ASSOCIATED ESTATES REALTY CORP
Form 10-Q
November 10, 2003

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 September 30, 2003

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)
5025 Swetland Court, Richmond Hts., Ohio	44143-1467
(Address of principal executive offices)	(Zip Code)

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

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 is an accelerated filer

as identified in Rule 12B-2 of the Act. Yes [x] No [ ]

Number of shares outstanding as of November 4, 2003: 19,478,681 shares

ASSOCIATED ESTATES REALTY CORPORATION

INDEX

PART I - FINANCIAL INFORMATION		Page
ITEM 1	Consolidated Financial Statements (Unaudited)	
	Consolidated Balance Sheets as of	
	September 30, 2003 and December 31, 2002	3
	Consolidated Statements of Operations for the three and nine	
	month periods ended September 30, 2003 and 2002	4
	Consolidated Statement of Shareholders' Equity for the nine	5
	month period ended September 30, 2003	
	Consolidated Statements of Cash Flows for the nine	
	month periods ended September 30, 2003 and 2002	6
	Notes to Financial Statements	7
ITEM 2	Management's Discussion and Analysis of Financial	18
	Condition and Results of Operations	
ITEM 3	Quantitative and Qualitative Disclosures About Market Risk	25
ITEM 4	Controls and Procedures	25
PART II - OTHER INFORMATION		
ITEM 1	Legal Proceedings	26
ITEM 2	Changes in Securities	26
ITEM 3	Defaults Upon Senior Securities	26
ITEM 4	Submission of Matters to a Vote of Security Holders	27
ITEM 5	Other Information	27
ITEM 6	Exhibits and Reports on Form 8-K	27
SIGNATURES		30

Index

ASSOCIATED ESTATES REALTY CORPORATION

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

September 30,	December 31,

	2003	2002
(In thousands, except share amounts)		
ASSETS		
Real estate assets		
Land	$ 91,368	$ 90,240
Buildings and improvements	791,868	787,052
Furniture and fixtures	34,072	33,248
	917,308	910,540
Less: accumulated depreciation	(257,753)	(233,350)
	659,555	677,190
Construction in progress	6,628	5,868
Real estate, net	666,183	683,058
Cash and cash equivalents	3,450	900
Restricted cash	10,100	13,326
Accounts and notes receivable		
Rents	776	904
Affiliates and joint ventures	5,826	6,013
Other	2,033	3,660
Investments in joint ventures, net	10,257	11,589
Goodwill	1,725	1,725
Intangible and other assets, net	13,325	14,128
	$ 713,675	$ 735,303
LIABILITIES AND SHAREHOLDERS' EQUITY		
Secured debt	$ 545,034	$ 540,393
Unsecured debt	105	105
Total indebtedness	545,139	540,498
Accounts payable and accrued expenses	25,585	25,325
Dividends payable	3,311	3,310
Resident security deposits	4,256	4,054
Funds held on behalf of managed properties		
Affiliates and joint ventures	4,006	3,648
Other	1,131	1,785
Accrued interest	2,556	2,846
Total liabilities	585,984	581,466
Operating partnership minority interest	2,172	2,972
Commitments and contingencies (Note 11)	-	-
Shareholders' equity		
Preferred shares, Class A cumulative, without par value;		
3,000,000 authorized; 225,000 issued and outstanding	56,250	56,250
Common shares, without par value, $.10 stated value; 50,000,000		
authorized; 22,995,763 issued and 19,478,894 and 19,473,576 out-		
standing at September 30, 2003 and December 31, 2002, respectively	2,300	2,300
Paid-in capital	279,027	279,039
Accumulated distributions in excess of accumulated net income	(180,283)	(154,798)
Less: Treasury shares, at cost, 3,516,869 and 3,522,187 shares		
at September 30, 2003 and December 31, 2002, respectively	(31,775)	(31,926)

Total shareholders' equity	125,519	150,865
	$ 713,675	$ 735,303

The accompanying notes are an integral part

of these consolidated financial statements

Index

ASSOCIATED ESTATES REALTY CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
(In thousands, except per share amounts)	2003	2002	2003	2002
Revenues				
Rental	$ 34,811	$ 35,124	$ 102,345	$ 102,917
Property management fees and reimbursements	3,024	4,874	8,952	15,032
Asset management fees	470	715	1,343	2,190
Painting services	594	593	1,417	1,233
Other	873	890	2,670	2,662
Total revenues	39,772	42,196	116,727	124,034
Expenses				
Property operating and maintenance	18,643	17,521	54,681	49,460
Depreciation and amortization	8,743	8,887	26,185	25,829
Direct property management and service				
companies expenses	3,168	5,668	9,379	15,921
Painting services	586	549	1,534	1,292
General and administrative	1,566	1,830	4,845	5,387
Interest expense	10,172	10,231	30,614	30,482
Total expenses	42,878	44,686	127,238	128,371
(Loss) income before gain on disposition of				
properties, equity in net loss of joint ventures, minority				
interest and income from discontinued operations	(3,106)	(2,490)	(10,511)	(4,337)
Gain on disposition of properties	-	-	-	216
Equity in net loss of joint ventures	(454)	(423)	(873)	(1,053)
Minority interest in operating partnership	(16)	(74)	(58)	(299)
(Loss) income before income from discontinued operations	(3,576)	(2,987)	(11,442)	(5,473)
Income from discontinued operations:				
Operating loss	-	(28)	-	(18)

