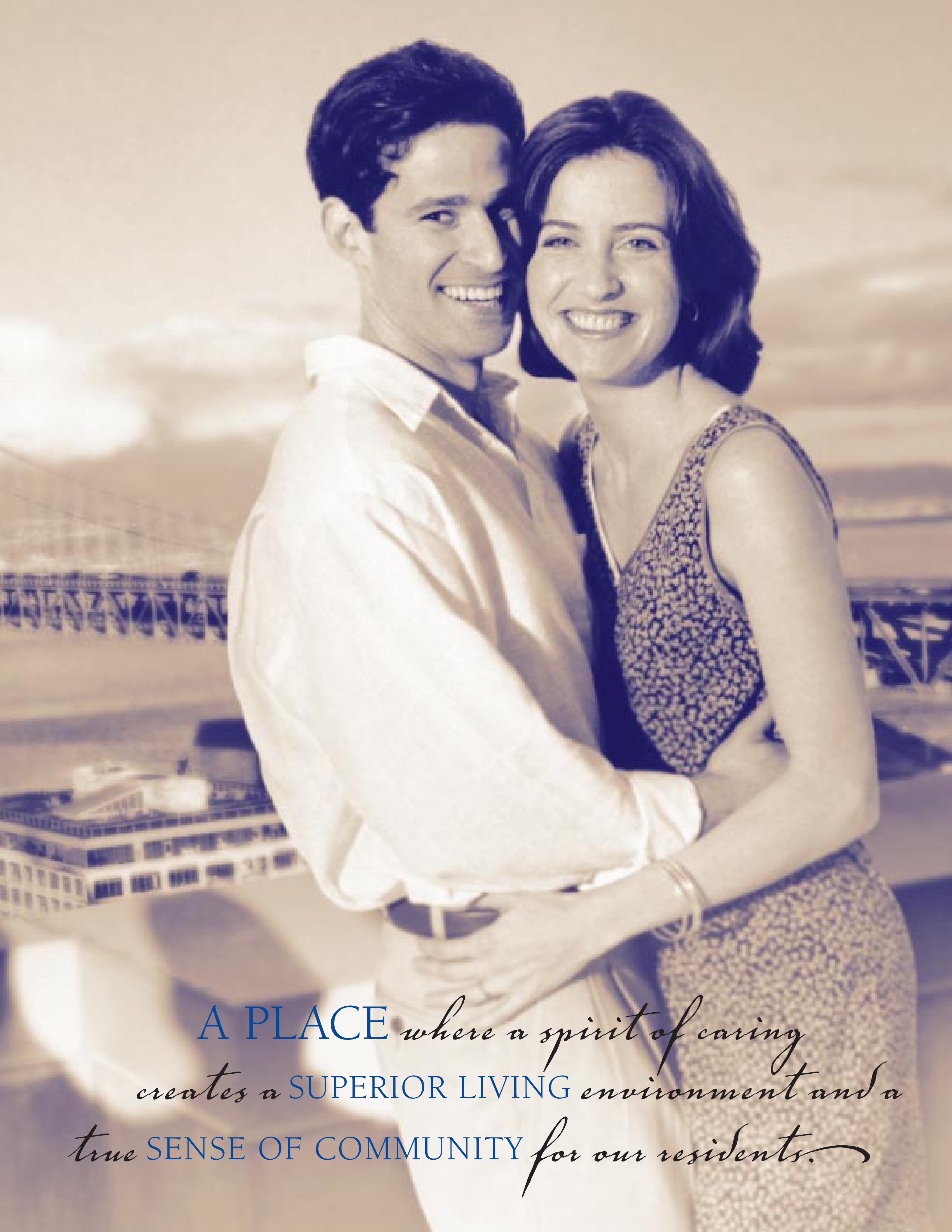
AvalonBay Communities, Inc.

1999 Annual Report

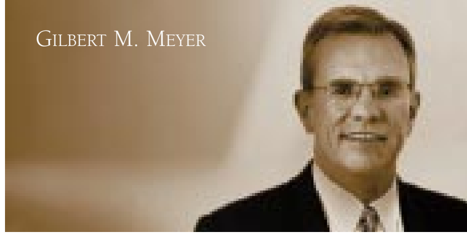
AvalonBay Communities has delivered consistently strong financial results and increased the value of its apartment home community portfolio through a focused urban and suburban infill, high barrier-to-entry market strategy. The Company is a self-administered and self-managed equity REIT that develops, redevelops, acquires and manages multifamily apartment communities. At year-end, AvalonBay owned or held ownership interests in 134 apartment communities containing 39,181 apartment homes in 12 states and the District of Columbia. Accomplishments during 1999 included:

- Growing FFO per share by 12.2 percent over 1998.
- Increasing same store EBIDTA by 4.7 percent.
- Completing ten development communities with 2,335 apartment homes.
- Completing 13 redevelopment communities with 4,051 apartment homes.
- Increasing fixed charge coverage ratios and improving the strength and flexibility of the balance sheet.
- Generating gross proceeds of $317 million through the sale of non-strategic assets, reinvesting in core markets.
- Achieving stabilized occupancy of 96.7 percent.

on cover:
Avalon Towers, San Francisco, CA


A PLACE where a spirit of caring
creates a SUPERIOR LIVING environment and a
true SENSE OF COMMUNITY for our residents.

