ESSEX PROPERTY TRUST INC
Form 10-Q
November 05, 2009

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

FORM 10-Q

T 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 001-13106

ESSEX PROPERTY TRUST, INC.
(Exact name of Registrant as Specified in its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	77-0369576 (I.R.S. Employer Identification Number)

925 East Meadow Drive
Palo Alto, California 94303
(Address of Principal Executive Offices including Zip Code)

(650) 494-3700
(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 reports), and (2) has been subject to such filing requirements for the past 90 days. YES T 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 (§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 file, 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 T	Accelerated filer £	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 T

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 29,117,693 shares of Common Stock as of November 3, 2009.

ESSEX PROPERTY TRUST, INC.
FORM 10-Q
INDEX

Index

Part I -- Financial Information

Item 1: Condensed Financial Statements (Unaudited)

"Essex" or the "Company" means Essex Property Trust, Inc., a real estate investment trust incorporated in the State of Maryland, or where the context otherwise requires, Essex Portfolio, L.P., a limited partnership (the "Operating Partnership") in which Essex Property Trust, Inc. is the sole general partner.

The information furnished in the accompanying unaudited condensed consolidated balance sheets, statements of operations, stockholders' equity, noncontrolling interest, and comprehensive income and cash flows of the Company reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of the aforementioned condensed consolidated financial statements for the interim periods and are normal and recurring in nature, except as otherwise noted.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the notes to such unaudited condensed consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations herein. Additionally, these unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2008.

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)
(Dollars in thousands, except per share amounts)

Assets	September 30, 2009	December 31, 2008
Real estate:		
Rental properties:		
Land and land improvements	$ 682,599	$ 683,876
Buildings and improvements	2,701,148	2,595,912
	3,383,747	3,279,788
Less accumulated depreciation	(721,078)	(640,026)
	2,662,669	2,639,762
Real estate under development	222,976	272,273
Co-investments	70,763	76,346
	2,956,408	2,988,381
Cash and cash equivalents-unrestricted	81,942	41,909
Cash and cash equivalents-restricted	17,128	12,810
Marketable securities	131,349	23,886
Funds held by 1031 exchange facilitator	-	21,424
Notes and other receivables	45,762	47,637
Prepaid expenses and other assets	17,555	17,430
Deferred charges, net	14,878	11,346
Total assets	$ 3,265,022	$ 3,164,823
Liabilities and Equity		
Mortgage notes payable	$ 1,608,570	$ 1,468,931
Lines of credit	150,000	120,000
Exchangeable bonds	98,220	165,457
Accounts payable and accrued liabilities	52,383	38,223
Construction payable	9,438	18,605
Dividends payable	33,269	32,124
Cash flow hedge liabilities	45,965	73,129
Other liabilities	16,393	16,444
Total liabilities	2,014,238	1,932,913
Commitments and contingencies		
Cumulative convertible preferred stock; $.0001 par value: 4.875% Series G - 5,980,000 issued and 238,249 and 5,980,000 outstanding	5,813	145,912
Stockholders' equity and noncontrolling interest:		
Common stock, $.0001 par value, 649,702,178 shares authorized 28,344,510 and 26,395,807 shares issued and outstanding	3	3
Cumulative redeemable preferred stock; $.0001 par value:7.8125% Series F - 1,000,000 shares authorized, issued and outstanding, liquidation value	25,000	25,000
Additional paid-in capital	1,235,989	1,043,984
Distributions in excess of accumulated earnings	(199,600)	(141,336)
Accumulated other comprehensive (loss) income	(38,551)	(75,424)
Total stockholders' equity	1,022,841	852,227
Noncontrolling interest	222,130	233,771
Total stockholders' equity and noncontrolling interest	1,244,971	1,085,998

Total liabilities and equity	$ 3,265,022	$ 3,164,823

See accompanying notes to the unaudited condensed consolidated financial statements.