Gain on disposition of properties	-	955	-	8,836
Income from discontinued operations	-	927	-	8,818
Net (loss) income	(3,576)	(2,060)	(11,442)	3,345
Preferred share dividends	(1,371)	(1,371)	(4,114)	(4,113)
Net (loss) income applicable to common shares	$ (4,947)	$ (3,431)	$ (15,556)	$ (768)
Earnings per common share - basic:				
(Loss) income applicable to common shares before				
income from discontinued operations	$ (.26)	$ (.23)	$ (.80)	$ (.50)
Income from discontinued operations	-	.05	-	.46
Net (loss) income applicable to common shares	$ (.26)	$ (.18)	$ (.80)	$ (.04)
Earnings per common share - diluted:				
(Loss) income applicable to common shares before				
income from discontinued operations	$ (.26)	$ (.23)	$ (.80)	$ (.50)
Income from discontinued operations	-	.05	-	.46
Net (loss) income applicable to common shares	$ (.26)	$ (.18)	$ (.80)	$ (.04)
Dividends declared per common share	$ .17	$ .25	$ .51	$ .75
Weighted average number of common				
shares outstanding - basic	19,404	19,364	19,397	19,335
- diluted	19,404	19,364	19,397	19,335

The accompanying notes are an integral part

of these consolidated financial statements

Index

ASSOCIATED ESTATES REALTY CORPORATION

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(UNAUDITED)

						Accumulated	
		Class A				Distributions	
		Cumulative		Total Paid-in Capital		In Excess Of	Treasury
		Preferred	Common Shares	Paid-In	Unearned	Accumulated	Shares
(In thousands, except share amounts)	Total	Shares	(at $.10 stated value)	Capital	Compensation	Net Income	(at cost)
Balance, December 31, 2002	$ 150,865	$ 56,250	$ 2,300	$ 279,481	$ (442)	$ (154,798)	$ (31,926)
Comprehensive (loss) income:							
Net (loss) income	(11,442)	-	-	-	-	(11,442)	-
Total comprehensive (loss) income	(11,442)	-	-	-	-	(11,442)	-
Amortization of unearned compensation	190	-	-	-	190	-	-
Forfeiture of 6,030 restricted common shares	(1)	-	-	(4)	47	-	(44)
Issuance of 22,462 restricted common shares	12	-	-	(116)	(125)	-	253
Purchase of 11,964 treasury shares	(68)	-	-	-	-	-	(68)
Issuance of 850 common shares from treasury	6	-	-	(4)	-	-	10

Common share dividends declared	(9,929)	-	-	-	-	(9,929)	-
Preferred share dividends declared	(4,114)	-	-	-	-	(4,114)	-
Balance, September 30, 2003	$ 125,519	$ 56,250	$ 2,300	$ 279,357	$ (330)	$ (180,283)	$ (31,775)

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Index

ASSOCIATED ESTATES REALTY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTH PERIODS ENDED SEPTEMBER 30,

(UNAUDITED)

	2003	2002
(In thousands)		
Cash flow from operating activities:		
Net (loss) income	$ (11,442)	$ 3,345
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	26,185	26,125
Loss on fixed asset replacements write-off	250	231
Minority interest in operating partnership	58	299
Gain on disposition of properties	-	(9,052)
Equity in net loss of joint ventures	873	1,053
Capitalized costs on investment in joint ventures	(29)	-
Earnings distributed from joint ventures	13	139
Net change in assets and liabilities:		
- Accounts and notes receivable	1,755	1,302
- Accounts and notes receivable of affiliates and joint ventures	187	304
- Accounts payable and accrued expenses	347	2,695
- Other operating assets and liabilities	535	(3,009)
- Restricted cash	3,226	(4,525)
- Funds held for non-owned managed properties	(654)	81
- Funds held for non-owned managed properties of affiliates		
and joint ventures	358	(1,595)
Total adjustments	33,104	14,048
Net cash flow provided by operations	21,662	17,393
Cash flow from investing activities:		
Recurring fixed asset additions	(6,530)	(6,613)
Investment/revenue enhancing and/or non-recurring fixed asset additions	(3,255)	(2,778)
Acquisition and development fixed asset additions	-	(1,673)

