ASSOCIATED ESTATES REALTY CORP
Form 10-Q
November 01, 2013

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, 2013

OR

o 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 44143-1550
(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 o

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 x No o

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

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

The number of shares outstanding as of October 25, 2013 was 57,502,056 shares.

ASSOCIATED ESTATES REALTY CORPORATION

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PART 1. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(In thousands, except share and per share amounts)	September 30, 2013	December 31, 2012
ASSETS		
Real estate assets		
Land	$289,340	$241,159
Buildings and improvements	1,280,578	1,223,042
Furniture and fixtures	38,144	36,997
Construction in progress	40,051	10,449
Gross real estate	1,648,113	1,511,647
Less: Accumulated depreciation	(385,283)	(371,730)
Net real estate owned	1,262,830	1,139,917
Investment in unconsolidated entities	8,909	—
Total net real estate	1,271,739	1,139,917
Cash and cash equivalents	5,325	4,740
Restricted cash	6,358	4,429
Accounts receivable, net		
Rents	1,158	1,395
Other	950	553
Other assets, net	39,307	21,443
Total assets	$1,324,837	$1,172,477
LIABILITIES AND EQUITY		
Mortgage notes payable	$373,299	$376,278
Unsecured notes	150,000	—
Unsecured revolving credit facility	177,000	190,500
Unsecured term loan	150,000	150,000
Total debt	850,299	716,778
Accounts payable and other liabilities	42,591	32,865
Dividends payable	10,659	10,149
Resident security deposits	4,016	3,846
Accrued interest	3,519	2,363
Total liabilities	911,084	766,001
Noncontrolling redeemable interest	1,734	1,734
Equity		
Common shares, without par value, $.10 stated value; 91,000,000 authorized; 50,454,527 issued and 50,454,098 outstanding at September 30, 2013 and 49,526,639 issued and outstanding at December 31, 2012, respectively	5,045	4,953
Paid-in capital	638,054	634,587
Accumulated distributions in excess of accumulated net income	(230,177)	(233,208)
Accumulated other comprehensive loss	(1,247)	(2,934)
Less: Treasury shares, at cost, 429 and 0 shares at September 30, 2013 and December 31, 2012, respectively	(6)	—
Total shareholders' equity attributable to AERC	411,669	403,398
Noncontrolling interest	350	1,344
Total equity	412,019	404,742

Total liabilities and equity	$1,324,837	$1,172,477

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

ASSOCIATED ESTATES REALTY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2013	2012	2013	2012
Revenue				
Property revenue	$46,874	$42,528	$135,136	$118,673
Office revenue	450	350	1,000	663
Total revenue	47,324	42,878	136,136	119,336
Expenses				
Property operating and maintenance	17,872	16,784	51,798	46,693
Depreciation and amortization	14,508	13,417	42,841	37,195
Construction and other services	—	28	—	181
General and administrative	4,946	3,936	14,302	12,569
Development costs	220	193	662	800
Costs associated with acquisitions	392	282	457	766
Total expenses	37,938	34,640	110,060	98,204
Operating income	9,386	8,238	26,076	21,132
Interest expense	(7,633)	(6,978)	(22,449)	(22,890)
Income (loss) from continuing operations	1,753	1,260	3,627	(1,758)
Income from discontinued operations:				
Operating income, net of interest expense	182	841	1,527	2,619
Gain on disposition of properties	18,072	—	26,868	22,819
Income from discontinued operations	18,254	841	28,395	25,438
Net income	20,007	2,101	32,022	23,680
Net (income) loss attributable to noncontrolling interests	(14)	(8)	(45)	1
Net income attributable to AERC	$19,993	$2,093	$31,977	$23,681
Allocation to participating securities	(85)	—	(136)	—
Net income applicable to common shares	$19,908	$2,093	$31,841	$23,681
Earnings per common share - basic:				
Income (loss) from continuing operations applicable to common shares	$0.03	$0.02	$0.07	$(0.04)
Income from discontinued operations	0.37	0.02	0.57	0.57
Net income applicable to common shares - basic	$0.40	$0.04	$0.64	$0.53
Earnings per common share - diluted:				
Income (loss) from continuing operations applicable to common shares	$0.03	$0.02	$0.07	$(0.04)
Income from discontinued operations	0.37	0.02	0.56	0.57
Net income applicable to common shares - diluted	$0.40	$0.04	$0.63	$0.53
Comprehensive income:				
Net income	$20,007	$2,101	$32,022	$23,680
Other comprehensive income:				
Change in fair value and reclassification of hedge instruments	(622)	(896)	1,687	(2,529)
Total comprehensive income	19,385	1,205	33,709	21,151
Comprehensive (income) loss attributable to noncontrolling interests	(14)	(8)	(45)	1

Total comprehensive income attributable to AERC	$19,371	$1,197	$33,664	$21,152
Dividends declared per common share	$0.19	$0.18	$0.57	$0.53
Weighted average number of common shares outstanding - basic	49,949	49,461	49,816	44,924
Weighted average number of common shares outstanding - diluted	50,267	49,927	50,376	44,924