To Our Stockholders



Gilbert M. Meyer

Executive Chairman

Richard L. Michaux

Chief Executive Officer and President

AvalonBay COMMUNITIES, INC.

During the past year, we saw our vision starting to become a reality — creating value through the merger and enhancing value through our strategic plan. AvalonBay Communities grew Funds From Operations (FFO) per share by 12.2 percent. We sharpened our strategy to strengthen the Company's presence in core, high barrier-to-entry markets from coast to coast. These markets are characterized by a lack of zoned apartment land and long, arduous entitlement processes.

In the face of a difficult capital environment, management utilized opportunistic strategies to finance AvalonBay's growth, including the sale of non-core assets located in several markets. We chose to exit these markets in favor of those regions where the value of our core market development strategy can be maximized. In addition, we implemented a major reorganization of our management structure to better match the Company's long-range strategies.

The Company benefited from its focus on high barrier-to-entry suburban and urban infill apartment development and the continued strength of its markets. Job growth in many of our markets is at or near a 10-year high. We targeted development in these markets, completing 2,335 new apartment homes. Occupancy of stabilized communities at year-end was 96.7 percent. Additionally, same store rents grew approximately four percent over 1998.

Same store EBITDA growth was strong, increasing 4.7 percent over 1998; over the past five years we have realized average annual EBITDA growth of 6.4 percent.

Our financial performance accelerated during the latter half of 1999. Our markets strengthened, and we replaced revenues lost from the assets sold with lease-up activity at new development communities, minimizing the dilution from dispositions. We plan fewer asset sales in 2000.

We increased our dividend, while maintaining a highly conservative payout ratio of 64.0 percent of FFO in 1999. We recently

AvalonBay Creates Superior Communities

announced a further increase in our dividend for the first quarter of 2000. As a result, the dividend for the first quarter of 2000 is approximately 10 percent greater than the dividend for the first quarter of 1999. This provides a larger portion of total return from dividends while helping us meet our goal of distributing 100 percent of taxable income to avoid corporate level tax.

A Simple, Yet Focused Strategy

Our underlying high barrier to entry strategy is simple: We have created an advantageous position over the past 20 years in markets where it is extremely difficult to develop apartments. We create superior communities in these superior markets. We believe that greater long-term value is realized by building a strong presence in those markets where the approval and financial hurdles discourage our competition from doing business. In addition, we believe these markets provide a more predictable revenue stream and typically experience a more advantageous supply and demand balance.

Our markets are often characterized by difficult jurisdictional and neighborhood challenges and demonstrate the value of our local, sharpshooter capabilities. AvalonBay's development teams are long-term members of their local communities and are deeply integrated in them. Their relationships facilitate jurisdictional approvals and community support and often position us as the developer of choice.

A key driver of our market strategy is the concept of "smart growth" which is gaining increasing support in metropolitan areas. This approach seeks to foster the development of high density residential communities around mass transit corridors and near centers of employment, shopping and entertainment in both suburban and urban infill markets.

The broader use of smart growth planning dovetails nicely with our market strategy, as in many cases our residents choose to rent so that they can enjoy a more leisurely lifestyle and the amenities of living in an infill location. Infill communities also appeal to the fastest growing segments of our rental market—young singles and couples who are 25–30 years old and pre-retirees and retirees who are 55–65 years old.

Active Development/Redevelopment Programs

During 1999, we completed ten development communities with 2,335 apartment homes at a total capital cost of $392 million. Development capital was largely supplied by the sale of non-core communities. This capital recycling plan creates value because the yields on cost of new development exceeds the cap rate of the assets sold. We believe that this differential or value creation

This mission statement embodies everything we do and is reflected not only in the quality of our communities, but also by the living experience our associates create in providing a home for our residents.

from left:
Parkside Commons, Sunnyvale, CA
Barrington Hills, Hayward, CA
Longwood Towers, Brookline, MA

spread of approximately 250 basis points is industry-leading for AvalonBay. Because of our development focused strategy, the average age of our portfolio at year end was a relatively "young" eight years.

Two communities that highlight our development activities during the year were Avalon Foxmill and Avalon Towers by the Bay. Avalon Foxmill, located in Herndon, Virginia, sits in the middle of the rapidly growing Dulles Corridor, which is experiencing explosive Internet and telecommunications employment growth. Avalon Towers is the first new major apartment high-rise in downtown San Francisco in nearly a decade.

We also completed 13 redevelopment communities at a total investment of $77 million. These communities are now generating higher rents and experiencing higher occupancy levels.

