to \$350,000 for the three months ended September 30, 1998 compared to \$140,000 for the comparable period of the preceding year. These costs increased \$80,000 (11.9%) to \$750,000 for the nine months ended September 30, 1998 compared to \$670,000 for the comparable period of the preceding year. These increases are the result of higher provisions related to abandoned projects in the current year, offset by a significant one time charge in the prior year related to a large west coast portfolio acquisition that was not completed.

Equity in income of unconsolidated joint ventures of \$608,000 and \$846,000 for the three and nine months ended September 30, 1998, respectively, represents the Company's share of income of certain joint ventures that were acquired in conjunction with the Merger.

Interest income increased \$1,170,000 to \$1,222,000 for the three months ended September 30, 1998 compared to \$52,000 for the comparable period of the preceding year. Interest income increased \$1,527,000 to \$1,690,000 for the nine months ended September 30, 1998 compared to \$163,000 for the comparable period of the preceding year. These increases are primarily due to the interest on the Avalon Arbor note that was obtained from the Merger and the Fairlane Woods note acquired during August 1998.

Management generally considers Funds from Operations ("FFO") to be an appropriate measure of the operating performance of the Company because it provides investors an understanding of the ability of the Company to incur and service debt and to make capital expenditures. The Company believes that in order to facilitate a clear understanding of the operating results of the Company, FFO should be examined in conjunction with the net income as presented in the condensed consolidated financial statements included elsewhere in this report. FFO is determined in accordance with a resolution adopted by the Board of Governors of the National Association of Real Estate Investment Trusts(R), and is defined as net income (loss) (computed in accordance with generally accepted accounting principles ("GAAP"), excluding gains (or losses) from debt restructuring and sales of property, plus depreciation of real estate assets and after adjustments for unconsolidated partnerships and joint ventures). FFO does not represent cash generated

from operating activities in accordance with GAAP and therefore should not be considered an alternative to net income as an indication of the Company's performance or to net cash flows from operating activities as determined by GAAP as a measure of liquidity and is not necessarily indicative of cash available to fund cash needs. Further, FFO as calculated by other REITs may not be comparable to the Company's calculation of FFO.

For the three months ended September 30, 1998, FFO increased to \$47,492,000 from \$16,178,000 for the comparable period in the preceding year. This increase is primarily due to the delivery of high yielding new development and redevelopment communities from the Merger with Avalon as well as the Company's existing redevelopment programs. Growth in earnings from Established Communities also contributed to the increase. Acquisition activity in 1998 and 1997 was also an important component of FFO growth between years.

FFO for the three months ended September 30, 1998 and the preceding four quarters are summarized as follows (dollars in thousands):

<TABLE>  
<CAPTION>

	For the three months ended				
	9-30-98	6-30-98	3-31-98	12-31-97	9-30-97
<S>	<C>	<C>	<C>	<C>	<C>
Net income	\$31,540	\$18,242	\$12,979	\$12,039	\$10,653
Preferred dividends (1,222)	(7,769)	(4,494)	(2,856)	(1,469)	
Depreciation - real estate assets	23,018	14,164	9,523	7,669	6,659
Joint venture adjustments	183	62	--	--	--
Minority interest expense	470	250	--	--	--
Gain on sale of communities	(40)	--	--	--	--
Non-recurring adjustments to net income:					
Amortization of non-recurring costs, primarily legal, from the issuance of tax exempt bonds (1)	90	90	90	90	88
Funds from Operations	\$47,492	\$28,314	\$19,736	\$18,329	\$16,178

- (1) Represents the amortization of pre-1986 bond issuance costs carried forward to the Company and costs associated with the reissuance of tax-exempt bonds incurred prior to the initial public offering of Bay in March 1994 (the "Initial Offering") in order to preserve the tax-exempt status of the bonds at the Initial Offering.

#### CAPITALIZATION OF FIXED ASSETS AND COMMUNITY IMPROVEMENTS

The Company maintains a policy with respect to capital expenditures that generally provides that only non-recurring expenditures are capitalized. Improvements and upgrades are capitalized only if the item exceeds \$15,000, extends the useful life of the asset and 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, including costs of carpet and appliance replacements, floor coverings, interior painting and other redecorating costs. Purchases of personal property (such as computers and furniture) are capitalized only if the item is a new addition (i.e., not a replacement) and only if the item exceeds \$2,500. The application of these policies for the nine months ended September 30, 1998 resulted in non-revenue generating capitalized expenditures for Stabilized Communities of approximately \$3,373,000 or \$100 per apartment home on a pro forma basis. For the nine months ended September 30, 1998, the Company charged to maintenance expense, including carpet and appliance replacements, a total of approximately \$20,666,000 for Stabilized Communities or \$745 per apartment home on a pro forma basis. Management anticipates that capitalized costs per apartment home will gradually rise as the Company's portfolio of communities matures.

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#### LIQUIDITY AND CAPITAL RESOURCES

Liquidity. A primary source of liquidity to the Company is cash flows from operations. Operating cash flows have historically been determined by the number of apartment homes, rental rates, occupancy levels and the Company's expenses with respect to such apartment homes. The cash flows used in investing activities and provided by financing activities have historically been dependent on the number of apartment homes under active development and construction or that were acquired during any given period.

Cash and cash equivalents increased from \$3,829,000 at September 30, 1997 to \$9,458,000 at September 30, 1998 due to the excess of cash provided by financing and operating activities over cash flow used in investing activities.

Net cash provided by operating activities increased by \$87,625,000 from \$33,259,000 for the nine months ended September 30, 1997 to \$120,884,000 for the nine months ended September 30, 1998 primarily due to an increase in operating income from newly developed and acquired communities and Established Communities.

Cash used in investing activities increased by \$189,046,000 from \$299,653,000 for the nine months ended September 30, 1997 to \$488,699,000. This increase reflects the expenditures for the 1998 and 1997 communities acquired, and the amounts used to acquire, develop, and construct the Development and Redevelopment Communities.

Net cash provided by financing activities increased by \$104,782,000 from \$269,303,000 for the nine months ended September 30, 1997 to \$374,085,000 for the nine months ended September 30, 1998 primarily due to the proceeds from the sale of unsecured senior notes and a net increase in borrowings under the Unsecured Facilities compared to the comparable period in the prior year, offset by a reduction in proceeds raised through the sale of common stock and an increase in dividends paid.

The Company regularly reviews its short-term liquidity needs and the adequacy of FFO and other expected liquidity sources to meet these needs. The Company believes that its principal short-term liquidity needs are to fund normal recurring operating expenses, debt service payments and the minimum dividend payment required to maintain the Company's REIT qualification under the Internal Revenue Code of 1986, as amended. Management anticipates that these needs will be fully funded from cash flows provided by operating activities. Any short-term liquidity needs not provided by current operating cash flows would be funded from the Company's Unsecured Facility.

Management anticipates that no significant portion of the principal of any indebtedness will be repaid prior to maturity, and if the Company does not have funds on hand sufficient to repay such indebtedness, it will be necessary for the Company to refinance this debt. Such refinancing may be accomplished

through additional debt financing, which may be collateralized by mortgages on individual communities or groups of communities, by uncollateralized private or public debt offerings or by additional equity offerings. There can be no assurance that such additional debt financing or debt offerings will be available or, if available, that they will be on terms satisfactory to the Company.

Capital Resources. To sustain the Company's active development program, continuous access to the capital markets is required. Management intends to match the long-term nature of its real estate assets with long-term cost effective capital. Management follows a focused strategy to help facilitate uninterrupted access to capital. This strategy includes:

1. Hire, train and retain associates with a strong resident service focus, which should lead to higher rents, lower turnover and reduced operating costs;
2. Manage, acquire and develop institutional-quality communities with in-fill locations that should provide consistent, sustained earnings growth;
3. Operate in markets with growing demand (as measured by household formation and job growth) and high barriers-to-entry. These characteristics combine to provide a favorable demand-supply balance, which the Company believes will create a favorable environment for future rental rate growth while protecting existing and new communities from new supply. This strategy is expected to result in a high level of quality to the revenue stream;
4. Maintain a conservative capital structure largely comprised of equity and with modest, cost-effective leverage. Secured debt will generally be avoided and used primarily to obtain low cost, tax-exempt debt. Such a structure should promote an environment whereby current ratings levels can be maintained;
5. Accounting practices that provide a high level of quality to reported earnings; and
6. Timely, accurate and detailed disclosures to the investment community.

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Management believes that these strategies provide a disciplined approach to capital access to help position the Company to fund portfolio growth.

Recent volatility in the capital markets has resulted in a shortage of liquidity for most companies. See "Future Financing Needs" for a discussion of Management's response to the current capital markets environment.

The following is a discussion of specific capital transactions, arrangements and agreements that are important to the capital resources of the Company.

#### UNSECURED FACILITY

The Company's Unsecured Facility is provided by a consortium of banks that provides for \$600,000,000 in short-term credit and is subject to an annual facility fee of \$900,000. The Unsecured Facility bears interest at the London Interbank Offered Rate ("LIBOR") based on rating levels achieved on the Company's senior unsecured notes and on a maturity selected by the Company. The current pricing is LIBOR plus 0.60% per annum and matures in July 2001. The Unsecured Facility, which was put into place during June 1998, replaced three separate credit facilities previously available to the separate companies prior to the Merger, with terms similar to the Unsecured Facility. A competitive bid option is available for up to \$400,000,000 which may result in lower pricing if market conditions allow. Pricing under the competitive bid option resulted in average pricing of LIBOR plus 0.47% for balances most recently placed under the competitive bid option. At September 30, 1998, \$327,600,000 was outstanding, \$15,891,000 was used to provide letters of credit and \$256,509,000 was available for borrowing under the Unsecured Facility. The Company will use borrowings under the Unsecured Facility for capital expenditures, acquisitions of developed or undeveloped communities, construction, development and renovation costs, credit enhancement for tax-exempt bonds and for working capital purposes.

#### INTEREST RATE PROTECTION AGREEMENTS

The Company is not a party to any long-term interest rate agreements, other than interest rate protection and swap agreements on certain tax-exempt indebtedness. The Company intends, however, to evaluate the need for long-term interest rate protection agreements as interest rate market conditions dictate and has engaged a consultant to assist in managing the Company's interest rate risks and

exposure.

#### FINANCING COMMITMENTS/TRANSACTIONS COMPLETED

Sale of senior unsecured notes. On July 7, 1998, the Company issued \$250 million of senior unsecured notes, of which \$100 million of the notes bear interest at 6.5% and will mature in July 2003 and \$150 million of the notes bear interest at 6.8% and will mature in July 2006. The net proceeds of \$247.6 million to the Company were used to reduce borrowings under the Company's Unsecured Facility.

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Preferred offering. In October 1998, the Company completed an underwritten public offering of 4,000,000 shares of 8.7% Series H Cumulative Redeemable Preferred Stock at a public price of \$25 per share (the "Offering"). The net proceeds from the Offering of approximately \$96.6 million were used to reduce borrowings under the Company's Unsecured Facility.

#### FUTURE FINANCING NEEDS

Substantially all of the capital expenditures to complete the communities currently under construction and reconstruction will be funded from the Unsecured Facility and/or issuance of debt or equity securities. Management expects to continue to fund deferred development costs related to future developments from FFO and advances under the Unsecured Facility. The Company believes that these sources of capital are adequate to take each of the proposed communities to the point in the development cycle where construction can commence.

Management anticipates that available borrowing capacity under the Unsecured Facility and FFO will be adequate to meet future expenditures required to commence construction of each of the Development Rights. In addition, the Company currently anticipates funding construction of some (but not all) of the Development Rights under the expected remaining capacity of the Unsecured Facility. However, before the construction of a Development Right commences, the Company intends to ensure that adequate liquidity sources are in place to fund the construction of a Development Right, although no assurance can be given in this regard. If necessary, the Company will issue additional equity or debt securities, arrange additional capacity under the Unsecured Facility (or future credit facilities) or obtain additional construction loan commitments not currently in place.