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

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

	Nine Months Ended September 30,	
(In thousands)	2013	2012
Cash flow from operating activities:		
Net income	$32,022	$23,680
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization (including discontinued operations)	43,564	40,912
Gain on disposition of properties	(26,868)	(22,819)
Amortization of deferred financing costs and other	909	1,515
Share-based compensation expense	3,385	2,890
Net change in assets and liabilities:		
Accounts receivable	(464)	3,830
Accounts payable and accrued expenses	4,349	2,057
Other operating assets and liabilities	452	(448)
Total adjustments	25,327	27,937
Net cash flow provided by operating activities	57,349	51,617
Cash flow from investing activities:		
Recurring fixed asset additions	(8,310)	(6,694)
Revenue enhancing/non-recurring fixed asset additions	(1,322)	(1,311)
Acquisition fixed asset additions	(143,308)	(158,925)
Development fixed asset additions	(70,012)	(44,485)
Net proceeds from disposition of operating properties	90,453	57,523
Investment in joint ventures	(8,874)	—
Deposits on potential future acquisitions	(15,721)	(250)
Other investing activity	(1,667)	(777)
Net cash flow used for investing activities	(158,761)	(154,919)
Cash flow from financing activities:		
Principal amortization payments on mortgage notes payable	(2,371)	(2,123)
Principal repayments of mortgage notes payable	—	(123,448)
Payment of debt procurement costs	(2,453)	(3,469)
Proceeds from secured mortgages	—	48,513
Proceeds from issuance of unsecured notes	150,000	—
Revolving credit facility borrowings	344,200	468,800
Revolving credit facility repayments	(357,700)	(359,800)
Common share dividends paid	(28,170)	(23,549)
Operating partnership distributions paid	(42)	(40)
Exercise of stock options	1,550	51
Issuance of common shares	1,870	98,355
Purchase of treasury shares	(704)	(958)
Noncontrolling interest investment in partnership	—	350
Purchase of noncontrolling interest in partnership	(4,544)	—
Other financing activities, net	361	494
Net cash flow provided by financing activities	101,997	103,176
Increase (decrease) in cash and cash equivalents	585	(126)
Cash and cash equivalents, beginning of period	4,740	4,328
Cash and cash equivalents, end of period	$5,325	$4,202
Supplemental disclosure of cash flow information:		

Dividends declared but not paid	$10,659	$9,583
Issuance of shares for share-based compensation	—	1,910
Net change in accounts payable related to fixed asset additions	6,770	1,188
Net change in accounts payable and security deposits related to disposition of operating properties	(690)	(432)
Net change in accounts payable and security deposits related to acquisition of operating properties	1,231	1,042
Mortgage loan assumed	—	27,509

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

ASSOCIATED ESTATES REALTY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

1. BUSINESS

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.

We are a fully-integrated, self-administered and self-managed equity real estate investment trust ("REIT") specializing in multifamily ownership, operation, acquisition, development, construction, disposition and property management activities. Our primary source of income is rental revenue. We own a taxable REIT subsidiary that performs construction services for our own account in connection with the development of multifamily properties we own and operate, including consolidated and unconsolidated joint ventures. As of September 30, 2013, our operating portfolio consisted of 52 apartment communities containing 13,323 units in ten states that are owned, either directly or indirectly, through subsidiaries. In conjunction with our acquisition of land for development of an apartment community, we acquired an office building in Los Angeles, California, containing approximately 78,800 square feet of office and retail space.

2. SIGNIFICANT ACCOUNTING POLICIES

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, 2012.

Segment Reporting

Substantially all of our properties are multifamily communities that have similar economic characteristics and offer similar products and services, and as such, our apartment communities have been aggregated into one reportable segment. Management evaluates the performance of our properties on an individual basis. During the nine months ended September 30, 2013, substantially all of our consolidated revenue was provided by our multifamily properties. We have determined that we have only one reportable segment, which is multifamily properties.

Derivative Instruments and Hedging Activities

We utilize interest rate swaps 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.

We do not use derivatives for trading or speculative purposes. Further, we have a policy of 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 for which the derivatives are designed to hedge, we have not sustained a material loss from these hedges.

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. 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. See Note 12 for additional information related to our derivative and hedging activities.

Real Estate and Depreciation

Real estate assets are stated at cost less accumulated depreciation. Depreciation is recognized on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	5 - 30 years
Furniture, fixtures and equipment	5 - 10 years

We capitalize replacements and improvements, such as HVAC equipment, structural replacements, windows, appliances, flooring, carpeting and kitchen/bath replacements and renovations. Ordinary repairs and maintenance, such as unit cleaning, painting and appliance repairs, are expensed when incurred.

We allocate the purchase price of acquired properties to net tangible and identified intangible assets acquired based on their fair values. In making estimates of fair values for purposes of allocating purchase price, we utilize a number of sources, including analysis provided by an advisor, independent appraisals that may be obtained in connection with the acquisition or financing of the respective property, our analysis of recently acquired and existing comparable properties in our portfolio and other market data. The intangible assets are amortized over the remaining lease terms or estimated life of the tenant relationship, which is approximately 12 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. The intangible assets associated with one commercial lease are being amortized over the life of the lease, which is 60 months.

For properties under development, we capitalize interest costs on funds used in construction, real estate taxes and insurance from the commencement of development activity through the time the property is ready for leasing. For properties under development accounted for under the equity method, we capitalize interest costs on our investment through the time the property is substantially complete and ready for leasing. We also capitalize internal costs related to our consolidated and equity method ventures, which are primarily payroll, but may also include costs such as travel, lodging and temporary construction facilities that are directly attributable to the construction of a property or asset. Internal costs associated with the lease up of development properties are not capitalized. Revenue from incidental operations are recognized as reductions of capitalized project costs. Capitalized payroll costs are allocated to projects based upon time incurred by the applicable personnel. Capitalized costs related to development and construction are transferred to buildings and improvements and/or furniture and fixtures, as applicable, upon substantial completion of the project. Total capitalized interest during the three and nine months ended September 30, 2013, was $1.1 million and $2.4 million, respectively. Total capitalized interest during the three and nine months ended September 30, 2012, was $410,000 and $1.0 million, respectively. Total capitalized payroll costs during the three and nine months ended September 30, 2013, were $690,000 and $2.0 million, respectively. Total capitalized payroll costs during the three and nine months ended September 30, 2012, were $670,000 and $1.7 million, respectively.

