**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, 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 October 26, 2009 was 16,704,871 shares.

**ASSOCIATED ESTATES REALTY CORPORATION**

**Index**

**PART 1. FINANCIAL INFORMATION**
**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

**ASSOCIATED ESTATES REALTY CORPORATION**
**CONSOLIDATED BALANCE SHEETS**
**(UNAUDITED)**

| *(In thousands, except share amounts)* | | September 30, 2009 | | December 31, 2008 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Real estate assets | | | | |
| Land | $ | 107,815 | $ | 110,220 |
| Buildings and improvements | | 795,178 | | 812,443 |
| Furniture and fixtures | | 29,279 | | 29,315 |
| | | 932,272 | | 951,978 |
| Less: accumulated depreciation | | (294,293) | | (280,541) |
| | | 637,979 | | 671,437 |
| Construction in progress | | 3,158 | | 745 |
| Real estate associated with property held for sale, net | | - | | 1,666 |
| Real estate, net | | 641,137 | | 673,848 |
| Cash and cash equivalents | | 4,061 | | 3,551 |
| Restricted cash | | 7,530 | | 6,873 |
| Accounts and notes receivable, net | | | | |
| Rents | | 1,138 | | 1,320 |
| Affiliates | | 308 | | 606 |
| Other | | 1,631 | | 1,842 |
| Goodwill | | 1,725 | | 1,725 |
| Other assets, net | | 10,325 | | 10,131 |
| **Total assets** | $ | 667,855 | $ | 699,896 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | |
| Mortgage notes payable | $ | 488,369 | $ | 510,201 |
| Unsecured revolving credit facility | | 12,000 | | 21,500 |
| Unsecured debt | | 25,780 | | 25,780 |
| Total debt | | 526,149 | | 557,481 |
| Accounts payable, accrued expenses and other liabilities | | 26,858 | | 26,217 |
| Dividends payable | | 2,995 | | 2,920 |
| Resident security deposits | | 3,010 | | 3,360 |
| Accrued interest | | 2,248 | | 2,468 |
| **Total liabilities** | | 561,260 | | 592,446 |
| Noncontrolling redeemable interest | | 1,829 | | 1,829 |
| Shareholders' equity | | | | |
| Preferred shares, without par value; 9,000,000 shares authorized; 8.70% Class B Series II cumulative redeemable, $250 per share liquidation preference, 232,000 issued and 193,050 outstanding at September 30, 2009 and December 31, 2008, respectively | | 48,263 | | 48,263 |
| Common shares, without par value, $.10 stated value; 41,000,000 authorized; 22,995,763 issued and 16,704,871 and 16,556,221 outstanding at September 30, 2009 and December 31, 2008, respectively | | 2,300 | | 2,300 |
| Paid-in capital | | 282,897 | | 282,501 |
| Accumulated distributions in excess of accumulated net income | | (162,405) | | (159,595) |
| Accumulated other comprehensive loss | | (1,965) | | (2,899) |
| Less: Treasury shares, at cost, 6,290,892 and 6,439,542 shares at September 30, 2009 and December 31, 2008, respectively | | (64,324) | | (64,949) |
| **Total shareholders' equity** | | 104,766 | | 105,621 |
| **Total liabilities and shareholders' equity** | $ | 667,855 | $ | 699,896 |