A shortage of liquidity for corporate borrowers emerged during the third quarter of 1998. Management estimates that a significant portion of the Company's liquidity needs will be met from retained operating cash and borrowings under the Company's Unsecured Facility during the next 18 to 24 months. To meet the balance of the Company's liquidity needs, it will be necessary to arrange additional capacity under the Company's existing Unsecured Facility, complete the sale of existing communities or issue additional debt or equity securities. While Management believes the Company has the financial position to expand its short term credit capacity and support such capital markets activity, no assurance can be provided that the Company will be successful in completing these arrangements, offerings or sales. If these transactions cannot be completed, the liquidity shortage described herein could have a material and adverse impact on the operating results and financial condition of the Company.

During the third quarter of 1998, the Company determined that it would pursue a disposition strategy for certain assets in markets that were in outlying locations. In connection with this decision, the Company's Board of Directors authorized Management to pursue the disposition of select communities within specific markets. During October 1998, the Board of Directors authorized additional communities to be disposed. The Company will solicit competing bids from unrelated parties for these individual assets, and will consider the sales price and tax ramifications of each proposal. Management anticipates these assets will be sold during the upcoming twelve months. One of these communities authorized for sale, Arbor Park, was disposed during September 1998, resulting in a net gain of \$40,000.

The assets to be disposed include land, buildings and improvements and furniture, fixtures and equipment. At September 30, 1998, total real estate, net of accumulated depreciation, of all communities currently subject to sale totaled \$234,422,000. Certain individual assets are secured by mortgage indebtedness which may be assumed by the purchaser or repaid by the Company from the net sales proceeds. The net income of the communities held for sale of \$4,341,000 and \$2,261,000 for the nine months ended September 30, 1998 and 1997, respectively, are included in the Company's condensed consolidated statements of operations.

The table on the following page summarizes debt maturities for the next five years (excluding the Unsecured Facility):

AVALONBAY COMMUNITIES, INC.  
DEBT MATURITY SCHEDULE  
(Dollars in thousands)

<TABLE>  
<CAPTION>

Community	ALL-IN INTEREST Rate	PRINCIPAL MATURITY Date	BALANCE 12-31-97	OUTSTANDING 9-30-98	1998	1999
-----	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Tax-Exempt Bonds:						
FIXED RATE						
Canyon Creek	6.48%	Jun-25	\$ 38,534	\$ 38,176	\$123	\$ 517
Waterford	5.88%	Aug-14	33,100	33,100	--	--
City Heights	5.80%	Jun-25	20,714	20,552	56	233
CountryBrook	7.87%	Mar-12	19,850	19,641	73	305
Villa Mariposa	5.88%	Mar-17	18,300	18,300	--	--
Sea Ridge	6.48%	Jun-25	17,479	17,317	56	235
Foxchase I	5.88%	Nov-07	16,800	16,800	--	--
Barrington Hills	6.48%	Jun-25	13,185	13,062	43	177
Rivershore	6.48%	Nov-22	10,309	10,200	38	158
Foxchase II	5.88%	Nov-07	9,600	9,600	--	--
Fairway Glen	5.88%	Nov-07	9,580	9,580	--	--
Crossbrook	6.48%	Jun-25	8,484	8,408	26	109
Larkspur Canyon	5.50%	Jun-25	7,610	7,551	20	85
Avalon Ridge	5.69%	Jun-26	--	26,815	--	--
Avalon View	7.55%	Aug-24	--	19,150	65	290
Chase Lea	5.71%	Jun-26	--	16,835	--	--
Avalon at Lexington	6.56%	Feb-25	--	14,902	56	240
Avalon Knoll	6.95%	Jun-26	--	13,796	42	175
Avalon at Dulles	7.04%	Jul-24	--	12,360	--	--
Avalon Fields	7.57%	May-27	--	11,924	33	137
Avalon at Hampton II	7.04%	Jul-24	--	11,550	--	--
Avalon at Symphony Glen	7.06%	Jul-24	--	9,780	--	--
Avalon West	7.73%	Dec-36	--	8,693	8	50
Avalon Landing	6.85%	Jun-26	--	6,830	22	89
			-----	-----	-----	-----
			223,545	374,922	661	2,800
VARIABLE RATE						
Avalon Devonshire		Dec-25	--	27,305	--	--
Avalon at Fairway Hills I		Jun-26	--	11,500	--	--
Laguna Brisas		Mar-09	--	10,400	--	--
Avalon at Hampton I		Jun-26	--	8,060	--	--
Avalon Pointe		Jun-26	--	6,387	--	--
			-----	-----	-----	-----
			--	63,652	--	--
CONVENTIONAL LOANS:						
FIXED RATE						
\$100 Million Senior Unsecured Notes	7.375%	Sep-02	--	100,000	--	--
\$100 Million Senior Unsecured Notes	6.625%	Jan-05	--	100,000	--	--
\$110 Million Senior Unsecured Notes	6.875%	Dec-07	--	110,000	--	--
\$50 Million Senior Unsecured Notes	6.25%	Jan-03	--	50,000	--	--
\$50 Million Senior Unsecured Notes	6.50%	Jan-05	--	50,000	--	--
\$50 Million Senior Unsecured Notes	6.625%	Jan-08	--	50,000	--	--
\$100 Million Senior Unsecured Notes	6.500%	Jul-03	--	100,000	--	--
\$150 Million Senior Unsecured Notes	6.800%	Jul-06	--	150,000	--	--
Governor's Square	7.65%	Aug-04	14,184	14,098	45	142
The Arbors	7.25%	May-04	12,870	12,870	--	--
Gallery Place	7.31%	May-01	11,685	11,537	34	214
Cedar Ridge	6.50%	Jul-99	1,000	1,000	--	--
Avalon Walk II	8.93%	Nov-04	--	12,815	53	221
Avalon Pines	8.00%	Dec-03	--	5,364	34	112
			-----	-----	-----	-----
			39,739	767,684	166	689
VARIABLE RATE-NONE						
			-----	-----	-----	-----
			--	--	--	--
TOTAL INDEBTEDNESS - EXCLUDING CREDIT FACILITY			\$263,284	\$1,206,258	\$827	\$3,489
			=====	=====	=====	=====

<CAPTION>

ALL-IN INTEREST	PRINCIPAL MATURITY	TOTAL MATURITIES	-----	-----
--------------------	-----------------------	------------------	-------	-------

Community	Rate	Date	2000	2001	2002	Thereafter
<S>	<C>	<C>	<C>	<C>	<C>	<C>
<b>Tax-Exempt Bonds:</b>						
FIXED RATE						
Canyon Creek	6.48%	Jun-25	\$ 554	\$ 594	\$ 637	\$ 35,751
Waterford	5.88%	Aug-14	--	--	--	33,100
City Heights	5.80%	Jun-25	250	268	288	19,457
CountryBrook	7.87%	Mar-12	330	357	386	18,190
Villa Mariposa	5.88%	Mar-17	--	--	--	18,300
Sea Ridge	6.48%	Jun-25	251	270	289	16,216
Foxchase I	5.88%	Nov-07	--	--	--	16,800
Barrington Hills	6.48%	Jun-25	190	203	218	12,231
Rivershore	6.48%	Nov-22	171	184	198	9,451
Foxchase II	5.88%	Nov-07	--	--	--	9,600
Fairway Glen	5.88%	Nov-07	--	--	--	9,580
Crossbrook	6.48%	Jun-25	117	126	136	7,894
Larkspur Canyon	5.50%	Jun-25	91	98	105	7,152
Avalon Ridge	5.69%	Jun-26	--	--	--	26,815
Avalon View	7.55%	Aug-24	330	350	373	17,742
Chase Lea	5.71%	Jun-26	--	--	--	16,835
Avalon at Lexington	6.56%	Feb-25	255	271	288	13,792
Avalon Knoll	6.95%	Jun-26	187	200	214	12,978
Avalon at Dulles	7.04%	Jul-24	--	--	--	12,360
Avalon Fields	7.57%	May-27	147	157	169	11,281
Avalon at Hampton II	7.04%	Jul-24	--	--	--	11,550
Avalon at Symphony Glen	7.06%	Jul-24	--	--	--	9,780
Avalon West	7.73%	Dec-36	53	57	61	8,464
Avalon Landing	6.85%	Jun-26	95	101	108	6,415
			-----	-----	-----	-----
			3,021	3,236	3,470	361,734
VARIABLE RATE						
Avalon Devonshire		Dec-25	--	--	--	27,305
Avalon at Fairway Hills I		Jun-26	--	--	--	11,500
Laguna Brisas		Mar-09	--	--	--	10,400
Avalon at Hampton I		Jun-26	--	--	--	8,060
Avalon Pointe		Jun-26	--	--	--	6,387
			-----	-----	-----	-----
			--	--	--	63,652
CONVENTIONAL LOANS:						
FIXED RATE						
\$100 Million Senior Unsecured Notes	7.375%	Sep-02	--	--	100,000	--
\$100 Million Senior Unsecured Notes	6.625%	Jan-05	--	--	--	100,000
\$110 Million Senior Unsecured Notes	6.875%	Dec-07	--	--	--	110,000
\$50 Million Senior Unsecured Notes	6.25%	Jan-03	--	--	--	50,000
\$50 Million Senior Unsecured Notes	6.50%	Jan-05	--	--	--	50,000
\$50 Million Senior Unsecured Notes	6.625%	Jan-08	--	--	--	50,000
\$100 Million Senior Unsecured Notes	6.500%	Jul-03	--	--	--	100,000
\$150 Million Senior Unsecured Notes	6.800%	Jul-06	--	--	--	150,000
Governor's Square	7.65%	Aug-04	153	165	178	13,415
The Arbors	7.25%	May-04	--	--	--	12,870
Gallery Place	7.31%	May-01	230	11,042	--	17
Cedar Ridge	6.50%	Jul-99	--	--	--	1,000
Avalon Walk II	8.93%	Nov-04	241	264	288	11,748
Avalon Pines	8.00%	Dec-03	121	131	142	4,824
			-----	-----	-----	-----
			745	11,602	100,608	653,874
VARIABLE RATE-NONE						
			-----	-----	-----	-----
			--	--	--	--
TOTAL INDEBTEDNESS - EXCLUDING CREDIT FACILITY			\$3,766	\$14,838	\$104,078	\$1,079,260
			=====	=====	=====	=====

</TABLE>

INFLATION

Substantially all of the leases at the Current Communities are for a term of one year or less, which may enable the Company to realize increased rents upon renewal of existing leases or commencement of new leases. Such short-term leases generally minimize the risk to the Company of the adverse effects of inflation, although these leases generally permit residents to leave at the end of the lease term without penalty. Short-term leases combined with relatively consistent demand allow rents, and therefore cash flow from the Company's portfolio of apartments, to provide an attractive inflation hedge.

The statements in the following section include "Year 2000 readiness disclosure" within the meaning of the Year 2000 Information and Readiness Disclosure Act of 1998.

The Year 2000 compliance issue concerns the inability of computer systems to accurately calculate, store or use a date after 1999. This could result in a system failure causing disruptions of operations or create erroneous results. The Year 2000 issue affects virtually all companies and organizations.

Management has been taking the necessary steps to understand the nature and extent of the work required to make its information computer systems and non-information embedded systems Year 2000 compliant. Management has identified certain phases necessary to become Year 2000 compliant and has established an estimated timetable for completion of those phases, as shown in the table on the following page:

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<TABLE>  
<CAPTION>

PHASE -----		DEFINITION -----	ESTIMATED COMPLETION DATE -----
<S>	<C>	<C>	<C>
1.	Designate Task Force	Assign key management personnel to the Company's Year 2000 Task Force ("the Task Force") to coordinate compliance efforts	Completed
2.	Introduce Year 2000 Awareness	Communicate the Year 2000 issue to the Company. Ensure current and future acquisition, development and operation processes address Year 2000 compliance	Completed
3.	Inventory System	Identify the Company's information computer systems ("IT Systems") and non-information embedded systems ("Non-IT Systems")	Completed
4.	Contact Vendors	Contact vendors of all IT and Non-IT Systems to request information regarding compliance of those systems	December 15, 1998
5.	Prioritize and Budget	Prioritize non-compliant IT and Non-IT Systems and prepare initial budget for cost of becoming compliant	January 31, 1999
6.	Contingency Plan	Develop contingency plan to minimize disruptions and data processing errors in the event impacted IT and Non-IT Systems are not Year 2000 compliant on January 1, 2000	January 31, 1999
7.	Identify Solutions	Identify the course of action necessary to become Year 2000 compliant, and engage third party service providers where needed	March 31, 1999
8.	Replace and Test Solutions	Replace non-compliant IT and Non-IT Systems and ensure functionality.	August 31, 1999
9.	Communicate to Residents	Communicate to residents steps the Company has taken towards becoming Year 2000 compliant and remaining IT and Non-IT Systems that may still be impacted	September 30, 1999

</TABLE>

The Task Force has completed the Inventory System Phase for computerized IT Systems. The assessment determined that it will be necessary to modify, update or replace limited portions of the Company's computer hardware and software applications.