We discontinue the depreciation of assets we have specifically identified as held for sale. There were no properties classified as held for sale at September 30, 2013 or December 31, 2012.

Classification of Fixed Asset Additions

We define recurring fixed asset additions to a property as 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 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.

Offsetting Assets and Liabilities

In January 2013, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This ASU applies to derivatives accounted for in accordance with ASC 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse purchase agreements, in addition to securities borrowing and lending transactions that are either offset in accordance with ASC 210 or ASC 815 or subject to an enforceable master netting arrangement or similar agreement. This ASU requires disclosure of quantitative information separately for assets and liabilities in a tabular format and a description of the rights of setoff associated with the assets and liabilities subject to the master netting arrangements. See Note 12 for additional information related to our derivative and hedging activities. This updated guidance applies to fiscal years and interim periods within those years, beginning on or after January 1, 2013. We adopted this guidance effective January 1, 2013.

Other Comprehensive Income

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which requires an entity to present information about significant reclassification adjustments from accumulated other comprehensive income in a single note or on the face of the financial statements. This information is required to be presented by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. See Note 12 for additional information related to our derivative and hedging activities. This updated guidance is effective prospectively for reporting periods beginning after December 15, 2012. We adopted this guidance effective January 1, 2013.

Reclassifications

Certain reclassifications have been made to the 2012 financial statements to conform to the 2013 presentation as a result of discontinued operations.

3. ACQUISTION, DEVELOPMENT, AND DISPOSITION ACTIVITY

Acquisition Activity

On September 20, 2013, we entered into an agreement to acquire a portfolio of seven properties, as identified in the following table, for total cash consideration of approximately $323.9 million, less the assumption of $28.0 million of existing mortgage financing. We expect to acquire each of the properties based on the closing periods set forth in the following table. The closing of The Apartments at Blakeney, which occurred on October 10, 2013, was contingent upon the assumption of an existing $28.0 million mortgage loan. See Note 15 for further information on this acquisition and loan assumption. The closing of Alpha Mill Apartments Phase I and Alpha Mill Apartments Phase II is contingent on the completed construction of Alpha Mill Apartments Phase II. The closing of each of Perimeter Town Center and Varela is contingent upon the completed construction of such property. Our obligation to purchase this portfolio is subject to certain closing conditions specified in the agreement. If we choose not to purchase one or more of the properties, despite the closing conditions having been satisfied within the time period contemplated by the purchase agreement, we would forfeit the then-remaining balance of our earnest money deposits, which aggregate $15.0 million. We consider our deposits allocated to the entities developing the properties under construction to be variable interests and the development entities to be variable interest entities for which we are not the primary beneficiary as of this reporting date. Although we intend to acquire the entire portfolio and regard our acquisition of each property in the portfolio as probable, there can be no assurance that we will acquire such properties.

The table below provides details for each property the Company plans to acquire:

(Dollar amounts in thousands, except for unit data)

Property	Location	Units	Estimated Closing Period	Purchase Price Allocation
The Apartments at Blakeney	Charlotte, NC	295	Closed on October 10	$53,180
Lofts at Weston Lakeside	Cary, NC	215	Q4 2013	38,300
St. Mary's Square	Raleigh, NC	134	Q4 2013	27,325
Alpha Mill Apartments Phase I	Charlotte, NC	167	Q1 2014	27,220
Alpha Mill Apartments Phase II	Charlotte, NC	100	Q1 2014	18,050
Perimeter Town Center	Atlanta, GA	345	Q4 2014	80,350
Varela	Tampa, FL	350	Q4 2014	79,450
		1,606		$323,875

On September 27, 2013, we acquired Rienzi at Turtle Creek, a 152-unit property located in Dallas, Texas, for a purchase price of $48.9 million. We paid cash for this acquisition, which was primarily funded from borrowings on our unsecured revolver.

On July 16, 2013, we acquired Doral West, a 388-unit property located in Doral, Florida, for a purchase price of $93.5 million. We paid cash for this acquisition, which was primarily funded from borrowings on our unsecured revolver.

On May 28, 2013, we acquired a 3.35 acre parcel of land in San Francisco, California, in the South of Market ("SoMa") neighborhood for $46.6 million. The purchase price for the site known as 8th and Harrison includes the related entitlement rights, architectural drawings and other matters for which we intend to develop a 408-unit apartment community with ground floor retail and underground parking. Construction is expected to commence in 2014.

During the year ended December 31, 2012, we entered into an agreement to acquire for a purchase price of $80.2 million an apartment project that is being developed in Ft. Lauderdale, Florida. Our purchase obligation is conditioned upon the successful completion of the property in accordance with agreed upon plans and specifications and up to an 18-month period to allow for lease up of the property. Closing will not occur unless the conditions are satisfied, which is currently expected to occur in 2016. The developer may elect to terminate our agreement to purchase by agreeing to the release of our $4.0 million earnest money deposit from escrow and paying us an $8.0 million termination fee. If we choose not to purchase the property, despite the closing conditions having been satisfied within the time period contemplated by the purchase agreement, we would forfeit our $4.0 million earnest money deposit. We consider our deposit to be a variable interest and the development entity to be a variable interest entity for which we are not the primary beneficiary as of this reporting date.