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARES
Condensed Consolidated Statements of Operations
(Unaudited)
(Dollars 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
Revenues:				
Rental and other property	$100,823	$101,942	$307,525	$300,014
Management and other fees from affiliates	1,024	1,311	3,377	3,965
	101,847	103,253	310,902	303,979
Expenses:				
Property operating, excluding real estate taxes	26,935	25,462	75,937	73,817
Real estate taxes	9,231	8,546	27,294	24,654
Depreciation and amortization	29,895	27,712	87,867	81,852
Interest	21,966	21,122	63,680	63,017
General and administrative	6,086	6,524	18,134	19,661
Impairment and other charges	11,104	-	16,893	-
	105,217	89,366	289,805	263,001
Earnings (loss) from operations	(3,370)	13,887	21,097	40,978
Interest and other income	3,471	2,841	9,521	8,042
Equity (loss) income in co-investments	(32)	335	664	7,325
Gain on early retirement of debt	-	-	6,124	-
Gain on sale of real estate	-	2,446	103	2,446
Income before discontinued operations	69	19,509	37,509	58,791
Income (loss) from discontinued operations	2,280	(243)	5,630	(360)
Net income	2,349	19,266	43,139	58,431
Net income attributable to noncontrolling interest	(3,588)	(5,535)	(12,984)	(16,555)
Net income (loss) attributable to controlling interest	(1,239)	13,731	30,155	41,876
Dividends to preferred stockholders	(902)	(2,310)	(4,312)	(6,931)
Excess of the carrying amount of preferred stock redeemed over the cash paid to redeem preferred stock	23,880	-	49,575	-
Net income available to common stockholders	$21,739	$11,421	$75,418	$34,945
Per common share data:				
Basic:				
Income before discontinued operations available to common stockholders	$0.71	$0.46	$2.61	$1.42
Income (loss) from discontinued operations	0.08	(0.01)	0.19	(0.02)
Net income available to common stockholders	$0.79	$0.45	$2.80	$1.40
Weighted average number of common shares outstanding during the period	27,591,341	25,110,710	26,887,537	24,876,611
Diluted:				
Income before discontinued operations available to common stockholders	$0.66	$0.46	$2.50	$1.40

Income (loss) from discontinued operations	0.08	(0.01)	0.19	(0.01)
Net income available to common stockholders	$0.74	$0.45	$2.69	$1.39
Weighted average number of common shares outstanding during the period	30,070,076	25,474,924	29,360,710	25,182,107
Dividend per common share	$1.03	$1.02	$3.09	$3.06

See accompanying notes to the unaudited condensed consolidated financial statements.

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Stockholders' Equity, Noncontrolling Interest, and Comprehensive Income for the nine months ended September 30, 2009
(Unaudited)
(Dollars and shares in thousands)

	Series F Preferred stock	Common stock		Additional paid-in capital	Distributions in excess of accumulated earnings	Accumulated other comprehensive income (loss)	Noncontrolling Interest	Total
	Amount	Shares	Amount					
Balances at December 31, 2008 (as reported)	$ 25,000	26,396	$ 3	$ 1,026,036	$ (130,697)	$ (75,424)	$ -	$ 844,918
Adoption of new accounting prouncements	-	-	-	17,948	(10,639)	-	233,771	241,080
Balances at December 31, 2008 (revised)	25,000	26,396	3	1,043,984	(141,336)	(75,424)	233,771	1,085,998
Comprehensive income:								
Net income	-	-	-	-	30,155	-	12,984	43,139
Change in fair value of cash flow hedges and amortization of settlements of swaps	-	-	-	-	-	24,739	2,282	27,021
Change in fair value of marketable securities	-	-	-	-	-	12,134	1,078	13,212
Comprehensive income								83,372
Issuance of common stock under:								
Stock option plans	-	22	-	704	-	-	-	704
Sale of common stock	-	2,277	-	159,987	-	-	-	159,987
Equity based compensation costs	-	-	-	6,471	-	-	(142)	6,329
Retirement of Series G preferred stock	-	-	-	49,575	-	-	-	49,575
Retirement of common stock	-	(350)	-	(20,271)	-	-	-	(20,271)

Retirement of exchangeable bonds	-	-	-	(4,461)	-	-	-	(4,461)
Distributions to noncontrolling interest	-	-	-	-	-	-	(16,782)	(16,782)
Dividends declared	-	-	-	-	(88,419)	-	-	(88,419)
Redemptions of noncontrolling interest	-	-	-	-	-	-	(11,061)	(11,061)
Balances at September 30, 2009	$25,000	28,345	$3	$1,235,989	$ (199,600)	$ (38,551)	$ 222,130	$1,244,971

See accompanying notes to the unaudited condensed consolidated financial statements