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 September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| **Revenue** | | | | |
| Property revenue | $ 32,255 | $ 33,077 | $ 96,217 | $ 95,467 |
| Management and service company revenue: | | | | |
| Fees, reimbursements and other | 232 | 428 | 1,057 | 1,378 |
| Construction and other services | 379 | 547 | 730 | 872 |
| Total revenue | 32,866 | 34,052 | 98,004 | 97,717 |
| **Expenses** | | | | |
| Property operating and maintenance | 13,999 | 14,413 | 41,566 | 40,789 |
| Depreciation and amortization | 8,502 | 9,304 | 26,297 | 26,726 |
| Direct property management and service company expense | 210 | 420 | 918 | 1,213 |
| Construction and other services | 465 | 578 | 999 | 1,098 |
| General and administrative | 3,831 | 3,668 | 10,136 | 10,379 |
| Total expenses | 27,007 | 28,383 | 79,916 | 80,205 |
| Operating income | 5,859 | 5,669 | 18,088 | 17,512 |
| Interest income | 6 | 16 | 41 | 122 |
| Interest expense | (8,665) | (9,012) | (25,586) | (26,624) |
| (Loss) income before gain on insurance recoveries, equity in net loss of joint ventures and income from discontinued operations | (2,800) | (3,327) | (7,457) | (8,990) |
| Gain on insurance recoveries | - | - | 544 | - |
| Equity in net loss of joint ventures | - | (28) | - | (72) |
| (Loss) income from continuing operations | (2,800) | (3,355) | (6,913) | (9,062) |
| Income from discontinued operations: | | | | |
| Operating income (loss) | - | 325 | 568 | (678) |
| Gain on disposition of properties | (2) | - | 15,411 | 45,203 |
| Income from discontinued operations | (2) | 325 | 15,979 | 44,525 |
| **Net (loss) income** | (2,802) | (3,030) | 9,066 | 35,463 |
| Net income attributable to noncontrolling redeemable interest | (14) | (13) | (40) | (40) |
| **Net (loss) income attributable to AERC** | (2,816) | (3,043) | 9,026 | 35,423 |
| Preferred share dividends | (1,049) | (1,201) | (3,149) | (3,603) |
| Allocation to participating securities | - | - | (457) | (755) |
| **Net (loss) income applicable to common shares** | $ (3,865) | $ (4,244) | $ 5,420 | $ 31,065 |
| **Earnings per common share - basic and diluted:** | | | | |
| (Loss) income from continuing operations applicable to common shares | $ (0.23) | $ (0.28) | $ (0.61) | $ (0.78) |
| Income from discontinued operations | - | 0.02 | 0.94 | 2.70 |
| Net (loss) income applicable to common shares | $ (0.23) | $ (0.26) | $ 0.33 | $ 1.92 |
| **Dividends declared per common share** | $ 0.17 | $ 0.17 | $ 0.51 | $ 0.51 |
| **Weighted average number of common shares outstanding - basic and diluted** | 16,539 | 16,298 | 16,500 | 16,222 |

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

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

| *(In thousands)* | Nine Months Ended September 30, 2009 | 2008 |
|---|---|---|
| **Cash flow from operations:** | | |
| Net income | $ 9,066 | $ 35,463 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation and amortization (including discontinued operations) | 26,771 | 28,376 |
| Loss on fixed asset replacements write-off | 16 | 85 |
| Gain on disposition of properties | (15,411) | (45,203) |
| Gain on insurance recoveries | (544) | - |
| Amortization of deferred financing costs and other | 925 | 984 |
| Share-based compensation | 1,479 | 1,448 |
| Equity in net loss of joint ventures | - | 72 |
| Net change in assets and liabilities: | | |
| Accounts and notes receivable | 1,108 | 1,135 |
| Accounts payable and accrued expenses | 2,038 | (2,260) |
| Other operating assets and liabilities | (1,915) | (2,252) |
| Restricted cash | (656) | 364 |
| Total adjustments | 13,811 | (17,251) |
| Net cash flow provided by operations | 22,877 | 18,212 |
| **Cash flow from investing activities:** | | |
| Recurring fixed asset additions | (6,240) | (7,145) |
| Revenue enhancing/non-recurring fixed asset additions | (3,065) | (1,291) |
| Acquisition/development fixed asset additions | (1,939) | (34,484) |
| Net proceeds from disposition of operating properties | 32,714 | 88,348 |
| Net cash flow provided by investing activities | 21,470 | 45,428 |
| **Cash flow from financing activities:** | | |
| Principal amortization payments on mortgage notes payable | (2,186) | (2,112) |
| Principal repayments of mortgage notes payable | (72,096) | (42,851) |
| Payment of debt procurement costs | (686) | (601) |
| Proceeds from mortgage notes obtained | 52,450 | - |
| Revolving credit facility borrowings | 131,900 | 93,075 |
| Revolving credit facility repayments | (141,400) | (98,575) |
| Common share dividends paid | (8,452) | (8,305) |
| Preferred share dividends paid | (3,149) | (3,603) |
| Operating partnership distributions paid | (40) | (40) |
| Exercise of stock options | - | 1,843 |
| Purchase of preferred and/or treasury shares | (178) | (220) |
| Net cash flow used for financing activities | (43,837) | (61,389) |
| Increase in cash and cash equivalents | 510 | 2,251 |
| Cash and cash equivalents, beginning of period | 3,551 | 1,549 |
| **Cash and cash equivalents, end of period** | $ 4,061 | $ 3,800 |
| Supplemental disclosure of cash flow information: | | |
| Dividends declared but not paid | $ 2,995 | $ 2,905 |
| Cash paid for interest, net of capitalized interest | 24,913 | 28,941 |
| Net change in accounts payable related to fixed asset additions | 739 | 1,230 |
| 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 September 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) one apartment community that we manage for a third party owner consisting of 258 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 November 3, 2009, which is the date the financial statements were issued.