The Company anticipates that replacing and upgrading its existing IT Systems (both hardware and software) in the normal course of business will result in Year 2000 compliance by the end of the second quarter of 1999. The vendor that provides the Company's existing accounting software has a compliant version of its product, but growth in the Company's operations is expected to require a general ledger system with scope and functionality that is not present in either the system currently in use or the Year 2000 compliant version of that system. Accordingly, the Company is replacing the current general ledger system with an enhanced system that, in addition to increased functionality, is Year 2000 compliant. The new general ledger system has been selected and is expected to be implemented by the third quarter of 1999. The Company is not treating the cost of this new system as a Year 2000 expense because the implementation date has not been accelerated due to Year 2000 compliance concerns. The cost of the new general ledger system, after considering anticipated efficiencies provided by the new system, is not currently expected to have a material effect (either beneficial or adverse) on the Company's financial condition or results of operations.

The Task Force has also completed the Inventory System Phase of the Company's Non-IT Systems (e.g., security, heating and cooling, fire and elevator systems) at each community that may not be Year 2000 compliant, and has identified areas of risks for non-compliance by community type. The high-rises, mid-rises and newer garden communities represent the greatest risk of non-compliant systems as they have the most systems per community. The Task Force is currently conducting an assessment of these systems at all communities to identify and evaluate the changes and modifications necessary to make these systems compliant for Year 2000 processing. The Company's Task Force is currently in the process of contacting all system vendors to obtain information regarding the system's Year 2000 compliance, and this process is expected to be completed by December 15, 1998. Upon receipt of the vendors' responses, the Task Force will prioritize the non-compliant systems, if any, and proceed according to the phases described above. No assurance, however, can be given that the responses received will identify all non-compliant systems.

Upon completion of each of the above described upgrades and replacements of the Company's IT and Non-IT Systems, the Company will commence testing to ensure Year 2000 compliance. The Company currently expects its testing to be completed during the third quarter of 1999. While the Company anticipates such tests will be successful in all material respects, the Task Force intends to closely monitor the Company's Year 2000 compliance and will develop contingency plans by January 31, 1999, and continue to review both compliance and contingency plans, in the event certain systems are not compliant on time.

The Company continues to evaluate the estimated costs associated with these compliance efforts and, therefore, the total cost of bringing all Non-IT Systems into Year 2000 compliance has not been determined. Management anticipates that the costs of becoming Year 2000 compliant for all impacted Non-IT Systems will be reasonably measurable upon completion of the Prioritize and Budget Phase, currently scheduled to be completed by January 31, 1998. Based on available information, the Company believes that these costs will not have a material adverse effect on its business, financial condition or results of operations. However, no assurance can be given that all the Company's Non-IT Systems will be Year 2000 compliant by December 31, 1999 or that the Company will not incur significant costs pursuing Year 2000 compliance for Non-IT Systems.

The third parties with which the Company has material relationships include the Company's utility providers and the vendor that will provide the Company's new accounting software system. The Company is communicating with these, and other, third party providers and vendors with which it does business to determine the efforts being made on their part for compliance. The Company is currently requesting compliance certificates from all third parties that have an impact on the Company's operations,

but no assurance can be given that such certifications will be received by the Company or that they will prove to be accurate. As described above, the Company expects that its accounting software will be Year 2000 compliant.

The Company is not aware of third parties other than its residents to which it

could have potential material liabilities should its IT or Non-IT Systems be non-compliant on January 1, 2000. The inability of the Company to achieve Year 2000 compliance on its Non-IT Systems by January 1, 2000 may cause disruption in services that could potentially lead to declining occupancy rates, rental concessions, or higher operating expenses, and other material adverse effects, which are not quantifiable at this time. These disruptions may include, but are not limited to, disabled fire control systems, lighting controls, utilities, telephone and elevator operations.

Currently, the Company has not delayed any information technology or non-information technology projects due to the Year 2000 compliance efforts. However, the Company can neither provide assurance that future delays in such projects will not occur as a result of Year 2000 compliance efforts, nor anticipate the effects of such delays on the Company's operations.

The Company has not yet begun development of contingency plans for use in the event certain systems are not compliant on time. However, as previously shown, the Company does intend to develop contingency plans, and the development of such plans are scheduled to be completed by January 31, 1999.

#### NATURAL DISASTERS

Many of the Company's West Coast communities are located in the general vicinity of active earthquake faults. In July 1998, the Company obtained a seismic risk analysis from an engineering firm which estimated the probable maximum damage ("PMD") for each of the 60 West Coast communities that the Company owned at that time and for each of the five West Coast communities under development, individually and for all of those communities combined. To establish a PMD, the engineers first define a severe earthquake event for the applicable geographic area, which is an earthquake that has only a 10% likelihood of occurring over a 50-year period. The PMD is determined as the structural and architectural damage and business interruption loss that has a 10% probability of being exceeded in the event of such an earthquake. Because a significant number of the Company's communities are located in the San Francisco Bay Area, the engineers' analysis defined an earthquake on the Hayward Fault with a Richter Scale magnitude of 7.1 as a severe earthquake with a 10% probability of occurring within a 50-year period. The engineers then established an aggregate PMD at that time of \$113 million for the 60 West Coast communities that the Company owned at that time and the five West Coast communities under development. The \$113 million PMD for those communities was a PMD level that the engineers expected to be exceeded only 10% of the time in the event of such a severe earthquake. The actual aggregate PMD could be higher or lower as a result of variations in soil classifications and structural vulnerabilities. For each community, the engineers' analysis calculated an individual PMD as a percentage of the community's replacement cost and projected revenues. No assurance can be given that an earthquake would not cause damage or losses greater than the PMD assessments indicate, that future PMD levels will not be higher than the current PMD levels for the Company's communities located on the West Coast, or that future acquisitions or developments will not have PMD assessments indicating the possibility of greater damage or losses than currently indicated.

In August 1998, the Company renewed its earthquake insurance, both for physical damage and lost revenue, with respect to all communities it owned at that time and all of the communities under development. For any single occurrence, the Company self-insures the first \$25 million of loss, and has in place \$75 million of coverage above this amount. In addition, the Company's general liability and property casualty insurance provides coverage for personal liability and fire damage. In the event that an uninsured disaster or a loss in excess of insured limits were to occur, the Company could lose its capital invested in the affected community, as well as anticipated future revenue from that community, and would continue to be obligated to repay any mortgage indebtedness or other obligations related to the community. Any such loss could

materially and adversely affect the business of the Company and its financial condition and results of operations.

#### DEVELOPMENT COMMUNITIES

Currently 16 Development Communities are under construction. The total capitalized cost of these Development Communities, when completed, is expected to be approximately \$694.7 million. There can be no assurance that the Company will complete the Development Communities, that the Company's budgeted costs,

leasing, start dates, completion dates, occupancy or estimates of "EBITDA as % of Total Budgeted Cost" will be realized or that future developments will realize comparable returns.

The following page presents a summary of Development Communities:

AVALONBAY COMMUNITIES, INC.  
DEVELOPMENT COMMUNITIES SUMMARY

<TABLE>  
<CAPTION>

Projected  
EBITDA as  
of total  
budgeted  
cost (3)

Number of  
apartment  
homes

Budgeted  
cost (1)  
(\$ millions)

Construction  
start

Initial  
occupancy

Estimated  
completion  
date

Estimated  
stabilization  
date (2)

%

<S> <C>	<C>	<C>	<C>	<C>	<C>	<C>
1. Avalon at Cameron Court Alexandria, VA 11.7%	460	\$ 44.7	Q2 1997	Q1 1998	Q4 1998	Q1 1999
2. Toscana Sunnyvale, CA 10.8%	710	\$119.9	Q3 1996	Q3 1997	Q4 1998	Q2 1999
3. CentreMark San Jose, CA 10.5%	311	\$ 47.9	Q1 1997	Q3 1998	Q1 1999	Q2 1999
4. Avalon Willow Mamaroneck, NY 8.6%	227	\$ 46.8	Q2 1997	Q4 1998	Q2 1999	Q3 1999
5. Rosewalk II San Jose, CA 11.1%	156	\$ 20.3	Q4 1997	Q4 1998	Q1 1999	Q2 1999
6. Paseo Alameda San Jose, CA 9.9%	305	\$ 54.0	Q3 1997	Q4 1998	Q2 1999	Q3 1999
7. The Tower at Avalon Cove Jersey City, NJ 10.0%	269	\$ 51.8	Q1 1998	Q2 1999	Q3 1999	Q4 1999
8. The Avalon Bronxville, NY 9.3%	110	\$ 28.1	Q1 1998	Q2 1999	Q3 1999	Q4 1999
9. Avalon Valley Danbury, CT 10.3% (4)	268	\$ 26.1	Q1 1998	Q1 1999	Q3 1999	Q1 2000
10. Avalon Lake Danbury, CT 10.3% (4)	135	\$ 17.0	Q2 1998	Q2 1999	Q3 1999	Q1 2000
11. Avalon Oaks (5) Wilmington, MA 10.5%	204	\$ 21.9	Q2 1998	Q1 1999	Q2 1999	Q4 1999
12. Avalon Crest Fort Lee, NJ 10.3%	351	\$ 57.4	Q4 1997	Q2 1999	Q4 1999	Q1 2000
13. Bay Towers San Francisco, CA 9.6%	226	\$ 65.9	Q4 1997	Q3 1999	Q3 1999	Q1 2000
14. Avalon Corners Stamford, CT 10.4%	195	\$ 32.5	Q3 1998	Q3 1999	Q1 2000	Q3 2000
15. Avalon Fox Mill						

10.2%	Herndon, VA	165	\$ 20.1	Q4 1998	Q3 1999	Q1 2000	Q2 2000
11.7%	16. Avalon Court North Melville, NY	340	\$ 40.3	Q4 1998	Q3 1999	Q1 2000	Q3 2000
-----							
10.3%	Total/Weighted average	4,432	\$694.7				
=====							

=====  
</TABLE>

- (1) Budgeted cost includes all capitalized costs projected to be incurred to develop the respective Development Community, including land acquisition costs, construction costs, real estate taxes, capitalized interest and loan fees, permits, professional fees, allocated development overhead and other regulatory fees determined in accordance with GAAP.
- (2) Stabilized operations is defined as the first full quarter of 95% or greater occupancy after completion of construction.
- (3) Projected EBITDA represents gross potential earnings projected to be achieved at completion of construction before interest, income taxes, depreciation, amortization and extraordinary items, minus (a) projected economic vacancy and (b) projected stabilized operating expenses. EBITDA is relevant to an understanding of the economics of the Company because it indicates cash flow available from Company operations to service fixed obligations. EBITDA should not be considered as an alternative to operating income, as determined in accordance with GAAP, as an indicator of the Company's operating performance, or to cash flows from operating activities (as determined in accordance with GAAP) as a measure of liquidity. EBITDA as disclosed by other REITs may not be comparable to the Company's calculation of EBITDA.
- (4) Represents a combined yield for Avalon Valley and Avalon Lake.
- (5) Financed with tax-exempt bonds.