6

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net cash provided by operating activities	$147,662	$143,048
Cash flows used in investing activities:		
Additions to real estate:		
Acquisitions of real estate	-	(87,533)
Improvements to recent acquisitions	(2,560)	(6,373)
Redevelopment expenditures	(20,345)	(28,652)
Revenue generating capital expenditures	(190)	(4,781)
Non-revenue generating capital expenditures	(14,989)	(18,987)
Additions to real estate under development	(68,763)	(92,497)
Dispositions of real estate	31,998	44,980
Changes in restricted cash and refundable deposits	17,702	(2,791)
Purchases of marketable securities	(106,444)	(62,522)
Sales and maturities of marketable securities	15,200	5,925
Proceeds from tax credit investor	3,762	-
Advances under notes and other receivables	(1,566)	(1,958)
Collections of notes and other receivables	2,960	5,980
Contributions to co-investments	(270)	(4,183)
Distributions from co-investments	-	9,423
Net cash used in investing activities	(143,505)	(243,969)
Cash flows from financing activities:		
Borrowings under mortgage and other notes payable and lines of credit	304,563	565,096
Repayment of mortgage and other notes payable and lines of credit	(134,943)	(450,485)
Additions to deferred charges	(1,982)	(2,105)
Settlement of forward-starting swaps	-	(1,840)
Retirement of exchangeable bonds	(66,460)	-
Retirement of common stock	(20,271)	(13,723)
Retirement of preferred stock, Series G	(90,614)	-
Net proceeds from stock options exercised	704	4,841
Net proceeds from issuance of common stock	159,987	133,654
Distributions to noncontrolling interest	(16,782)	(18,128)
Redemption of noncontrolling interest	(11,061)	(12,304)
Common and preferred stock dividends paid	(87,265)	(80,637)
Net cash provided by financing activities	35,876	124,369
Net increase in cash and cash equivalents	40,033	23,448
Cash and cash equivalents at beginning of period	41,909	9,956
Cash and cash equivalents at end of period	$81,942	$33,404
Supplemental disclosure of cash flow information:		

Cash paid for interest, net of $8.4 million and $5.3 million capitalized in 2009 and 2008, respectively	$50,973	$46,929
Supplemental disclosure of noncash investing and financing activities:		
Mortgage note assumed by buyer in connection with sale of property	$-	$42,200
Mortgage note issued to buyer in connection with sale of property	$-	$4,070
Property received in satisfaction of note receivable	$-	$1,500
Accrual of dividends	$33,269	$32,037
Change in value of cash flow hedge liabilities	$27,164	$6,923
Change in construction payable	$9,167	$14,724
Land contributed to consolidated joint venture	$-	$10,500
Transfer of assets from real estate under development to rental properties	$96,836	$-

See accompanying notes to the unaudited condensed consolidated financial statements.

Index

ESSEX PROPERTY TRUST, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2009 and 2008
(Unaudited)

(1) Organization and Basis of Presentation

The unaudited condensed consolidated financial statements of the Company are prepared in accordance with U.S. generally accepted accounting principles for interim financial information and in accordance with the instructions to Form 10-Q. In the opinion of management, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented have been included and are normal and recurring in nature, except as otherwise noted. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2008.

All significant intercompany balances and transactions have been eliminated in the condensed consolidated financial statements.

The unaudited condensed consolidated financial statements for the three and nine months ended September 30, 2009 and 2008 include the accounts of the Company and Essex Portfolio, L.P. (the "Operating Partnership", which holds the operating assets of the Company). See below for a description of entities consolidated by the Operating Partnership. The Company is the sole general partner in the Operating Partnership, with a 92% general partnership interest as of September 30, 2009. Total Operating Partnership units outstanding were 2,449,317 and 2,413,078 as of September 30, 2009 and December 31, 2008, respectively, and the redemption value of the units, based on the closing price of the Company’s common stock totaled $194.9 million and $185.2 million, as of September 30, 2009 and December 31, 2008, respectively.

As of September 30, 2009, the Company owned or had ownership interests in 133 apartment communities, (aggregating 27,221 units) (collectively, the “Communities”, and individually, a “Community”), five office and commercial buildings and three active development projects (collectively, the “Portfolio”). The Communities are located in Southern California (Los Angeles, Orange, Riverside, Santa Barbara, San Diego, and Ventura counties), Northern California (the San Francisco Bay Area) and the Seattle metropolitan area.

Fund Activities

Essex Apartment Value Fund II, L.P. (“Fund II”) is an investment fund formed by the Company to add value through rental growth and asset appreciation, utilizing the Company’s development, redevelopment and asset management capabilities.

Fund II has eight institutional investors, and the Company, with combined partner equity contributions of $265.9 million. The Company contributed $75.0 million to Fund II, which represents a 28.2% interest as general partner and limited partner. Fund II utilized leverage equal to approximately 55% upon the initial acquisition of the underlying real estate. Fund II invested in apartment communities in the Company’s targeted West Coast markets and, as of September 30, 2009, owned 14 apartment communities. The Company records revenue for its asset management, property management, development and redevelopment services when earned, and promote income when realized if Fund II exceeds certain financial return benchmarks.