### Segment Reporting

All of our properties are multifamily communities that have similar economic characteristics. Management evaluates the performance of our properties on an individual basis. We previously reported separate segments primarily due to the different operating characteristics related to our Affordable Housing properties and to segregate third party fee management income. However, with our exit from the ownership and management of our Affordable Housing properties and our exit in 2009 from substantially all third party fee management, our multifamily properties now provide approximately 98.2% of our consolidated revenue for the nine months ended September 30, 2009. As a result, we determined that it would be appropriate to have only one reportable segment, which will be multifamily properties.

### Noncontrolling Redeemable Interest

In December 2007, the Financial Accounting Standards Board ("FASB") issued guidance which establishes and expands accounting and reporting standards for minority interests in a subsidiary and the deconsolidation of a subsidiary and also requires minority interests to be recharacterized as noncontrolling interests. This guidance 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 nine months ended September 30, 2009, we recognized total share-based compensation cost of $ 432,000 and $1.5 million, respectively, in "General and administrative expense" in the Consolidated Statements of Operations. During the three and nine months ended September 30, 2008, we recognized total share-based compensation cost of $484,000 and $1.4 million, respectively, in "General and administrative expense."

*Stock Options.* During the nine months ended September 30, 2009, there were 58,000 options awarded and no options exercised. During the nine months ended September 30, 2008, there were no stock options awarded and 180,021 stock options were exercised. 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 nine months ended September 30, 2009, were as follows:

| | | |
|---|---|---|
| Expected volatility | | 39.1% |
| Risk-free interest rate | | 2.6% |
| Expected life of options (in years) | | 6.4 |
| Dividend yield | | 8.4% |
| Grant-date fair value | $ | 1.38 |

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 nine months ended September 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 | 110,793 | $ | 9.23 |
| Forfeited | 2,018 | $ | 10.06 |
| Nonvested at end of period | 261,126 | $ | 9.74 |

At September 30, 2009, there was $2.0 million of unrecognized compensation cost related to nonvested restricted share awards that we expect to recognize over a weighted average period of 2.0 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 nine months ended September 30, 2009.

**Derivative Instruments and Hedging Activities**

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 nine months ended September 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 $1.9 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 September 30, 2009:

| *(Dollar amount in thousands)*<br>Interest Rate Derivative | Number of<br>Instruments | | Notional<br>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 September 30, 2009 | | As of December 31, 2008 | |
| *(In thousands)* | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments: | | | | |
| Interest rate swaps | Accounts payable, accrued expenses and other liabilities | $ 1,965 | 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 Operations (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) | Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | |
|---|---|---|---|---|---|
| Derivatives in Cash Flow Hedging Relationships | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2009 | Reclassified from Accumulated OCI into Income (Effective Portion) | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2009 |
| Interest rate swaps | $ (440) | $ (655) | Interest expense | $ 625 | $ 1,589 |

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 September 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 $2.2 million. As of September 30, 2009, we have not posted any collateral related to these agreements. If we had breached any of these provisions at September 30, 2009, we would have been required to settle our obligations under the agreements at their termination value of $2.2 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/development 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 $2.0 million at September 30, 2009 and includes capitalized interest costs on funds used in construction and real estate taxes and insurance. Capitalized interest costs for the three and nine months ended September 30, 2009 were $41,000 and $66,000, respectively.

**Disposition Activity**

We report the results of operations and gain/loss related to the sale of real estate assets as discontinued operations. 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 nine months ended September 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 September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | 2009 | 2008 | 2009 | 2008 |
| **REVENUE** | | | | |
| Property revenue | $ - | $ 1,292 | $ 2,021 | $ 7,850 |
| **EXPENSES** | | | | |
| Property operating and maintenance | - | 479 | 948 | 3,868 |
| Depreciation and amortization | - | 298 | 474 | 1,650 |
| Total expenses | - | 777 | 1,422 | 5,518 |
| Operating income | - | 515 | 599 | 2,332 |
| Interest income | - | - | - | 5 |
| Interest expense (1) | - | (190) | (31) | (3,015) |
| Gain on disposition of properties | (2) | - | 15,411 | 45,203 |
| **Income from discontinued operations** | $ (2) | $ 325 | $ 15,979 | $ 44,525 |

(1) Interest expense for the nine months ended September 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:

| | September 30, 2009 | | December 31, 2008 | |
|---|---|---|---|---|
| *(Dollar amounts in thousands)* | Balance Outstanding | Weighted Average Interest Rate | Balance Outstanding | Weighted Average Interest Rate |
| **FIXED RATE DEBT** | | | | |
| Mortgages payable - CMBS | $ 116,000 | 7.7% | $ 154,685 | 7.7% |
| Mortgages payable - other (1) | 337,385 | 5.8% | 320,516 | 5.8% |
| Unsecured borrowings | 25,780 | 7.9% | 25,780 | 7.9% |
| **Total fixed rate debt** | 479,165 | 6.4% | 500,981 | 6.5% |
| **VARIABLE RATE DEBT** | | | | |
| Mortgages payable | 34,984 | 4.7% | 35,000 | 1.6% |
| Unsecured revolving credit facility | 12,000 | 1.8% | 21,500 | 3.7% |
| **Total variable rate debt** | 46,984 | 4.0% | 56,500 | 2.4% |
| **Total debt** | $ 526,149 | 6.2% | $ 557,481 | 6.1% |