Purchase of operating partnership units	(211)	(1,904)
Net proceeds received from sale of properties	-	24,456
Joint venture distribution from sale proceeds	475	-
Contributions to joint ventures	-	(767)
Net cash flow (used for) provided by investing activities	(9,521)	10,721
Cash flow from financing activities:		
Principal payments on secured debt	(9,605)	(29,493)
Payment of debt procurement costs	(54)	(97)
Proceeds from secured debt	9,346	11,089
Line of credit borrowings	37,873	40,500
Line of credit repayments	(32,973)	(33,000)
Common share dividends paid	(9,929)	(14,591)
Preferred share dividends paid	(4,114)	(4,113)
Operating partnership distributions paid	(67)	(341)
(Purchase) issue of treasury shares - net	(68)	408
Net cash flow used for financing activities	(9,591)	(29,638)
Increase (decrease) in cash and cash equivalents	2,550	(1,524)
Cash and cash equivalents, beginning of period	900	3,164
Cash and cash equivalents, end of period	$ 3,450	$ 1,640
Supplemental disclosure of cash flow information:		
Dividends declared but not paid	$ 3,311	$ 4,870
Adjustment for purchase of minority interest	589	2,396
Land contributed to joint venture	-	1,250
Assumption of debt in connection with the joint venture transaction	-	28,770
Relinquishment of debt in connection with the joint venture transaction	-	13,878
Cash paid for interest (excluding capitalized interest)	30,029	30,138
Capital lease obligation	130	-
Costs related to prepayment of debt	339	77
Fixed asset replacement write-off	1,797	1,294

The accompanying notes are an integral part

of these consolidated financial statements

Index

ASSOCIATED ESTATES REALTY CORPORATION

NOTES TO FINANCIAL STATEMENTS

UNAUDITED

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

Business

Associated Estates Realty Corporation (the "Company") is a self-administered and self-managed real estate investment trust ("REIT"), which specializes in multifamily property management, advisory, development, acquisition, disposition, operation and ownership activities. The Company and its affiliates receive certain property and asset management fees, acquisition, disposition and incentive fees, loan origination and consulting fees, and mortgage servicing fees. MIG II Realty Advisors, Inc. ("MIG"), an affiliate of the Company, is a registered investment advisor and serves as a real estate advisor to large pension funds. The Company owns four taxable REIT subsidiaries which provide management and other services for the Company and third parties, collectively the Service Companies.

As of November 4, 2003, the Company owns, manages or is a joint venture partner in 107 apartment communities, consisting of 24,770 units, in twelve states. The Company owns and holds ownership interests, either directly or through subsidiaries, in 78 of those apartment communities, containing 18,313 units, in 10 states. Thirteen of those owned or partially owned apartment communities, consisting of 1,354 units, are affordable housing communities. The Company, or one of its subsidiaries, also manages or serves as asset manager for 29 communities, containing 6,457 units, and five commercial properties, containing in excess of 980,000 square feet, which are owned by large pension funds, non profit organizations or affiliated and unaffiliated third party owners.

Principles of Consolidation

The accompanying unaudited financial statements have been prepared by the Company's management in accordance with generally accepted accounting principles ("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 presentation 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 the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

Stock Based Employee Compensation

The Company uses the intrinsic value method in accordance with the Accounting Principles Board Opinion No. 25 ("APB No. 25") to account for stock-based employee compensation arrangements. Under this method, the Company does not recognize compensation cost for stock options when the option exercise price equals or exceeds the market value on the date of the grant. Restricted stock grants are recorded initially as a reduction to shareholders' equity and recognized as compensation expense over the vesting periods based upon the market value on the date of the grant. The amount of compensation recorded as a reduction to shareholders' equity related to restricted stock grants was $330,000 and $442,000 at September 30, 2003 and December 31, 2002, respectively. If the fair value method had been applied to the stock option grants, the fair values of the options granted at the grant dates would be recognized as compensation expense over the vesting periods, and the Company's net income and earnings per share for the periods ended September 30, 2003 and 2002 would have been as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
(In thousands, except per share data)	2003	2002	2003	2002
Net (loss) income	$ (3,576)	$ (2,060)	$ (11,442)	$ 3,345
Total stock compensation cost recognized	57	121	190	353
Total stock compensation cost had SFAS 123 been adopted	(87)	(194)	(278)	(574)
Proforma net (loss) income had SFAS 123 been adopted	$ (3,606)	$ (2,133)	$ (11,530)	$ 3,124
Net (loss) income applicable to common shares:				
Net (loss) income as reported	$ (4,947)	$ (3,431)	$ (15,556)	$ (768)
Total stock compensation cost recognized	57	121	190	353
Total stock compensation cost had SFAS 123 been adopted	(87)	(194)	(278)	(574)
Pro forma net (loss) income had SFAS 123 been adopted	$ (4,977)	$ (3,504)	$ (15,644)	$ (989)
(Loss) income per common share - Basic				
Net (loss) income as reported	$ (.26)	$ (.18)	$ (.80)	$ (.04)
Total stock compensation cost recognized	-	.01	-	.02
Total stock compensation cost had SFAS 123 been adopted	-	(.01)	(.01)	(.03)
Pro forma net (loss) income had SFAS 123 been adopted	$ (.26)	$ (.18)	$ (.81)	$ (.05)
(Loss) income per common share - Diluted				
Net (loss) income as reported	$ (.26)	$ (.18)	$ (.80)	$ (.04)
Total stock compensation cost recognized	-	.01	-	.02
Total stock compensation cost had SFAS 123 been adopted	-	(.01)	(.01)	(.03)
Pro forma net (loss) income had SFAS 123 been adopted	$ (.26)	$ (.18)	$ (.81)	$ (.05)