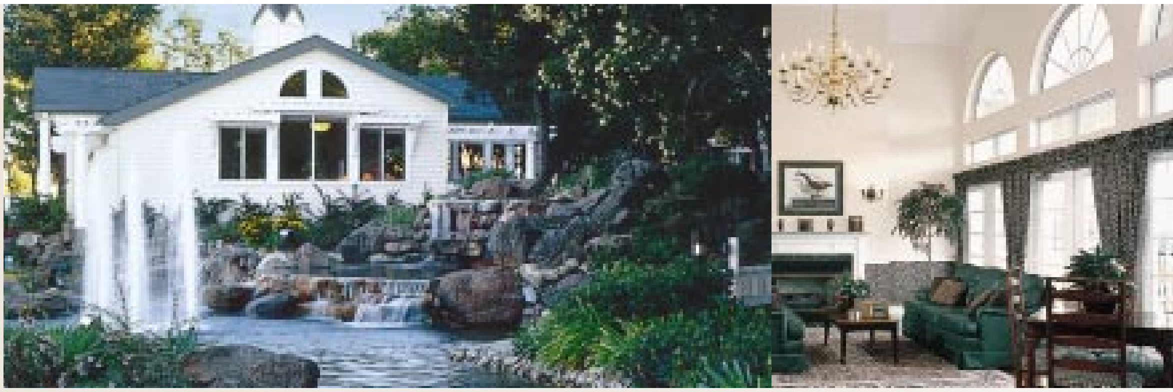
Our Company and communities continued to garner industry recognition during 1999. Our Longwood Towers community in Brookline, Massachusetts, received two NAHB awards, including the best Mid-or High Rise Apartment Community and best Multi-Family Redevelopment Program.

In the year ahead, our core development and redevelopment strategies will continue with little or no acquisition activity planned. We have one of the strongest development pipelines in the industry and we started 2000 with 12 communities under development. These communities will add 3,173 apartment homes to the portfolio. We also own, or have under contract, another 30 development sites to serve as value creation engines for the next several years. Redevelopment activity will also continue with programs ongoing at four communities containing 1,455 apartment homes and representing an incremental investment of $39 million.

A Sharper Focus

Although market diversity continues to be an important element of our growth strategy, we exited several markets during the year (St. Louis, Cincinnati, Detroit and Indianapolis). The proceeds from asset sales in these markets, combined with those from the disposition of other non-core assets, resulted in gross proceeds of $317 million. These funds were reinvested in several of the core markets we have determined to be the best high barrier-to-entry markets for diversification and growth. In 2000, we plan to continue to more sharply focus our development activity in 19 core markets and to sell assets in markets that do not meet our long-term strategy.

This enhanced market focus not only improves the quality of our earnings, but the recycled capital that results from disposing of non-core assets, when combined with retained earnings, also helps provide a significant amount of self-funding. This helps us retain our conservative capital structure.



AvalonBay Creates Stockholder Value

At year end, the average interest rate on our debt was a favorable 6.7 percent with average years to maturity of ten years, while our unsecured credit carried solid ratings of Baa1/BBB+. We will continue to manage our balance sheet conservatively to maintain flexibility and control debt costs in a rising interest rate environment.

Building for the Future

Looking to the future, we are laying the foundation to ensure continued vibrancy and success at AvalonBay. Through new signage and a more centralized approach to marketing, we will continue to realize value from our strategic marketing initiatives as we become a more consistent and recognizable brand.

In addition, we continue to work on a key technology initiative involving the development of an Internet-based solution to optimize internal growth. Known informally as Javalon, it is a Web-based transactional system that will provide us more accurate and timely management information and help us maximize occupancy and rental rates. In addition, this technology will reduce the administrative workload and allow us to automate the leasing process with a view to conducting resident business transactions over the Internet.

Javalon is also the core of the Company's future e-commerce strategy. It will enhance our internet marketing programs through a virtual leasing office that enables us to expand from 40 "store front hours" a week to round-the-clock interaction with current and prospective residents.

Recently enacted legislation has created a new vehicle—a Taxable REIT Subsidiary (TRS)—that beginning in 2001 allows us to provide new services to our residents and to enter new businesses from which we were previously prohibited. We are currently studying which services and apartment-related businesses have the potential to provide incremental value for our stockholders.

As part of the corporate reorganization that occurred in early 1999, we have created a succession program for key management positions. We have what we believe is the finest team of executives in our industry, backed by a dedicated group of more than 1,700 associates who are resident-focused and committed to the delivery of "Legendary Service".

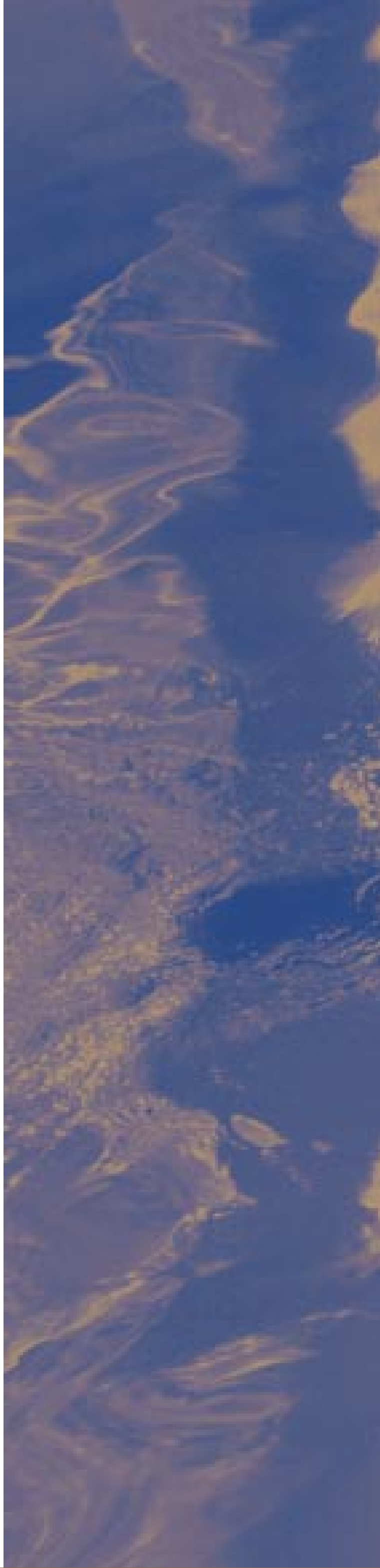
As we grow, we are staying true to our core values—a spirit of caring, a commitment to integrity and a focus on continuous improvement. With this unwavering dedication, the future of AvalonBay is bright and we look forward to reporting on our success in the years ahead.