Marketable Securities

As of September 30, 2009 marketable securities consisted primarily of investment-grade unsecured bonds and investment funds that invest in U.S. treasury or agency securities. As of September 30, 2009 the Company had classified the marketable securities as available for sale and the Company reports these securities at fair value, based on quoted market prices (Level 2 for the unsecured bonds and level 1 for the investment funds, as defined by the Financial Accounting Standards Board ("FASB") standard entitled “Fair Value Measurements and Disclosures” as discussed later in Note 1), and any unrealized gain or loss is recorded as other comprehensive income (loss). Realized gains and losses and interest income are included in interest and other income on the condensed consolidated statement of operations. Amortization of unearned discounts is included in interest income.

Variable Interest Entities

The Company consolidates 19 DownREIT limited partnerships (comprising twelve communities), an office building that is subject to loans made by the Company, and 55 low income housing units since the Company is the primary beneficiary of these variable interest entities (“VIEs”). As of December 31, 2008 the consolidated VIEs include a development joint venture, which is no longer a VIE as of September 30, 2009 as a result of the Company’s buyout of almost all of the co-investment’s interests. Total DownREIT units outstanding were 1,137,623 and 1,148,510 as of September 30, 2009 and December 31, 2008 respectively, and the redemption value of the units, based on the closing price of the Company’s common stock totaled $90.5 million and $88.1 million, as of September 30, 2009 and December 31, 2008, respectively. The consolidated total assets and liabilities related to these VIEs, net of intercompany eliminations, were approximately $237.0 million and $163.1 million, respectively, as of September 30, 2009 and $256.0 million and $169.1 million, respectively, as of December 31, 2008. Interest holders in VIEs consolidated by the Company are allocated net income equal to the cash payments made to those interest holders or distributions from cash flow. The remaining results of operations are generally allocated to the Company. As of September 30, 2009 and December 31, 2008, the Company did not have any VIE’s of which it was not deemed to be the primary beneficiary.

Index

Stock-Based Compensation

The Company accounts for share based compensation using the fair value method of accounting. The estimated fair value of stock options granted by the Company is being amortized over the vesting period of the stock options. The estimated grant date fair values of the long term incentive plan units (discussed in Note 13, "Stock Based Compensation Plans," in the Company's Form 10-K for the year ended December 31, 2008) are being amortized over the expected service periods.

Stock-based compensation expense for options and restricted stock totaled $0.2 million and $0.4 million for the three months ended September 30, 2009 and 2008, respectively, and $0.7 million and $0.9 million for the nine months ended September 30, 2009 and 2008, respectively. The intrinsic value of the stock options exercised during the three months ended September 30, 2009 and 2008 totaled $0.1 million and $1.4 million, respectively and $0.5 million and $4.1 million for the nine months ended September 30, 2009 and 2008 respectively. As of September 30, 2009, the intrinsic value of the stock options outstanding and fully vested totaled $3.3 million. As of September 30, 2009, total unrecognized compensation cost related to unvested share-based compensation granted under the stock option and restricted stock plans totaled $2.9 million. The cost is expected to be recognized over a weighted-average period of 2 to 5 years for the stock option plans and is expected to be recognized straight-line over 7 years for the restricted stock awards.

The Company has adopted an incentive program involving the issuance of Series Z and Series Z-1 Incentive Units (collectively referred to as "Z Units") of limited partnership interest in the Operating Partnership. Stock-based compensation expense for Z Units totaled $0.4 million for the three months ended September 30, 2009 and 2008, respectively, and $1.1 million for the nine months ended September 30, 2009 and 2008, respectively.

Stock-based compensation capitalized for stock options, restricted stock awards, and the Z Units totaled $0.1 million and $0.2 million for the three months ended September 30, 2009 and 2008, respectively, and $0.3 million and $0.6 million for the nine months ended September 30, 2009 and 2008, respectively. As of September 30, 2009, the intrinsic value of the Z Units subject to future vesting totaled $8.7 million. As of September 30, 2009, total unrecognized compensation cost related to Z Units subject to future vesting granted under the Z Units totaled $5.0 million. The unamortized cost is expected to be recognized over the next 2 to 10 years subject to the achievement of the stated performance criteria.

Stock-based compensation expense for the Outperformance Plan, (the "OPP") adopted in December 2007 totaled approximately $0.3 million for three months ended September 30, 2009 and 2008, respectively and $0.9 million for the nine months ended September 30, 2009 and 2008. During September 2009, the Company elected to cancel the OPP for senior officers and non-employee directors and wrote-off $3.8 million in unamortized costs related to the OPP.

Fair Value of Financial Instruments

The Company adopted an accounting standard issued by the FASB entitled "Fair Value Measurements and Disclosures" as of January 1, 2008, which provides guidance on using fair value to measure assets and liabilities. The Company values its financial instruments based on the fair value hierarchy of valuation techniques described in this standard. Level 1 inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability.