Recent Accounting Pronouncements

In April 2002, the FASB issued SFAS No. 145 "Rescission of FAS Nos. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections" (the "Statement"). This Statement rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that Statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." This Statement also rescinds SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers." This Statement amends SFAS No. 13, "Accounting for Leases." This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings or describe their applicability under changed conditions. The Company has adopted this Statement effective January 1, 2003 and will no longer record gains or losses from the early extinguishment of debt as extraordinary items but will record them as a component of the Company's continuing operations. The Company has reclassified previously reported items to present them on the same basis, where applicable.

In November 2002, the FASB issued Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("Interpretation No. 45"). Interpretation No. 45 elaborates on the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements of Interpretation No. 45 are effective for financial statements of periods ending after December 15, 2002. The initial recognition and initial measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Company has adopted Interpretation No. 45 effective January 1, 2003.

In January 2003, the FASB issued Interpretation No. 46 "Consolidation of Variable Interest Entities" ("Interpretation No. 46"). Interpretation No. 46 of Accounting Research Bulletin No. 51 "Consolidated Financial Statements" addresses consolidation by business enterprises of variable interest entities in which the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties or in which the equity investors do not have the characteristics of a controlling financial interest. Interpretation No. 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. Interpretation No. 46 also requires disclosures about variable interest entities that the company is not required to consolidate, but in which it has a significant variable interest. The consolidation requirements of Interpretation No. 46 apply immediately to variable interest entities created after January 31, 2003 and in the first fiscal year or interim period ending after December 15, 2003 to existing variable interest entities. The Company is in the process of evaluating all of its joint venture relationships in order to determine whether the entities are variable interest entities and whether the Company is considered to be the primary beneficiary or whether it holds a significant variable interest. The Company has several joint venture arrangements where it is reasonably possible that such joint ventures will be determined to be variable interest entities in which the Company is considered to be the primary beneficiary or holds a significant variable interest. It is possible that the Company will be required to consolidate certain of these entities in which the Company is the primary beneficiary or make additional disclosures related to its involvement with the entity.

In May 2003, the FASB issued SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (the "Statement"). This Statement establishes standards for the classification and measurement in a statement of financial position of certain financial instruments with characteristics of both liabilities and equity. It requires a financial instrument that is within its scope be classified as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the Company. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003, excluding certain mandatorily redeemable non-controlling interests, for which the classification and measurement provisions of the Statement will be deferred indefinitely pursuant to FASB Staff Position 150-3. The Company has determined that currently it has no instruments that are within the scope of SFAS No. 150.

Classification of Fixed Asset Additions

The Company considers recurring fixed asset additions to a property to be capital expenditures made to replace worn out assets so as to maintain the property's value. The Company considers investment/revenue enhancing and/or non-recurring fixed assets to be capital expenditures if such improvements increase the value of the property and/or enable the Company to increase rents. The Company considers acquisition and development fixed asset additions to be for the purchase of, or construction of, new properties to be added to the Company's portfolio.

Reclassifications

Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 presentation.

2. DEVELOPMENT OF MULTIFAMILY PROPERTIES

Construction in progress, including the cost of land, for the development of multifamily properties was $6.6 million and $5.9 million at September 30, 2003 and December 31, 2002, respectively. The Company capitalizes interest costs on funds used in construction, real estate taxes and insurance from the commencement of development activity through the time the property is available for leasing. Capitalized interest, real estate taxes and insurance aggregated approximately $29,000 and $884,000 during the nine month periods ended September 30, 2003 and 2002, respectively.

3. SALE OF PROPERTIES

On April 17, 2003, the Company and its joint venture partner completed the sale of a 36-unit Market Rate property located in Northeast Ohio in which the Company was a 50.0% partner. The sales price was $990,000. The Company's proportionate share of the gain was $450,000 which is included in "Equity in net loss of joint ventures" in the Consolidated Statements of Operations.

On January 18, 2002, the Company completed the sale of Muirwood Village at London located in Central Ohio. The buyer purchased the property for net cash proceeds of $3.8 million which resulted in the Company recording a gain of $255,000. Since this property was held for sale as of December 31, 2001, the financial results are excluded from the discontinued operations presentation.