During the nine months ended September 30, 2012, we acquired (a) four apartment communities for a total purchase price of $162.6 million, and (b) an office and retail building, in conjunction with a development project, consisting of approximately 78,800 square feet of space in Los Angeles, California, for a purchase price of $37.3 million.

The following table presents the purchase allocation for the properties acquired during the nine months ended September 30, 2013 and September 30, 2012, respectively. The purchase allocation for the property acquired in October 2013 was not complete as of the filing date of this document, and is therefore not included in the table below. See Note 15 for more information related to this purchase.

	Nine Months Ended September 30,	
	2013	2012
(Dollar amounts in thousands)		
Land	$15,971	$42,888
Buildings and improvements	123,193	150,186
Furniture and fixtures	1,154	3,190
Existing leases and tenant relationships (Other assets) (1)	2,082	6,313
Acquired debt (2)	—	(27,530)
Total	$142,400	$175,047

(1) See Note 5 for additional information related to intangible assets identified as existing leases and tenant relationships.

(2) Recorded at fair value; actual loan assumed was $24.9 million.

The following table presents actual and pro forma information related to the properties acquired during the three and nine months ended September 30, 2013 and 2012, respectively. The pro forma information is presented as if the properties were acquired on January 1, 2012. We recognized acquisition costs during the three and nine months ended September 30, 2013, totaling $392,000 and $457,000, respectively, which are included in "Costs associated with acquisitions" in the Consolidated Statements of Operations and Comprehensive Income. The purchase allocation for the property acquired in October 2013 was not complete as of the filing date of this document. Therefore, the impact of this property cannot be estimated and included in the pro forma information below. See Note 15 for more information related to this purchase. The pro forma presentation is presented for informational purposes only, and is not necessarily indicative of what our actual results of operations would have been had the acquisitions occurred at such time.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share data)	2013	2012	2013	2012
Actual revenue from acquisitions	$1,732	$3,192	$1,732	$3,834
Actual net income from acquisitions	139	11	139	243
Pro forma revenue	49,243	47,118	144,405	138,711
Pro forma net income applicable to common shares	20,702	2,959	33,877	25,541
Pro forma earnings per common share - basic:				
Pro forma net income applicable to common shares	$0.41	$0.06	$0.68	$0.57
Pro forma earnings per common share - diluted:				
Pro forma net income applicable to common shares	$0.41	$0.06	$0.67	$0.57

Development Activity

During the three months ended September 30, 2013, we entered into a partnership in which we are a 50.0% partner to develop a 154-unit apartment community located in Monrovia, California, which we refer to as Monrovia. See Note 6 for additional information related to this development.

During the three months ended June 30, 2013, we entered into a partnership in which we are a 50.0% partner to develop a 472-unit apartment community located in Los Angeles, California, which we refer to as 950 Third. See Note 6 for additional information related to this development.

The following table identifies our consolidated development activity on which construction has commenced:

(Dollar amounts in thousands) Under Construction	Ownership %		Planned Total Units	Total Budgeted Capital Cost [1]	Costs to Date [3]	Total Debt	Actual Construction Start	Estimated Construction Completion
San Raphael Phase II	100.0%		99	$13,750	$13,300	$—	Q2 2012	Q4 2013
Dallas, TX								
7001 Bethesda	97.0%	[2]	140	$53,400	$21,184	$—	Q4 2012	Q2 2015
Bethesda, MD								
Cantabria	100.0%		249	$56,800	$16,856	$—	Q2 2013	Q1 2015
Dallas, TX								
The Desmond on Wilshire	100.0%		175	$76,300	$24,987	$—	Q2 2013	Q4 2015
Los Angeles, CA								
Total			663	$200,250	$76,327	$—		

(1) Total budgeted capital cost represents estimated costs for projects under development inclusive of all capitalized costs.

(2) Ownership percentage based on current equity of the joint venture and is subject to change based on changes in total equity. Costs are shown at 100%. Joint venture partner contribution is $350.

(3) Costs to date include the cost of land.

The following table identifies our consolidated development activity that is in the planning phase:

(Dollar amounts in thousands) Name	Location	Ownership %	Estimated Total Units [1]	Costs to Date [2]
8th and Harrison	San Francisco, CA	100.0%	408	$48,422

(1) Based on current projections as of October 22, 2013.

(2) Costs to date include the cost of land.

The following table identifies our unconsolidated development activity that is in the planning phase:

(Dollar amounts in thousands) Name	Location	Ownership %	Estimated Total Units [1]	Costs to Date [2]
950 Third [3]	Los Angeles, CA	50.0%	472	$32,050
Monrovia [4]	Monrovia, CA	50.0%	154	$13,695
Total			626	$45,745

(1) Based on current projections as of October 22, 2013.

(2) Costs to date include the cost of land.

(3) The Company's total investment in this entity at September 30, 2013, is $2.0 million. Costs to date include the cost of land, which was contributed by the joint venture partner. Costs shown are at 100%. See Note 6 for further information on this unconsolidated variable interest entity.

(4) The Company's total investment in this entity at September 30, 2013, is $6.9 million. Costs to date include the joint venture partner's contribution. Costs shown are at 100%. See Note 6 for further information on this unconsolidated variable interest entity.

Disposition Activity

The results of operations for all periods presented and gains related to the sale of operating properties are reported in "Income from discontinued operations" in the accompanying Consolidated Statements of Operations and Comprehensive Income. Real estate assets classified as held for sale are also reported as discontinued operations. We classify properties as held for sale when all significant contingencies surrounding the completion of the disposition 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.

During the nine months ended September 30, 2013, we completed the sale of two properties for an aggregate total sales price of $92.7 million and recognized an aggregate gain of $26.9 million. One of the properties was located in Georgia and one in Ohio.

"Income from discontinued operations" in the accompanying Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2013 and 2012 include the operating results and related gains recognized for two properties sold in 2013 and six properties sold in 2012. The following table summarizes "Income from discontinued operations:"

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Revenue				
Property revenue	$649	$3,275	$4,417	$13,699
Expenses				
Property operating and maintenance	329	1,635	2,167	6,925
Depreciation and amortization	138	799	723	3,717
Total expenses	467	2,434	2,890	10,642
Operating income	182	841	1,527	3,057
Interest expense	—	—	—	(438)
Operating income, net of interest expense	182	841	1,527	2,619
Gain on disposition of properties	18,072	—	26,868	22,819
Income from discontinued operations	$18,254	$841	$28,395	$25,438

We have engaged Hancock Real Estate Strategies ("HRES"), a full service investment real estate brokerage and advisory firm, to provide certain real estate brokerage services. HRES is owned by Matthew E. Friedman, a son of our CEO. For the nine months ended September 30, 2013, in conjunction with the sale of two properties and our joint venture to develop the 950 Third land, HRES has received commissions totaling $1.1 million. The aggregate value of these transactions was $122.7 million. These transactions were approved by the independent Directors in compliance with Company policy.

4. DEBT

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

	September 30, 2013			December 31, 2012		
(Dollar amounts in thousands)	Balance Outstanding	Weighted Average Interest Rate		Balance Outstanding	Weighted Average Interest Rate	
Fixed Rate Debt:						
Secured	$373,299	5.4	%	$376,278	5.4	%
Unsecured - notes	150,000	4.3	%	—	—	%
Total Fixed Rate Debt	523,299	5.1	%	376,278	5.4	%
Variable Rate Debt Swapped to Fixed:						
Unsecured - term loan (1)	125,000	3.0	%	125,000	1.9	%
Total Variable Rate Debt Swapped to Fixed	125,000	3.0	%	125,000	1.9	%
Variable Rate Debt Unhedged:						
Unsecured - revolver	177,000	1.5	%	190,500	1.7	%
Unsecured - term loan	25,000	1.9	%	25,000	1.9	%
Total Variable Rate Debt Unhedged	202,000	1.5	%	215,500	1.7	%
Total Debt	$850,299	3.9	%	$716,778	3.7	%

(1) We entered into a forward starting swap in December 2011 fixing the rate at 1.26%, plus the credit spread which was 1.70% at September 30, 2013, or an all-in rate of 2.96% beginning June 2013 through June 2016. Additionally, we entered into a forward starting swap in April 2013, fixing the rate beginning June 2016 at a rate of 1.55%, plus the credit spread which was 1.70% as of September 30, 2013, or an all-in rate of 3.25% until the loan matures in January 2018. See Note 12 for additional information related to these swaps.

Unsecured Debt

On June 19, 2013, we amended our $350.0 million revolving credit facility. Among other modifications, the amendment extends the maturity date from January 12, 2016 to June 15, 2017, and reduces the interest spread and facility fee across the pricing grid. Total costs associated with this amendment were $1.2 million. Additionally, on June 19, 2013, we amended our $150.0 million term loan to implement modifications corresponding to the revolving credit facility modifications.

On January 22, 2013, we completed the issuance of $150.0 million of unsecured senior notes. The notes were offered in a private placement with two maturity tranches: $63.0 million with an 8-year maturity at a fixed rate of 4.02%, and $87.0 million with a 10-year maturity at a fixed rate of 4.45%. The $150.0 million total issuance had a weighted average term of 9.2 years and a weighted average interest rate of 4.27%. Proceeds from the issuance were used to repay borrowings on the unsecured revolver. Total costs associated with this issuance were approximately $1.0 million.

Mortgage Notes Payable

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 was 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. We subsequently learned that, for certain defeasance transactions, the successor borrower was able to prepay certain loans, thus enabling us to receive a refund of a portion of the costs incurred in connection with the transactions. During the nine months ended September 30, 2012, we received a refund of $279,000, which represents the last refund we could receive as all defeased loans have now matured and have been repaid in full.

Cash paid for interest, excluding $2.4 million and $1.0 million of capitalized interest, respectively, was $19.8 million and $21.8 million for the nine months ended September 30, 2013 and 2012, respectively. Cash paid for interest was reduced by the defeasance refund received of $279,000 for the nine months ended September 30, 2012. Additionally, $1.7 million of prepayment costs is included in the cash paid for interest for the nine months ended September 30, 2012.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

Our goodwill was allocated to our properties on a relative fair value basis. Upon disposition of properties, the goodwill allocated is included in the calculation of the gain or loss on disposal and subsequently written-off. During the nine months ended September 30, 2013, we wrote-off $180,000 of our goodwill as a result of property dispositions. The carrying value of our goodwill as of September 30, 2013 and December 31, 2012, was $1.5 million and $1.7 million, respectively. Our annual review of goodwill impairment is completed 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, 2013, determined that goodwill was not impaired and no other events have occurred that would require goodwill to be reevaluated. In performing this analysis, we compare the net book value of each property, including the amount of allocated goodwill, to its estimated fair market value. Should the estimates used to determine the fair value of the properties 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 in place 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 months. Due to the short term nature of residential leases, we believe existing lease rates approximate market rates. Therefore, no allocation is made for above/below market leases. The intangible assets associated with one commercial lease are being amortized over the life of the lease, which is 60 months.

6. INVESTMENT IN UNCONSOLIDATED ENTITIES

Monrovia

During the three months ended September 30, 2013, we entered into a partnership agreement with LPC MM Monrovia, LLC ("Lincoln"), an unrelated third-party for the limited purpose of acquiring a property in Monrovia, California, and to produce construction drawings for improvements to the property. The land, upon which the partnership intends to construct a 154-unit multifamily apartment complex, was purchased by the partnership on August 9, 2013, for $13.1 million. We are a 50.0% partner with Lincoln, who has contributed $6.9 million to the partnership. As of September 30, 2013, we have contributed $6.9 million to the partnership. Any future equity capital needs will be funded on a 50/50 basis by the partners. Both partners have equal voting rights with respect to all major decisions and all such decisions must be unanimous, including, among other things, development planning, budgeting and operational budgets. Lincoln will perform the day-to-day activities on behalf of the partnership. As the joint venture is not sufficiently funded to finance the activities of the entity, and not all of the capital will be funded up front, the joint venture is not deemed to have sufficient equity, and has therefore been determined to be a variable interest entity. It has also been determined that we do not control the decisions that most significantly affect the economics of the entity, and that we do not hold a controlling financial interest in the entity. As such, our investment in the entity is included in our consolidated financial statements using the equity method. Our maximum exposure to loss, as a result of our involvement in this entity, is the carrying value of our investment, which was $6.9 million as of September 30, 2013. See Note 3 for more information related to this development.

950 Third

During the quarter ended June 30, 2013, we entered into a partnership agreement with Legendary Investors Group No. 1 LLC ("Legendary"), an unrelated third-party for the development and operation of 950 Third, a 472-unit apartment community located in Los Angeles, California. We are a 50.0% partner with Legendary, who contributed the land at a value of $30.0 million to the joint venture. As of September 30, 2013, we have contributed $1.6 million to the partnership. We expect to fund the remaining portion of our capital contribution during the development and construction process. Both partners have equal voting rights with respect to all major decisions and all such decisions must be unanimous, including, among other things, development planning, budgeting and operational budgets. We will perform construction management and property management services in accordance with the approved budgets for which we will receive a fee approximating market rates. As the joint venture is not sufficiently funded to finance the activities of the entity, and not all of the capital will be funded up front, the joint venture is not deemed to have sufficient equity, and has therefore been determined to be a variable interest entity. It has also been determined that we do not control the decisions that most significantly affect the economics of the entity, and that we do not hold a controlling financial interest in the entity. As such, our investment in the entity is included in our consolidated financial statements using the equity method. The amount of capitalized interest associated with our investment in this property was approximately $30,000 as of September 30, 2013. We also capitalized internal payroll and overhead costs directly related to the development of this property for which we are not being reimbursed in the amount of $470,000 as of September 30, 2013. This excess of our investment over our equity in the underlying net assets of the joint venture is included in "Investment in unconsolidated entities" in our Consolidated Balance Sheets, and will be amortized as a reduction to earnings on a straight-line basis over the lives of the related assets. Our maximum exposure to loss, as a result of our involvement in this entity, is the carrying value of our investment, which was $2.0 million as of September 30, 2013. See Note 3 for more information related to this development.

7. NONCONTROLLING INTERESTS

Noncontrolling Redeemable Interest

In 1998, we issued a total of 522,032 operating partnership units ("OP units") in conjunction with the acquisition of an operating partnership that owned two apartment communities, one of which was sold in October 2005. Holders of OP units are entitled to receive cumulative distributions per OP unit equal to the per share distributions on our common shares. If and when the OP units are presented for redemption, we have the option to redeem the OP units for common shares exchangeable on a one-for-one basis, or the cash equivalent amount, determined as the average closing price for our common shares over the 20-day period preceding the redemption. All units presented to date for redemption were redeemed for cash. No OP units were redeemed during the nine months ended September 30, 2013 or 2012. There were 74,083 OP units remaining as of September 30, 2013. See Note 15 for additional information related to the OP units.

Activity related to noncontrolling redeemable interest is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Balance at beginning of period	$1,734	$1,734	$1,734	$1,734
Net income attributable to noncontrolling redeemable interest	14	13	42	40
Distribution to noncontrolling redeemable interest	(14)	(13)	(42)	(40)
Balance at end of period	$1,734	$1,734	$1,734	$1,734

Noncontrolling Interests

On July 14, 2011, we entered into a partnership agreement with Keating Project Development, Inc., an unrelated third-party, pursuant to which we hold a 97.0% equity interest in the partnership. In March 2012, the partnership acquired a 2.5 acre parcel of land in Bethesda, Maryland, for $12.2 million on which it is developing 140 multifamily units and 7,000 square feet of retail space. We have determined that this entity is not a variable interest entity and that we hold a controlling interest in the entity. As such, this entity is included in our consolidated financial statements. We have also determined that the noncontrolling interest in this entity meets the criteria to be classified as a component of permanent equity.

On September 24, 2010, we entered into a partnership agreement with Bristol Development Group, an unrelated third-party, for the development of Vista Germantown, a 242-unit apartment community located in downtown Nashville, Tennessee. We contributed $9.4 million to the partnership and held a 90.0% equity interest in the partnership. In February 2013, we funded the redemption of the interest of the minority 10.0% partner of this partnership for $4.5 million and as a result we own a 100% interest in Vista Germantown.

The following table provides details of the activity related to the noncontrolling interests:

	Nine Months Ended September 30,	
(In thousands)	2013	2012
Balance at beginning of period	$1,344	$1,029
Net income (loss)	3	(41)
Purchase of noncontrolling interest	(997)	—
Noncontrolling interest cash contribution	—	350
Balance at end of period	$350	$1,338

The following table provides details of the activity related to changes in ownership of noncontrolling interests:

	Nine Months Ended September 30,	
	2013	2012
Net income attributable to AERC	$31,977	$23,681
Decrease in equity for purchase of noncontrolling interest	(3,547)	—
Change from net income attributable to AERC and net transfers to noncontrolling interest	$28,430	$23,681

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8. EQUITY

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

	Nine Months Ended September 30, 2013					
(In thousands)	Common Shares (at $.10 stated value)	Paid-In Capital	Accumulated Distributions in Excess of Accumulated Net Income	Accumulated Other Comprehensive Loss	Treasury Shares (at Cost)	Noncontrolling Interest
Balance, December 31, 2012	$4,953	$634,587	$(233,208)	$(2,934)	$—	$ 1,344
Net income attributable to AERC	—	—	31,977	—	—	—
Other comprehensive income:						
Changes in fair value of hedge instruments	—	—	—	1,687	—	—
Net income attributable to noncontrolling interest	—	—	—	—	—	3
Purchase of noncontrolling interest	—	(3,547)	—	—	—	(997)
Share-based compensation	68	4,315	2	—	—	—
Purchase of common shares	—	—	—	—	(703)	—
Option exercises	13	840	—	—	697	—
Issuance of common shares	11	1,859	—	—	—	—
Common share dividends declared	—	—	(28,948)	—	—	—
Balance, September 30, 2013	$5,045	$638,054	$(230,177)	$(1,247)	$(6)	$ 350

9. COMMON SHARES

In April 2013, we registered an at-the-market ("ATM") program allowing us to sell up to $75.0 million of our common shares in open market transactions at the then current market price per share. As of September 30, 2013, we sold 107,498 shares under this ATM program for total net proceeds of $1.9 million. The proceeds were used for general corporate purposes.

Under Forward Sale Agreements (FSAs) that we entered into with forward purchasers on May 29, 2013, we agreed to sell 6,500,000 shares plus an option to purchase up to 975,000 additional shares, of which 547,958 shares were exercised on July 2, 2013, for a total of 7,047,958 shares at a public offering price of $17.25 per share that was settled on October 1, 2013.

We had the option to settle the FSAs by cash or net share settlement for all or a portion of our obligation under the FSAs. We chose to physically settle the FSAs by issuing 7,047,958 shares of our common stock to the forward purchasers, who at settlement paid us the proceeds less certain adjustments from their sale of borrowed shares to the underwriters, including the third quarter dividend.

On October 1, 2013, by delivering 7,047,958 shares of our common stock to the forward purchasers at a public offering price of $17.25 per share, we received net proceeds of approximately $115.1 million based on the adjusted net settlement price of $16.33 per share, inclusive of the underwriting discount, estimated costs and the deduction for the third quarter dividend. Net proceeds were used to partially repay our scheduled debt maturities for 2013 consisting of five mortgage loans totaling approximately $129.3 million.

As of September 30, 2013, we classified the FSAs as equity transactions because the forward sale transactions were indexed to our own stock and physical settlement was within our control. As a result of this classification, no amounts were recorded in the consolidated financial statements until settlement of each FSA.

Whether we decided to physically settle or net share settle the FSAs, delivery of our shares upon settlement will result in dilution to our earnings per share ("EPS") at the date of the settlement. The inclusion of any incremental shares in the calculation of diluted EPS under the treasury stock method began during the quarter ending June 30, 2013. Any dilutive effect of the FSAs on our EPS will occur only during periods when the average market price per share of our common stock during that reporting period is above the per share forward sale price.

10. EARNINGS PER SHARE

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, except per share amounts)	2013	2012	2013	2012
Numerator - basic and diluted:				
Income (loss) from continuing operations	$1,753	$1,260	$3,627	$(1,758)
Net (income) loss attributable to noncontrolling interests	(14)	(8)	(45)	1
Allocation to participating securities	(7)	—	(15)	—
Income (loss) from continuing operations applicable to common shares	$1,732	$1,252	$3,567	$(1,757)
Income from discontinued operations	$18,254	$841	$28,395	$25,438
Allocation to participating securities	(78)	—	(121)	—
Income from discontinued operations applicable to common shares	$18,176	$841	$28,274	$25,438
Denominator - basic	49,949	49,461	49,816	44,924
Effect of dilutive securities [(1)]	318	466	560	—
Denominator - diluted	50,267	49,927	50,376	44,924
Earnings per common share - basic:				
Income (loss) from continuing operations	$0.03	$0.02	$0.07	$(0.04)
Income from discontinued operations	0.37	0.02	0.57	0.57
Net income attributable to AERC - basic	$0.40	$0.04	$0.64	$0.53
Earnings per common share - diluted:				
Income (loss) from continuing operations	$0.03	$0.02	$0.07	$(0.04)
Income from discontinued operations	0.37	0.02	0.56	0.57
Net income attributable to AERC - diluted	$0.40	$0.04	$0.63	$0.53

(1) For the three and nine months ended September 30, 2013, the effect of 93 stock options are excluded as their inclusion would be anti-dilutive. Additionally, 7,048 shares from the FSA are excluded for the three and nine months ended September 30, 2013, as their inclusion would be anti-dilutive. For the three months ended September 30, 2012, the effect of 145 stock options are excluded as their inclusion would be anti-dilutive. For the nine months ended September 30, 2012, all potential common shares are excluded as their inclusion would be anti-dilutive to the net loss from continuing operations.