The Company uses Level 1 inputs for the fair values of its cash equivalents and its marketable securities except for unsecured bonds. The Company uses Level 2 inputs for its investments in unsecured bonds, notes receivable, notes payable, and cash flow hedges. These inputs include interest rates for similar financial instruments. The Company's valuation methodology for cash flow hedges is described in more detail in Note 8. The Company does not use Level 3 inputs to estimate fair values of any of its financial instruments. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Index

Management believes that the carrying amounts of its amounts outstanding under lines of credit, notes receivable and other receivables from related parties, and notes and other receivables approximate fair value as of September 30, 2009 and December 31, 2008, because interest rates, yields and other terms for these instruments are consistent with yields and other terms currently available for similar instruments. Management has estimated that the fair value of the Company's $1.46 billion of fixed rate debt at September 30, 2009 is approximately $1.48 billion and the fair value of the Company's $251.6 million of variable rate debt at September 30, 2009 is $228.5 million based on the terms of existing mortgage notes payable and variable rate demand notes compared to those available in the marketplace. Management believes that the carrying amounts of cash and cash equivalents, restricted cash, accounts payable and accrued liabilities, other liabilities and dividends payable approximate fair value as of September 30, 2009 due to the short-term maturity of these instruments. Marketable securities and cash flow hedge liabilities are carried at fair value as of September 30, 2009, as discussed further above and in Note 8.

Accounting Estimates and Reclassifications

The preparation of condensed consolidated financial statements, in accordance with U.S. generally accepted accounting principles, requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to acquiring, developing and assessing the carrying values of its real estate properties, its investments in and advances to joint ventures and affiliates, its notes receivables and its qualification as a Real Estate Investment Trust ("REIT"). The Company bases its estimates on historical experience, current market conditions, and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may vary from those estimates and those estimates could be different under different assumptions or conditions. Reclassifications for discontinued operations and noncontrolling interest have been made to prior year statements of operations balances in order to conform to current year presentation. Such reclassifications have no impact on reported earnings, cash flows, total assets or total liabilities.

New Accounting Pronouncements and the Resulting Revision of Previously Reported Amounts

In July 2009, the FASB established a codification as the single source of authoritative nongovernmental US GAAP (except for SEC rules and interpretive releases) which is effective for interim and annual reporting periods ending after September 15, 2009 (the "Codification"). The Codification is intended to reorganize, rather than change, existing US GAAP. However, all existing accounting standard documents are superseded by the Codification and all accounting literature excluded from the Codification became nonauthoritative upon the effective date in September 2009. Accordingly, all references to currently existing US GAAP have been removed and have been replaced with references to the Codification or plain English explanations of our accounting policies. The adoption of the Codification did not have a material impact on the Company's financial position or results of operations.

In December 2007, the FASB issued a standard entitled "Noncontrolling Interests in Consolidated Financial Statements" which establishes accounting and reporting standards that require the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated balance sheet within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of operations; changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently; when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value; and entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The standard is effective for fiscal years beginning on or after December 15, 2008. As summarized in the table below, the accompanying 2008 condensed consolidated financial statements have been revised to record the impact of the adoption of the standard.

In May 2008, the FASB issued FASB a standard entitled “Accounting for Convertible Debt Instruments That May be Settled in Cash Upon Conversion,” which requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) upon conversion to separately account for the liability (debt) and equity (conversion option) components of the instruments in a manner that reflects the issuer’s nonconvertible debt borrowing rate. This standard requires the initial debt proceeds from the sale of a company’s convertible debt instrument to be allocated between the liability component and the equity component. The resulting debt discount will be amortized over the period during which the debt is expected to be outstanding (i.e., through the first optional redemption dates) as additional non-cash interest expense. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Accounting for the Company’s $225.0 million exchangeable bonds (the “Bonds”) with a coupon rate of 3.625% due November 2025, which were issued in the fourth quarter of 2005, was impacted by the standard. During the fourth quarter of 2008, the Company repurchased $53.3 million of the Bonds, and during the first quarter of 2009 the Company repurchased an additional $71.3 million of the Bonds.