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#### REDEVELOPMENT COMMUNITIES

There are 13 Redevelopment Communities. The total capitalized cost of these Redevelopment Communities, when completed, is expected to be approximately \$462.5 million. There can be no assurance that the Company will complete the Redevelopment Communities, that the Company's budgeted costs, leasing, start dates, completion dates, occupancy or estimates of "EBITDA as % of Total Budgeted Cost" will be realized or that future redevelopments will realize comparable returns.

In accordance with GAAP, cost capitalization during redevelopment and reconstruction of assets (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 reconstruction and ends when the apartment home reconstruction is completed and the apartment home is placed-in-service.

The following page presents a summary of Redevelopment Communities:

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<TABLE>  
<CAPTION>

Projected

EBITDA as total budgeted cost (4)	Number of apartment homes	Budgeted cost (2) (\$ millions)	Reconstruction start	Reconstruction completion	Estimated restabilized operations (3)	% of
<S>	<C>	<C>	<C>	<C>	<C>	
<C>						
1. The Arbors Campbell, CA 9.1%	252	\$ 31.2	Q4 1997	Q1 1999	Q2 1999	
2. Arbor Heights (5) Hacienda Heights, CA 9.4%	351	\$ 28.7	Q2 1998	Q3 1999	Q1 2000	
3. Lakeside Burbank, CA 9.4%	750	\$ 65.6	Q2 1998	Q4 2000	Q2 2001	
4. Gallery Place Redmond, WA 8.3%	222	\$ 25.3	Q1 1998	Q2 1999	Q3 1999	
5. Viewpointe Woodland Hills, CA 9.7%	663	\$ 72.7	Q2 1998	Q2 1999	Q3 1999	
6. Landing West Seattle, WA 9.3%	190	\$ 11.9	Q1 1998	Q2 1999	Q3 1999	
7. Waterhouse Place Beaverton, OR 8.9%	279	\$ 20.3	Q2 1998	Q2 1999	Q3 1999	
8. Westside Terrace (6) Los Angeles, CA 9.3%	363	\$ 39.9	Q3 1998	Q1 1999	Q3 1999	
9. Warner Oaks Woodland Hills, CA 9.2%	227	\$ 25.0	Q3 1998	Q4 1999	Q1 2000	
10. Amberway Anaheim, CA 8.8%	272	\$ 21.2	Q3 1998	Q3 1999	Q1 2000	
11. Avalon Ridge Renton, WA 9.8%	420	\$ 35.7	Q3 1998	Q2 2000	Q3 2000	
12. Governor's Square Sacramento, CA 8.4%	302	\$ 27.7	Q1 1998	Q1 1999	Q2 1999	
13. Bay Pointe (7) San Diego, CA 9.1%	564	\$ 57.3	Q3 1998	Q4 1999	Q1 2000	
---						
Total/Weighted average 9.2%	4,855	\$462.5				
===						

</TABLE>

- (1) Redevelopment Communities are communities acquired for which redevelopment costs are expected to exceed the lesser of 10% of the original acquisition cost or \$5,000,000.
- (2) Budgeted 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.
- (3) Restabilized operations is defined as the first full quarter of 95% or greater occupancy after completion of redevelopment.
- (4) Projected EBITDA represents gross potential earnings projected to be achieved at completion of redevelopment before interest, income taxes, depreciation, amortization and extraordinary items, minus (a) projected economic vacancy and (b) projected stabilized operating expenses.
- (5) Formerly named "The Park."
- (6) Formerly named "Westwood Club."
- (7) Formerly named "Mission Bay."

## DEVELOPMENT RIGHTS

The Company is considering the development of 23 new apartment communities. The status of these Development Rights range from land owned or under contract for which design and architectural planning has just commenced to land under contract or owned by the Company with completed site plans and drawings where construction can commence almost immediately. There can be no assurance that the Company will succeed in obtaining zoning and other necessary governmental approvals or the financing required to develop these communities, or that the Company will decide to develop any particular community. Further, there can be no assurance that construction of any particular community will be undertaken or, if undertaken, will begin at the expected times assumed in the financial projections or be completed at the total budgeted cost. Although there can be no assurance that all or any of these communities will proceed to development, Management estimates that the successful completion of all of these communities would ultimately add approximately 6,377 institutional-quality apartment homes to the Company's portfolio. At September 30, 1998, the cumulative capitalized costs incurred in pursuit of the 23 Development Rights was approximately \$35.5 million. Many of these apartment homes will offer features like those offered by the communities currently owned by the Company. The 23 Development Rights that the Company is currently pursuing are summarized on the following table.

AVALONBAY COMMUNITIES, INC.  
DEVELOPMENT RIGHTS SUMMARY

<TABLE>  
<CAPTION>

		Estimated number of homes	Total budgeted cost (\$ millions)
	Location		
	-----	-----	-----
<S>	<C>	<C>	<C>
1.	Peabody, MA	154	\$20.6
2.	Bellevue, WA	200	29.1
3.	Mountain View, CA (1)	238	58.8
4.	San Jose, CA (1)	278	52.9
5.	Hull, MA	162	18.9
6.	New Rochelle, NY	400	78.8
7.	Stamford, CT	319	57.6
8.	Freehold, NJ	452	29.8
9.	Orange, CT	168	16.4
10.	New Canaan, CT (1) (2)	104	23.8
11.	Darien, CT	172	28.9
12.	Yonkers, NY	256	35.0
13.	Greenburgh - II, NY	500	80.3
14.	Greenburgh - III, NY	266	42.7
15.	Arlington I, VA	566	68.8
16.	Arlington II, VA	324	35.5
17.	Florham Park, NJ	270	39.1
18.	Edgewater, NJ	408	74.6
19.	Hopewell, NJ	280	29.8
20.	Naperville, IL	100	15.2
21.	Westbury, NY	361	49.8
22.	Providence, RI	247	30.4
23.	Quincy, MA	152	18.7
		-----	-----
	Totals	6,377	\$935.5
		=====	=====

</TABLE>

- (1) Company owns land, but construction has not yet begun.
- (2) Currently anticipated that the land seller will retain a minority limited partner interest.

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#### RISKS OF DEVELOPMENT AND REDEVELOPMENT

The Company intends to continue to pursue the development and construction of apartment home communities in accordance with the Company's development and underwriting policies. Risks associated with the Company's development and construction activities may include: the abandonment of development and acquisition opportunities explored by the Company; construction costs of a community may exceed original estimates due to increased materials, labor or other expenses, which could make completion of the community uneconomical; occupancy rates and rents at a newly completed community are dependent on a number of factors, including market and general economic conditions, and may not be sufficient to make the community profitable; financing may not be available on favorable terms for the development of a community; and construction and lease-up may not be completed on schedule, resulting in increased debt service expense and construction costs. Development activities are also subject to risks relating to the inability to obtain, or delays in obtaining, all necessary zoning, land-use, building, occupancy, and other required governmental permits and authorizations. The occurrence of any of the events described above could adversely affect the Company's ability to achieve its projected yields on communities under development or reconstruction and could prevent the Company from paying distributions to its stockholders.

For each new development community, the Company establishes a target for projected EBITDA as a percentage of total budgeted cost. Projected EBITDA represents gross potential earnings projected to be achieved at completion of development or redevelopment before interest, income taxes, depreciation, amortization and extraordinary items, minus (a) projected economic vacancy and (b) projected stabilized operating expenses. Total budgeted cost includes all capitalized costs projected to be incurred to develop the respective Development or Redevelopment Community, including land, acquisition costs, construction costs, real estate taxes, capitalized interest and loan fees, permits, professional fees, allocated development overhead and other regulatory fees determined in accordance with GAAP. Gross potential earnings and construction costs reflect those prevailing in the community's market at the time the Company's development budgets are prepared taking into consideration certain changes to those market conditions anticipated by the Company at the time. Although the Company attempts to anticipate changes in market conditions, the Company cannot predict with certainty what those changes will be. Construction costs have been increasing and, for certain of the Company's Development Communities, the total construction costs have been or are expected to be higher than the original budget. Nonetheless, because of increases in prevailing market rents Management believes that, in the aggregate, the Company will still achieve its targeted projected EBITDA as a percentage of total budgeted cost for those communities experiencing costs in excess of the original budget. Management believes that it could experience similar increases in construction costs and market rents with respect to other development communities resulting in total construction costs that exceed original budgets. Likewise, costs to redevelop communities that have been acquired have, in some cases, exceeded Management's original estimates and similar increases in costs may be experienced in the future. There can be no assurances that market rents in effect at the time new development communities or repositioned communities complete lease-up will be sufficient to fully offset the effects of any increased construction costs.

#### CAPITALIZED INTEREST

In accordance with GAAP, the Company capitalizes interest expense during construction until each building obtains a final certificate of occupancy. Thereafter, interest for each completed building is expensed. Capitalized interest for all communities under construction or reconstruction for the three months ended September 30, 1998 and 1997 totaled \$4,847,000 and \$2,009,000, respectively, and for the nine months ended September 30, 1998 and 1997 totaled \$11,372,000 and \$4,430,000, respectively.

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#### PART II. OTHER INFORMATION

##### ITEM 1. Legal Proceedings

The Company is involved in certain ordinary routine litigation incidental to the conduct of its business. While the outcome of such litigation cannot be predicted with certainty,

management does not expect any current litigation to have a material effect on the business or financial condition of the Company.

ITEM 2. Changes in Securities

None

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 and Reports on Form 8-K

(a) Exhibits

Exhibit No. Description  
- - - - -

- 3(i).1 Articles of Amendment and Restatement of Articles of Incorporation of the Company, dated as of June 4, 1998 (Incorporated by reference to Exhibit 3(i).1 to Form 10-Q of the Company for the quarter ended June 30, 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 Bylaws of the Company, as amended and restated, on July 24, 1998 (Incorporated by reference to Exhibit 3(ii).1 to Form 10-Q of the Company).
- 4.1 Indenture, dated as of January 16, 1998, between the Company and State Street Bank and Trust Company, as Trustee (Incorporated by reference to Exhibit 4.1 to Form 8-K of the Company filed on January 21, 1998).
- 4.2 First Supplemental Indenture, dated as of January 20, 1998, between the Company and the Trustee (Incorporated by reference to Exhibit 4.2 to Form 8-K of the Company filed on January 21, 1998).
- 4.3 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).
- 4.4 The Company's 6.50% Senior Note due 2003 (Incorporated by reference to Exhibit 4.3 to Form 8-K of the Company filed on July 9, 1998).
  
- 4.5 The Company's 6.80% Senior Note due 2006 (Incorporated by reference to Exhibit 4.4 to Form 8-K of the Company filed on July 9, 1998).
- 10.1 1994 Stock Incentive Plan, as amended and restated on April 13, 1998 and subsequently amended on July 24, 1998.
- 12.1 Statements re: Computation of ratios.
- 27.1 Financial Data Schedule.

(b) Reports on Form 8-K

1. Form 8-K of the Company, filed July 9, 1998, announcing the completion of an underwritten public offering of the Company's Senior Notes.

2. Form 8-K of the Company, filed August 5, 1998, relating to the Company's acquisition of the Prudential Center Apartments on July 16, 1998.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 16, 1998

/s/ Richard L. Michaux

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Richard L. Michaux  
Chief Executive Officer and Director

Date: November 16, 1998

/s/ Thomas J. Sargeant

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Thomas J. Sargeant  
Chief Financial Officer and Treasurer

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AVALON BAY COMMUNITIES, INC.  
1994 STOCK INCENTIVE PLAN

As Amended and Restated on April 13, 1998  
and Subsequently Amended on July 24, 1998

SECTION 1. GENERAL PURPOSE OF THE PLAN; DEFINITIONS

The name of the plan is the Avalon Bay Communities, Inc. 1994 Stock Incentive Plan (the "Plan"). The purpose of the Plan is to encourage and enable the officers, employees, Directors and other key persons of Avalon Bay Communities, Inc. (the "Company") and its Subsidiaries upon whose judgment, initiative and efforts the Company largely depends for the successful conduct of its business to acquire a proprietary interest in the Company. It is anticipated that providing such persons with a direct stake in the Company's welfare will assure a closer identification of their interests with those of the Company, thereby stimulating their efforts on the Company's behalf and strengthening their desire to remain with the Company.