Richard L. Michaux Gilbert M. Meyer

By staying true to our mission and core values, we fulfill our commitments to provide residents a superior living experience, enhance the quality of our surrounding communities and foster associate growth and development—all of which build long-term value for our investors.

from left:
Country Brook, San Jose, CA
Avalon Gardens, Nanuet, NJ
Alicante, Fremont, CA

BUILDING LONG-TERM VALUE FOR STOCKHOLDERS



Our success in building superior communities and offering a high quality living experience for our residents maximizes the value of our stockholders' investment in the Company.

Because of our ability to serve a market niche where only the best will do, we are able to command premium rents and maintain consistently high occupancy levels at our communities. Additionally, our consistent strategy of focusing on high barrier-to-entry markets—where challenges to development are often the greatest—leads to above sector yields on our development communities and strong growth in same store EBIDTA which are reflected in sector-leading FFO per share growth.

Our retained earnings and ability to sell assets when strategically desired at a premium also enable us to provide internally generated funds in a capital constrained environment.

AVALONBAY IS A PLACE

Barrington Hills
Hayward, CA

A PLACE WHERE *the consistency of a high quality living experience for residents creates more predictable long-term value for investors.*

PROVIDING RESIDENTS THE GIFT OF TIME

We recognize that many of our residents are renters by choice. They seek a lifestyle that gives them the time to pursue busy careers and still enjoy the benefits of nearby entertainment and cultural attractions.

We strive to give our residents the gift of time everyday. Our communities are strategically located close to shopping, employment centers and transportation for this very reason. The communities themselves are designed with time in mind, often providing state-of-the-art business centers and fitness facilities. We are even developing unique apartment homes that have an attached office with street front entrances.

We have also created on-site retail space that brings restaurants, video rental and dry cleaners to our residents' doorsteps. In our fast-paced, technology-driven world, these amenities not only offer a high level of convenience to our residents, but also provide a place for them to connect with their neighbors and feel a sense of community.

In addition, our resident-focused associates look for ways to give time back to our residents through an exceptional level of service, whether it's delivering a package or watering house plants when a resident is out of town. AvalonBay is a place to enjoy the gift of time.

AVALONBAY IS A PLACE

Avalon on the Alameda
San Jose, CA

A PLACE TO *enjoy the gift of time.*

Whether it's lingering over a cup of coffee in your kitchen or at an onsite Starbucks— it is always time well spent.

ADDING VALUE TO OUR LOCAL COMMUNITIES

Our communities are more than an asset on the Company's balance sheet.

Our communities, the associates who manage them and our residents become resources to the communities and neighborhoods in which they are located. Our ten offices across the country are staffed principally by "home grown" associates who have often spent the majority—if not all—of their lives in the community. Just as we seek to enhance the quality of life for our residents, we strive to contribute to the communities around us.

In many cases, a new AvalonBay community has led to the revitalization of a neighborhood, attracting other residential and new retail development. Our track record provides us a competitive advantage in the bidding process for apartment home sites and also facilitates approval of our development communities.

Enhancing our neighbors' quality of life is an integral part of the Company's mission and core values. As a result, AvalonBay communities often host celebrations and fund raising events and provide financial and volunteer support for local civic and charitable organizations.

AVALONBAY IS A PLACE

Avalon Grove
Stamford, CT

A PLACE THAT *promotes involvement in its local communities, such as sponsoring holiday events in 1999 for the Boy's and Girl's Clubs of Stamford, Connecticut.*

ENHANCING RESIDENT SATISFACTION THROUGH EMPLOYEE DEVELOPMENT

We believe that the key to providing quality lifestyles for residents, developing strong bonds with our neighbors and generating desirable returns for our stockholders begins with the quality of our associates.

We engender associate commitment to management's goals with training programs that enhance their skills and knowledge, while facilitating personal and professional growth. "AvalonBay University" is the centerpiece of training efforts that foster our core value of continuous improvement.

We provide associates with the skills to meet resident needs—whether it's fixing a leaky faucet or solving a computer problem in a community's business center.