Index

On January 1, 2009, the Company retrospectively adopted the standard discussed above for the Bonds. The Company estimated that the market interest rate for the debt only portion of the Bonds as of the date of issuance was 5.75%, compared to the coupon rate of 3.625%. The Company computed the estimated fair value of the debt portion of the Bonds as the present value of the expected cash flows discounted at 5.75%. The difference between the fair value of the debt portion of the Bonds and the carrying value as previously reported was added to additional paid in capital as of the date of issuance. The discount on the debt is amortized over the period from issuance to the date of the first call option by the holders of the Bonds which occurs in November 2010 resulting in non-cash interest expense in addition to the interest expense calculated based on the coupon rate. This resulted in non-cash interest charges of $0.5 million and $1.0 million for the three months ended September 30, 2009 and 2008, respectively, and $1.6 million and $3.0 million for the nine months ended September 30, 2009 and 2008, respectively. The standard requires that the fair value of the debt portion of any bonds that are retired early be estimated to calculate the gain on retirement. The difference between the estimated fair value of the debt portion of the Bonds and the standard carrying value of the debt portion of the Bonds is recorded as gain on early retirement of debt and additional paid in capital is reduced to reflect the remaining portion of the total amount paid to retire the Bonds.

The following is a summary of the impact to the December 31, 2008 consolidated balance sheet and the three and nine months ended September 30, 2008 consolidated statement of operations from amounts previously reported to amounts included in the accompanying condensed consolidated financial statements as a result of the retrospective adoption of the standards discussed above (in thousands except per share amounts):

	As reported December 31, 2008	Noncontrolling Interest Retrospective Adjustments	Bonds Retrospective Adjustment	Revised December 31, 2008
Selected balance sheet data:				
Exchangeable bonds	$ 171,716	$ -	$ (6,259)	$ 165,457
Minority interests	234,821	(233,771)	(1,050)	-
Additional paid-in-capital	1,026,036	-	17,948	1,043,984
Distributions in excess of accumulated earnings	(130,697)	-	(10,639)	(141,336)
Noncontrolling interest	-	233,771	-	233,771

	Three Months Ended September 30,			
Selected statement of operations data:	As reported 2008 (1)	Noncontrolling Interest Retrospective Adjustments	Bonds Retrospective Adjustment	Revised 2008
Interest expense	$20,085	-	1,037	$21,122
Noncontrolling interest	5,666	-	(131)	5,535
Earnings per diluted share	0.49	-	(0.04)	0.45

	Nine Months Ended September 30,			
Selected statement of operations data:	As reported 2008 (1)	Noncontrolling Interest Retrospective Adjustments	Bonds Retrospective Adjustment	Revised 2008
Interest expense	$59,944	-	3,073	$63,017
Noncontrolling interest	16,929	-	(374)	16,555

Earnings per diluted share	1.50	-	(0.11	) 1.39

(1) As reported balances are adjusted for discontinued operations.

In June 2009, the FASB issued a standard entitled, "Business Combinations" which establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in a business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This standard is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of this standard on January 1, 2009 did not have any impact on the Company's consolidated financial position, results of operations or cash flows as it relates only to business combinations for the Company that take place on or after January 1, 2009.

Index

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)", which amends existing standards to replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which enterprise has a controlling financial interest in a variable interest entity. This Statement has not been incorporated into the FASB Accounting Standards Codification as of September 30, 2009. The new standard shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. Management is currently evaluating the impact this standard will have on the Company's condensed consolidated financial statements.

In May 2009, the FASB issued a standard entitled "Subsequent Events" which defines subsequent events as events or transactions that occur after the balance sheet date but before financial statements are issued or available to be issued. Under the standard, the requirements for disclosing subsequent events remain unchanged from the previous requirements. However, the standard contains an additional requirement that companies must disclose the date through which subsequent events have been evaluated and the rationale for selecting that date. The Company has adopted the provisions of the standard and has evaluated subsequent events for the period ended September 30, 2009 through November 4, 2009, the date the financial statements were issued. There were no events or transactions subsequent to September 30, 2009 that required recognition or disclosure in the financial statements.

(2) Significant Transactions During the Third Quarter

(a) Dispositions

During the third quarter, the Company sold Spring Lake, a 69-unit community located in Seattle, Washington for $5.7 million and recognized a gain of $2.5 million.

(b) Equity

During the third quarter, the Company issued 1,130,800 shares of common stock at an average price of $75.56 for $84.2 million, net of fees and commissions through the Company's Controlled Equity Offering Program.

During the third quarter, the Company repurchased $81.9 million of its Series G Cumulative Convertible Preferred Stock, at a $23.9 million discount to its carrying value.

(c) Debt and Financing Activities

The Company obtained a fixed rate mortgage loan secured by Huntington Breakers totaling $40.5 million at a fixed rate of 5.4% which matures in October 2019, during the third quarter. Additionally, the Company paid-off a $5.6 million mortgage loan secured by Mt. Sutro at a fixed rate of 7.7%.