On April 19, 2002, the Company and its joint venture partners completed the exchange of five Market Rate properties located in Northeast Ohio. Under the terms of the agreement, the Company became the 100% fee owner of three of the properties, the Americana Apartments (738 units) which was subsequently sold (see below), College Towers (458 units) and the Watergate Apartments (949 units). The Company relinquished its 66.67% ownership interest in Gates Mills III (320 units) and its 33.34% ownership interest in Gates Mills Towers (757 units). The exchange was recorded on the Company's books as a non-monetary transaction in accordance with APB 29 "Accounting for Non-Monetary Transactions." There was no gain or loss recorded in connection with this transaction as the exchange was not the culmination of the earnings process. The assets exchanged were considered similar production assets and the historical costs were allocated to the properties based on relative fair value. Prior to the exchange, Gates Mills III was consolidated and therefore the operating results of this property are included in "Income from discontinued operations."

On April 24, 2002, the Company completed the sale of the Americana Apartments as noted above. The sales price was $18.5 million. The Company paid off the existing debt of $11.6 million and received net cash proceeds of $6.2 million. This resulted in a gain of $7.9 million which is included in "Income from discontinued operations."

On July 29, 2002, the Company completed the sale of Jennings Commons, a 50-unit Affordable Housing property located in Northeast Ohio. The sales price was $1.9 million. This resulted in a gain of $976,000 which is included in "Income from discontinued operations."

The Company sold two additional properties during the fourth quarter of 2002. The results of operations of these properties for the periods presented have been included in "Income from discontinued operations." Interest expense included in "Income from discontinued operations" is limited to interest on debt that was assumed by the buyer or that was required to be repaid as a result of the sale of an asset included in discontinued operations. No allocation of interest expense to discontinued operations has been made for corporate debt that is not directly attributable to, or related to, other operations of the Company. The following chart summarizes the "Income from discontinued operations" for the three and nine months ended September 30, 2002.

	For the three months ended September 30, 2002	For the nine months ended September 30, 2002
(In thousands)		
Total property revenues	$ 314	$ 1,760
Total revenues	314	1,760
Property operating and maintenance expense	(177)	(1,067)
Real estate asset depreciation and amortization	(71)	(296)
Interest expense	(94)	(415)
Total expenses	(342)	(1,778)
Operating (loss) income	(28)	(18)
Gain on disposition of properties	955	8,836
Income from discontinued operations	$ 927	$ 8,818

4. DEBT

Conventional

On May 1, 2003, the Company repaid a $2.7 million nonrecourse loan encumbering a Market Rate property located in Michigan. The interest rate on this loan was 7.50%. On June 30, 2003, the Company obtained a new loan secured by this same property in the amount of $3.9 million. The Company has the right to elect LIBOR plus 2.0% or the Prime Loan Rate as the interest rate from time to time on the new loan. The Company currently has elected to pay interest at LIBOR plus 2.0%, which was 3.12% at September 30, 2003. This loan matures on July 1, 2006 and requires payments of only interest until maturity. The Company has two one-year options to extend this loan, each of which are conditioned upon achieving a satisfactory debt service coverage ratio at the property. During the extension periods, the Company must make principal payments based upon a 20-year amortization schedule in addition to payments of interest as provided above.

On April 22, 2003, the Company repaid a $2.3 million nonrecourse loan encumbering a Market Rate property located in Northeast Ohio. The interest rate on this loan was 9.63%. The Company incurred a prepayment penalty of approximately $330,000 related to this prepayment, which is included in "Interest expense" in the Company's Consolidated Statements of Operations. On May 12, 2003, the Company obtained a new loan secured by this same property in the amount of $5.5 million. The Company has the right to elect LIBOR plus 2.0% or the Prime Loan Rate as the interest rate from time to time on the new loan. The Company has elected to pay interest at LIBOR plus 2.0% through May 2004. The rate at September 30, 2003 was 3.19%. This loan matures on June 1, 2006 and requires payments of only interest until maturity. The Company has two one-year options to extend this loan, each of which are conditioned upon achieving a satisfactory debt service coverage ratio at the property. During the extension periods, the Company must make principal payments based upon a 20-year amortization schedule in addition to payments of interest as provided above.

On February 1, 2002, the Company completed the refinancing of $10.9 million of maturing debt. The new loan requires monthly principal and interest payments through the maturity date of January 1, 2005. The interest rate is equal to the Prime Loan Rate or under certain conditions at a rate of LIBOR plus 2.0%. The Company is currently paying interest at a rate of LIBOR plus 2.0% (3.24% at September 30, 2003) through November 2003.

Federal Insured Mortgage Debt

On June 27, 2002, the Company prepaid a $2.7 million HUD insured mortgage. The Company incurred a prepayment penalty and wrote off unamortized costs totaling $76,000 in connection with this prepayment. The $76,000 is included in "Interest expense" in the Company's Consolidated Statements of Operations.

