

ESSEX PROPERTY TRUST INC
Form 10-K
February 26, 2010

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

FORM 10-K

(MARK ONE)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2009

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1-13106

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.0001 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

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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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K.

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

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

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

As of June 30, 2009, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$1,662,116,047. The aggregate market value was computed with reference to the closing price on the New York Stock Exchange on such date. Shares of common stock held by executive officers, directors and holders of more than ten percent of the outstanding common stock have been excluded from this calculation because such persons may be deemed to be affiliates. This exclusion does not reflect a determination that such persons are affiliates for any other purposes.

As of February 24, 2010, 29,662,879 shares of common stock (\$.0001 par value) were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

The following document is incorporated by reference in Part III of the Annual Report on Form 10-K: Proxy statement for the annual meeting of stockholders of Essex Property Trust, Inc. to be held May 18, 2010.

Essex Property Trust, Inc.
2009 ANNUAL REPORT ON FORM 10-K

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PART I

Forward Looking Statements

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such forward-looking statements are described in Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations, in the section, “Forward Looking Statements.” Our actual results could differ materially from those set forth in each forward-looking statement. Certain factors that might cause such a difference are discussed in this report, including Item 1A, Risk Factors of this Form 10-K.

Item 1. Business

OVERVIEW

Essex Property Trust, Inc. (“Essex” or the “Company”) is a Maryland corporation that operates as a self-administered and self-managed real estate investment trust (“REIT”). The Company owns all of its interest in its real estate investments directly or indirectly through Essex Portfolio, L.P. (the “Operating Partnership”). The Company is the sole general partner of the Operating Partnership and as of December 31, 2009 owns a 92.3% general partnership interest. In this report, the terms “we,” “us” and “our” refer to Essex Property Trust, its Operating Partnership and the Operating Partnership’s subsidiaries.

The Company has elected to be treated as a REIT for federal income tax purposes, commencing with the year ended December 31, 1994 as the Company completed an initial public offering on June 13, 1994. In order to maintain compliance with REIT tax rules, the Company utilizes taxable REIT subsidiaries for various revenue generating or investment activities. All taxable REIT subsidiaries are consolidated by the Company.

We are engaged primarily in the ownership, operation, management, acquisition, development and redevelopment of predominantly apartment communities. As of December 31, 2009, we owned or held an interest in 133 apartment communities, aggregating 27,248 units, located along the West Coast, as well as five office buildings (totaling approximately 215,840 square feet), and four active development projects with 581 units in various stages of development (collectively, the “Portfolio”).

The Company’s website address is <http://www.essexpropertytrust.com>. The Company’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports, and the Proxy Statement for its Annual Meeting of Stockholders are available, free of charge, on our website as soon as practicable after we file the reports with the Securities and Exchange Commission (“SEC”).

BUSINESS STRATEGIES

The following is a discussion of our business strategies in regards to real estate investment and management.

Business Strategies

Research Driven Approach – We believe that successful real estate investment decisions and portfolio growth begin with extensive regional economic research and local market knowledge.

Utilizing a proprietary research model that we have developed over the last two decades, we continually assess markets where we currently operate, as well as markets where we consider future investment opportunities by

evaluating the following:

- Markets in major metropolitan areas that have regional population primarily in excess of one million;
- Constraints on new supply driven by: (i) low availability of developable land sites where competing housing could be built; (ii) political growth barriers, such as protected land, urban growth boundaries, and potential lengthy and expensive development permit processes; and (iii) natural limitations to development, such as mountains or waterways;
 - Rental demand is enhanced by affordability of rents compared to expensive for-sale housing; and
- Housing demand that is based on proximity to jobs, high quality of life and related commuting factors, as well as potential job growth.

Recognizing that all real estate markets are cyclical, we regularly evaluate the results of our regional economic, as well as our local market research, and adjust the geographic focus of our portfolio accordingly. We seek to increase our portfolio allocation in markets projected to have the strongest local economies and to decrease such allocations in markets projected to have declining economic conditions. Likewise, the Company also seeks to increase its portfolio allocation in markets that have attractive property valuations and to decrease such allocations in markets that have inflated valuations and low relative yields.

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Property Operations – We manage our communities by focusing on strategies that will generate above-average rental growth, tenant retention/satisfaction and long-term asset appreciation. We intend to achieve this by utilizing the strategies set forth below:

- Property Management – The Chief Operating Officer, Senior Vice President of Operations, Divisional Managers, Regional Portfolio Managers and Area Managers are accountable for the performance and maintenance of the communities. They supervise, provide training for the on-site managers, review actual performance against budget, monitor market trends and prepare operating and capital budgets.
- Capital Preservation – The Capital and Maintenance department is responsible for the planning, budgeting and completion of major capital improvement projects at our communities.
- Business Planning and Control – Comprehensive business plans are implemented in conjunction with every investment decision. These plans include benchmarks for future financial performance, based on collaborative discussions between on-site managers and senior management.
- Development and Redevelopment – We focus on acquiring and developing apartment communities in supply constrained markets, and redeveloping our existing communities to improve the financial and physical aspects of our communities.

CURRENT BUSINESS ACTIVITIES

Acquisitions of Real Estate

Acquisitions are an important component of our business plan, and during 2009, we completed the acquisition of two communities totaling \$43.0 million.

- In December, the Company acquired Axis 2300 (formerly known as “DuPont Lofts”), a 115-unit condominium development project in Irvine, California for \$27.0 million. The project is 85 percent complete and will require an additional six months of construction and estimated remaining costs of development are \$9.1 million, consisting primarily of unit interior finishes. Following construction, the Company intends to operate the asset as an apartment community. All units feature 11-foot ceilings, custom finishes, a washer and dryer and a fireplace.
- Also during December, the Company acquired Regency at Encino, a 75-unit community located in Encino, California for \$16.0 million. The community features upgraded appliances and finishes in 51 of the units. The Company intends to renovate the additional 24 units upon normal resident turnover. All units feature 9-foot ceilings and a washer and dryer.

In November, the Company acquired a 3.6 acre site in Dublin, California for \$5.0 million. The land parcel is located adjacent to the Dublin Bay Area Rapid Transit station, and the Company intends to pursue entitlements on this land parcel for future development.

The 2010 acquisition plan targets the purchase of up to \$300 million of real estate.

Dispositions of Real Estate

As part of our strategic plan to own quality real estate in supply-constrained markets the Company continually evaluates all the communities and sell those which no longer meet our strategic criteria. The Company may use the capital generated from the dispositions to invest in higher-return communities or other real estate investments, repurchase the Company’s common stock, or repay debts. The Company believes that the sale of these communities will not have a material impact on our future results of operations or cash flows nor will their sale materially affect our ongoing operations. Generally, the Company seeks to have any impact of earnings dilution resulting from these

dispositions offset by the positive impact of its acquisitions, development and redevelopment activities.

In 2009, in accordance with our strategic plan, the Company sold five apartment communities for gross proceeds of \$38.0 million for an aggregate gain of \$8.6 million.

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The 2010 disposition plan targets the sale of up to \$100 million of real estate.

Development Pipeline

The Company defines development activities as new communities that are in various stages of active development, or the community is in lease-up and phases of the project are not completed. As of December 31, 2009, the Company had four development projects comprised of 581 units for an estimated cost of \$216.1 million, of which \$65.9 million remains to be expended.

The Joule Broadway project, a 295-unit development in Seattle, Washington had \$26.7 million in estimated costs remaining to be funded in 2010 and such costs will be funded by a construction loan that is variable based on LIBOR plus 155 basis points and matures in June 2011 with two one-year extension options, exercisable at the Company's option. The estimated remaining costs to be incurred totaling \$39.2 million for the other three active development projects including Fourth & U, Tasman Retail Pad and Garage, and Axis 2300 will be financed by the Company's lines of credit.

The following table sets forth information regarding the Company's consolidated development pipeline:

Development Pipeline	Location	Units	As of 12/31/09 (\$ in millions)		
			Incurred Project Cost	Estimated Remaining Cost	Estimated Project Cost(1)
Development Projects					
Fourth & U	Berkeley, CA	171	\$49.5	\$13.8	\$63.3
Joule Broadway	Seattle, WA	295	68.1	26.7	94.8
Tasman Retail Pad and Garage	Sunnyvale, CA	-	5.4	16.3	21.7
Axis 2300	Irvine, CA	115	27.2	9.1	36.3
		581	150.2	65.9	216.1
Predevelopment projects	various	332	53.7	89.3	143.0
Land held for future development or sale	various	1,329	71.1	-	71.1
Development Pipeline		2,242	\$275.0	\$155.2	\$430.2

(1) Includes incurred costs and estimated costs to complete these development projects.