The effect of exercise of rights to redeem OP units in exchange for common shares was not included in the computation of diluted EPS because we intend to settle the redemption of these interests in cash.

11. EQUITY BASED AWARD PLANS

During the three and nine months ended September 30, 2013, we recognized total share-based compensation cost of $980,000 and $3.4 million, respectively, in "General and administrative expense" in the Consolidated Statements of Operations and Comprehensive Income. During the three and nine months ended September 30, 2012, we recognized total share-based compensation cost of $880,000 and $2.7 million, respectively, in "General and administrative expense" in the Consolidated Statements of Operations and Comprehensive Income. During the three and nine months ended September 30, 2013, we capitalized $90,000 and $300,000, respectively, of share-based compensation, which relates to employees dedicated to internal development. During the three and nine months ended September 30, 2012, we capitalized $50,000 and $145,000, respectively, of share-based compensation, which relates to employees dedicated to internal development. See Note 2 for additional information related to capitalized payroll.

Restricted Shares. Restricted shares generally have the same rights as our common shares, except for transfer restrictions and forfeiture provisions. Our officers and directors may elect to defer the receipt of restricted shares under our deferred compensation plans. Deferred restricted share awards are reflected as restricted share equivalent units ("RSUs") in an individual bookkeeping account maintained for each participant. The vesting of such RSUs occurs on the same schedule as the restricted shares subject to the deferral election, and the valuation and attribution of cost in our consolidated financial statements are also the same as the restricted shares subject to the deferral election. RSUs are not included in the number of issued and outstanding common shares reflected in the "Equity" section of our Consolidated Balance Sheets. RSUs with non-forfeitable dividend rights are included in the allocation to participating securities using the two-class method. RSUs with forfeitable dividend rights do not qualify as participating securities, and are included in the calculation of diluted earnings per share to the extent they are not anti-dilutive for the period presented.

The following table represents restricted share and RSU activity for the nine months ended September 30, 2013:

	Number of Shares	Weighted Average Grant Date Fair Value	Number of RSUs	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	525,406	$9.23	58,825	$14.13
Granted	726,620	$10.44	25,848	$17.44
Vested	162,830	$15.97	36,817	$16.01
Forfeited	81,511	$8.48	1,865	$8.38
Nonvested at end of period	1,007,685	$9.06	45,991	$14.72

The weighted average grant-date fair value of restricted shares and RSUs granted during the nine months ended September 30, 2012 was $16.52. The total fair value of restricted shares vested during the nine months ended September 30, 2013 and 2012 was $2.7 million and $3.6 million, respectively. The total fair value of RSUs vested during the nine months ended September 30, 2013 and 2012 was $590,000 and $715,000, respectively. At September 30, 2013, there was a total of $6.5 million of unrecognized compensation cost related to non-vested restricted share awards and RSUs that we expect to recognize over a weighted-average period of 2.5 years.

During 2013, we issued restricted share awards in which the number of shares that will ultimately vest is subject to market conditions over a three-year period and service conditions over a four-year period. The total estimated grant-date fair value of these awards, including the awards that were deferred, was $4.3 million. We used the Monte Carlo method to estimate the fair value of these awards. The Monte Carlo method, which is similar to the binomial analysis, evaluates the award for changing stock prices over the term of vesting, and uses random situations that are averaged based on past stock characteristics. There were one million simulation paths used to estimate the fair value of these awards. The expected volatility for the awards granted in 2013 was based upon a 50/50 blend of historical and implied volatility. The historical volatility was based upon changes in the weekly closing prices of our shares over a period equal to the expected life of the restricted shares granted. The implied volatility was the trailing month average of daily implied volatilities calculated by interpolating between the volatilities implied by stock call option contracts that were both closest to the expected life and the exercise price of the restricted shares. The risk-free interest rate used was based on a yield curve derived from U.S. Treasury zero-coupon bonds on the date of grant with a maturity equal to the market condition performance periods. The expected life used was the market condition performance period.
The following table represents the assumption ranges used in the Monte Carlo method during 2013:

Expected volatility - AERC	18.1% to 22.5%
Expected volatility - peer group	14.7% to 29.5%
Risk-free interest rate	0.1% to 0.5%
Expected life (performance period)	3 years

Stock Options. We use the Black-Scholes option pricing model to estimate the fair value of share-based awards that do not include a market condition. There were no stock options awarded and 169,164 options exercised during the nine months ended September 30, 2013. There were 125,000 stock options awarded, 10,000 options expired and 5,000 stock options exercised during the nine months ended September 30, 2012. The Black-Scholes assumptions and fair value for the options awarded in 2012 were as follows:

Expected volatility	33.9	%
Risk-free interest rate	1.3	%
Expected life of options	7 years	
Dividend yield	4.7	%
Grant-date fair value	$2.97	

The expected volatility was based upon a 50/50 blend of historical and implied volatility. The historical volatility was based upon changes in the weekly closing prices of our shares over a period equal to the expected life of the options granted. The implied volatility was the trailing month average of daily implied volatilities calculated by interpolating between the volatilities implied by stock call option contracts that were both closest to the expected life and the exercise price of the options. The longest terms of such options over the trailing month averaged 7.1 months. The risk-free interest rate used was the yield from U.S. Treasury zero-coupon bonds on the date of the grant with a maturity equal to the expected life of the options. The expected life 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.

The following table represents stock option activity for the nine months ended September 30, 2013:

	Number of Stock Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contract Life
Outstanding at beginning of period	769,184	$10.81	
Exercised	169,164	$9.16	
Outstanding at end of period	600,020	$11.28	3.6
Exercisable at end of period	496,687	$10.60	