Lines of Credit

On July 23, 2003, the Company replaced its $20.0 million line of credit with a new $15.0 million secured line of credit with a maturity date of July 31, 2006. Borrowings under this new line of credit bear interest at the rate of LIBOR plus 1.5% and are currently limited to $8.8 million. At September 30, 2003, there were $4.9 million of borrowings outstanding.

The Company also has a $14.0 million line of credit. There were no regular borrowings outstanding under this line at September 30, 2003 or December 31, 2002. $1.6 million of this line of credit is reserved exclusively for derivative transactions. The remaining $12.4 million is available for regular borrowings and letter of credit transactions. At September 30, 2003, letters of credit totaling $4.3 million have been issued against this line. On October 17, 2003, a $220,000 letter of credit related to Berkley Manor was canceled, see Note 13 for further information. The maturity date of this line of credit was recently extended for one year to December 31, 2004. There were no other material changes to the terms and conditions of this line of credit.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

In June 1998, the Company merged with MIG Realty Advisors, Inc. and, as a result, recorded goodwill and an intangible asset subject to amortization. The intangible asset, which is the only intangible asset currently recorded on the Company's books, represents asset advisory and property management contracts. The asset advisory and property management contracts are attributed to properties owned by pension fund clients and are generally terminable upon 30 days notice. The intangible asset and goodwill have been allocated fully to the Management and Service Operations Segment.

On March 17, 2003, MIG was directed by one of its advisory clients to initiate the sale of all of the client's real estate investments. Upon the successful sale of these investments, the Company will no longer receive the property and asset management fee revenue associated with them. Revenue received from these investments for the three and nine months ended September 30, 2003 was $420,000 and $1.3 million, respectively, which represented 1.0% of total Company revenues for both periods presented. The approximate amount of annual fee revenue generated by these investments is $1.7 million.

Information on the intangible asset is as follows:

Intangible Asset Subject to Amortization

Net

(In thousands)	Intangible Subject to Amortization	Deferred Tax Liability	Intangible Asset Subject to Amortization
Intangible Asset Subject to Amortization:			
Gross carrying amount	$ 5,405	$ (663)	$ 4,742
Less: Accumulated amortization	(4,803)	560	(4,243)
Less: Impairment write off in 2002	(312)	46	(266)
Balance as of September 30, 2003	$ 290	$ (57)	$ 233
Estimated remaining amortization expense:			
For the three months ended December 31, 2003	$ 96	$ (19)	$ 77
For the year ended December 31, 2004	194	(38)	156

The net amount of the intangible asset write down and amortization expense recorded for the three and nine months ended September 30, 2003 and 2002 was $78,000 and $235,000 and $234,000 and $469,000, respectively. There were no write downs in 2003.

Goodwill

The carrying amount of goodwill at September 30, 2003 was $1.7 million. The Company completed its annual review of goodwill during the quarter ended March 31, 2003. The review included the effect of the above mentioned advisory client directive to liquidate the client's real estate holdings. The Company used the discounted value of expected future cash flows to determine the fair value of the goodwill. Based on its analysis, the Company determined that the goodwill was not currently impaired. Therefore, there were no changes to the carrying amount of goodwill during the nine months ended September 30, 2003.

6. OPERATING PARTNERSHIP MINORITY INTEREST

In June 2003, 35,033 of the OP units were purchased for cash in the amount of $211,000, which represented a value of $6.02 per unit. These units had a recorded amount of approximately $800,000 when issued in connection with the purchase of real estate. The difference of the cash paid and the recorded amount was approximately $589,000 which reduced the recorded amount of the underlying real estate.

7. TRANSACTIONS WITH AFFILIATES AND JOINT VENTURES

Management and Other Services

The Company provides management and other services to (and is reimbursed for certain expenses incurred on behalf of) certain non-owned properties in which the Company's Chief Executive Officer and/or other related parties have varying ownership interests. The entities which own these properties, as well as other related parties, are referred to as "affiliates." The Company or one of its subsidiaries or Service Companies also provides similar services to joint venture properties.

Summarized affiliate and joint venture transaction activity is as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
(In thousands)	2003	2002	2003	2002
Property management fee and other				
miscellaneous service revenues - affiliates	$ 413	$ 406	$ 1,218	$ 1,188
- joint ventures	76	45	217	392
Painting service revenues - affiliates	88	201	371	399
- joint ventures	166	122	260	256
Expenses incurred on behalf				
of and reimbursed by [1] - affiliates	1,039	959	2,888	2,867
- joint ventures	88	125	304	1,305
Interest income - affiliates	24	30	76	91
Interest expense - affiliates	(8)	(18)	(26)	(58)
- joint ventures	-	(1)	(2)	(7)

(1) *Primarily payroll and employee benefits, reimbursed at cost.*

Property management fees and other miscellaneous receivables due from affiliates and joint venture properties aggregated $2.1 million and $2.2 million at September 30, 2003 and December 31, 2002, respectively.