(1) Includes $63.0 million of variable rate debt swapped to fixed as of September 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 | 4.7% | (1) | March 2016 |
| Courtney Chase | - | N/A | | 21,440 | 4.7% | (1) | March 2016 |
| | $ 72,096 | 4.6% | (2) | $ 52,450 | 5.1% | (2) | |

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

During 2008, 2007 and 2006, we defeased 21 CMBS loans. These loans were defeased pursuant to the terms of the underlying loan documents. In accordance with GAAP, 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 September 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**

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)* | Nine Months Ended September 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 | 396 | 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 | 282,897 | 282,501 |
| **Accumulated distributions in excess of accumulated net income** | | |
| Balance outstanding at beginning of period | (159,595) | (180,436) |
| Net income | 9,066 | 34,680 |
| Net loss attributable to noncontrolling redeemable interest | (40) | (53) |
| Share based compensation | 5 | 8 |
| Purchase and retirement of Class B Cumulative Redeemable Preferred Shares | - | 2,146 |
| Common share dividends declared | (8,692) | (11,285) |
| Preferred share dividends declared | (3,149) | (4,655) |
| Balance outstanding at end of period | (162,405) | (159,595) |
| **Accumulated other comprehensive loss** | | |
| Balance outstanding at beginning of period | (2,899) | (1,050) |
| Change in fair value of hedge instruments | 934 | (1,849) |
| Balance outstanding at end of period | (1,965) | (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 | 803 | 734 |
| Shares issued from treasury for stock option exercises | - | 1,931 |
| Balance outstanding at end of period | (64,324) | (64,949) |
| **Total shareholders' equity** | $ 104,766 | $ 105,621 |

The following table identifies total comprehensive income:

| | Nine Months Ended September 30, | |
|---|---|---|
| *(In thousands)* | 2009 | 2008 |
| Comprehensive income: | | |
| Net income attributable to AERC | $ 9,026 | $ 35,423 |
| Other comprehensive income (loss): | | |
| Change in fair value of hedge instruments | 934 | (275) |
| Total comprehensive income | $ 9,960 | $ 35,148 |

**6. EARNINGS PER SHARE**

In June 2008, the FASB issued guidance which 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 guidance was effective for us January 1, 2009, and requires retrospective application to all periods presented.

There were 1.4 million options to purchase common shares outstanding at September 30, 2009 and 2008. 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 September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | 2009 | 2008 | 2009 | 2008 |
| **Numerator - basic and diluted:** | | | | |
| (Loss) income from continuing operations | $ (2,800) | $ (3,355) | $ (6,913) | $ (9,062) |
| Net income attributable to noncontrolling redeemable interest | (14) | (13) | (40) | (40) |
| Preferred share dividends | (1,049) | (1,201) | (3,149) | (3,603) |
| (Loss) income from continuing operations applicable to common shares | $ (3,863) | $ (4,569) | $ (10,102) | $ (12,705) |
| Income from discontinued operations | $ (2) | $ 325 | $ 15,979 | $ 44,525 |
| Allocation to participating securities | - | - | (457) | (755) |
| Income from discontinued operations applicable to common shares | $ (2) | $ 325 | $ 15,522 | $ 43,770 |
| **Denominator - basic and diluted:** | 16,539 | 16,298 | 16,500 | 16,222 |
| **Net income (loss) applicable to common shares - basic and diluted:** | | | | |
| (Loss) income from continuing operations applicable to common shares | $ (0.23) | $ (0.28) | $ (0.61) | $ (0.78) |
| Income from discontinued operations | - | 0.02 | 0.94 | 2.70 |
| Net income (loss) applicable to common shares - basic and diluted | $ (0.23) | $ (0.26) | $ 0.33 | $ 1.92 |

**7. FAIR VALUE**

Fair value determined in accordance with GAAP should be based on the assumptions that market participants would use when pricing certain assets or liabilities. Inputs used in determining fair value should be from the highest level available in the following hierarchy:

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access;
Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as interest rates and yield curves that are observable at commonly quoted intervals; and
Level 3 inputs are unobservable inputs for the asset or liability that are typically based on an entity s own assumptions as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the fair value measurement will fall within the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents the financial liabilities that we measured at fair value on a recurring basis as of September 30, 2009:

| *(In thousands)* | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Interest rate swaps | $ - | | | |