Our training and culture result in a level of service to our residents that not just meets but exceeds residents' expectations, or what we call "Legendary Service". While we recognize many associates throughout the year, we honor one annually who has demonstrated unparalleled commitment to this principle with the "Legendary Service" award.

The 1999 honoree is Elot Albor, an associate at Crossbrook in Rohnert Park, California. One of many examples of how Elot delivers "Legendary Service" was when he assisted an elderly resident who had a minor "fender bender", but for health reasons was afraid to be without the car for the time it would take to be repaired. Elot took it upon himself to pull out the dent and repair the taillight on his own time. As a result, the resident was able to drive to doctor appointments and make other necessary trips safely and worry free.

AVALONBAY IS A PLACE

AvalonBay 1999 "Legendary Service" award winner: Elot Albor

A PLACE WHERE *associates not only learn skills to make them more valuable to our residents, but also to themselves through personal and professional growth*

AvalonBay is a place that *people call home across the country*

At Year-End	Number of Communities	Number of Apts.
California	54	15,559
Connecticut	12	3,892
District of Columbia	1	308
Illinois	3	887
Massachusetts	10	2,671
Maryland	10	2,590
Minnesota	5	1,328
New Jersey	9	3,306
New York	10	2,561
Oregon	1	279
Rhode Island	1	225
Virginia	13	4,276
Washington	5	1,299

For more detailed information about our communities visit us at www.avalonbay.com

This Annual Report, including the Letter to Stockholders, contains "forward-looking statements" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934. See the discussion under "Forward-Looking Statements" in this report for matters to be considered in this regard.

’99 REVIEW

FINANCIALS

Selected Financial Data

The following table provides historical consolidated financial, operating and other data for AvalonBay Communities, Inc. You should read the table with our consolidated financial statements and the notes included in this report.

	Company[1]				
	Years ended				
(Dollars in thousands, except per share information)	**12-31-99**	12-31-98	12-31-97	12-31-96	12-31-95
Operating Information:					
Revenue:					
Rental income	**$ 503,132**	$ 369,945	$ 169,442	$ 123,354	$ 94,821
Management fees	**1,176**	1,377	1,029	1,439	1,926
Other income	**236**	81	633	420	466
Total revenue	**504,544**	371,403	171,104	125,213	97,213
Expenses:					
Operating expenses, excluding property taxes	**134,172**	104,346	47,279	36,491	27,963
Property taxes	**42,701**	31,775	14,429	10,583	8,035
Interest expense	**74,699**	54,650	16,977	9,545	11,056
Depreciation and amortization	**109,759**	77,374	29,113	20,956	16,558
General and administrative	**9,502**	9,124	5,093	3,438	3,132
Development costs write-off	**—**	—	—	450	400
Non-recurring items	**16,782**	—	—	—	—
Total expenses	**387,615**	277,269	112,891	81,463	67,144
Equity in income of unconsolidated joint ventures	**2,867**	2,638	5,689	1,025	440
Interest income	**7,362**	3,508	1,346	887	953
Minority interest in unconsolidated partnerships	**(1,975)**	(1,770)	174	495	633
Income before gain on sale of communities and extraordinary item	**125,183**	98,510	65,422	46,157	32,095
Gain on sale of communities	**47,093**	25,270	677	7,850	—
Income before extraordinary item	**172,276**	123,780	66,099	54,007	32,095
Extraordinary item	**—**	(245)	(1,183)	(2,356)	(1,158)
Net income	**172,276**	123,535	64,916	51,651	30,937
Dividends attributable to preferred stock	**(39,779)**	(28,132)	(19,656)	(10,422)	—
Net income available to common stockholders	**$ 132,497**	$ 95,403	$ 45,260	$ 41,229	$ 30,937
Per Common Share and Share Information:					
Income before extraordinary item—basic	**$ 2.02**	$ 1.87	$ 1.64	$ 1.85	$ 1.47
Income before extraordinary item—diluted	**$ 2.00**	$ 1.84	$ 1.63	$ 1.84	$ 1.47
Extraordinary item	**$ —**	$ (0.00)	$ (0.04)	$ (0.10)	$ (0.05)
Net income—basic	**$ 2.02**	$ 1.87	$ 1.60	$ 1.75	$ 1.42
Net income—diluted	**$ 2.00**	$ 1.84	$ 1.59	$ 1.74	$ 1.42
Cash dividends declared	**$ 2.06**	$ 2.04	$ 2.00	$ 1.94	$ 1.90
Weighted average common shares and units outstanding—basic	**65,657,921**	51,113,206	28,245,314	23,617,161	21,793,158
Weighted average common shares and units outstanding—diluted	**66,110,664**	51,771,247	28,431,823	23,691,447	21,828,020
Other Information:					
Net income	**$ 172,276**	$ 123,535	$ 64,916	$ 51,651	$ 30,937
Depreciation and amortization	**109,759**	77,374	29,113	20,956	16,558
Interest expense	**74,699**	54,650	16,977	9,545	11,056
Interest income	**(7,362)**	(3,508)	(1,346)	(887)	(953)
Non-recurring items	**16,782**	—	—	—	—
Gain on sale of communities	**(47,093)**	(25,270)	(677)	(7,850)	—
Extraordinary item	**—**	245	1,183	2,356	1,158
Gross EBITDA[2]	**$ 319,061**	$ 227,026	$ 110,166	$ 75,771	$ 58,756
Funds from Operations[3]	**$ 212,840**	$ 148,487	$ 73,525	$ 54,622	$ 46,879
Stabilized apartment communities[4]	**118**	113	64	45	38