Effective October 9, 2003, five properties owned by an affiliate were sold to an unrelated third party. The Company will continue to manage these five properties, however, from that date forward, the management fee revenue will no longer be classified as affiliate.

Advances to Affiliates and Joint Ventures

In the normal course of business, the Company has advanced funds on behalf of affiliates and joint ventures. Funds advanced to affiliates and joint ventures aggregated $77,000 and $329,000 at September 30, 2003, respectively, and $63,000 and $420,000 at December 31, 2002, respectively, and represented funds not yet repaid to the Company. The Company also holds funds for the benefit of affiliates and joint ventures which in the aggregate amounted to $3.5 million and $474,000 at September 30, 2003, respectively, and $3.3 million and $362,000 at December 31, 2002, respectively.

Notes Receivable

At September 30, 2003 and December 31, 2002, two notes of equal amounts were receivable from the Company's Chief Executive Officer aggregating $3.4 million (included in "Accounts and notes receivables-affiliates and joint ventures" in the Consolidated Balance Sheets) both of which mature May 1, 2005. One of the notes is partially secured by 150,000 of the Company's common shares; the other note is unsecured. For the nine months ended September 30, 2003 and 2002, the interest rates charged on these notes were approximately 3.0% and 3.6%, respectively. The Company recognized interest income of $76,000 and $91,000 for the nine months ended September 30, 2003 and 2002, respectively, relating to these notes.

Professional Services Agreements

Effective July 1, 2002, the Company entered into a professional services agreement with Gelber & Associates Corporation ("Gelber") in which a brother-in-law of the Company's Chief Executive Officer is a principal. Under the agreement, Gelber will consult with the Company on the purchase of natural gas. Gelber will receive a service fee of $3,000 plus 30.0% of any savings, as defined in the agreement, realized by the Company. The Company paid Gelber $31,000 during the nine months ended September 30, 2003. The Company is presently negotiating a renewal of that agreement.

During September 2003, Merit Painting Services, Inc. ("Merit"), a subsidiary of the Company, was retained by JAS Construction, Inc. ("JAS") under two subcontracts for the performance of certain rehabilitation work at two properties owned by an unrelated party. JAS is owned by the son of the Company's Chief Executive Officer. The total amounts of the subcontracts are yet to be determined because the contract prices are based upon per unit charges and the number of units where work to be performed is currently unknown. During the quarter ended September 30, 2003, $22,000 of revenue was reported in painting revenues in the Company's Consolidated Statements of Operations. As of September 30, 2003, $22,000 was still owed Merit and is included in "Accounts and notes receivable affiliates and joint ventures" in the Company's Consolidated Balance Sheets. Moreover, Merit anticipates it will enter into additional contracts with JAS as the general contractor for the performance of similar work at other properties owned by unrelated parties.

8. SHARES

On March 14, 2003 and May 7, 2003, the Company granted 3,770 and 2,404 of restricted shares, respectively, to executives of the Company under the annual incentive plan. These awards were made from the Company's Equity-Based Incentive Compensation Plan and the Year 2001 Equity Incentive Plan and were granted from treasury shares and vest in equal increments over three years from the date of the grant. On August 28, 2003, the Company granted 16,000 of restricted shares to Directors of the Company. This award was made from the Company's Year 2001 Equity Incentive Plan and was granted from treasury shares and vests in its entirety three years from the date of the grant. The Company's policy on the reissuance of treasury shares is to account for the issuance on the first-in first-out method. At September 30, 2003, the Company held 3,516,869 treasury shares at a cost of $31.8 million.

9. EARNINGS PER SHARE

Earnings per share ("EPS") has been computed pursuant to the provisions of SFAS No. 128. There were 2.3 million and 2.4 million options to purchase common shares outstanding at September 30, 2003 and 2002, respectively. None of the options were included in the calculation of diluted earnings per share for the periods presented as their inclusion would be antidilutive to the net loss available to common shares before discontinued operations.

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

10. INTERIM SEGMENT REPORTING

The Company has four reportable segments: (1) Acquisition/Disposition Multifamily Properties; (2) Same Store Market Rate ("Market Rate") Multifamily Properties; (3) Affordable Housing Multifamily Properties; and (4) Management and Service Operations. The Company has identified these segments based upon how management makes decisions regarding resource allocation and performance assessment. The Acquisition/Disposition properties represent acquired or developed properties which have not yet reached stabilization (the Company considers a property stabilized when its occupancy rate reaches 93.0% or one year following the purchase or delivery of the final units, whichever occurs first), and properties that have been sold. The Market Rate properties are same store conventional multifamily residential apartments. The Affordable Housing properties are multifamily properties for which the rents are subsidized and certain aspects of the operations are regulated by HUD pursuant to Section 8 of the National Housing Act of 1937. The Management and Service Operations provide management and advisory services to the Acquisition/Disposition, Market Rate and Affordable Housing properties which are owned by the Company, as well as to clients and properties not owned by the Company. All of the Company's segments are located in the United States.