The Company defines the predevelopment pipeline as proposed communities in negotiation or in the entitlement process with a high likelihood of becoming entitled development projects. As of December 31, 2009, the Company had two development projects aggregating 332 units that were classified as predevelopment projects. The estimated total cost of the predevelopment pipeline at December 31, 2009 was \$143.0 million, of which \$89.3 million remains to be expended. The Company may also acquire land for future development purposes or sale. The Company has incurred \$71.1 million in costs related to land held for future development or sale aggregating 1,329 units as of December 31, 2009.

Redevelopment Pipeline

The Company defines redevelopment communities as existing properties owned or recently acquired, which have been targeted for additional investment by the Company with the expectation of increased financial returns through property improvement. During redevelopment, apartment units may not be available for rent and, as a result, may have less than stabilized operations. As of December 31, 2009, the Company had ownership interests in nine

redevelopment communities aggregating 2,659 apartment units with estimated redevelopment costs of \$128.0 million, of which approximately \$41.6 million remains to be expended.

Mortgage Debt Transactions

During 2009, the Company obtained fixed rate mortgage loans due in 10 years totaling \$176.6 million for an average interest rate of 5.8% and paid-off mortgage loans totaling \$23.6 million for an average interest rate of 6.9%.

Lines of Credit

In the fourth quarter, the Company entered into a new \$200 million unsecured line of credit facility and cancelled the existing \$200 million unsecured facility which was to mature in March 2010. The new unsecured facility has a one year maturity with two one-year extension options, exercisable at the Company's option, and the underlying interest rate on this unsecured facility is based on a tiered rate structure tied to the Company's corporate ratings and is currently at LIBOR plus 3.00%.

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Also in the fourth quarter, the Company exercised its option to increase the borrowing capacity of the secured line of credit facility from \$150 million to \$250 million which matures in December 2013.

Equity and Noncontrolling Interest Transactions

During the first quarter of 2009, the Company, under its stock repurchase program, repurchased and retired 350,000 shares of its common stock for approximately \$20.3 million, at an average stock price of \$57.89 per share.

During 2009, the Company issued 2,740,450 shares of common stock at an average share price of \$73.54 for \$198.5 million, net of fees and commissions. The Company used the net proceeds to invest in marketable securities and to fund the development pipeline.

During 2009, the Company repurchased \$145.0 million of 4.875% Series G Cumulative Convertible Preferred Stock at a discount to par value of \$50.0 million.

ESSEX APARTMENT VALUE FUND II

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 commitments of \$265.9 million which were fully contributed as of December 2008. The Company contributed \$75.0 million to Fund II, which represents a 28.2% interest as general partner and limited partner, and the Company uses the equity method of accounting for its investment in Fund II. 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 December 31, 2009, owned fourteen 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.

OFFICES AND EMPLOYEES

The Company is headquartered in Palo Alto, California, and has regional offices in Woodland Hills, California; Irvine, California; San Diego, California and Bellevue, Washington. As of December 31, 2009, the Company had 938 employees.

INSURANCE

The Company carries comprehensive liability, fire, extended coverage and rental loss insurance for each of the communities. Insured risks for comprehensive liabilities covers claims in excess of \$25,000 per incident, and property casualty insurance covers losses in excess of a \$5.0 million deductible per incident. There are, however, certain types of extraordinary losses, such as, for example, losses from terrorism and earthquakes, for which the Company does not have insurance. Substantially all of the communities are located in areas that are subject to earthquakes.

The Company believes it has a proactive approach to its potential earthquake losses. The Company utilizes third-party seismic consultants for its acquisitions and may perform seismic upgrades to those acquisitions that are determined to have a higher level of potential loss from an earthquake. The Company utilizes third-party loss models to help to determine its exposure. The majority of the communities are lower density garden-style apartments which may be less susceptible to material earthquake damage. The Company will continue to monitor third-party earthquake

insurance pricing and conditions and may consider obtaining third-party coverage if it deems it cost effective.

Although the Company may carry insurance for potential losses associated with its communities, employees, residents, and compliance with applicable laws, it may still incur losses due to uninsured risks, deductibles, co-payments or losses in excess of applicable insurance coverage and those losses may be material.

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COMPETITION

There are numerous housing alternatives that compete with the Company's communities in attracting residents. These include other apartment communities and single-family homes that are available for rent in the markets in which the apartment communities are located. The communities also compete for residents with new and existing homes and condominiums that are for sale. If the demand for our communities is reduced or if competitors develop and/or acquire competing apartment communities on a more cost-effective basis, rental rates and occupancy may drop which may have a material adverse affect on our financial condition and results of operations.

The Company faces competition from other real estate investment trusts, businesses and other entities in the acquisition, development and operation of apartment communities. Some competitors are larger and have greater financial resources than the Company. This competition may result in increased costs of apartment communities the Company acquires and/or develops.

WORKING CAPITAL

The Company believes that cash flows generated by its operations, existing cash and marketable securities balances, availability under existing lines of credit, access to capital markets and the ability to generate cash from the disposition of real estate are sufficient to meet all of our reasonably anticipated cash needs during 2010. The timing, source and amounts of cash flows provided by financing activities and used in investing activities are sensitive to changes in interest rates and other fluctuations in the capital markets environment, which can affect our plans for acquisitions, dispositions, development and redevelopment activities.

ENVIRONMENTAL CONSIDERATIONS

See the discussion under the caption, "The Company's Portfolio may have unknown environmental liabilities" in Item 1A, Risk Factors, for information concerning the potential effect of environmental regulations on our operations.

OTHER MATTERS

Certain Policies of the Company

We intend to continue to operate in a manner that will not subject us to regulation under the Investment Company Act of 1940. The Company has in the past five years and may in the future (i) issue securities senior to its common stock, (ii) fund acquisition activities with borrowings under its line of credit and (iii) offer shares of common stock and/or units of limited partnership interest in the Operating Partnership or affiliated partnerships as partial consideration for property acquisitions. The Company from time to time acquires partnership interests in partnerships and joint ventures, either directly or indirectly through subsidiaries of the Company, when such entities' underlying assets are real estate.

We invest primarily in apartment communities that are located in predominantly coastal markets within Southern California, the San Francisco Bay Area, and the Seattle metropolitan area. The Company currently intends to continue to invest in apartment communities in such regions. However, these practices may be reviewed and modified periodically by management.

Item 1A. Risk Factors

Our business, operating results, cash flows and financial condition are subject to various risks and uncertainties, including, without limitation, those set forth below, any one of which could cause our actual results to vary materially

from recent results or from our anticipated future results.

We depend on our key personnel. Our success depends on our ability to attract and retain executive officers, senior officers and company managers. There is substantial competition for qualified personnel in the real estate industry and the loss of any of our key personnel could have an adverse effect on the Company.

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Capital and credit market conditions may affect our access to sources of capital and/or the cost of capital, which could negatively affect our business, results of operations, cash flows and financial condition. Over the past two years, the Company's financing activities have been impacted by the instability and tightening in the credit markets which has led to an increase in spreads and pricing of secured debt, unsecured debt, and lines of credit. The Company's strong balance sheet, the debt capacity available on the unsecured line of credit with a bank group and the secured line of credit with Freddie Mac, and access to Fannie Mae and Freddie Mac secured debt financing have provided some insulation to the Company from the turmoil being experienced by many other real estate companies. The Company has benefited from borrowing from Fannie Mae and Freddie Mac, and there are no assurances that these entities will lend to the Company in the future. Continued turmoil in the capital markets and further job losses could negatively impact the Company's ability to make acquisitions, develop communities, obtain new financing, and refinance existing borrowing at competitive rates.

Debt financing has inherent risks. At December 31, 2009, we had approximately \$1.85 billion of indebtedness (including \$490.6 million of variable rate indebtedness, of which \$197.1 million is subject to interest rate protection agreements). We are subject to the risks normally associated with debt financing, including the following:

- cash flow may not be sufficient to meet required payments of principal and interest;
- inability to refinance maturing indebtedness on encumbered apartment communities;
- inability to comply with debt covenants could cause an acceleration of the maturity date; and
- repaying debt before the scheduled maturity date could result in prepayment penalties.

The Company is uncertain about its ability to refinance balloon payments. As of December 31, 2009, we had approximately \$1.85 billion of mortgage loans, exchangeable bonds and line of credit borrowings, most of which are subject to balloon payments (see Notes 7 and 8 to the Company's consolidated financial statements for more details). We do not expect to have sufficient cash flows from operations to make all of these balloon payments.

We may not be able to refinance such mortgage indebtedness, bonds, or lines of credit. The communities subject to these mortgages could be foreclosed upon or otherwise transferred to the lender. This could cause us to lose income and asset value. We may be required to refinance the debt at higher interest rates or on terms that may not be as favorable as the terms of existing indebtedness.

Debt financing of communities may result in insufficient cash flow to service debt. Where possible, we intend to continue to use leverage to increase the rate of return on our investments and to provide for additional investments that we could not otherwise make. There is a risk that the cash flow from the communities will be insufficient to meet both debt payment obligations and the distribution requirements of the real estate investment trust provisions of the Internal Revenue Code. We may obtain additional debt financing in the future through mortgages on some or all of the communities. These mortgages may be recourse, non-recourse, or cross-collateralized.

As of December 31, 2009, the Company had 77 of its 118 consolidated communities encumbered by debt. Of the 77 communities, 61 are secured by deeds of trust relating solely to those communities. With respect to the remaining 16 communities, there are 3 cross-collateralized mortgages secured by 11 communities, 3 communities, and 2 communities, respectively. The holders of this indebtedness will have rights with respect to these communities and, to the extent indebtedness is cross-collateralized, lenders may seek to foreclose upon communities which are not the primary collateral for their loan. This may accelerate other indebtedness secured by communities. Foreclosure of communities would reduce our income and net asset value.

Rising interest rates may affect our costs of capital and financing activities and results of operation. Interest rates could increase rapidly, which could result in higher interest expense on our variable rate indebtedness. Prolonged interest rate increases could negatively impact our ability to make acquisitions and develop apartment communities

with positive economic returns on investment and our ability to refinance existing borrowings.

Interest rate hedging arrangements may result in losses. Periodically, we have entered into agreements to reduce the risks associated with increases in interest rates, and may continue to do so. Although these agreements may partially protect against rising interest rates, they also may reduce the benefits to us if interest rates decline. If a hedging arrangement is not indexed to the same rate as the indebtedness that is hedged, we may be exposed to losses to the extent that the rate governing the indebtedness and the rate governing the hedging arrangement change independently of each other. Finally, nonperformance by the other party to the hedging arrangement may subject us to increased credit risks. In order to minimize counterparty credit risk, our policy is to enter into hedging arrangements only with A-rated financial institutions.

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Bond compliance requirements may limit income from certain communities. At December 31, 2009, we had approximately \$214.1 million of variable rate tax-exempt financing relating to the following apartment communities: Inglenook Court, Wandering Creek, Boulevard, Huntington Breakers, Camarillo Oaks, Fountain Park, Anchor Village, Hidden Valley and Belmont Station. This tax-exempt financing subjects these communities to certain deed restrictions and restrictive covenants. We expect to engage in tax-exempt financings in the future. The Internal Revenue Code and rules and regulations thereunder impose various restrictions, conditions and requirements excluding interest on qualified bond obligations from gross income for federal income tax purposes. The Internal Revenue Code also requires that at least 20% of apartment units be made available to residents with gross incomes that do not exceed a specified percentage, generally 50%, of the median income for the applicable family size as determined by the Housing and Urban Development Department of the federal government. In addition to federal requirements, certain state and local authorities may impose additional rental restrictions. These restrictions may limit income from the tax-exempt financed communities if we are required to lower rental rates to attract residents who satisfy the median income test. If the Company does not reserve the required number of apartment homes for residents satisfying these income requirements, the tax-exempt status of the bonds may be terminated, the obligations under the bond documents may be accelerated and we may be subject to additional contractual liability.

General real estate investment risks may adversely affect property income and values. Real estate investments are subject to a variety of risks. The yields available from equity investments in real estate depend on the amount of income generated and expenses incurred. If the communities do not generate sufficient income to meet operating expenses, including debt service and capital expenditures, cash flow and the ability to make distributions to stockholders will be adversely affected. Income from the communities may be further adversely affected by, among other things, the following factors:

- the general economic climate;
- local economic conditions in which the communities are located, such as oversupply of housing or a reduction in demand for rental housing;
- the attractiveness of the communities to tenants;
- competition from other available housing; and
- the Company's ability to provide for adequate maintenance and insurance.

As leases at the communities expire, tenants may enter into new leases on terms that are less favorable to us. Income and real estate values also may be adversely affected by such factors as applicable laws (e.g., the Americans with Disabilities Act of 1990 and tax laws). Real estate investments are relatively illiquid and, therefore, our ability to vary our portfolio promptly in response to changes in economic or other conditions may be quite limited.

National and regional economic environments can negatively impact our operating results. During the past two years, a confluence of factors has resulted in job losses, turmoil and volatility in the capital markets, and caused a national and global recession. The Company's forecast for the national economy assumes the return of growth, with estimated gross domestic product growth of the national economy and the economies of the western states. In the event of a continued recession, the Company could incur continued reduction in rental rates, occupancy levels, property valuations and increases in operating costs such as advertising and turnover expenses.

Inflation/Deflation may affect rental rates and operating expenses. Substantial inflationary or deflationary pressures could have a negative effect on rental rates and property operating expenses.

Acquisitions of communities may fail to meet expectations. The Company intends to continue to acquire apartment communities. However, there are risks that acquisitions will fail to meet our expectations. The Company's estimates of future income, expenses and the costs of improvements or redevelopment that are necessary to allow us to market an acquired apartment community as originally intended may prove to be inaccurate. We expect to finance future

acquisitions, in whole or in part, under various forms of secured or unsecured financing or through the issuance of partnership units by the Operating Partnership or related partnerships or additional equity by the Company. The use of equity financing, rather than debt, for future developments or acquisitions could dilute the interest of the Company's existing stockholders. If we finance new acquisitions under existing lines of credit, there is a risk that, unless we obtain substitute financing, the Company may not be able to secure further lines of credit for new development or such lines of credit may be not available on advantageous terms.

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Development and redevelopment activities may be delayed, not completed, and/or not achieve expected results. We pursue development and redevelopment projects and these projects generally require various governmental and other approvals, which have no assurance of being received. The Company's development and redevelopment activities generally entail certain risks, including the following:

- funds may be expended and management's time devoted to projects that may not be completed;
- construction costs of a project may exceed original estimates possibly making the project economically unfeasible;
 - projects may be delayed due to, without limitation, adverse weather conditions;
 - occupancy rates and rents at a completed project may be less than anticipated; and
 - expenses at completed development projects may be higher than anticipated.

These risks may reduce the funds available for distribution to the Company's stockholders. Further, the development and redevelopment of communities is also subject to the general risks associated with real estate investments. For further information regarding these risks, please see the risk factor "General real estate investment risks may adversely affect property income and values."

The geographic concentration of the Company's communities and fluctuations in local markets may adversely impact our financial condition and operating results. The Company generated significant amounts of rental revenues for the year ended December 31, 2009, from our communities concentrated in Southern California (Los Angeles, Orange, Santa Barbara, San Diego, and Ventura counties), Northern California (the San Francisco Bay Area), and the Seattle metropolitan area. For the year ended December 31, 2009, 81% of the Company's rental revenues were generated from communities located in California. This geographic concentration could present risks if local property market performance falls below expectations. The economic condition of these markets could affect occupancy, property revenues, and expenses, from the communities and their underlying asset values. The financial results of major local employers also may impact the cash flow and value of certain of the communities. This could have a negative impact on our financial condition and operating results, which could affect our ability to pay expected dividends to our stockholders.

Competition in the apartment community market may adversely affect operations and the rental demand for our communities. There are numerous housing alternatives that compete with our communities in attracting residents. These include other apartment communities and single-family homes that are available for rent in the markets in which the communities are located. If the demand for our communities is reduced or if competitors develop and/or acquire competing apartment communities on a more cost-effective basis, rental rates may drop, which may have a material adverse affect on our financial condition and results of operations. We also face competition from other real estate investment trusts, businesses and other entities in the acquisition, development and operation of apartment communities. This competition may result in an increase in costs and prices of apartment communities that we acquire and/or develop.

The price per share of the Company's stock may fluctuate significantly. The market price per share of the Company's common stock may fluctuate significantly in response to many factors, including:

- national and global economic conditions;
- actual or anticipated variations in our quarterly operating results or dividends;
 - changes in our funds from operations or earnings estimates;
 - issuances of common stock, preferred stock or convertible debt securities;
 - publication of research reports about us or the real estate industry;
- the general reputation of real estate investment trusts and the attractiveness of their equity securities in comparison to other equity securities (including securities issued by other real estate based companies);
-

general stock and bond market conditions, including changes in interest rates on fixed income securities, that may lead prospective purchasers of our stock to demand a higher annual yield from dividends;

- availability to credit markets and cost of credit;
- a change in analyst ratings or our credit ratings; and
- terrorist activity may adversely affect the markets in which our securities trade, possibly increasing market volatility and causing erosion of business and consumer confidence and spending.

Many of the factors listed above are beyond the Company's control. These factors may cause the market price of shares of the Company's common stock to decline, regardless of our financial condition, results of operations, or business prospects.

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The Company's future issuances of common stock, preferred stock or convertible debt securities could adversely affect the market price of our common stock. In order to finance our acquisition and development activities, we have issued and sold common stock, preferred stock and convertible debt securities. For example, during 2009 and 2008, the Company issued and sold 2,740,450 and 1,209,050 shares of common stock for \$198.5 million and \$142.8 million, net of fees and commissions, respectively. The Company may in the future sell further shares of common stock, including pursuant to its controlled equity offering program with Cantor Fitzgerald & Co.

In 2007, the Company filed a new shelf registration statement with the SEC, allowing the Company to sell an undetermined number of equity and debt securities as defined in the prospectus. Future sales of common stock, preferred stock or convertible debt securities may dilute stockholder ownership in the Company and could adversely affect the market price of the common stock.

The Company's Chairman is involved in other real estate activities and investments, which may lead to conflicts of interest. Our Chairman, George M. Marcus is not an employee of the Company, and is involved in other real estate activities and investments, which may lead to conflicts of interest. Mr. Marcus owns interests in various other real estate-related businesses and investments. He is the Chairman of The Marcus & Millichap Company ("TMMC"), which is a holding company for certain real estate brokerage and services companies. TMMC has an interest in Pacific Property Company, a company that invests in apartment communities.

Mr. Marcus has agreed not to divulge any information that may be received by him in his capacity as Chairman of the Company to any of his affiliated companies and that he will abstain his vote on any and all resolutions by the Company Board of Directors regarding any proposed acquisition and/or development of an apartment community where it appears that there may be a conflict of interest with any of his affiliated companies. Notwithstanding this agreement, Mr. Marcus and his affiliated entities may potentially compete with us in acquiring and/or developing apartment communities, which competition may be detrimental to us. In addition, due to such potential competition for real estate investments, Mr. Marcus and his affiliated entities may have a conflict of interest with us, which may be detrimental to the interests of the Company's stockholders.

The influence of executive officers, directors and significant stockholders may be detrimental to holders of common stock. As of December 31, 2009, George M. Marcus, the Chairman of our Board of Directors, wholly or partially owned 1,774,375 shares of common stock (including shares issuable upon exchange of limited partnership interests in the Operating Partnership and certain other partnerships and assuming exercise of all vested options). This represents approximately 5.7% of the outstanding shares of our common stock. Mr. Marcus currently does not have majority control over us. However, he currently has, and likely will continue to have, significant influence with respect to the election of directors and approval or disapproval of significant corporate actions. Consequently, his influence could result in decisions that do not reflect the interests of all our stockholders.

Under the partnership agreement of the Operating Partnership, the consent of the holders of limited partnership interests is generally required for any amendment of the agreement and for certain extraordinary actions. Through their ownership of limited partnership interests and their positions with us, our directors and executive officers, including Mr. Marcus, have substantial influence on us. Consequently, their influence could result in decisions that do not reflect the interests of all stockholders.

The voting rights of preferred stock may allow holders of preferred stock to impede actions that otherwise benefit holders of common stock. In general, the holders of our outstanding shares of preferred stock do not have any voting rights. However, if full distributions are not made on any outstanding preferred stock for six quarterly distributions periods, the holders of preferred stock who have not received distributions, voting together as a single class, will have the right to elect two additional directors to serve on our Board of Directors.

These voting rights continue until all distributions in arrears and distributions for the current quarterly period on the preferred stock have been paid in full. At that time, the holders of the preferred stock are divested of these voting rights, and the term and office of the directors so elected immediately terminates. While any shares of our preferred stock are outstanding, the Company may not, without the consent of the holders of two-thirds of the outstanding shares of each series of preferred stock, each voting separately as a single class:

- authorize or create any class or series of stock that ranks senior to such preferred stock with respect to the payment of dividends, rights upon liquidation, dissolution or winding-up of our business;
- amend, alter or repeal the provisions of the Company's Charter or Bylaws, including by merger or consolidation, that would materially and adversely affect the rights of such series of preferred stock; or

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- in the case of the preferred stock into which our preferred units are exchangeable, merge or consolidate with another entity or transfer substantially all of its assets to another entity, except if such preferred stock remains outstanding with the surviving entity and has the same terms and in certain other circumstances.

These voting rights of the preferred stock may allow holders of preferred stock to impede or veto actions that would otherwise benefit the holders of our common stock.

The redemption rights of the Series B preferred units and Series F preferred stock may be detrimental to holders of the Company's common stock. Upon the occurrence of one of the following events, the terms of the Operating Partnership's Series B Preferred Units require it to redeem all of such units and the terms of the Company's Series F Preferred Stock provide the holders of the majority of the outstanding Series F Preferred Stock the right to require the Company to redeem all of such stock:

- the Company completes a "going private" transaction and its common stock is no longer registered under the Securities Exchange Act of 1934, as amended;
- the Company completes a consolidation or merger or sale of substantially all of its assets and the surviving entity's debt securities do not possess an investment grade rating;
- the Company fails to qualify as a REIT.

The aggregate redemption price of the Series B Preferred Units would be \$80 million and the aggregate redemption price of the Series F Preferred Stock would be \$25 million, plus, in each case, any accumulated distributions.

These redemption rights may discourage or impede transactions that might otherwise be in the interest of holders of common stock. Further, these redemption rights might trigger situations where the Company needs to conserve its cash reserves, in which event such redemption might adversely affect the Company and its common holders.

The Maryland business combination law may not allow certain transactions between the Company and its affiliates to proceed without compliance with such law. Under Maryland law, "business combinations" between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as any person (and certain affiliates of such person) who beneficially owns ten percent or more of the voting power of the then-outstanding voting stock. The law also requires a supermajority stockholder vote for such transactions. This means that the transaction must be approved by at least:

- 80% of the votes entitled to be cast by holders of outstanding voting shares; and
- Two-thirds of the votes entitled to be cast by holders of outstanding voting shares other than shares held by the interested stockholder with whom the business combination is to be effected.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the board of directors prior to the time that the interested stockholder becomes an interested stockholder. These voting provisions do not apply if the stockholders receive a minimum price, as defined under Maryland law. As permitted by the statute, the Board of Directors of the Company irrevocably has elected to exempt any business combination by the Company, George M. Marcus, who is the chairman of the Company, and TMMC or any entity owned or controlled by Mr. Marcus and TMMC. Consequently, the five-year prohibition and supermajority vote requirement described above will not apply to any business combination between the Company, Mr. Marcus, or TMMC. As a result, the Company may in the future enter into business combinations with Mr. Marcus and TMMC, without compliance with the supermajority vote requirements and other provisions of the Maryland General Corporation Law.

Anti-takeover provisions contained in the Operating Partnership agreement, charter, bylaws, and certain provisions of Maryland law could delay, defer or prevent a change in control. While the Company is the sole general partner of the Operating Partnership, and generally has full and exclusive responsibility and discretion in the management and control of the Operating Partnership, certain provisions of the Operating Partnership agreement place limitations on the Company's ability to act with respect to the Operating Partnership. Such limitations could delay, defer or prevent a transaction or a change in control that might involve a premium price for our stock or otherwise be in the best interest of the stockholders or that could otherwise adversely affect the interest of the Company's stockholders. The partnership agreement provides that if the limited partners own at least 5% of the outstanding units of partnership interest in the Operating Partnership, the Company cannot, without first obtaining the consent of a majority-in-interest of the limited partners in the Operating Partnership, transfer all or any portion of our general partner interest in the Operating Partnership to another entity. Such limitations on the Company's ability to act may result in our being precluded from taking action that the Board of Directors believes is in the best interests of the Company's stockholders. As of December 31, 2009, the limited partners held or controlled approximately 7.7% of the outstanding units of partnership interest in the Operating Partnership, allowing such actions to be blocked by the limited partners.

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The Company's Charter authorizes the issuance of additional shares of common stock or preferred stock and the setting of the preferences, rights and other terms of such preferred stock without the approval of the holders of the common stock. We may establish one or more series of preferred stock that could delay, defer or prevent a transaction or a change in control. Such a transaction might involve a premium price for our stock or otherwise be in the best interests of the holders of common stock. Also, such a class of preferred stock could have dividend, voting or other rights that could adversely affect the interest of holders of common stock.

The Company's Charter contains other provisions that may delay, defer or prevent a transaction or a change in control that might be in the best interest of the Company's stockholders. The Charter contains ownership provisions limiting the transferability and ownership of shares of capital stock, which may have the effect of delaying, deferring or preventing a transaction or a change in control. For example, subject to receiving an exemption from the Board of Directors, potential acquirers may not purchase more than 6% in value of the stock (other than qualified pension trusts which can acquire 9.9%). This may discourage tender offers that may be attractive to the holders of common stock and limit the opportunity for stockholders to receive a premium for their shares of common stock.

The Maryland General Corporations Law restricts the voting rights of shares deemed to be "control shares." Under the Maryland General Corporations Law, "control shares" are those which, when aggregated with any other shares held by the acquirer, entitle the acquirer to exercise voting power within specified ranges. Although the Bylaws exempt the Company from the control share provisions of the Maryland General Corporations Law, the Board of Directors may amend or eliminate the provisions of the Bylaws at any time in the future. Moreover, any such amendment or elimination of such provision of the Bylaws may result in the application of the control share provisions of the Maryland General Corporations Law not only to control shares which may be acquired in the future, but also to control shares previously acquired. If the provisions of the Bylaws are amended or eliminated, the control share provisions of the Maryland General Corporations Law could delay, defer or prevent a transaction or change in control that might involve a premium price for the stock or otherwise be in the best interests of the Company's stockholders.

Our Charter and bylaws also contain other provisions that may impede various actions by stockholders without approval of our board of directors, which in turn may delay, defer or prevent a transaction, including a change in control. Those provisions include:

- the Company's directors have terms of office of three years and the board of directors is divided into three classes with staggered terms; as a result, less than a majority of directors are up for re-election to the board in any one year;
- directors may be removed, without cause, only upon a two-thirds vote of stockholders, and with cause, only upon a majority vote of stockholders;
- the Company's board can fix the number of directors and fill vacant directorships upon the vote of a majority of the directors;
- stockholders must give advance notice to nominate directors or propose business for consideration at a stockholders' meeting; and
- for stockholders to call a special meeting, the meeting must be requested by not less than a majority of all the votes entitled to be cast at the meeting.

The Company's joint ventures and joint ownership of communities and partial interests in corporations and limited partnerships could limit the Company's ability to control such communities and partial interests. Instead of purchasing apartment communities directly, we have invested and may continue to invest in joint ventures. Joint venture partners often have shared control over the operation of the joint venture assets. Therefore, it is possible that a joint venture partner in an investment might become bankrupt, or have economic or business interests or goals that are inconsistent with our business interests or goals, or be in a position to take action contrary to our instructions or requests, or our policies or objectives. Consequently, a joint venture partners' actions might subject property owned by the joint venture to additional risk. Although we seek to maintain sufficient influence over any joint venture to

achieve its objectives, we may be unable to take action without our joint venture partners' approval, or joint venture partners could take actions binding on the joint venture without our consent. Should a joint venture partner become bankrupt, we could become liable for such partner's share of joint venture liabilities.

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From time to time, the Company, through the Operating Partnership, invests in corporations, limited partnerships, limited liability companies or other entities that have been formed for the purpose of acquiring, developing or managing real property. In certain circumstances, the Operating Partnership's interest in a particular entity may be less than a majority of the outstanding voting interests of that entity. Therefore, the Operating Partnership's ability to control the daily operations of such an entity may be limited. Furthermore, the Operating Partnership may not have the power to remove a majority of the board of directors (in the case of a corporation) or the general partner or partners (in the case of a limited partnership) of such an entity in the event that its operations conflict with the Operating Partnership's objectives. The Operating Partnership may not be able to dispose of its interests in such an entity. In the event that such an entity becomes insolvent, the Operating Partnership may lose up to its entire investment in and any advances to the entity. We have, and in the future may, enter into transactions that could require us to pay the tax liabilities of partners, which contribute assets into joint ventures or the Operating Partnership, in the event that certain taxable events, which are within our control, occur. Although we plan to hold the contributed assets or defer recognition of gain on their sale pursuant to the like-kind exchange rules under Section 1031 of the Internal Revenue Code, we can provide no assurance that we will be able to do so and if such tax liabilities were incurred they can expect to have a material impact on our financial position.

There are risks that Fund II may operate in ways that may adversely impact the Company's interests. The Company is the general partner of Fund II, and with Fund II there are the following risks:

- the Company's partners in Fund II might remove the Company as the general partner of Fund II;
- the Company's partners in Fund II might have economic or business interests or goals that are inconsistent with our business interests or goals; or
- the Company's partners in Fund II might fail to approve decisions regarding Fund II that are in the Company's best interest.

Investments in mortgages and other real estate securities could affect our ability to make distributions to stockholders. The Company may invest in securities related to real estate, which could adversely affect our ability to make distributions to stockholders. The Company may purchase securities issued by entities which own real estate and invest in mortgages or unsecured debt obligations. These mortgages may be first, second or third mortgages that may or may not be insured or otherwise guaranteed. In general, investments in mortgages include the following risks:

- that the value of mortgaged property may be less than the amounts owed, causing realized or unrealized losses;
- the borrower may not pay indebtedness under the mortgage when due, requiring us to foreclose, and the amount recovered in connection with the foreclosure may be less than the amount owed;
 - that interest rates payable on the mortgages may be lower than our cost of funds; and
 - in the case of junior mortgages, that foreclosure of a senior mortgage could eliminate the junior mortgage.

If any of the above were to occur, cash flows from operations and our ability to make expected dividends to stockholders could be adversely affected.

Compliance with laws benefiting disabled persons may require us to make significant unanticipated expenditures or impact our investment strategy. A number of federal, state and local laws (including the Americans with Disabilities Act) and regulations exist that may require modifications to existing buildings or restrict certain renovations by requiring improved access to such buildings by disabled persons and may require other structural features which add to the cost of buildings under construction. Legislation or regulations adopted in the future may impose further burdens or restrictions on us with respect to improved access by disabled persons. The costs of compliance with these laws and regulations may be substantial.

The Company's Portfolio may have unknown environmental liabilities. Under various federal, state and local laws, ordinances and regulations, an owner or operator of real estate is liable for the costs of removal or remediation of certain hazardous or toxic substances on, in, to or migrating from such property. Such laws often impose liability without regard as to whether the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. The presence of such substances, or the failure to properly remediate such substances, may adversely affect the owner's or operator's ability to sell or rent such property or to borrow using such property as collateral. Persons exposed to such substances, either through soil vapor or ingestion of the substances may claim personal injury damages. Persons who arrange for the disposal or treatment of hazardous or toxic substances or wastes also may be liable for the costs of removal or remediation of such substances at the disposal or treatment facility to which such substances or wastes were sent, whether or not such facility is owned or operated by such person. Certain environmental laws impose liability for release of asbestos-containing materials ("ACMs") into the air, and third parties may seek recovery from owners or operators of apartment communities for personal injury associated with ACMs. In connection with the ownership (direct or indirect), operation, management and development of apartment communities, the Company could be considered an owner or operator of such properties or as having arranged for the disposal or treatment of hazardous or toxic substances and, therefore, may be potentially liable for removal or remediation costs, as well as certain other costs, including governmental fines and costs related to injuries of persons and property.

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Investments in real property create a potential for environmental liabilities on the part of the owner of such real property. We carry certain limited insurance coverage for this type of environmental risk. We have conducted environmental studies which revealed the presence of groundwater contamination at certain communities. Such contamination at certain of these apartment communities was reported to have migrated on-site from adjacent industrial manufacturing operations. The former industrial users of the communities were identified as the source of contamination. The environmental studies noted that certain communities are located adjacent to possible down gradient from sites with known groundwater contamination, the lateral limits of which may extend onto such apartment communities. The environmental studies also noted that at certain of these apartment communities, contamination existed because of the presence of underground fuel storage tanks, which have been removed. In general, in connection with the ownership, operation, financing, management and development of apartment communities we may be potentially liable for removal or clean-up costs, as well as certain other costs and environmental liabilities. The Company may also be subject to governmental fines and costs related to injuries to persons and property.

There has been a number of lawsuits in recent years against owners and managers of apartment communities alleging personal injury and property damage caused by the presence of mold in residential real estate. Some of these lawsuits have resulted in substantial monetary judgments or settlements. The Company has been sued for mold related matters and has settled some, but not all, of such matters. Insurance carriers have reacted to mold related liability awards by excluding mold related claims from standard policies and pricing mold endorsements at prohibitively high rates. The Company has, however, purchased pollution liability insurance, which includes some coverage for mold. The Company has adopted policies for promptly addressing and resolving reports of mold when it is detected, and to minimize any impact mold might have on residents of the property. The Company believes its mold policies and proactive response to address any known existence, reduces its risk of loss from these cases. There can be no assurances that the Company has identified and responded to all mold occurrences, but the company promptly addresses all known reports of mold. Liabilities resulting from such mold related matters are not expected to have a material adverse effect on the Company's financial condition, results of operations or cash flows. As of December 31, 2009, potential liabilities for mold and other environmental liabilities are not considered probable or the loss cannot be quantified or estimated.

California has enacted legislation commonly referred to as "Proposition 65" requiring that "clear and reasonable" warnings be given to consumers who are exposed to chemicals known to the State of California to cause cancer or reproductive toxicity, including tobacco smoke. Although we have sought to comply with Proposition 65 requirements, we cannot assure you that we will not be adversely affected by litigation relating to Proposition 65.

Methane gas is a naturally-occurring gas that is commonly found below the surface in several areas, particularly in the Southern California coastal areas. Methane is a non-toxic gas, but can be ignitable in confined spaces. Although naturally-occurring, methane gas is not regulated at the state or federal level, however some local governments, such as the County of Los Angeles, have imposed requirements that new buildings install detection systems in areas where methane gas is known to be located. Methane gas is also associated with certain industrial activities, such as former municipal waste landfills. Radon is also a naturally-occurring gas that is found below the surface. The Company cannot assure you that it will not be adversely affected by costs related to its compliance with methane or radon gas related requirements or litigation costs related to methane or radon gas.

The Company has almost no indemnification agreements from third parties for potential environmental clean-up costs at its communities. The Company has no way of determining at this time the magnitude of any potential liability to which it may be subject arising out of unknown environmental conditions or violations with respect to communities formerly owned by the Company. No assurance can be given that existing environmental studies with respect to any of the communities reveal all environmental liabilities, that any prior owner or operator of an apartment community did not create any material environmental condition not known to the Company, or that a material environmental

condition does not exist as to any one or more of the communities. The Company has limited insurance coverage for the types of environmental liabilities described above.

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The Company may incur general uninsured losses. The Company carries comprehensive liability, fire, extended coverage and rental loss insurance for each of the communities. There are, however, certain types of extraordinary losses, such as, for example, losses for terrorism or earthquake, for which the Company does not have insurance coverage. Substantially all of the communities are located in areas that are subject to earthquake activity. In January 2007, the Company canceled its then existing earthquake policy and established a wholly owned insurance subsidiary, Pacific Western Insurance LLC ("PWI"). Through PWI, the Company is self-insured as it relates to earthquake related losses. Additionally, since January 2008, PWI has provided property and casualty insurance coverage for the first \$5.0 million of the Company's property level insurance claims per incident.

Although the Company may carry insurance for potential losses associated with its communities, employees, residents, and compliance with applicable laws, it may still incur losses due to uninsured risks, deductibles, co-payments or losses in excess of applicable insurance coverage and those losses may be material. In the event of a substantial loss, insurance coverage may not be able to cover the full replacement cost of the Company's lost investment, or the insurance carrier may become insolvent and not be able to cover the full amount of the insured losses. Inflation, changes in building codes and ordinances, environmental considerations and other factors might also affect the Company's ability to replace or renovate an apartment community after it has been damaged or destroyed.

Changes in real estate tax and other laws may adversely affect the Company's results of operations. Generally we do not directly pass through costs resulting from changes in real estate tax laws to residential property tenants. We also do not generally pass through increases in income, service or other taxes, to tenants under leases. These costs may adversely affect funds from operations and the ability to make distributions to stockholders. Similarly, compliance with changes in (i) laws increasing the potential liability for environmental conditions existing on apartment communities or the restrictions on discharges or other conditions or (ii) rent control or rent stabilization laws or other laws regulating housing may result in significant unanticipated decrease in revenue or increase in expenditures, which would adversely affect funds from operations and the ability to make distributions to stockholders.

Changes in the Company's financing policy may lead to higher levels of indebtedness. The Company has adopted a policy of maintaining a limit on debt financing to a maximum of a 50% debt to total market capitalization and to be consistent with the existing covenants required to maintain the Company's unsecured line of credit bank facility. The Company's organizational documents do not limit the amount or percentage of indebtedness that may be incurred. If the Company changed this policy, the Company could incur more debt, resulting in an increased risk of default on our obligations and the obligations of the Operating Partnership, and an increase in debt service requirements that could adversely affect our financial condition and results of operations. Such increased debt could exceed the underlying value of the communities.

The Company is subject to various tax risks. The Company has elected to be taxed as a REIT under the Internal Revenue Code. The Company's qualification as a REIT requires it to satisfy numerous requirements (some on an annual and quarterly basis) established under highly technical and complex Internal Revenue Code provisions for which there are only limited judicial or administrative interpretations, and involves the determination of various factual matters and circumstances not entirely within the Company's control. Although the Company intends that its current organization and method of operation enables it to qualify as a REIT, it cannot assure you that it so qualifies or that it will be able to remain so qualified in the future. Future legislation, new regulations, administrative interpretations or court decisions (any of which could have retroactive effect) could adversely affect the Company's ability to qualify as a REIT or adversely affect our stockholders. If the Company fails to qualify as a REIT in any taxable year, the Company would be subject to U.S. federal income tax (including any applicable alternative minimum tax) on our taxable income at corporate rates, and the Company would not be allowed to deduct dividends paid to its shareholders in computing its taxable income. The Company may also be disqualified from treatment as a REIT for the four taxable years following the year in which the Company failed to qualify. The additional tax liability would reduce its net earnings available for investment or distribution to stockholders, and the Company would no longer be

required to make distributions to its stockholders. Even if the Company continues to qualify as a REIT, it will continue to be subject to certain federal, state and local taxes on our income and property.

The Company has established several taxable REIT subsidiaries (“TRSs”). Despite its qualification as a REIT, the Company’s TRSs must pay U.S. federal income tax on their taxable income. While the Company will attempt to ensure that its dealings with its TRSs do not adversely affect its REIT qualification, it cannot provide assurance that it will successfully achieve that result. Furthermore, it may be subject to a 100% penalty tax, or its TRSs may be denied deductions, to the extent its dealings with its TRSs are not deemed to be arm’s length in nature. No assurances can be given that the Company’s dealings with its TRSs will be arm’s length in nature.

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From time to time, the Company may transfer or otherwise dispose of some of its Properties. Under the Internal Revenue Code, any gain resulting from transfers of Properties that the Company holds as inventory or primarily for sale to customers in the ordinary course of business would be treated as income from a prohibited transaction subject to a 100% penalty tax. Since the Company acquires properties for investment purposes, it does not believe that its occasional transfers or disposals of property are prohibited transactions. However, whether property is held for investment purposes is a question of fact that depends on all the facts and circumstances surrounding the particular transaction. The Internal Revenue Service may contend that certain transfers or disposals of properties by the Company are prohibited transactions. If the Internal Revenue Service were to argue successfully that a transfer or disposition of property constituted a prohibited transaction, then the Company would be required to pay a 100% penalty tax on any gain allocable to it from the prohibited transaction and the Company's ability to retain future gains on real property sales may be jeopardized. Income from a prohibited transaction might adversely affect our ability to satisfy the income tests for qualification as a REIT for U.S. federal income tax purposes. Therefore, no assurances can be given that we will be able to satisfy the income tests for qualification as a REIT.

The U.S. federal tax rate on certain corporate dividends paid to individuals and other non-corporate taxpayers is at a reduced rate of 15% (until December 31, 2010). It is uncertain whether this reduced rate will be continued beyond the scheduled expiration date. Dividends paid by REITs to individuals and other non-corporate stockholders are not eligible for the reduced 15% rate, however. This may cause investors to view REIT investments to be less attractive than investments in non-REIT corporations, which in turn may adversely affect the value of stock in REITs, including our stock.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's Portfolio as of December 31, 2009 (including communities owned by Fund II) was comprised of 133 apartment communities (comprising 27,248 apartment units), of which 13,087 units are located in Southern California, 8,270 units are located in the San Francisco Bay Area, and 5,891 units are located in the Seattle metropolitan area. The Company's apartment communities accounted for 95.9% of the Company's revenues for the year ended December 31, 2009.

Occupancy Rates

The 133 apartment communities had an average Same-Properties occupancy (as defined in Item 7), based on "financial occupancy," during the year ended December 31, 2009, of approximately 97.0%. With respect to stabilized apartment communities with sufficient operating history, occupancy figures are based on financial occupancy (the percentage resulting from dividing actual rental revenue by total possible rental revenue). Actual rental revenue represents contractual revenue pursuant to leases without considering delinquency and concessions. Total possible rental revenue represents the value of all apartment units, with occupied units valued at contractual rental rates pursuant to leases and vacant units valued at estimated market rents. We believe that financial occupancy is a meaningful measure of occupancy because it considers the value of each vacant unit at its estimated market rate. Financial occupancy may not completely reflect short-term trends in physical occupancy and financial occupancy rates as disclosed by other REITs may not be comparable to our calculation of financial occupancy.

With respect to apartment communities which have not yet stabilized or have insufficient operating history, occupancy figures are based on "physical occupancy" which refers to the percentage resulting from dividing leased and occupied units by rentable units. For the year ended December 31, 2009, none of the Company's apartment

communities had book values equal to 10% or more of total assets of the Company or gross revenues equal to 10% or more of aggregate gross revenues of the Company.

Apartment Communities

Our apartment communities are generally suburban garden apartments and town homes comprising multiple clusters of two and three story buildings situated on three to fifteen acres of land. The apartment communities have an average of approximately 205 units, with a mix of studio, one, two and some three-bedroom units. A wide variety of amenities are available at the Company's communities, including covered parking, fireplaces, swimming pools, clubhouses with fitness facilities, volleyball and playground areas and tennis courts.

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We select, train and supervise on-site service and maintenance personnel. We believe that the following primary factors enhance our ability to retain tenants:

- located near employment centers;
- attractive communities that are well maintained; and
- proactive customer service approach.

Office and Other Commercial Buildings

The Company's corporate headquarters is located in two office buildings with approximately 31,900 square feet located at 925/935 East Meadow Drive, Palo Alto, California. The Company acquired the properties in 1997 and 2007, respectively. The Company also owns an office building in Woodland Hills, California, comprised of approximately 38,940 square feet, of which the Company occupies approximately 11,500 square feet at December 31, 2009. The Company acquired the Woodland Hills property in 2001. The Company owns a mortgage loan receivable on an office building with approximately 110,000 square feet located in Irvine, California, which is consolidated in accordance with GAAP. The Company acquired Essex-Hollywood in 2006, a 35,000 square foot commercial building as a future development site that is currently 100% leased as a production studio.

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The following tables describe the Company's Portfolio as of December 31, 2009. The first table describes the Company's apartment communities and the second table describes the Company's other real estate assets. (See Note 7 of the Company's consolidated financial statements for more information about the Company's secured mortgage debt and Schedule III for a list of secured mortgage loans related to the Company's Portfolio.)

Apartment Communities (1)	Location	Units	Rentable Square Footage	Year Built	Year Acquired	Occupancy(2)
Southern California						
Alpine Country	Alpine, CA	108	81,900	1986	2002	98%
Alpine Village	Alpine, CA	306	254,400	1971	2002	98%
Barkley, The(3)(4)	Anaheim, CA	161	139,800	1984	2000	98%
Bonita Cedars	Bonita, CA	120	120,800	1983	2002	97%
Camarillo Oaks	Camarillo, CA	564	459,000	1985	1996	95%
Camino Ruiz Square	Camarillo, CA	160	105,448	1990	2006	99%
Cielo (5)	Chatsworth, CA	119	125,400	2009	2009	90%
Cambridge	Chula Vista, CA	40	22,100	1965	2002	95%
Woodlawn Colonial	Chula Vista, CA	159	104,500	1974	2002	95%
Mesa Village	Clairemont, CA	133	43,600	1963	2002	96%
Parcwood(5)	Corona, CA	312	270,000	1989	2004	96%
Tierra del Sol/Norte	El Cajon, CA	156	117,000	1969	2002	98%
Regency at Encino	Encino, CA	75	78,487	1989	2009	100%
Valley Park(6)	Fountain Valley, CA	160	169,700	1969	2001	96%
Capri at Sunny Hills(6)	Fullerton, CA	100	128,100	1961	2001	97%
Wilshire Promenade	Fullerton, CA	149	128,000	1992(7)	1997	98%
Montejo(6)	Garden Grove, CA	124	103,200	1974	2001	97%
CBC Apartments	Goleta, CA	148	91,538	1962	2006	97%
Chimney Sweep Apartments	Goleta, CA	91	88,370	1967	2006	91%
Hampton Court	Glendale, CA	83	71,500	1974(8)	1999	97%
Hampton Place	Glendale, CA	132	141,500	1970(9)	1999	97%
Devonshire	Hemet, CA	276	207,200	1988	2002	94%
Huntington Breakers	Huntington Beach, CA	342	241,700	1984	1997	98%
Hillsborough Park	La Habra, CA	235	215,500	1999	1999	98%
Trabuco Villas	Lake Forest, CA	132	131,000	1985	1997	98%
Marbrisa	Long Beach, CA	202	122,800	1987	2002	98%
Pathways	Long Beach, CA	296	197,700	1975(10)	1991	96%
Belmont Station		275	225,000	2008	2008	99%

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	Los Angeles, CA					
Bunker Hill	Los Angeles, CA	456	346,600	1968	1998	97%
Cochran Apartments	Los Angeles, CA	58	51,400	1989	1998	95%
Kings Road	Los Angeles, CA	196	132,100	1979(11)	1997	97%
Marbella, The	Los Angeles, CA	60	50,108	1991	2005	95%
Park Place	Los Angeles, CA	60	48,000	1988	1997	95%
Renaissance, The(5)	Los Angeles, CA	168	154,268	1990(12)	2006	97%
Windsor Court	Los Angeles, CA	58	46,600	1988	1997	95%
Marina City Club(13)	Marina Del Rey, CA	101	127,200	1971	2004	96%
Mirabella	Marina Del Rey, CA	188	176,800	2000	2000	95%
Mira Monte	Mira Mesa, CA	355	262,600	1982(14)	2002	97%
Hillcrest Park	Newbury Park, CA	608	521,900	1973(15)	1998	97%
Fairways(16)	Newport Beach, CA	74	107,100	1972	1999	94%
Country Villas	Oceanside, CA	180	179,700	1976	2002	97%
Mission Hills	Oceanside, CA	282	244,000	1984	2005	97%
Mariners Place	Oxnard, CA	105	77,200	1987	2000	97%
Monterey Villas	Oxnard, CA	122	122,100	1974(17)	1997	98%
Tierra Vista	Oxnard, CA	404	387,100	2001	2001	97%
Monterra del Mar	Pasadena, CA	123	74,400	1972(18)	1997	99%
Monterra del Rey	Pasadena, CA	84	73,100	1972(19)	1999	98%
Monterra del Sol	Pasadena, CA	85	69,200	1972(20)	1999	97%
Villa Angelina(6)	Placentia, CA	256	217,600	1970	2001	97%

(continued)

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Apartment Communities (1)	Location	Units	Rentable Square Footage	Year Built	Year Acquired	Occupancy(2)
Southern California (continued)						
Fountain Park	Playa Vista, CA	705	608,900	2002	2004	95%
Highridge(6)	Rancho Palos Verdes, CA	255	290,200	1972(21)	1997	95%
Bluffs II, The(22)	San Diego, CA	224	126,700	1974	1997	98%
Summit Park	San Diego, CA	300	229,400	1972	2002	97%
Vista Capri - North	San Diego, CA	106	51,800	1975	2002	95%
Brentwood(6)	Santa Ana, CA	140	154,800	1970	2001	95%
Treehouse(6)	Santa Ana, CA	164	135,700	1970	2001	96%
Hope Ranch Collection	Santa Barbara, CA	108	126,700	1965&73	2007	98%
Hidden Valley(23)	Simi Valley, CA	324	310,900	2004	2004	97%
Meadowood	Simi Valley, CA	320	264,500	1986	1996	96%
Shadow Point	Spring Valley, CA	172	131,200	1983	2002	98%
Coldwater Canyon	Studio City, CA	39	34,125	1979	2007	97%
Studio 40-41 (5)	Studio City, CA	149	127,238	2009	2009	95%
Lofts at Pinehurst, The	Ventura, CA	118	71,100	1971(24)	1997	97%
Pinehurst(25)	Ventura, CA	28	21,200	1973	2004	99%
Woodside Village	Ventura, CA	145	136,500	1987	2004	98%
Walnut Heights	Walnut, CA	163	146,700	1964	2003	96%
Avondale at Warner Center	Woodland Hills, CA	446	331,000	1970(26)	1997	97%
		13,087	10,952,982			97%
Northern California						
Belmont Terrace	Belmont, CA	71	72,951	1974	2006	98%
Carlmont Woods(5)	Belmont, CA	195	107,200	1971	2004	98%
Davey Glen(5)	Belmont, CA	69	65,974	1962	2006	97%
Pointe at Cupertino, The	Cupertino, CA	116	135,200	1963(27)	1998	98%
Harbor Cove(5)	Foster City, CA	400	306,600	1971	2004	98%
Stevenson Place	Fremont, CA	200	146,200	1971(28)	1983	97%
Boulevard	Fremont, CA	172	131,200	1978(29)	1996	98%

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City View	Hayward, CA	560	462,400	1975(30)	1998	98%
Alderwood Park(5)	Newark, CA	96	74,624	1987	2006	97%
Bridgeport	Newark, CA	184	139,000	1987(31)	1987	98%
The Grand	Oakland, CA	238	205,026	2009	2009	98%
Regency Towers(5)	Oakland, CA	178	140,900	1975(32)	2005	96%
San Marcos	Richmond, CA	432	407,600	2003	2003	98%
Mt Sutro	San Francisco, CA	99	64,000	1973	2001	98%
Carlyle, The	San Jose, CA	132	129,200	2000	2000	97%
Enclave, The(5)	San Jose, CA	637	525,463	1998	2005	98%
Esplanade	San Jose, CA	278	279,000	2002	2004	98%
Waterford, The	San Jose, CA	238	219,600	2000	2000	99%
Hillsdale Garden(33)	San Mateo, CA	697	611,505	1948	2006	97%
Bel Air	San Ramon, CA	462	391,000	1988/2000(34)	1997	97%
Canyon Oaks	San Ramon, CA	250	237,894	2005	2007	98%
Foothill Gardens	San Ramon, CA	132	155,100	1985	1997	98%
Mill Creek at Windermere	San Ramon, CA	400	381,060	2005	2007	97%
Twin Creeks	San Ramon, CA	44	51,700	1985	1997	98%
Le Parc Luxury Apartments	Santa Clara, CA	140	113,200	1975(35)	1994	98%
Marina Cove(36)	Santa Clara, CA	292	250,200	1974(37)	1994	98%
Chestnut Street	Santa Cruz, CA	96	87,640	2002	2008	98%
Harvest Park	Santa Rosa, CA	104	116,628	2004	2007	97%
Bristol Commons	Sunnyvale, CA	188	142,600	1989	1997	99%
Brookside Oaks(6)	Sunnyvale, CA	170	119,900	1973	2000	98%
Magnolia Lane(38)	Sunnyvale, CA	32	31,541	2001	2007	99%
Montclair, The	Sunnyvale, CA	390	294,100	1973(39)	1988	98%
Summerhill Park	Sunnyvale, CA	100	78,500	1988	1988	99%
Thomas Jefferson(6)	Sunnyvale, CA	156	110,824	1969	2007	99%
Windsor Ridge	Sunnyvale, CA	216	161,800	1989	1989	98%
Vista Belvedere	Tiburon, CA	76	78,300	1963	2004	97%
Tuscana	Tracy, CA	30	29,088	2007	2007	97%
		8,270	7,054,718			98%
(continued)						

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Apartment Communities (1)	Location	Units	Rentable Square Footage	Year Built	Year Acquired	Occupancy(2)
Seattle, Washington Metropolitan Area						
Cedar Terrace	Bellevue, WA	180	174,200	1984	2005	96%
Emerald Ridge-North	Bellevue, WA	180	144,000	1987	1994	97%
Foothill Commons	Bellevue, WA	388	288,300	1978(40)	1990	95%
Palisades, The	Bellevue, WA	192	159,700	1977(41)	1990	99%
Sammamish View	Bellevue, WA	153	133,500	1986(42)	1994	99%
Woodland Commons	Bellevue, WA	236	172,300	1978(43)	1990	97%
Canyon Pointe	Bothell, WA	250	210,400	1990	2003	97%
Inglenook Court	Bothell, WA	224	183,600	1985	1994	96%
Salmon Run at Perry Creek	Bothell, WA	132	117,100	2000	2000	98%
Stonehedge Village	Bothell, WA	196	214,800	1986	1997	97%
Highlands at Wynhaven	Issaquah, WA	333	424,674	2000	2008	96%
Park Hill at Issaquah	Issaquah, WA	245	277,700	1999	1999	97%
Wandering Creek	Kent, WA	156	124,300	1986	1995	98%
Bridle Trails	Kirkland, WA	108	99,700	1986(44)	1997	97%
Evergreen Heights	Kirkland, WA	200	188,300	1990	1997	97%
Laurels at Mill Creek, The	Mill Creek, WA	164	134,300	1981	1996	97%
Morning Run(5)	Monroe, WA	222	221,786	1991	2005	97%
Anchor Village(6)	Mukilteo, WA	301	245,900	1981	1997	97%
Castle Creek	Newcastle, WA	216	191,900	1997	1997	98%
Brighton Ridge	Renton, WA	264	201,300	1986	1996	97%
Fairwood Pond	Renton, WA	194	189,200	1997	2004	97%
Forest View	Renton, WA	192	182,500	1998	2003	97%
Cairns, The	Seattle, WA	100	70,806	2006	2007	95%
Eastlake 2851(5)	Seattle, WA	127	234,086	2008	2008	97%
Fountain Court	Seattle, WA	320	207,000	2000	2000	98%
Linden Square	Seattle, WA	183	142,200	1994	2000	97%
Tower @ 801(5)	Seattle, WA	173	118,500	1970	2005	98%
Wharfside Pointe	Seattle, WA	142	119,200	1990	1994	97%
Echo Ridge(5)	Snoqualmie, WA	120	124,359	2000	2005	98%
		5,891	5,295,611			98%
Total/Weighted Average		27,248	23,303,311			97%

Other real estate assets(1)	Location	Tenants	Rentable Square Footage	Year Built	Year Acquired	Occupancy(2)
Office Buildings						
925 / 935 East Meadow Drive(45)	Palo Alto, CA	1	31,900	1988 / 1962	1997 / 2007	100%
6230 Sunset Blvd(46)	Los Angeles, CA	1	35,000	1938	2006	100%
17461 Derian Ave(47)	Irvine, CA	8	110,000	1983	2000	100%
22110-22120 Clarendon Street(48)	Woodland Hills, CA	9	38,940	1982	2001	87%

Total Office Buildings	19	215,840	98%
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Footnotes to the Company's Portfolio Listing as of December 31, 2009

- (1) Unless otherwise specified, the Company has a 100% ownership interest in each community.
- (2) For apartment communities, occupancy rates are based on financial occupancy for the year ended December 31, 2009; for the office buildings or properties which have not yet stabilized, or have insufficient operating history, occupancy rates are based on physical occupancy as of December 31, 2009. For an explanation of how financial occupancy and physical occupancy are calculated, see "Properties-Occupancy Rates" in this Item 2.
- (3) The Company has a 30% special limited partnership interest in the entity that owns this apartment community. This investment was made under arrangements whereby Essex Management Corporation ("EMC") became the general partner and the existing partners were granted the right to require the applicable partnership to redeem their interest for cash. Subject to certain conditions, the Company may, however, elect to deliver an equivalent number of shares of the Company's common stock in satisfaction of the applicable partnership's cash redemption obligation.

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- (4) The community is subject to a ground lease, which, unless extended, will expire in 2082.
- (5) This community is owned by Fund II. The Company has a 28.2% interest in Fund II which is accounted for using the equity method of accounting.
- (6) The Company holds a 1% special limited partner interest in the partnerships which own these apartment communities. These investments were made under arrangements whereby EMC became the 1% sole general partner and the other limited partners were granted the right to require the applicable partnership to redeem their interest for cash. Subject to certain conditions, the Company may, however, elect to deliver an equivalent number of shares of the Company's common stock in satisfaction of the applicable partnership's cash redemption obligation.
- (7) In 2002 the Company purchased an additional 21 units adjacent to this apartment community for \$3 million. This property was built in 1992.
 - (8) The Company completed a \$1.6 million redevelopment in 2000.
 - (9) The Company completed a \$2.3 million redevelopment in 2000.
 - (10) The Company is in the process of performing a \$10.8 million redevelopment.
 - (11) The Company completed a \$6.2 million redevelopment in 2007.
 - (12) Fund II completed a \$5.3 million redevelopment in 2008.
 - (13) This community is subject to a ground lease, which, unless extended, will expire in 2067.
 - (14) The Company completed a \$6.1 million redevelopment in 2007.
- (15) The Company completed an \$11.0 million redevelopment in 2001 and an additional \$3.6 million redevelopment in 2005.
 - (16) This community is subject to a ground lease, which, unless extended, will expire in 2027.
 - (17) The Company completed a \$3.2 million redevelopment in 2002.
 - (18) The Company completed a \$1.9 million redevelopment in 2000.
 - (19) The Company completed a \$1.9 million redevelopment in 2001.
 - (20) The Company completed a \$1.7 million redevelopment in 2001.
 - (21) The Company is in the process of performing a \$16.6 million redevelopment.
- (22) The Company had an 85% controlling limited partnership interest as of December 31, 2006, and during January 2007 the Company acquired the remaining 15% partnership interest.
 - (23) The Company and EMC have a 74.0% and a 1% member interest, respectively.
 - (24) The Company completed a \$3.5 million redevelopment in 2002.
- (25) The community is subject to a ground lease, which, unless extended, will expire in 2028.
- (26) The Company is in the process of performing a \$14.1 million redevelopment.
- (27) The Company completed a \$2.7 million redevelopment in 2001.
- (28)