	Company(1)				
	Years ended				
(Dollars in thousands)	**12-31-99**	12-31-98	12-31-97	12-31-96	12-31-95
BALANCE SHEET INFORMATION:					
Real estate, before accumulated depreciation	**$ 4,266,426**	$ 4,006,456	$ 1,534,986	$ 1,081,906	$ 782,433
Total assets	**$ 4,154,662**	$ 4,005,013	$ 1,529,703	$ 1,082,771	$ 786,711
Notes payable and Unsecured Facilities	**$ 1,593,647**	$ 1,484,371	$ 506,129	$ 310,606	$ 340,686
CASH FLOW INFORMATION:					
Net cash flows provided by operating activities	**$ 250,066**	$ 193,478	$ 93,649	$ 65,841	$ 56,314
Net cash flows used in investing activities	**$ (264,619)**	$ (617,685)	$ (421,420)	$ (261,033)	$ (189,582)
Net cash flows provided by financing activities	**$ 13,284**	$ 426,375	$ 320,252	$ 207,632	$ 132,207

Notes to Selected Financial Data

(1) See our consolidated financial statements and the related notes included in this report, including Note 2 thereof for a discussion of a revision to the financial presentation resulting from a change in accounting.

(2) Gross EBITDA represents earnings before interest, income taxes, depreciation and amortization, non-recurring items, gain on sale of communities and extraordinary items. Gross EBITDA is relevant to an understanding of the economics of AvalonBay because it indicates cash flow available from operations to service fixed obligations. Gross EBITDA should not be considered as an alternative to operating income, as determined in accordance with GAAP, as an indicator of our operating performance, or to cash flows from operating activities (as determined in accordance with GAAP) as a measure of liquidity. Our calculation of gross EBITDA may not be comparable to gross EBITDA as calculated by other companies.

(3) We generally consider Funds from Operations, or FFO, to be an appropriate measure of our operating performance because it helps investors understand our ability to incur and service debt and to make capital expenditures. We believe that to gain a clear understanding of our operating results, FFO should be examined with net income as presented in the consolidated financial statements included elsewhere in this report. FFO is determined based on a definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts and is defined as:

- net income or loss computed in accordance with GAAP, excluding gains or losses from debt restructuring, other non-recurring items and sales of property;
- plus depreciation of real estate assets; and
- after adjustments for unconsolidated partnerships and joint ventures.

FFO does not represent cash generated from operating activities in accordance with GAAP. Therefore it should not be considered as an alternative to net income or as an indication of performance. FFO should also not be considered an alternative to net cash flows from operating activities as determined by generally accepted accounting principles as a measure of liquidity. Additionally, it is not necessarily indicative of cash available to fund cash needs. Further, FFO as calculated by other REITs may not be comparable to our calculation of FFO. The calculation of FFO for the periods presented is reflected in the following table:

Summary Calculation of Funds from Operations

	Company(1)				
	Years ended				
(Dollars in thousands)	**12-31-99**	12-31-98	12-31-97	12-31-96	12-31-95
Net income available to common stockholders	**$ 132,497**	$ 95,403	$ 45,260	$ 41,229	$ 30,937
Depreciation (real estate related)	**107,928**	75,614	27,360	18,566	14,468
Joint venture adjustments	**751**	725	399	321	316
Minority interest	**1,975**	1,770	—	—	—
Gain on sale of communities	**(47,093)**	(25,270)	(677)	(7,850)	—
Non-recurring items(5)	**16,782**	—	—	—	—
Extraordinary items	**—**	245	1,183	2,356	1,158
Funds from Operations	**$ 212,840**	$ 148,487	$ 73,525	$ 54,622	$ 46,879
Net cash provided by operating activities	**$ 250,066**	$ 193,478	$ 93,649	$ 65,841	$ 56,314
Net cash used in investing activities	**$ (264,619)**	$ (617,685)	$ (421,420)	$ (261,033)	$ (189,582)
Net cash provided by financing activities	**$ 13,284**	$ 426,375	$ 320,252	$ 207,632	$ 132,207
Weighted average common shares and units outstanding—diluted	**66,110,664**	51,771,247	28,431,823	23,691,447	21,828,020

(4) These amounts include communities only after stabilized occupancy has occurred. We consider a community to have achieved stabilized occupancy on the earlier of (i) the first day of any month in which the community reaches 95% physical occupancy or (ii) one year after completion of construction or reconstruction. These amounts also include joint venture investments.

(5) Year to date consists of $16,076 related to management and other organizational changes and $706 for Y2K compliance costs.

Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This Annual Report, including the footnotes to the Company's consolidated financial statements, contains "forward-looking statements" as that term is defined under the Private Securities Litigation Reform Act of 1995. You can identify forward-looking statements by our use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," and other similar expressions in this Annual Report, that predict or indicate future events and trends or that do not relate to historical matters. In addition, information concerning the following are forward-looking statements:

- the timing and cost of completion of apartment communities under construction, reconstruction, development or redevelopment;
- the timing of lease-up and occupancy of apartment communities;
- the pursuit of land on which we are considering future development;
- cost, yield and earnings estimates;
- the development, implementation and use of management information systems.

We cannot assure the future results or outcome of the matters described in these statements; rather, these statements merely reflect our current expectations of the approximate outcomes of the matters discussed. You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors, some of which are beyond our control. These risks, uncertainties and other factors may cause our actual results, performance or achievements to differ materially from the anticipated future results, performance or achievements expressed or implied by these forward-looking statements. Some of the factors that could cause our actual results, performance or achievements to differ materially from those expressed or implied by these forward-looking statements include, but are not limited to, the following:

- we may be unsuccessful in managing our current growth in the number of apartment communities and the related growth of our business operations;
- our previous or possible future expansion into new geographic market areas may not produce financial results that are consistent with our historical performance;
- we may fail to secure development opportunities due to an inability to reach agreements with third parties or to obtain desired zoning and other local approvals;
- we may abandon development opportunities for a number of reasons, including changes in local market conditions which make development less desirable, increases in costs of development and increases in the cost of capital;
- construction costs of a community may exceed our original estimates;
- we may not complete construction and lease-up of communities under development or redevelopment on schedule, resulting in increased interest expense, construction costs and reduced rental revenues;
- occupancy rates and market rents may be adversely affected by local economic and market conditions which are beyond our control;
- financing may not be available on favorable terms and our cash flow from operations and access to cost effective capital may be insufficient for the development of our pipeline and could limit our pursuit of opportunities;
- our cash flow may be insufficient to meet required payments of principal and interest, and we may be unable to refinance existing indebtedness or the terms of such refinancing may not be as favorable as the terms of existing indebtedness;
- the development, implementation and use of new management information systems may cost more than anticipated or may be delayed for a number of reasons, including unforeseen technological or integration issues.

You should read our consolidated financial statements and notes for the year ended December 31, 1999 included in this report in conjunction with the following discussion. These forward-looking statements represent our estimates and assumptions only as of the date of this report. We do not undertake to update these forward-looking statements, and you should not rely upon them after the date of this report.

BUSINESS DESCRIPTION AND COMMUNITY INFORMATION

AvalonBay is a Maryland corporation that has elected to be treated as a real estate investment trust, or REIT, for federal income tax purposes. We focus on the ownership and operation of upscale apartment communities (which we consider to be apartment communities that generally command among the highest rents in their submarkets) in high barrier-to-entry markets of the United States. This is because we believe that the limited new supply of upscale apartment homes in these markets helps achieve more predictable cash flows. These barriers-to-entry generally include a difficult and lengthy entitlement process with local jurisdictions and dense in-fill locations where zoned and entitled land is in limited supply. These markets are located in Northern and Southern California and selected states in the Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions of the country.

AvalonBay is the surviving corporation from the merger of Avalon Properties, Inc. with and into Bay Apartment Communities, Inc. Prior to December 31, 1999, we accounted for the merger under the purchase method of accounting, using the historical financial statements of Bay prior to and after the merger. Based on discussions with the Securities and Exchange Commission, we agreed to revise our financial presentation as of and for the years ended December 31, 1998 and 1997 to present the merger whereby the historical financial statements for Avalon are presented prior to the merger. At that time, Avalon ceased to legally exist, and Bay as the surviving legal entity adopted the historical financial statements of Avalon, with Bay's assets recorded in the historical financial statements of Avalon at an amount equal to Bay's debt outstanding at that time plus the value of capital stock retained by the Bay stockholders, which approximates fair value.

We are a fully-integrated real estate organization with in-house expertise in the following areas:

- acquisition;
- development and redevelopment;
- construction and reconstruction;
- financing;
- marketing;
- leasing and management; and
- information technologies.

With our expertise and in-house capabilities, we believe we are well-positioned to continue to pursue opportunities to develop and acquire upscale apartment homes in our target markets. Our ability to pursue attractive opportunities, however, may be constrained by capital market conditions that limit the availability of cost effective capital to finance these activities. We limited our acquisition activity in 1999 as compared to prior years due to these capital constraints, and we expect to direct most of our invested capital to new developments and redevelopments for the foreseeable future.

We believe apartment communities present an attractive investment opportunity compared to other real estate investments because a broad potential resident base results in relatively stable demand during all phases of a real estate cycle. We intend to pursue appropriate new investments, including both new developments and acquisitions of communities, in markets where constraints to new supply exist and where new household formations have out-paced multifamily permit activity in recent years.