The accounting policies of the reportable segments are the same as those described in the "Basis of Presentation and Significant Accounting Policies" in the Company's Form 10-K for the year ended December 31, 2002. The Company evaluates the performance of its reportable segments based on Net Operating Income ("NOI"). NOI is determined by deducting property operating and maintenance expenses from total revenues for the Acquisition/Disposition, Market Rate and Affordable Housing segments and deducting direct property management and service companies expenses and painting services expenses from total revenues for the Management and Service Operations segment. The Company considers NOI to be an appropriate supplemental measure of its performance because it reflects the operating performance of its real estate portfolio and management and service companies at the property and management and service company level and is used to assess regional property level performance. Effective January 1, 2003, the Company revised its method of allocating expenses to its service companies. Previously the Company allocated an amount equal to 85.0% of the Management and Service Companies revenues as service companies expenses. The Company now identifies expenses which are directly associated with the management and service companies and classifies them as service companies expenses for the current and all prior periods. NOI should not be considered (i) as an alternative to net income (determined in accordance with GAAP), (ii) as an indicator of the Company's financial performance, (iii) as cash flow from operating activities (determined in accordance with GAAP) or (iv) as a measure of the Company's liquidity; nor is it necessarily indicative of sufficient cash flow to fund all of the Company's needs. Certain other real estate companies may define NOI in a different manner.

Information on the Company's segments for the three and nine months ended September 30, 2003 and 2002 is as follows:

	For the three months ended September 30, 2003				
				Management	
	Acquisition/		Affordable	and Service	Total
(In thousands)	Disposition	Market Rate	Housing	Operations	Consolidated
Total segment revenues	$ -	$ 33,311	$ 2,359	$ 6,275	$ 41,945
Elimination of intersegment revenues	-	(71)	(4)	(2,098)	(2,173)
Consolidated revenues	-	33,240	2,355	4,177	39,772
Equity in net (loss) income of joint ventures	(241)	(216)	3	-	(454)
*NOI	21	15,615	1,316	423	17,375
Total assets	16,487	655,571	9,232	32,385	713,675

*Intersegment revenues and expenses have been eliminated in the computation of NOI for each of the segments.

	For the nine months ended September 30, 2003				
				Management	
	Acquisition/		Affordable	and Service	Total
(In thousands)	Disposition	Market Rate	Housing	Operations	Consolidated
Total segment revenues	$ 5,794	$ 92,091	$ 7,039	$ 18,294	$ 123,218
Elimination of intersegment revenues	-	(203)	(10)	(6,278)	(6,491)
Consolidated revenues	5,794	91,888	7,029	12,016	116,727

Equity in net loss of joint ventures	(399)	(425)	(49)	-	(873)
*NOI	1,652	44,578	3,800	1,103	51,133
Total assets	25,581	646,477	9,232	32,385	713,675

*Intersegment revenues and expenses have been eliminated in the computation of NOI for each of the segments.

	For the three months ended September 30, 2002				
				Management	
	Acquisition/		Affordable	and Service	Total
(In thousands)	Disposition	Market Rate	Housing	Operations	Consolidated
Total segment revenues	$ -	$ 33,624	$ 2,320	$ 8,395	$ 44,339
Elimination of intersegment revenues	-	(61)	(2)	(2,080)	(2,143)
Consolidated revenues	-	33,563	2,318	6,315	42,196
Equity in net loss of joint ventures	(149)	(267)	(7)	-	(423)
*NOI	11	17,071	1,278	98	18,458
Total assets	10,483	699,807	9,840	42,883	763,013

*Intersegment revenues and expenses have been eliminated in the computation of NOI for each of the segments.

	For the nine months ended September 30, 2002				
				Management	
	Acquisition/		Affordable	and Service	Total
(In thousands)	Disposition	Market Rate	Housing	Operations	Consolidated
Total segment revenues	$ 3,599	$ 94,636	$ 7,007	$ 25,082	$ 130,324
Elimination of intersegment revenues	(1)	(170)	(9)	(6,110)	(6,290)
Consolidated revenues	3,598	94,466	6,998	18,972	124,034
Equity in net loss of joint ventures	(755)	(284)	(14)	-	(1,053)
*NOI	1,366	50,380	3,856	1,759	57,361
Total assets	20,701	689,589	9,840	42,883	763,013

*Intersegment revenues and expenses have been eliminated in the computation of NOI for each of the segments.

A reconciliation of total segment NOI to total consolidated net (loss) income for the three and nine months ended September 30, 2003 and 2002 is as follows: