ASSOCIATED ESTATES REALTY CORP
Form 10-Q
August 04, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from ____________ to ______

Commission File Number 1-12486

Associated Estates Realty Corporation
(Exact name of registrant as specified in its charter)

OHIO	**34-1747603**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

1 AEC Parkway, Richmond Hts., Ohio 44143-1467
(Address of principal executive offices)

(216) 261-5000
(Registrant's telephone number, including area code)

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 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 90 days. Yes [x] No [ ]

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [ ]

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

The number of shares outstanding as of July 27, 2009 was 16,705,327 shares.

ASSOCIATED ESTATES REALTY CORPORATION

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PART 1. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

housands, except share amounts)	June 30, 2009	Decemb 31, 2008
ASSETS		
al estate assets		
nd	$ 107,815	$ 110,2
ldings and improvements	790,862	812,4
niture and fixtures	28,899	29,3
	927,576	951,9
ss: accumulated depreciation	(286,246)	(280,5
	641,330	671,4
nstruction in progress	3,927	7
al estate associated with property held for sale, net	-	1,6
al estate, net	645,257	673,8
sh and cash equivalents	4,321	3,5
stricted cash	7,862	6,8
counts and notes receivable, net		
nts	1,056	1,3
liates	455	6
ner	2,756	1,8
odwill	1,725	1,7
ner assets, net	7,962	10,1
tal assets	$ 671,394	$ 699,8
LIABILITIES AND SHAREHOLDERS' EQUITY		
rtgage notes payable	$ 489,135	$ 510,2
secured revolving credit facility	10,000	21,5
secured debt	25,780	25,7
al debt	524,915	557,4
counts payable, accrued expenses and other liabilities	25,202	26,2
idends payable	2,979	2,9
sident security deposits	3,211	3,3
crued interest	2,251	2,4
tal liabilities	558,558	592,4
ncontrolling redeemable interest	1,829	1,8
areholders' equity		
eferred shares, without par value; 9,000,000 shares authorized; 8.70% Class B Series II cumulative eemable, $250 per share liquidation preference, 232,000 issued and 193,050 standing at June 30, 2009 and December 31, 2008, respectively	48,263	48,2
mmon shares, without par value, $.10 stated value; 41,000,000 authorized; 22,995,763 issued and 705,327 and 16,556,221 outstanding at June 30, 2009 and December 31, 2008, respectively	2,300	2,3
d-in capital	282,480	282,5
cumulated distributions in excess of accumulated net income	(155,560)	(159,5
cumulated other comprehensive loss	(2,150)	(2,8
ss: Treasury shares, at cost, 6,290,436 and 6,439,542 shares		

June 30, 2009 and December 31, 2008, respectively	(64,326)	(64,9
tal shareholders' equity	111,007	105,6
tal liabilities and shareholders' equity	$ 671,394	$ 699,8

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

ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(In thousands, except per share amounts)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenue				
Property revenue	$ 32,138	$ 32,166	$ 63,962	$ 62,390
Management and service company revenue:				
Fees, reimbursements and other	357	397	825	950
Painting services	253	188	350	325
Total revenue	32,748	32,751	65,137	63,665
Expenses				
Property operating and maintenance	13,812	13,711	27,566	26,377
Depreciation and amortization	8,587	9,167	17,795	17,421
Direct property management and service company expense	348	398	708	793
Painting services	322	277	535	520
General and administrative	3,165	3,183	6,304	6,711
Total expenses	26,234	26,736	52,908	51,822
Operating income	6,514	6,015	12,229	11,843
Interest income	18	92	33	106
Interest expense	(8,736)	(8,784)	(16,919)	(17,611)
(Loss) income before gain on insurance recoveries, equity in net loss of joint ventures and income from discontinued operations	(2,204)	(2,677)	(4,657)	(5,662)
Gain on insurance recoveries	544	-	544	-
Equity in net loss of joint ventures	-	(23)	-	(45)
(Loss) income from continuing operations	(1,660)	(2,700)	(4,113)	(5,707)
Income from discontinued operations:				
Operating income (loss)	267	241	569	(1,003)
Gain on disposition of properties	13,135	2,293	15,413	45,203
Income from discontinued operations	13,402	2,534	15,982	44,200
Net income (loss)	11,742	(166)	11,869	38,493
Net loss attributable to noncontrolling redeemable interest	(14)	(13)	(27)	(27)
Net income (loss) attributable to AERC	11,728	(179)	11,842	38,466
Preferred share dividends	(1,049)	(1,201)	(2,100)	(2,402)
Allocation to participating securities	(429)	-	(482)	(768)
Net income (loss) applicable to common shares	$ 10,250	$ (1,380)	$ 9,260	$ 35,296
Earnings per common share - basic and diluted:				
(Loss) income from continuing operations applicable to common shares	$ (0.16)	$ (0.24)	$ (0.38)	$ (0.50)
Income from discontinued operations	0.78	0.15	0.94	2.68
Net income (loss) applicable to common shares	$ 0.62	$ (0.09)	$ 0.56	$ 2.18
Dividends declared per common share	$ 0.17	$ 0.17	$ 0.34	$ 0.34
Weighted average number of common shares outstanding - basic and diluted	16,528	16,200	16,481	16,184

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

ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30,	
(In thousands)	2009	2008
Cash flow from operations:		
Net income	$ 11,869	$ 38,493
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization (including discontinued operations)	18,269	18,764
Loss on fixed asset replacements write-off	5	38
Gain on disposition of properties	(15,413)	(45,203)
Gain on insurance recoveries	(544)	-
Amortization of deferred financing costs and other	624	664
Share-based compensation	1,049	996
Equity in net loss of joint ventures	-	45
Net change in assets and liabilities:		
Accounts and notes receivable	408	1,505
Accounts payable and accrued expenses	(974)	(4,926)
Other operating assets and liabilities	1,011	858
Restricted cash	(989)	(150)
Total adjustments	3,446	(27,409)
Net cash flow provided by operations	15,315	11,084
Cash flow from investing activities:		
Recurring fixed asset additions	(3,872)	(3,756)
Revenue enhancing/non-recurring fixed asset additions	(691)	(360)
Acquisition fixed asset additions	(1,514)	(34,310)
Net proceeds from disposition of operating properties	32,714	88,357
Net cash flow provided by investing activities	26,637	49,931
Cash flow from financing activities:		
Principal amortization payments on mortgage notes payable	(1,421)	(1,407)
Principal repayments of mortgage notes payable	(72,096)	(42,851)
Payment of debt procurement costs	(686)	(601)
Proceeds from mortgage notes obtained	52,450	-
Revolver borrowings	95,400	77,850
Revolver repayments	(106,900)	(84,750)
Common share dividends paid	(5,625)	(5,534)
Preferred share dividends paid	(2,100)	(2,402)
Operating partnership distributions paid	(27)	(27)
Purchase of preferred and/or treasury shares	(177)	(217)
Net cash flow used for financing activities	(41,182)	(59,939)
Increase in cash and cash equivalents	770	1,076
Cash and cash equivalents, beginning of period	3,551	1,549
Cash and cash equivalents, end of period	$ 4,321	$ 2,625
Supplemental disclosure of cash flow information:		
Dividends declared but not paid	$ 2,979	$ 2,784
Cash paid for interest	16,544	20,077
Net change in accounts payable/receivable related to fixed asset additions	(287)	1,345

Assumption of debt in connection with property acquisition	-	45,002

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

ASSOCIATED ESTATES REALTY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

Except as the context otherwise requires, all references to "we," "our," "us," "AERC" and the "Company" in this report collectively refer to Associated Estates Realty Corporation and its consolidated subsidiaries.

Business

We are a self-administered and self-managed equity real estate investment trust ("REIT") specializing in multifamily property management, advisory, development, acquisition, disposition, operation and ownership activities. Our primary source of income is rental revenue. Additional income is derived primarily from property and asset management fees.

As of June 30, 2009, our property portfolio consisted of: (i) 48 apartment communities containing 12,108 units in seven states that are wholly owned, either directly or indirectly through subsidiaries; (ii) two apartment communities that we manage for third party owners consisting of 343 units; and (iii) a 186-unit apartment community and a commercial property containing approximately 145,000 square feet that we asset manage for a government sponsored pension fund.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and applicable rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting only of normal and recurring adjustments considered necessary for a fair statement, have been included. The reported results of operations are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the audited financial statements and accompanying notes in our Annual Report on Form 10-K for the year ended December 31, 2008. We have evaluated all subsequent events through August 4, 2009, which is the date the financial statements were issued.

Noncontrolling Redeemable Interest

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51" ("SFAS 160"), which establishes and expands accounting and reporting standards for minority interests in a subsidiary and the deconsolidation of a subsidiary. SFAS 160 also requires minority interests to be recharacterized as noncontrolling interests. SFAS 160 was effective for us January 1, 2009, and as such, the operating partnership minority interest reported in our Annual Report on Form 10-K for the year ended December 31, 2008, has been recharacterized as "Noncontrolling redeemable interest" for all periods presented.

Share-Based Compensation

During the three and six months ended June 30, 2009, we recognized total share-based compensation cost of $ 450,000 and $1.0 million, respectively, in "General and administrative expense" in the Consolidated Statements of Operations. During the three and six months ended June 30, 2008, we recognized total share-based compensation cost of $429,000 and $900,000, respectively, in "General and administrative expense."

Stock Options. During the six months ended June 30, 2009, there were 8,000 options awarded and no options exercised. There were no stock options awarded or exercised during the six months ended June 30, 2008. We use the Black-Scholes option pricing model to estimate the fair value of share-based awards. The weighted average Black-Scholes assumptions and fair value for options awarded during the six months ended June 30, 2009, were as follows:

Expected volatility	36.5 %
Risk-free interest rate	2.0 %
Expected life of options (in years)	7.2
Dividend yield	12.2 %
Grant-date fair value	$ 0.44

The expected volatility was based upon the historical volatility of our weekly share closing prices over a period equal to the expected life of the options granted. The risk-free interest rate used was the yield from U.S. Treasury bonds on the date of grant with a maturity approximating the expected life of the options. The expected life of the options was derived using our historical experience for similar awards. The dividend yield was derived using our annual dividend rate as a percentage of the price of our shares on the date of grant.

Restricted Shares. The following table represents restricted share activity for the six months ended June 30, 2009:

	Number of Shares	Weighted Average Grant-Date Fair Value
Nonvested at beginning of period	189,867	$ 11.33
Granted	184,070	$ 5.37
Vested	110,445	$ 9.21
Forfeited	1,672	$ 9.59
Nonvested at end of period	261,820	$ 9.75

At June 30, 2009, there was $2.5 million of unrecognized compensation cost related to nonvested restricted share awards that we expect to recognize over a weighted average period of 2.2 years. Pursuant to the terms of the Company's Elective Deferred Compensation Program, certain of our officers elected to defer the receipt of all or a portion of the restricted shares granted them during the six months ended June 30, 2009.

Derivative Instruments and Hedging Activities

Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS 161"), amends and expands the disclosure requirements of FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments. SFAS 133, as amended and interpreted, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by SFAS 133, we record all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in earnings. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. Hedge ineffectiveness is measured by comparing the changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. For derivatives not designated as hedges, changes in fair value are recognized in earnings.

We do not use derivatives for trading or speculative purposes. Further, we have a policy of only entering into contracts with major financial institutions based upon their credit ratings and other factors. When viewed in conjunction with the underlying and offsetting exposure that the derivatives are designed to hedge, we have not sustained a material loss from these hedges.

We have utilized interest rate swaps and caps to add stability to interest expense and to manage our exposure to interest rate movements. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. Interest rate caps designated as cash flow hedges involve the receipt of variable-rate amounts if interest rates rise above a certain level in exchange for an up front premium.

Interest Rate Hedge Activity: During 2007, we executed two interest rate swaps to hedge the cash flows of existing variable rate debt. No hedge ineffectiveness on these cash flow hedges was recognized during the six months ended June 30, 2009. Amounts reported in "Accumulated other comprehensive loss" related to derivatives will be reclassified to "Interest expense" as interest payments are made on our variable-rate debt. During the next twelve months, we estimate that approximately $2.0 million will be reclassified from "Accumulated other comprehensive loss" as an increase to "Interest expense." The following table presents the notional amounts of the swaps as of June 30, 2009:

(Dollar amount in thousands) Interest Rate Derivative	Number of Instruments	Notional Amounts
Interest rate swaps	2	$ 63,000

The following table presents the fair value of our derivative financial instruments as well as their classification on the Consolidated Balance Sheets (see Note 7 for additional information regarding the fair value of these derivative instruments):

Fair Value of Derivative Instruments

	Liability Derivatives			
	As of June 30, 2009		As of December 31, 2008	
(In thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under SFAS 133:				
Interest rate swaps	Accounts payable, accrued expenses and other liabilities	$ 2,150	Accounts payable, accrued expenses and other liabilities	$ 2,899

The following table presents the effect of our derivative financial instruments on the Consolidated Statements of Income (see Note 5 for additional information regarding the effect of these derivative instruments on total comprehensive income):

The Effect of Derivative Instruments on the Consolidated Statements of Operations

(In thousands)	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated OCI into	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	
Derivatives in SFAS 133 Cash Flow Hedging Relationships	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009	Income (Effective Portion)	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
Interest rate swaps	$ (487)	$ (215)	Interest expense	$ 546	$ 964

We have agreements with each of our derivative counterparties that contain a provision where if we either default or are capable of being declared in default on any of our indebtedness, then such counterparty can declare us to be in default on our derivative obligations.

We have an agreement with a derivative counterparty that incorporates the loan covenant provisions of our indebtedness with a lender affiliate of the derivative counterparty. Failure to comply with the loan covenant provisions would result in our being in default on any derivative instrument obligations covered by the agreement.

As of June 30, 2009, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $2.6 million. As of June 30, 2009, we have not posted any collateral related to these agreements. If we had breached any of these provisions at June 30, 2009, we would have been required to settle our obligations under the agreements at their termination value of $2.6 million.

Classification of Fixed Asset Additions

We define recurring fixed asset additions to a property to be capital expenditures made to replace worn out assets to maintain the property's value. Revenue enhancing/non-recurring fixed asset additions are defined as capital expenditures that increase the value of the property and/or enable us to increase rents. Acquisition fixed asset additions are defined as capital expenditures for the purchase or construction of new properties to be added to our portfolio, or fixed asset additions identified at the time of purchase that are not made until subsequent periods.

Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 presentation.

2. DEVELOPMENT AND DISPOSITION ACTIVITY

Development Activity

We recently commenced construction of a 60-unit expansion of the existing 240-unit River Forest apartment community located in the Richmond, Virginia metropolitan market area. Construction in progress related to this development was $1.6 million at June 30, 2009. We capitalize interest costs on funds used in construction, real estate taxes and insurance from the commencement of development activity through the time the property is ready for leasing. Capitalized interest costs for the three and six months ended June 30, 2009 were $25,000.

Disposition Activity

We report the results of operations and gain/loss related to the sale of real estate assets as discontinued operations in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). Real estate assets that are classified as held for sale are also reported as discontinued operations. We classify properties as held for sale when all significant contingencies surrounding the closing have been resolved. In most transactions, these contingencies are not satisfied until the actual closing of the transaction. Interest expense included in discontinued operations is limited to interest on mortgage debt specifically associated with properties sold or classified as held for sale.

On June 17, 2009, we completed the sale of Chestnut Ridge apartments, a 468-unit property located in Pittsburgh, Pennsylvania. The sales price was $29.8 million and we recorded a gain of $13.1 million.

On January 9, 2009, we completed the sale of Bay Club apartments, a 96-unit property located in Northeast Ohio. The sales price was $4.1 million and we recorded a gain of $2.3 million.

"Income from discontinued operations" in the accompanying Consolidated Statements of Operations for the three and six months ended June 30, 2009 and 2008, includes the operating results for the properties sold in 2009 and prior years, as well as the gains recognized on properties sold during each reporting period. The following table summarizes "Income from discontinued operations:"

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2009	2008	2009	2008
REVENUE				
Property revenue	$ 925	$ 1,339	$ 2,021	$ 6,559
EXPENSES				
Property operating and maintenance	442	594	948	3,387
Depreciation and amortization	216	306	474	1,354
Total expenses	658	900	1,422	4,741
Operating income	267	439	599	1,818
Interest income	-	-	1	5
Interest expense (1)	-	(198)	(31)	(2,826)
Gain on disposition of properties	13,135	2,293	15,413	45,203
Income from discontinued operations	$ 13,402	$ 2,534	$ 15,982	$ 44,200

(1) Interest expense for the six months ended June 30, 2008 includes $2.0 million of defeasance and other prepayment costs.

3. DEBT

The following table identifies our total debt outstanding and weighted average interest rates:

(Dollar amounts in thousands)	June 30, 2009 Balance Outstanding	Weighted Average Interest Rate	December 31, 2008 Balance Outstanding	Weighted Average Interest Rate
FIXED RATE DEBT				
Mortgages payable - CMBS	$ 116,501	7.7%	$ 154,685	7.7%
Mortgages payable - other (1)	337,524	5.8%	320,516	5.8%
Unsecured borrowings	25,780	7.9%	25,780	7.9%
Total fixed rate debt	479,805	6.4%	500,981	6.5%
VARIABLE RATE DEBT				
Mortgages payable	35,110	4.8%	35,000	1.6%
Unsecured revolving credit facility	10,000	2.0%	21,500	3.7%
Total variable rate debt	45,110	4.1%	56,500	2.4%
TOTAL DEBT	$ 524,915	6.2%	$ 557,481	6.1%

(1) Includes $63.0 million of variable rate debt swapped to fixed as of June 30, 2009 and December 31, 2008.

Mortgage Notes Payable

The following table provides information on loans repaid at par as well as loans obtained during 2009:

(Dollar amounts in thousands)	Loans Repaid			Loans Obtained			
Property	Amount	Rate		Amount	Rate		Maturity
Saw Mill Village	$ 11,119	7.5%		$ 17,220	6.0%		April 2016
Georgetown Park	16,000	1.6%	(1)	-	N/A		N/A
Chestnut Ridge	19,000	1.4%	(1)	-	N/A		N/A
Oaks at Hampton	25,977	7.5%		-	N/A		N/A
Steeplechase at Shiloh	-	N/A		13,790	4.8%	(1)	March 2016
Courtney Chase	-	N/A		21,440	4.8%	(1)	March 2016
	$ 72,096	4.6%	(2)	$ 52,450	5.2%	(2)	

(1) Denotes variable rate loans. Variable rates on loans obtained are as of June 30, 2009.
(2) Represents weighted average interest rate for the loans listed.

During 2008, 2007 and 2006, we defeased 21 loans. These loans were defeased pursuant to the terms of the underlying loan documents. Also, in accordance with SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," we removed those financial assets and the mortgage loans from our financial records. All risk of loss associated with these defeasances have been transferred from us to the successor borrower and any ongoing relationship between the successor borrower and us was deemed inconsequential at the time of completion of the respective transfers. However, we subsequently learned that certain defeasance transactions, completed prior to June 2007, could enable us to receive a refund of a portion of the costs incurred in connection with the transaction. During the first quarter of 2009, we received refunds of $563,000, which were included as a reduction to interest expense. It is possible that we may receive additional refunds in the future, however such amounts cannot be estimated due to the uncertainty of future payments, and we believe that any amounts we may receive would not be material to our consolidated financial position, cash flow or results of operations.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

In June 1998, we recorded goodwill in connection with the MIG Realty Advisors, Inc. merger. We have a policy of completing our annual review of goodwill during the first quarter of each year and more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. The review that was completed during the three months ended March 31, 2009 determined that goodwill was not impaired and no other events have occurred which would require that goodwill be reevaluated and as such there were no changes to the carrying value of goodwill as of June 30, 2009. In performing this analysis, we use a multiple of revenues to the range of potential alternatives and assign a probability of the various alternatives under consideration by management. Should the estimates used to determine alternatives or the probabilities of the occurrence thereof change, impairment may result which could materially impact our results of operations for the period in which it is recorded.

Intangible Assets

In accordance with SFAS 141(R), "Business Combinations," we allocate a portion of the total purchase price of a property acquisition to any intangible assets identified, such as existing leases and tenant relationships. The intangible assets are amortized over the remaining lease terms or estimated life of the tenant relationship, which is approximately 12 to 16 months. Due to the short term nature of residential leases, we believe that existing lease rates approximate market rates; therefore, no allocation is made for above/below market leases.

5. SHAREHOLDERS' EQUITY

The following table provides a reconciliation of activity in Shareholders' equity accounts:

(In thousands)	Six Months Ended June 30, 2009	Twelve Months Ended December 31, 2008
Noncontrolling redeemable interest		
Balance outstanding at beginning of period	$ 1,829	$ 1,829
Balance outstanding at end of period	$ 1,829	$ 1,829
Preferred shares		
Balance outstanding at beginning of period	$ 48,263	$ 55,213
Purchase and retirement of Class B Cumulative Redeemable Preferred Shares	-	(6,950)
Balance outstanding at end of period	48,263	48,263
Common shares (at $.10 stated value)		
Balance outstanding at beginning and end of period	2,300	2,300
Paid-in capital		
Balance outstanding at beginning of period	282,501	281,152
Share based compensation	(21)	1,294
Shares issued from treasury for stock option exercises	-	(88)
Purchase and retirement of Class B Cumulative Redeemable Preferred Shares	-	143
Balance outstanding at end of period	282,480	282,501
Accumulated distributions in excess of accumulated net income		
Balance outstanding at beginning of period	(159,595)	(180,436)
Net income	11,869	34,680
Net loss attributable to noncontrolling redeemable interest	(27)	(53)
Share based compensation	2	8
Purchase and retirement of Class B Cumulative Redeemable Preferred Shares	-	2,146
Common share dividends declared	(5,709)	(11,285)
Preferred share dividends declared	(2,100)	(4,655)
Balance outstanding at end of period	(155,560)	(159,595)
Accumulated other comprehensive loss		
Balance outstanding at beginning of period	(2,899)	(1,050)
Change in fair value of hedge instruments	749	(1,849)
Balance outstanding at end of period	(2,150)	(2,899)
Treasury shares (at cost)		
Balance outstanding at beginning of period	(64,949)	(67,393)
Purchase of common shares	(178)	(221)
Share based compensation	801	734
Shares issued from treasury for stock option exercises	-	1,931
Balance outstanding at end of period	(64,326)	(64,949)
Total Shareholders' Equity	$ 111,007	$ 105,621

The following table identifies total comprehensive income:

	Six Months Ended June 30,	
(In thousands)	2009	2008
Comprehensive income:		
Net income attributable to AERC	$ 11,842	$ 38,466
Other comprehensive income (loss):		
Change in fair value of hedge instruments	749	(280)
Total comprehensive income	$ 12,591	$ 38,186

6. EARNINGS PER SHARE

Earnings per share ("EPS") have been computed pursuant to the provisions of SFAS 128, "Earnings per Share." In June 2008, the Financial Accounting Standards Board issued Staff Position FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities," which was effective for us January 1, 2009. This FSP clarifies that nonvested awards containing nonforfeitable dividend rights are participating securities and are therefore required to be included in the computations of basic and diluted earnings per share. This FSP requires retrospective application to all periods presented.

There were 1.4 million and 1.6 million options to purchase common shares outstanding at June 30, 2009 and 2008, respectively. The dilutive effect of these options were not included in the calculation of diluted earnings per share for the periods presented as their inclusion would be antidilutive to the net loss applicable to common shares from continuing operations.

The exchange of operating partnership noncontrolling interests into common shares was also not included in the computation of diluted EPS because we intend to settle these OP units in cash.

The following table presents a reconciliation of basic and diluted earnings per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2009	2008	2009	2008
Numerator - basic and diluted:				
(Loss) income from continuing operations	$ (1,660)	$		