The following terms shall be defined as set forth below:

"Act" means the Securities Exchange Act of 1934, as amended.

"Award" or "Awards," except where referring to a particular category of grant under the Plan, shall include Incentive Stock Options, Non-Qualified Stock Options, Restricted Stock Awards, Deferred Stock Awards, Unrestricted Stock Awards, Performance Share Awards and Dividend Equivalent Rights.

"Board" means the Board of Directors of the Company.

"Cause" means, except as provided in an individual agreement or by the Committee, a vote of the Board of Directors resolving that the participant should be dismissed as a result of (i) any material breach by the participant of any agreement to which the participant and the Company are parties, (ii) any act (other than retirement) or omission to act by the participant which may have a material and adverse effect on the business of the Company or any Subsidiary or on the participant's ability to perform services for the Company or any Subsidiary, including, without limitation, the commission of any crime (other than ordinary traffic violations), or (iii) any material misconduct or neglect of duties by the participant in connection with the business or affairs of the Company or any Subsidiary.

"Change of Control" is defined in Section 16.

"Code" means the Internal Revenue Code of 1986, as amended, and any successor Code, and related rules, regulations and interpretations.

"Committee" means the Committee of the Board referred to in Section 2.

"Covered Employee" means a participant designated prior to the grant of a Qualified Performance-based Award by the Committee who is or may be a "covered employee" within the meaning of Section 162(m)(3) of the Code in the year in which the Qualified Performance-based Award is expected to be taxable to such participant.

"Deferred Stock Award" means Awards granted pursuant to Section 7.

"Disability" means, except as provided in an individual agreement or by the Committee, an individual's inability to perform his normal required services for the Company and its Subsidiaries for a period of six consecutive months by reason of the individual's mental or physical disability, as determined by the Committee in good faith in its sole discretion.

"Dividend Equivalent Right" means Awards granted pursuant to Section 11.

"Effective Date" means the consummation of the merger contemplated by the Agreement and Plan of Merger, by and between the Company and Avalon Properties, Inc. dated as of March 9, 1998.

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

"Incentive Stock Option" means any Stock Option designated as, and qualified as, an "incentive stock option" as defined in Section 422 of the Code.

"Non-Employee Director" means a member of the Board who is not also an employee of the Company or any Subsidiary.

"Non-Qualified Stock Option" means any Stock Option that is not an Incentive Stock Option.

"Option" or "Stock Option" means any option to purchase shares of Stock granted pursuant to Section 5.

"Performance Cycle" means one or more periods of time, which may be of varying and overlapping durations, as the Committee may select, over which the attainment of one or more performance criteria will be measured for the purpose of determining a participant's right to and the payment of a Performance Share Award, Restricted Stock Award or Deferred Stock Award.

"Performance Share Award" means Awards granted pursuant to Section 9.

"Qualified Performance-based Award" means any Restricted Stock Award, Deferred Stock Award or Performance Share Award that is intended to qualify as "performance-based compensation" under Section 162(m) of the Code and the regulations promulgated thereunder.

"Restricted Stock Award" mean Awards granted pursuant to Section 6.

"Retirement" means the employee's termination of employment with the Company and its Subsidiaries after attainment of the age and/or service requirements to qualify for early or normal retirement specified in the written instrument evidencing the Award or, if not so specified, under the Company's retirement policy as in effect at the time of the Award.

"Stock" means the Common Stock, \$.01 par value per share, of the Company, subject to adjustments pursuant to Section 3.

"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 total combined voting power of all classes of stock or other interests in one of the other corporations or entities in the chain.

"Unrestricted Stock Award" means Awards granted pursuant to Section 8.

## SECTION 2. ADMINISTRATION OF PLAN; COMMITTEE AUTHORITY TO SELECT PARTICIPANTS AND DETERMINE AWARDS

(a) COMMITTEE. The Plan shall be administered by all of the Non-Employee Director members of the Compensation Committee of the Board, or a committee of not less than two Non-Employee Directors performing similar functions, as appointed by the Board from time to time. Any authority granted to the Committee may also be exercised by the full Board. To the extent that any permitted action taken by the Board conflicts with action taken by the Committee, the Board action shall control.

(b) POWERS OF COMMITTEE. The Committee shall have the power and authority to grant Awards consistent with the terms of the Plan, including the power and authority:

- (i) to select the officers, other employees, Non-Employee Directors and other key persons of the Company and its Subsidiaries to whom Awards may from time to time be granted;
- (ii) to determine the time or times of grant, and the extent, if any, of Incentive Stock Options, Non-Qualified Stock Options, Restricted Stock Awards, Deferred Stock Awards, Unrestricted Stock Awards, Performance Share Awards and Dividend Equivalent Rights, or any combination of the foregoing, granted to any one or more participants;
- (iii) to determine the number of shares to be covered by any Award;
- (iv) to determine and modify the terms and conditions, including restrictions, not inconsistent with the terms of the Plan, of any Award, which terms and conditions may differ among individual Awards and participants, and to approve the form of written instruments evidencing the Awards;
- (v) to accelerate the exercisability or vesting of all or any portion of any Award in circumstances involving a Change of Control or the death, disability or termination of employment of a Plan participant;
- (vi) subject to the provisions of Section 5(a)(ii), to extend the period in which Stock Options may be exercised;
- (vii) to determine whether, to what extent, and under what circumstances Stock and other amounts payable with respect to an Award shall be deferred either automatically or at the election of the participant and whether and to what extent the Company shall pay or

credit amounts constituting interest (at rates determined by the Committee) or dividends or deemed dividends on such deferrals; and

(viii) to adopt, alter and repeal such rules, guidelines and practices for administration of the Plan and for its own acts and proceedings as it shall deem advisable; to interpret the terms and provisions of the Plan and any Award (including related written instruments); to make all determinations it deems advisable for the administration of the Plan; to decide all disputes arising in connection with the Plan; and to otherwise supervise the administration of the Plan.

All decisions and interpretations of the Committee shall be binding on all persons, including the Company and Plan participants.

(c) DELEGATION OF AUTHORITY TO GRANT AWARDS. The Committee, in its discretion, may delegate to the Chief Executive Officer of the Company all or part of the Committee's authority and duties with respect to Awards, including the granting thereof, to individuals who are not subject to the reporting and other provisions of Section 16 of the Act or Covered Employees. The Committee may revoke or amend the terms of a delegation at any time but such action shall not invalidate any prior actions of the Committee's delegate or delegates that were consistent with the terms of the Plan.

### SECTION 3. SHARES ISSUABLE UNDER THE PLAN; MERGERS; SUBSTITUTION

(a) SHARES ISSUABLE. The maximum number of shares of Stock reserved and available for issuance under the Plan shall be the sum of (a) 2,500,000 shares of Stock, plus (b) 9.9 percent of any net increase in the total number of shares of Stock actually outstanding from time to time after April 13, 1998. Notwithstanding the foregoing, the maximum number of

shares of Stock for which Incentive Stock Options may be issued under the Plan shall not exceed 2,500,000. For purposes of this limitation, the shares of Stock underlying any Awards which are forfeited, canceled, reacquired by the Company, satisfied without the issuance of Stock or otherwise terminated (other than by exercise) shall be added back to the shares of Stock available for issuance under the Plan. Stock Options with respect to no more than 300,000 shares of Stock may be granted to any one individual participant during any one calendar year period. Shares issued under the Plan may be authorized but unissued shares or shares reacquired by the Company.

(b) RECAPITALIZATIONS. If, through or as a result of any merger, consolidation, sale of all or substantially all of the assets of the Company, reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split or other similar transaction, the outstanding shares of Stock are increased or decreased or are exchanged for a different number or kind of shares or other securities of the Company, or additional shares or new or different shares or other securities of the Company or other non-cash assets are distributed with respect to such shares of Stock or other securities, the Committee shall make an appropriate or proportionate adjustment in (i) the maximum number of shares reserved for issuance under the Plan, (ii) the number of Stock Options or shares of Stock that can be granted to any one individual participant, (iii) the number and kind of shares or other securities subject to any then outstanding Awards under the Plan, and (iv) the price for each share subject to any then outstanding Stock Options under the Plan, without changing the aggregate exercise price (i.e., the exercise price multiplied by the number of Stock Options) as to which such Stock Options remain exercisable. The adjustment by the Committee shall be final, binding and conclusive. No fractional shares of Stock shall be issued under the Plan resulting from any such adjustment, but the Committee in its discretion may make a cash payment in lieu of fractional shares.

(c) MERGERS. Upon consummation of a consolidation or merger or sale of all or substantially all of the assets of the Company in which outstanding shares of Stock are exchanged for securities, cash or other property of an unrelated corporation or business entity or in the event of a liquidation of the Company (in each case, a "Transaction"), the Board may, in its discretion, take any one or more of the following actions, as to outstanding Stock Options: (i) provide that such Stock Options shall be assumed, or equivalent options shall be substituted, by the acquiring or succeeding corporation (or an affiliate thereof), (ii) upon written notice to the optionees, provide that all unexercised Stock Options will terminate immediately prior to the consummation of the Transaction unless exercised by the optionee within a specified period following the date of such notice, and/or (iii) in the event of a business combination under the terms of which holders of the Stock of the Company will receive upon consummation thereof a cash payment for each share surrendered in the business combination, make or provide for a cash payment to the optionees equal to the difference between (A) the value (as determined by the Committee) of the consideration payable per share of Stock pursuant to the business combination (the "Merger Price") times the number of shares of Stock subject to such outstanding Stock Options (to the extent then exercisable at prices not in excess of the Merger Price) and (B) the aggregate exercise price of all such outstanding Stock Options in exchange for the termination of such Stock Options. In the event Stock

Options will terminate upon the consummation of the Transaction, each optionee shall be permitted, within a specified period determined by the Committee, to exercise all non-vested Stock Options, subject to the consummation of the Transaction.

(d) SUBSTITUTE AWARDS. The Committee may grant Awards under the Plan in substitution for stock and stock based awards held by employees of another corporation who concurrently become employees of the Company or a Subsidiary as the result of a merger or consolidation of the employing corporation with the Company or a Subsidiary or the acquisition by the Company or a Subsidiary of property or stock of the employing corporation. The Committee may direct that the substitute awards be granted on such terms and conditions as the Committee considers appropriate in the circumstances. Any substitute awards granted under this Plan shall not count against the share limitation set forth in Section 3(a).

#### SECTION 4. ELIGIBILITY

Participants in the Plan will be such full or part-time officers, other employees, Non-Employee Directors and key persons of the Company and its Subsidiaries who are responsible for or contribute to the management, growth or profitability of the Company and its Subsidiaries and who are selected from time to time by the Committee, in its sole discretion. Key persons, for purposes of this Plan, shall include consultants and prospective employees.

#### SECTION 5. STOCK OPTIONS

Any Stock Option granted under the Plan shall be in such form as the Committee may from time to time approve.

Stock Options granted under the Plan may be either Incentive Stock Options or Non-Qualified Stock Options. Incentive Stock Options may be granted only to employees of the Company or any Subsidiary that is a "subsidiary corporation" within the meaning of Section 424(f) of the Code. To the extent that any option does not qualify as an Incentive Stock Option, it shall constitute a Non-Qualified Stock Option.

No Awards shall be granted under the Plan after April 13, 2008.

(a) STOCK OPTIONS GRANTED TO EMPLOYEES AND KEY PERSONS. The Committee in its discretion may grant Stock Options to employees and key persons of the Company or any Subsidiary. Stock Options granted to employees and key persons pursuant to this Section 5(a) shall be subject to the following terms and conditions and shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as the Committee shall deem desirable. If the Committee so determines, Stock Options may be granted in lieu of cash compensation at the participant's election, subject to such terms and conditions as the Committee may establish, as well as in addition to other compensation.