(d) Outperformance Plan

During the third quarter, the Company elected to cancel the Outperformance Plan (the "OPP") for senior officers and non-employee directors and wrote-off $3.8 million in unamortized costs related to the OPP. The costs were included in impairment and other charges in the accompanying consolidated statement of operations.

(e) Land Impairment

The Company wrote-off development costs totaling $6.7 million related to two land parcels that will no longer be developed by the Company. The costs were included in impairment and other charges in the accompanying consolidated statement of operations.

Index

(3) Co-investments

The Company has joint venture investments in co-investments, which are accounted for under the equity method. The joint ventures own, operate and develop apartment communities. The following table details the Company's co-investments (dollars in thousands):

	September 30, 2009	December 31, 2008
Investments in joint ventures accounted for under the equity method of accounting:		
Limited partnership interest of 27.2% and general partner interest of 1% in Essex Apartment Value Fund II, L.P ("Fund II")	$ 70,263	$ 70,469
Development joint venture	-	5,377
	70,263	75,846
Investments accounted for under the cost method of accounting:		
Series A Preferred Stock interest in Multifamily Technology Solutions, Inc	500	500
Total co-investments	$ 70,763	$ 76,346

During 2006, the Company made a contribution to a development with a joint venture partner totaling $3.4 million, and over the past three years the Company made additional contributions and capitalized costs to this joint venture totaling $2.4 million for a total investment of $5.8 million. This joint venture was to obtain entitlements and make option payments towards the purchase of land parcels in Marina del Rey, California for a proposed development project. During the first quarter of 2009, the Company wrote-off its investment in the joint venture development project of $5.8 million, and the write-off of these costs is included in other non-cash expenses in the accompanying consolidated condensed statements of operations. The combined summarized balance sheet and statements of operations for co-investments, which are accounted for under the equity method, are as follows (dollars in thousands).

	September 30, 2009	December 31, 2008
Balance sheets:		
Rental properties and real estate under development	$ 499,152	$ 526,906
Other assets	36,603	40,877
Total assets	$ 535,755	$ 567,783
Mortgage notes and construction payable	$ 316,524	$ 308,853
Other liabilities	9,433	8,481
Partners' equity	209,798	250,449
Total liabilities and partners' equity	$ 535,755	$ 567,783
Company's share of equity	$ 70,263	$ 75,846

`	Three Months Ended	Nine Months Ended

	September 30,		September 30,	
	2009	2008	2009	2008
Statements of operations:				
Property revenues	$11,684	$11,906	$35,395	$34,232
Property operating expenses	(4,882)	(4,565)	(13,878)	(13,180)
Net property operating income	6,802	7,341	21,517	21,052
Interest expense	(2,878)	(2,876)	(7,723)	(8,205)
Depreciation and amortization	(4,066)	(3,308)	(11,447)	(9,979)
Total net (loss) income	$(142)	$1,157	$2,347	$2,868
Company's share of operating net (loss) income	(32)	335	664	1,007
Company's preferred interest/gain - Mt. Vista	-	-	-	6,318
Company's share of net (loss) income	$(32)	$335	$664	$7,325

Index

In January 2008, the Company received $7.5 million and recognized $6.3 million of preferred interest in the joint venture which is included in equity income in co-investments from the repayment of its investment in Mountain Vista Apartments, LLC.

(4) Notes and Other Receivables

Notes receivable secured by real estate, and other receivables consist of the following as of September 30, 2009 and December 31, 2008 (dollars in thousands):

	September 30, 2009	December 31, 2008
Note receivable, secured, bearing interest at LIBOR + 3.69%, due June 2010	$ 6,761	$ 7,325
Note receivable, secured, bearing interest at 8.0%, due November 2010	971	965
Note receivable, secured, bearing interest at LIBOR + 2.95%, due December 2010	12,541	14,043
Note receivable, secured, bearing interest at LIBOR + 4.75%, due March 2011	7,358	7,294
Note receivable, secured, bearing interest at 6.5%, due August 2011	3,221	4,070
Non-performing note receivable, secured	13,448	13,448
Other receivables	3,182	1,192
Allowance for loan losses	(1,720)	(700)
	$ 45,762	$ 47,637

In September 2007, the Company originated a loan to the owners of an apartment community under development in Vancouver, Washington, with a maturity date of February 2009. The proceeds from the loan refinanced the property and provided funding for the completion of the 146-unit apartment community. In July 2008, the Company ceased recording interest income and issued a notice of monetary default to the borrower, and the borrower filed for bankruptcy. During the fourth quarter of 2008, the Company recorded a loan loss reserve in the amount of $0.7 million with an additional reserve of $0.4 million recorded during the second quarter of 2009 on this non-performing note receivable. The Company recorded an additional $0.6 million loan loss reserve during the third quarter of 2009. In October the property was sold through the bankruptcy trustee and the loan was repaid at no additional loss to the Company.

In the second quarter of 2009, the borrower on the loan secured by Emeryville Marketplace, a mixed use commercial property located in Emeryville, California made a principal payment of $0.5 million to pay down the loan to $6.8 million and the Company extended the maturity of the loan until June 2010. In the first quarter of 2009, the borrower on the bridge loan secured by 301 Ocean Avenue, a 47-unit apartment community located in Santa Monica, California, made a principal payment of $1.6 million to pay down the loan to $12.5 million and the Company extended the maturity of the loan until December 2010.

(5) Related Party Transactions

Management and other fees from affiliates includes management, development and redevelopment fees from Fund II of $1.0 million and $1.3 million for the three months ended September 30, 2009 and 2008 respectively, and $3.4 million and $4.0 million for the nine months ended September 30, 2009 and 2008 respectively. As discussed in Note 3, in January 2008, the Company received $7.5 million from an investment held in an affiliate of TMMC and recognized $6.3 million of preferred income which is included in equity (loss) income from co-investments.

Index

(6) Segment Information

The Company defines its reportable operating segments as the three geographical regions in which its apartment communities are located: Southern California, Northern California and Seattle Metro. Excluded from segment revenues are properties classified in discontinued operations, management and other fees from affiliates, and interest and other income. Non-segment revenues and net operating income included in the following schedule also consist of revenue generated from commercial properties which are primarily office buildings. Other non-segment assets include co-investments, real estate under development, cash and cash equivalents, marketable securities, notes receivable, other assets and deferred charges. The revenues, net operating income, and assets for each of the reportable operating segments are summarized as follows for the three months ended September 30, 2009 and 2008 (dollars in thousands):

	Three Months Ended September 30, 2009	2008
Revenues:		
Southern California	$ 51,265	$ 52,002
Northern California	30,145	30,516
Seattle Metro	17,550	18,085
Other real estate assets	1,863	1,339
Total property revenues	$ 100,823	$ 101,942
Net operating income:		
Southern California	$ 33,733	$ 35,191
Northern California	19,263	19,740
Seattle Metro	10,583	11,833
Other real estate assets	1,078	1,170
Total net operating income	64,657	67,934
Depreciation and amortization	(29,895)	(27,712)
Interest expense	(21,966)	(21,122)
General and administrative	(6,086)	(6,524)
Impairment and other charges	(11,104)	-
Management and other fees from affiliates	1,024	1,311
Gain on sale of real estate	-	2,446
Interest and other income	3,471	2,841
Equity (loss) income from co-investments	(32)	335
Income before discontinued operations	$ 69	$ 19,509

Index

The revenues, net operating income, and assets for each of the reportable operating segments are summarized as follows for the nine months ended September 30, 2009 and 2008 (dollars in thousands):

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenues:		
Southern California	$ 155,716	$ 155,419
Northern California	91,523	88,783
Seattle Metro	54,774	51,822
Other real estate assets	5,512	3,990
Total property revenues	$ 307,525	$ 300,014
Net operating income:		
Southern California	$ 104,876	$ 106,626
Northern California	61,040	57,765
Seattle Metro	34,923	34,412
Other real estate assets	3,455	2,740
Total net operating income	204,294	201,543
Depreciation and amortization	(87,867)	(81,852)
Interest expense	(63,680)	(63,017)
General and administrative	(18,134)	(19,661)
Impairment and other charges	(16,893)	-
Management and other fees from affiliates	3,377	3,965
Gain on early retirement of debt	6,124	-
Gain on sale of real estate	103	2,446
Interest and other income	9,521	8,042
Equity income from co-investments	664	7,325
Income before discontinued operations	$ 37,509	$ 58,791

	September 30, 2009	December 31, 2008
Assets:		
Southern California	$ 1,228,809	$ 1,291,850
Northern California	927,708	850,170
Seattle Metro	423,736	431,041
Other real estate assets	82,416	66,701
Net reportable operating segments - real estate assets	2,662,669	2,639,762
Real estate under development	222,976	272,273
Cash and cash equivalents	99,070	54,719
Marketable securities	131,349	23,886
Funds held by 1031 exchange facilitator	-	21,424
Notes and other receivables	45,762	47,637
Other non-segment assets	103,196	105,122
Total assets	$ 3,265,022	$ 3,164,823

Index

(7) Net Income Per Common Share
(Amounts in thousands, except per share and unit data)

Three Months Ended September 30, 2009			Three Months Ended September 30, 2008	
Income	Weighted-average Common Shares	Per Common Share Amount	Income	Weighted-average Common Shares