(i) EXERCISE PRICE. The exercise price per share for the Stock covered by a Stock Option granted pursuant to this Section 5(a) shall be determined by the

Committee at the time of grant but shall be not less than 100% of Fair Market Value on the date of grant (other than options granted in lieu of cash compensation). If an employee owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Subsidiary or parent corporation and an Incentive Stock Option is granted to such employee, the option price shall be not less than 110% of Fair Market Value on the grant date.

(ii) OPTION TERM. The term of each Stock Option shall be fixed by the Committee, but no Incentive Stock Option shall be exercisable more than ten years after the date the option is granted. If an employee owns or is deemed to own (by reason of the attribution rules of Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Subsidiary or parent corporation and an Incentive Stock Option is granted to such employee, the term of such option shall be no more than five years from the date of grant.

(iii) EXERCISABILITY; RIGHTS OF A SHAREHOLDER. Stock Options shall become vested and exercisable at such time or times, whether or not in installments, as shall be determined by the Committee at or after the grant date. The Committee may at any time accelerate the exercisability of all or any portion of any Stock Option. An optionee shall have the rights of a shareholder only as to shares acquired upon the exercise of a Stock Option and not as to unexercised Stock Options.

(iv) METHOD OF EXERCISE. Stock Options may be exercised in whole or in part, by giving written notice of exercise to the Company, specifying the number of shares to be purchased. Payment of the purchase price may be made by one or more of the following methods:

(A) In cash, by certified bank check or other instrument acceptable to the Committee;

(B) Through the delivery (or attestation to the ownership) of shares of Stock that have been purchased by the optionee on the open market or that have been beneficially owned by the optionee for at least six months and are not then subject to restrictions under any Company plan. Such surrendered shares shall be valued at Fair Market Value on the exercise date; or

(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 so provided, the optionee and the broker shall comply with such procedures and enter into such agreements of indemnity and other agreements as the Committee shall prescribe as a condition of such payment procedure. Payment instruments will be received subject to collection.

The delivery of certificates representing shares of Stock to be purchased pursuant to the exercise of a Stock Option will be contingent upon receipt from the optionee (or a purchaser acting in his stead in accordance with the provisions of the Stock Option) by the Company of the full purchase price for such shares and the fulfillment of any other requirements contained in the Stock Option or applicable provisions of laws. In the event an optionee chooses to pay the purchase price by previously-owned shares of Stock through the attestation method, the shares of Stock transferred to the optionee upon the exercise of the Stock Option shall be net of the number of shares attested to.

(v) TERMINATION BY REASON OF DEATH. If any optionee's employment (or other business relationship) by the Company and its Subsidiaries terminates by reason of death, the Stock Option may thereafter be exercised, to the extent exercisable at the date of death, by the legal representative or legatee of the optionee, for a period of six months (or such longer period as the Committee shall specify at any time in the option, employment or other agreement) from the date of death, or until the expiration of the stated term of the Option, if earlier.

(vi) TERMINATION BY REASON OF DISABILITY.

(A) Any Stock Option held by an optionee whose employment (or other business relationship) by the Company and its Subsidiaries has terminated by reason of Disability may thereafter be exercised, to the extent it was exercisable at the time of such termination, for a period of twelve months (or such longer period as the Committee shall specify at any time in the option, employment or other agreement) from the date of such termination of employment (or other business relationship), or until the expiration of the stated term of the Option, if earlier.

(B) Except as otherwise provided by the Committee at the time of grant, the death of an optionee during a period provided in this Section 5(a)(vi) for the exercise of a Non-Qualified Stock Option shall extend such period for six months from the date of death, subject to termination on the expiration of the stated term of the Option, if earlier.

(vii) TERMINATION BY REASON OF RETIREMENT.

(A) Any Stock Option held by an optionee whose employment by the Company and its Subsidiaries is terminated by reason of Retirement may thereafter be exercised, to the extent it was exercisable at the time of such termination, for a period of twelve months (or such other period as the Committee shall specify at any time in the option, employment or other agreement) from the date of such termination of employment, or until the expiration of the stated term of the Option, if earlier.

(B) Except as otherwise provided by the Committee at any time, the death of an optionee during a period provided in this Section 5(a)(vii) for the exercise of a Stock Option shall extend such period for six months from the date of death, subject to termination on the expiration of the stated term of the Option, if earlier.

(viii) TERMINATION FOR CAUSE. If any optionee's employment (or other business relationship) by the Company and its Subsidiaries has been terminated for Cause, any Stock Option held by such optionee shall immediately terminate and be of no further force and effect; provided, however, that the Committee may, in its sole discretion, provide that such stock option can be exercised for a period of up to

30 days from the date of termination of employment (or other business relationship) or until the expiration of the stated term of the Option, if earlier.

(ix) OTHER TERMINATION. Unless otherwise determined by the Committee, if an optionee's employment (or other business relationship) by the Company and its Subsidiaries terminates for any reason other than death, Disability, Retirement or for Cause, any Stock Option held by such optionee may thereafter be exercised, to the extent it was exercisable on the date of termination of employment (or other business relationship), for three months (or such longer period as the Committee shall specify at any time in the option, employment or other agreement) from the date of termination of employment (or other business relationship) or until the expiration of the stated term of the Option, if earlier.

(x) ANNUAL LIMIT ON INCENTIVE STOCK OPTIONS. To the extent required for "incentive stock option" treatment under Section 422 of the Code, the aggregate Fair Market Value (determined as of the time of grant) of the Stock with respect to which Incentive Stock Options granted under this Plan and any other plan of the Company or its Subsidiaries become exercisable for the first time by an optionee during any calendar year shall not exceed \$100,000.

(xi) FORM OF SETTLEMENT. Shares of Stock issued upon exercise of a Stock Option shall be free of all restrictions under the Plan, except as otherwise provided in this Plan.

(b) RELOAD OPTIONS. At the discretion of the Committee, Options granted under the Plan may include a so-called "reload" feature pursuant to which an optionee exercising an option by the delivery of a number of shares of Stock in accordance with Section 5(a)(iv)(B) hereof would automatically be granted an additional Option (with an exercise price equal to the Fair Market Value of the Stock on the date the additional Option is granted and with the same expiration date as the original Option being exercised, and with such other terms as the Committee may provide) to purchase that number of shares of Stock equal to the number delivered to exercise the original Option.

(c) STOCK OPTIONS GRANTED TO NON-EMPLOYEE DIRECTORS.

(i) AUTOMATIC GRANT OF OPTIONS.

(A) Each Non-Employee Director who is serving as a Director of the Company on the fifth business day after the Effective Date shall automatically be granted on such date a Non-Qualified Stock Option to acquire 10,000 shares of Stock.

(B) Each Non-Employee Director who is serving as a Director of the Company on the fifth business day after each annual meeting of stockholders, beginning with the 1999 annual meeting of stockholders, shall automatically be granted on such day a Non-Qualified Stock Option to acquire 10,000 shares of Stock.

(C) The exercise price per share for the Stock covered by a Stock Option granted under this Section 5(c) shall be equal to the Fair Market Value of the Stock on the date the Stock Option is granted.

(D) The Committee, in its discretion, may grant additional Non-Qualified Stock Options to Non-Employee Directors.

(ii) EXERCISE; TERMINATION.

(A) Except as provided in Section 16 or in the option agreement, no Option granted under Section 5(c) may be exercised before the first anniversary of the date upon which it was granted; provided, however, that any Option so granted shall become exercisable upon the termination of service of the Non-Employee Director because of Disability or death. No Option issued under this Section 5(c) shall be exercisable after the expiration of ten years from the date upon which such Option is granted.

(B) The rights of a Non-Employee Director in an Option granted under Section 5(c) shall terminate on the specified expiration date; provided, however, that if the Non-Employee Director ceases to be a Director for Cause, the rights shall terminate immediately on the date on which he ceases to be a Director.

(C) Any Option granted to a Non-Employee Director and outstanding on the date of his death may be exercised by the legal representative or legatee of the optionee for a period of six months from the date of death or until the expiration of the stated term of the Option, if earlier.

(D) Options granted under this Section 5(c) may be exercised only by

written notice to the Company specifying the number of shares to be purchased. Payment of the full purchase price of the shares to be purchased may be made

by one or more of the methods specified in Section 5(a)(iv). An optionee shall have the rights of a shareholder only as to shares acquired upon the exercise of a Stock Option and not as to unexercised Stock Options.

(d) NON-TRANSFERABILITY OF OPTIONS. No Stock Option shall be transferable by the optionee otherwise than by will or by the laws of descent and distribution and all Stock Options shall be exercisable, during the optionee's lifetime, only by the optionee, or by the optionee's legal representative or guardian in the event of the optionee's incapacity. Notwithstanding the foregoing, the Committee may permit the optionee to transfer his Non-Qualified Stock Options to members of his immediate family, or to trusts for the benefit of such family members, or to partnerships in which such family members are the only partners, provided that the transferee agrees in writing with the Company to be bound by all of the terms and conditions of this Plan, the applicable option agreement and all insider trading rules of the Company.

#### SECTION 6. RESTRICTED STOCK AWARDS

(a) NATURE OF RESTRICTED STOCK AWARD. The Committee may grant Restricted Stock Awards to any participant. A Restricted Stock Award is an Award entitling the recipient to acquire, at no cost or for a purchase price determined by the Committee, shares of Stock subject to such restrictions and conditions as the Committee may determine at the time of grant ("Restricted Stock"). Conditions may be based on continuing employment (or other business relationship) and/or achievement of pre-established performance goals and objectives. In addition, a Restricted Stock Award may be granted to an employee by the Committee in lieu of a cash bonus due to such employee pursuant to any other plan of the Company.

##### (b) AUTOMATIC GRANT OF RESTRICTED STOCK TO INDEPENDENT DIRECTORS.

(i) Each Non-Employee Director who is serving as Director of the Company on the fifth business day after the Effective Date shall automatically be granted on such date 3,000 shares of Restricted Stock; provided, however, that a Non-Employee Director who has not served as a director of the Company or Avalon Properties, Inc. prior to the Effective Date shall automatically be granted on such date 2,000 shares of Restricted Stock. Except as otherwise provided in the award agreement, such shares of Restricted Stock shall vest twenty percent (20%) on the date of issuance and twenty percent (20%) on each of the first four anniversaries of the date of issuance.

(ii) Each Non-Employee Director who is serving as a Director of the Company on the fifth business day after each annual meeting of stockholders, beginning with the 1999 Annual Meeting of Stockholders, shall automatically be granted on such day 2,000 shares of Restricted Stock. Except as otherwise provided in the award agreement, such shares of Restricted Stock shall vest twenty percent (20%) on the date of issuance and twenty percent (20%) on each of the first four anniversaries of the date of issuance.

(iii) Each Non-Employee Director may, pursuant to the provisions of Section 7(b), elect to receive Deferred Stock instead of Restricted Stock provided in this Section 6(b). Any Deferred Stock granted in lieu of Restricted Stock shall be subject to the same vesting requirements applicable to the Restricted Stock.

(b) ACCEPTANCE OF AWARD. To the extent applicable, a participant who is granted a Restricted Stock Award shall have no rights with respect to such Award unless the participant shall have accepted the Award within 60 days (or such shorter time period as the Committee may specify) following the award date by making payment to the Company, if required, in cash, by certified or bank check or other instrument or form of payment acceptable to the Committee in an amount equal to the specified purchase price, if any, of the shares covered by the Award and by executing and delivering to the Company a written instrument that sets forth the terms and conditions of the Restricted Stock in such form as the Committee shall determine.

(c) RIGHTS AS A SHAREHOLDER. Upon complying with Section 6(b) above, a participant shall have all the rights of a shareholder with respect to the Restricted Stock including voting and dividend rights, subject to non-transferability restrictions and Company repurchase or forfeiture rights described in this Section 6 and subject to such other conditions contained in the written instrument evidencing the Restricted Stock Award. Unless the Committee shall otherwise determine, certificates evidencing shares of Restricted Stock shall remain in the possession of the Company until such shares are vested as provided in Section 6(e) below.

(d) RESTRICTIONS. Except as provided in an individual agreement or as otherwise determined by the Committee, shares of Restricted Stock may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of.

Except as provided in an individual agreement or as otherwise determined by the Committee, in the event of termination of employment (or other business relationship) by the Company and its Subsidiaries for any reason (including death, retirement, Disability, and for Cause), the Company shall have the right, at the discretion of the Committee, to repurchase shares of Restricted Stock with respect to which conditions have not lapsed at their purchase price, or to require forfeiture of such shares to the Company if acquired at no cost, from the participant or the participant's legal representative. The Company must exercise such right of repurchase or forfeiture not later than the 90th day following such termination of employment (or other business relationship), unless otherwise specified in the written instrument evidencing the Restricted Stock Award.

(e) VESTING OF RESTRICTED STOCK. The Committee at the time of grant shall specify the date or dates and/or the attainment of pre-established performance goals, objectives and other conditions on which the non-transferability of the Restricted Stock and the Company's right of repurchase or forfeiture shall lapse. Except as provided in Section 16, the vesting period for Restricted Stock shall be at least three years, except that in the case of Restricted Stock that becomes transferable and no longer subject to forfeiture upon the attainment of such pre-established performance goals, objectives and other conditions, the vesting period shall be at least one year. Subsequent to such date or dates and/or the attainment of such pre-established performance goals, objectives and other conditions, the shares on which all

restrictions have lapsed shall no longer be Restricted Stock and shall be deemed "vested."

(f) WAIVER, DEFERRAL AND REINVESTMENT OF DIVIDENDS. The written instrument evidencing the Restricted Stock Award may require or permit the immediate payment, waiver, deferral or investment of dividends paid on the Restricted Stock.

#### SECTION 7. DEFERRED STOCK AWARDS

(a) NATURE OF DEFERRED STOCK AWARDS. A Deferred Stock Award is an Award of phantom stock units to a participant, subject to restrictions and conditions as the Committee may determine at the time of grant. Conditions may be based on continuing employment (or other business relationship) and/or achievement of pre-established performance goals and objectives. The grant of a Deferred Stock Award is contingent on the participant executing the Deferred Stock Award agreement. The terms and conditions of each such agreement shall be determined by the Committee, and such terms and conditions may differ among individual Awards and participants. At the end of the deferral period, the Deferred Stock Award, to the extent vested, shall be paid to the participant in the form of shares of Stock. (b) Election to Receive Deferred Stock Awards in Lieu of Compensation. The Committee may, in its sole discretion, permit a participant, including a Non-Employee Director, to elect to receive a portion of the cash compensation or Restricted Stock Award otherwise due to such participant in the form of a Deferred Stock Award. Any such election shall be made in writing and shall be delivered to the Company no later than the date specified by the Committee and in accordance with rules and procedures established by the Committee. The Committee shall have the sole right to determine whether and under what circumstances to permit such elections and to impose such limitations and other terms and conditions thereon as the Committee deems appropriate.

(c) RIGHTS AS A STOCKHOLDER. During the deferral period, a participant shall have no rights as a stockholder; provided, however, that the participant may be credited with Dividend Equivalent Rights with respect to the phantom stock units underlying his Deferred Stock Award, subject to such terms and conditions as the Committee may determine.

(d) RESTRICTIONS. A Deferred Stock Award may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of during the deferral period.

(e) TERMINATION. Except as may otherwise be provided by the Committee either in the Award, employment or other agreement or, subject to Section 14 below, in writing after the Award agreement is issued, a participant's right in all Deferred Stock Awards that have not vested shall automatically terminate upon the participant's termination of employment (or cessation of business relationship) with the Company and its Subsidiaries for any reason.

#### SECTION 8. UNRESTRICTED STOCK AWARDS

The Committee may, in its sole discretion, grant (or sell at a purchase price determined by the Committee) an Unrestricted Stock Award to any participant which will entitle such

participant to receive shares of Stock free of any restrictions under the Plan ("Unrestricted Stock"). Unrestricted Stock Awards may be granted or sold as described in the preceding sentence in respect of past services or other valid

consideration, or in lieu of any cash compensation due to such participant.

#### SECTION 9. PERFORMANCE SHARE AWARDS

(a) NATURE OF PERFORMANCE SHARES. A Performance Share Award is an award entitling the recipient to acquire shares of Stock upon the attainment of specified performance goals. The Committee may make Performance Share Awards independent of or in connection with the granting of any other Award under the Plan. Performance Share Awards may be granted under the Plan to any participants, including those who qualify for awards under other performance plans of the Company. The Committee in its sole discretion shall determine whether and to whom Performance Share Awards shall be made, the performance goals applicable under each such Award, the periods during which performance is to be measured, and all other limitations and conditions applicable to the awarded Performance Shares; provided, however, that the Committee may rely on the performance goals and other standards applicable to other performance unit plans of the Company in setting the standards for Performance Share Awards under the Plan.

(b) RESTRICTIONS ON TRANSFER. Performance Share Awards and all rights with respect to such Awards may not be sold, assigned, transferred, pledged or otherwise encumbered.

(c) RIGHTS AS A SHAREHOLDER. A participant receiving a Performance Share Award shall have the rights of a shareholder only as to shares actually received by the participant under the Plan and not with respect to shares subject to the Award but not actually received by the participant. A participant shall be entitled to receive a stock certificate evidencing the acquisition of shares of Stock under a Performance Share Award only upon satisfaction of all conditions specified in the written instrument evidencing the Performance Share Award (or in a performance plan adopted by the Committee).

(d) TERMINATION. Except as may otherwise be provided by the Committee in the Award, employment or other agreement, a participant's rights in all Performance Share Awards shall automatically terminate upon the participant's termination of employment (or other business relationship) by the Company and its Subsidiaries for any reason (including death, Disability and for Cause).

(e) ACCELERATION, WAIVER, ETC. At any time prior to or upon the participant's termination of employment (or other business relationship) by the Company and its Subsidiaries, the Committee may in its sole discretion accelerate, waive or, subject to Section 14, amend any or all of the goals, restrictions or conditions imposed under any Performance Share Award.

#### SECTION 10. QUALIFIED PERFORMANCE-BASED AWARDS TO COVERED EMPLOYEES

Notwithstanding anything to the contrary contained herein, if any Restricted Stock Award, Deferred Stock Award or Performance Share Award granted to a Covered Employee is intended to qualify as "performance-based compensation" under Section 162(m) of the Code and the regulations promulgated thereunder (a "Performance-based Award"), such Award shall comply with the provisions set forth below:

(a) PERFORMANCE CRITERIA. The performance criteria used in performance goals governing Performance-based Awards granted to Covered Employees may include any or all of the following: (i) the Company's return on equity, assets, capital or investment, (ii) pre-tax or after-tax profit levels of the Company or any Subsidiary, a division, an operating unit or a business segment of the Company, or any combination of the foregoing; (iii) cash flow, funds from operations or similar measure; (iv) total shareholder return; (v) changes in the market price of the Stock; (vi) market share; or (vii) earnings per share.

(b) GRANT OF QUALIFIED PERFORMANCE-BASED AWARDS. With respect to each Performance-based Award granted to a Covered Employee, the Committee shall select, within the first 90 days of a Performance Cycle (or, if shorter, within the maximum period allowed under Section 162(m) of the Code) the performance criteria for such grant, and the achievement targets with respect to each performance criterion (including a threshold level of performance below which no amount will become payable with respect to such Award). Each Performance-based Award will specify the amount payable, or the formula for determining the amount payable, upon achievement of the various applicable performance targets. The performance criteria established by the Committee may be (but need not be) different for each Performance Cycle and different goals may be applicable to Performance-based Awards to different Covered Employees.

(c) PAYMENT OF QUALIFIED PERFORMANCE-BASED AWARDS. Following the completion of a Performance Cycle, the Committee shall meet to review and certify in writing whether, and to what extent, the performance criteria for the Performance Cycle have been achieved and, if so, to also calculate and certify in writing the amount of the Qualified Performance-based Awards earned for the Performance Cycle. The Committee shall then determine the actual size of each Covered Employee's Qualified Performance-based Award, and, in doing so, may reduce or eliminate the amount of the Qualified Performance-based Award for a Covered Employee if, in its sole judgment, such reduction or elimination is

appropriate.

(d) MAXIMUM AWARD PAYABLE. The maximum Qualified Performance-based Award payable to any one Covered Employee under the Plan for a Performance Cycle is 200,000 shares of Stock (subject to adjustment as provided in Section 3(b) hereof).

#### SECTION 11. DIVIDEND EQUIVALENT RIGHTS

(a) DIVIDEND EQUIVALENT RIGHTS. A Dividend Equivalent Right is an Award entitling the recipient to receive credits based on cash dividends that would have been paid on the shares of Stock specified in the Dividend Equivalent Right (or other award to which it

relates) if such shares had been issued to and held by the recipient. A Dividend Equivalent Right may be granted hereunder to any participant as a component of another Award or as a freestanding award. The terms and conditions of Dividend Equivalent Rights shall be specified in the grant. Dividend equivalents credited to the holder of a Dividend Equivalent Right may be paid currently or may be deemed to be reinvested in additional shares of Stock, which may thereafter accrue additional equivalents. Any such reinvestment shall be at Fair Market Value on the date of reinvestment or such other price as may then apply under a dividend reinvestment plan sponsored by the Company, if any. Dividend Equivalent Rights may be settled in cash or shares of Stock or a combination thereof, in a single installment or installments. A Dividend Equivalent Right granted as a component of another Award may provide that such Dividend Equivalent Right shall be settled upon exercise, settlement, or payment of, or lapse of restrictions on, such other award, and that such Dividend Equivalent Right shall expire or be forfeited or annulled under the same conditions as such other award. A Dividend Equivalent Right granted as a component of another Award may also contain terms and conditions different from such other award.

(b) INTEREST EQUIVALENTS. Any Award under this Plan that is settled in whole or in part in cash on a deferred basis may provide in the grant for interest equivalents to be credited with respect to such cash payment. Interest equivalents may be compounded and shall be paid upon such terms and conditions as may be specified by the grant.

(c) TERMINATION. Except as may otherwise be provided by the Committee in the Award, employment or other agreement, a participant's rights in all Dividend Equivalent Rights or interest equivalents shall automatically terminate upon the participant's termination of employment (or cessation of business relationship) with the Company and its Subsidiaries for any reason.

#### SECTION 12. TAX WITHHOLDING

(a) PAYMENT BY PARTICIPANT. Each participant shall, no later than the date as of which the value of an Award or of any Stock or other amounts received thereunder first becomes includable in the gross income of the participant for Federal income tax purposes, pay to the Company, or make arrangements satisfactory to the Committee regarding payment of, any Federal, state, or local taxes of any kind required by law to be withheld with respect to such income. The Company and its Subsidiaries shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the participant.

(b) PAYMENT IN SHARES. Subject to approval by the Committee, a participant may elect to have such tax withholding obligation satisfied, in whole or in part, by (i) authorizing the Company to withhold from shares of Stock to be issued pursuant to any Award a number of shares with an aggregate Fair Market Value (as of the date the withholding is effected) that would satisfy the withholding amount due, (ii) transferring to the Company shares of Stock owned by the participant with an aggregate Fair Market Value (as of the date the withholding is effected) that would satisfy the withholding amount due, or (iii) in a combination of (i) and (ii).

#### SECTION 13. TRANSFER, LEAVE OF ABSENCE, ETC.

For purposes of the Plan, the following events shall not be deemed a termination of employment (or other business relationship):

(a) a transfer to the employment (or other business relationship) of the Company from a Subsidiary or from the Company to a Subsidiary, or from one Subsidiary to another Subsidiary; or

(b) an approved leave of absence for military service or sickness, or for any other purpose approved by the Company, if the employee's right to re-employment (or other business relationship) is guaranteed either by a statute or by contract or under the policy pursuant to which the leave of absence was granted or if the Committee otherwise so provides in writing.

#### SECTION 14. AMENDMENTS AND TERMINATION

The Board may at any time amend or discontinue the Plan and the Committee may at any time amend or cancel any outstanding Award for the purpose of satisfying changes in law or for any other lawful purpose, but no such action shall (a) adversely affect rights under any outstanding Award without the holder's written consent or (b) without the prior approval of the Company's stockholders, reduce the exercise price of or otherwise reprice, including through replacement grants, any outstanding Stock Option. The Committee may also amend any outstanding Award that is not a Stock Option to reduce the exercise or purchase price in order to fulfill a legitimate corporate purpose (e.g., to retain a key employee) or to maintain the value of such outstanding Award under circumstances beyond the control of the Company's management, but in no event shall such amendments be made to outstanding Awards representing greater than 10% of the total number of shares of Stock authorized for issuance pursuant to the Plan. To the extent required by the Code to ensure that Options that have been granted hereunder as Incentive Stock Options continue to qualify as Incentive Stock Options, Plan amendments shall be subject to approval by the Company's stockholders.

#### SECTION 15. STATUS OF PLAN

With respect to the portion of any Award which has not been exercised and any payments in cash, Stock or other consideration not received by a participant, a participant shall have no rights greater than those of a general creditor of the Company unless the Committee shall otherwise expressly determine in connection with any Award or Awards. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the Company's obligations to deliver Stock or make payments with respect to Awards hereunder, provided that the existence of such trusts or other arrangements is consistent with the provision of the foregoing sentence.

#### SECTION 16. CHANGE OF CONTROL PROVISIONS

Notwithstanding anything in this Plan to the contrary, upon the occurrence of a Change of Control as defined in this Section 16:

(a) Each Stock Option shall automatically become fully exercisable.

(b) Restrictions and conditions on Restricted Stock Award, Deferred Stock Awards and Performance Share Awards shall automatically be deemed waived, and the recipients of such Awards shall become entitled to receipt of the Stock subject to such Awards unless the Committee shall otherwise expressly provide at the time of grant.

(c) "Change of Control" shall mean the occurrence of any one or more of the following events:

(i) Any individual, entity or group (a "Person") within the meaning of Sections 13(d) and 14(d) of the Act (other than the Company, any corporation, partnership, trust or other entity controlled by the Company (a "Subsidiary"), 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, becomes the "beneficial owner" (as such term is defined in Rule 13d-3 under the Act) of securities of the Company representing 30% or more of the combined voting power of the Company's then outstanding securities having the right to vote generally in an election of the Company's Board ("Voting Securities"), other than as a result of (A) an acquisition of securities directly from the Company or any Subsidiary or (B) an acquisition by any corporation pursuant to a reorganization, consolidation or merger if, following such reorganization, consolidation or merger the conditions described in clauses (A), (B) and (C) of subparagraph (iii) of this Section 16(c) are satisfied; or

(ii) Individuals who, as of the Effective Date, constitute the Company's Board (the "Incumbent Directors") cease for any reason to constitute at least a majority of the Board, provided, however, that any individual becoming a director of the Company subsequent to the Effective Date (excluding, for this purpose, (A) any such individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of members of the Board of Directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board, including by reason of agreement intended to avoid or settle any such actual or threatened contest or solicitation, and (B) any individual whose initial assumption of office is in connection with a reorganization, merger or consolidation, involving an unrelated entity), whose election or nomination for election by the Company's stockholders was approved by a vote of at least a majority of the persons then comprising Incumbent Directors shall for purposes of this Plan be considered an Incumbent Director;

(iii) The approval by the shareholders of a reorganization, merger or

consolidation of the Company, or, if consummation of such reorganization, merger or consolidation is subject, at the time of such approval by shareholders, to the consent of any government or governmental agency, obtaining such consent (either explicitly or implicitly by consummation), unless, following such reorganization, merger or consolidation, (A) more than 50% of, respectively, the then outstanding shares of common stock of the corporation resulting from such reorganization, merger or consolidation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors will beneficially own, directly or indirectly, by all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the outstanding Voting Securities immediately prior to such reorganization, merger or consolidation, (B) no Person (excluding the Company, any employee benefit plan (or related trust) of the Company, a Subsidiary or the corporation resulting from such reorganization, merger or consolidation or any subsidiary thereof, and any Person beneficially owning, immediately prior to such reorganization, merger or consolidation, directly or indirectly, 30% or more of the outstanding Voting Securities), will beneficially own, directly or indirectly, 30% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such reorganization, merger or consolidation or the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors, and (C) at least a majority of the members of the board of directors of the corporation resulting from such reorganization, merger or consolidation will have been members of the Incumbent Board at the time of the execution of the initial agreement providing for such reorganization, merger or consolidation;

(iv) Approval by the shareholders of the Company of a complete liquidation or dissolution of the Company; or

(v) The approval by the shareholders of the sale, lease, exchange or other disposition of all or substantially all of the assets of the Company, or, if consummation of such sale, lease, exchange or other disposition is subject, at the time of such approval by shareholders, to the consent of any government or governmental agency, obtaining such consent (either explicitly or implicitly by consummation), other than to a corporation, with respect to which following such sale, lease, exchange or other disposition (A) more than 50% of, respectively, the then outstanding shares of common stock of such corporation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors will beneficially own, directly or indirectly, by all or substantially all of the individuals and entities who were the beneficial owners of the outstanding Voting Securities immediately prior to such sale, lease, exchange or other disposition, (B) no Person (excluding the Company and any employee benefit plan (or related trust) of the Company or a Subsidiary or such corporation or a subsidiary thereof and any Person beneficially owning, immediately prior to such sale, lease, exchange or other disposition, directly or indirectly, 30% or more of the outstanding Voting Securities),

will beneficially own, directly or indirectly, 30% or more of, respectively, the then outstanding shares of common stock of such corporation and the combined voting power of the then outstanding voting securities of such corporation entitled to vote generally in the election of directors and (C) at least a majority of the members of the board of directors of such corporation will have been members of the Incumbent Board at the time of the execution of the initial agreement or action of the Board providing for such sale, lease, exchange or other disposition of assets of the Company.

Notwithstanding the foregoing, a "Change of Control" shall not be deemed to have occurred for purposes of this Agreement solely as the result of an acquisition of securities by the Company which, by reducing the number of shares of Voting Securities outstanding, increases 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 this sentence shall thereafter become the beneficial owner of any additional shares of 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 this Agreement.

#### SECTION 17. GENERAL PROVISIONS

(a) NO DISTRIBUTION; COMPLIANCE WITH LEGAL REQUIREMENTS. The Committee may require each person acquiring shares pursuant to an Award to represent to and agree with the Company in writing that such person is acquiring the shares without a view to distribution thereof.

No shares of Stock shall be issued pursuant to an Award until all applicable securities law and other legal and stock exchange requirements have been satisfied. The Committee may require the placing of such stop-orders and

restrictive legends on certificates for Stock and Awards as it deems appropriate.

(b) DELIVERY OF STOCK CERTIFICATES. Delivery of stock certificates to participants under this Plan shall be deemed effected for all purposes when the Company or a stock transfer agent of the Company shall have delivered such certificates in the United States mail, addressed to the participant, at the participant's last known address on file with the Company.

(c) OTHER COMPENSATION ARRANGEMENTS; NO EMPLOYMENT RIGHTS. Nothing contained in this Plan shall prevent the Board from adopting other or additional compensation arrangements, including trusts, subject to stockholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases. The adoption of the Plan and the grant of Awards do not confer upon any employee any right to continued employment with the Company or any Subsidiary.

#### SECTION 18. EFFECTIVE DATE OF PLAN

This Plan was amended and restated as of April 13, 1998 and subsequently amended on

July 24, 1998.

#### SECTION 19. GOVERNING LAW

This Plan shall be governed by Maryland law except to the extent such law is preempted by federal law.

DATE OF APPROVAL OF INITIAL PLAN BY SHAREHOLDERS:	February 15, 1994
DATE OF APPROVAL OF FIRST AMENDED AND RESTATED PLAN BY BOARD OF DIRECTORS:	August 28, 1996
DATE OF APPROVAL OF FIRST AMENDED AND RESTATED PLAN BY SHAREHOLDERS:	April 25, 1997
DATE OF APPROVAL OF SECOND AMENDED AND RESTATED PLAN BY BOARD OF DIRECTORS:	February 26, 1998
DATE OF APPROVAL OF THIRD AMENDED AND RESTATED PLAN BY BOARD OF DIRECTORS:	April 13, 1998
DATE OF APPROVAL OF THIRD AMENDED AND RESTATED PLAN BY SHAREHOLDERS:	June 4, 1998
DATE OF APPROVAL OF AMENDMENTS TO THIRD AMENDED AND RESTATED PLAN BY BOARD OF DIRECTORS:	July 24, 1998

## EXHIBIT 12.1

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

Year Ended December 31, 1993	Nine months Ended September 30, 1998	Year Ended December 31, 1997	Year Ended December 31, 1996	Year Ended December 31, 1995	March 17- December 31, 1994	January 1- March 16, 1994
<S> <C> Net Operating Income \$ (447)	\$62,721	\$38,941	\$19,626	\$11,460	\$ 7,486	\$ (716)
(Less) Nonrecurring item: Gain on sale \$ --	\$ (40)	\$ --	\$ --	\$ (2,412)	\$ --	\$ --
(Plus) Extraordinary item: Unamortized loan fee write-off \$ --	\$ --	\$ --	\$ 511	\$ --	\$ --	\$ --
(Plus) Fixed charges: Interest expense \$10,932	\$35,748	\$14,113	\$14,276	\$11,472	\$ 4,782	\$2,358
Interest capitalized	11,372	6,985	2,567	3,641	2,096	--
Debt cost amortization	504	505	667	1,278	241	80
Preferred dividend	16,292	7,480	4,264	917	--	--
Total fixed charges (1) \$11,150	\$63,916	\$29,083	\$21,774	\$17,308	\$ 7,119	\$2,438
(Less): Interest capitalized \$ --	\$11,372	\$ 6,985	\$ 2,567	\$ 3,641	\$ 2,096	\$ --
Preferred dividend --	16,292	7,480	4,264	917	--	--
Adjusted earnings (2) \$10,703	\$98,933	\$53,559	\$35,080	\$21,798	\$12,509	\$1,722
Ratio (2 divided by 1) 0.96	1.55	1.84	1.61	1.26	1.76	0.71

AVALONBAY COMMUNITIES, INC.  
RATIOS OF EARNINGS TO FIXED CHARGES

Year Ended December 31, 1993	Nine months Ended September 30, 1998	Year Ended December 31, 1997	Year Ended December 31, 1996	Year Ended December 31, 1995	March 17- December 31, 1994	January 1- March 16, 1994
<TABLE> <CAPTION>						

<S>	<C>	<C>	<C>	<C>	<C>	<C>
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Net Operating Income	\$62,721	\$38,941	\$19,626	\$11,460	\$ 7,486	\$ (716)
\$ (447)						
(Less) Nonrecurring item:						
Gain on sale	\$ (40)	\$ --	\$ --	\$ (2,412)	\$ --	\$ --
\$ --						
(Plus) Extraordinary item:						
Unamortized loan						
fee write-off	\$ --	\$ --	\$ 511	\$ --	\$ --	\$ --
\$ --						
(Plus) Fixed charges:						
Interest expense	\$35,748	\$14,113	\$14,276	\$11,472	\$ 4,782	\$2,358
\$10,932						
Interest capitalized	11,372	6,985	2,567	3,641	2,096	--
--						
Debt cost amortization	504	505	667	1,278	241	80
218						
-----	-----	-----	-----	-----	-----	-----
Total fixed charges (1)	\$47,624	\$21,603	\$17,510	\$16,391	\$ 7,119	\$2,438
\$11,150						
(Less) :						
Interest capitalized	\$11,372	\$ 6,985	\$ 2,567	\$ 3,641	\$ 2,096	\$ --
\$ --						
Adjusted earnings (2)	\$98,933	\$53,559	\$35,080	\$21,798	\$12,509	\$1,722
\$10,703						
-----	-----	-----	-----	-----	-----	-----
Ratio (2 divided by 1)	2.08	2.48	2.00	1.33	1.76	0.71
0.96	=====	=====	=====	=====	=====	=====
=====						

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<DEPRECIATION>	120,448
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<INTEREST-EXPENSE>	18,385
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