Our real estate investments as of March 1, 2000 consist primarily of stabilized operating apartment communities as well as communities in various stages of the development and redevelopment cycle and land or land options held for development. We classify these investments into the following categories:

	Number of communities	Number of apartment homes
Current Communities	121	35,648
Stabilized Communities	117	34,193
Established Communities:	63	17,706
Northern California	25	6,461
Southern California	3	600
Mid-Atlantic	18	5,259
Northeast	16	4,888
Midwest	1	498
Other Stabilized Communities:	54	16,487
Northern California	10	2,988
Southern California	13	4,476
Mid-Atlantic	4	1,240
Northeast	16	5,111
Midwest	7	1,717
Pacific Northwest	4	955
Lease-Up Communities	—	—
Redevelopment Communities	4	1,455
Development Communities	12	3,173
Development Rights	30	8,624(*)

(*) Represents an estimate

Current Communities are apartment communities that have been completed and have reached occupancy of at least 95%, have been complete for one year, are in the initial lease-up process or are under redevelopment. Current Communities consist of the following:

- STABILIZED COMMUNITIES. Represents all Current Communities that have completed initial lease-up by attaining physical occupancy levels of at least 95% or have been completed for one year, whichever occurs earlier. Stabilized Communities are categorized as either Established Communities or Other Stabilized Communities.

  Established Communities. Represents all Stabilized Communities owned by Avalon and, on a pro forma basis, those owned by Bay as of January 1, 1998, with stabilized operating costs as of January 1, 1998 such that a comparison of 1998 operating results to 1999 operating results is meaningful. Each of the Established Communities falls into one of the following six geographic areas: Northern California, Southern California, Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions. At December 31, 1999, there were no Established Communities in the Pacific Northwest. When used in connection with a comparison of 1998 and 1997 results, the term "Established Communities" refers to communities that were stabilized as of January 1, 1997.

  Other Stabilized Communities. Represents Stabilized Communities as defined above, but which became stabilized or were acquired after January 1, 1998.

- Lease-Up Communities. Represents all communities where construction has been complete for less than one year and where occupancy has not reached at least 95%.

- Redevelopment Communities. Represents all communities where substantial redevelopment has begun. Redevelopment is considered substantial when capital invested during the reconstruction effort exceeds the lesser of $5 million or 10% of the community's acquisition cost.

Development Communities are communities that are under construction and for which a final certificate of occupancy has not been received. These communities may be partially complete and operating.

Development Rights are development opportunities in the early phase of the development process for which we have an option to acquire land or where we own land to develop a new community. We capitalize all related pre-development costs incurred in pursuit of these new developments.

Of the Current Communities as of March 1, 2000, we own:

- a fee simple, or absolute, ownership interest in 106 operating communities, one of which is on land subject to a 149 year land lease;
- a general partnership interest in five partnerships that in the aggregate hold a fee simple interest in five other operating communities;
- a general partnership interest in four partnerships structured as "DownREITs," as described more fully below, that own an aggregate of nine communities; and
- a 100% interest in a senior participating mortgage note secured by one community, which allows us to share in part of the rental income or resale proceeds of the community.

We also hold a fee simple ownership interest in 11 of the Development Communities and a membership interest in a limited liability company that holds a fee simple interest in one Development Community.

In each of the four partnerships structured as DownREITs, either AvalonBay or one of our wholly-owned subsidiaries is the general partner, and there are one or more limited partners whose interest in the partnership is represented by units of limited partnership interest. For each DownREIT partnership, limited partners are entitled to receive distributions before any distribution is made to the general partner. Although the partnership agreements for each of the DownREITs are different, generally the distributions paid to the holders of units of limited partnership interests approximate the current AvalonBay common stock dividend rate. Each DownREIT partnership has been structured so that it is unlikely the limited partners will be entitled to a distribution greater than the initial distribution provided for in the partnership agreement. The holders of units of limited partnership interest have the right to present each unit of limited partnership interest for redemption for cash equal to the fair market value of a share of AvalonBay common stock on the date of redemption. In lieu of a cash redemption of a unit, we may elect to acquire any unit presented for redemption for one share of our common stock. As of December 31, 1999, there were 973,870 units outstanding. The DownREIT partnerships are consolidated for financial reporting purposes.

At December 31, 1999, we had positioned our portfolio of Stabilized Communities, excluding communities owned by unconsolidated joint ventures, to an average physical occupancy level of 96.7%. Our strategy is to maximize total rental revenue through management of rental rates and occupancy levels. Our strategy of maximizing total rental revenue could lead to lower occupancy levels. Given the current high occupancy level of our portfolio, we believe that any rental revenue and net income gains from our Established Communities would be achieved primarily through higher rental rates and the lower average operating costs per apartment home that result from economies of scale due to national and regional growth of our portfolio.

We elected to be taxed as a REIT for federal income tax purposes for the year ended December 31, 1994 and we have not revoked that election. We were incorporated under the laws of the State of California in 1978, and we were reincorporated in the State of Maryland in July 1995. Our principal executive offices are located at 2900 Eisenhower Avenue, Suite 300, Alexandria, Virginia, 22314, and our telephone number at that location is (703) 329-6300. We also maintain regional offices and administrative or specialty offices in or near the following cities:

- San Jose, California;
- Wilton, Connecticut;
- Boston, Massachusetts;
- Chicago, Illinois;
- Los Angeles, California;
- Minneapolis, Minnesota;
- Newport Beach, California;
- New York, New York;
- Princeton, New Jersey; and
- Seattle, Washington.

RECENT DEVELOPMENTS

SALES OF EXISTING COMMUNITIES. During 1998, we completed a strategic planning effort that resulted in our decision to increase our geographical concentration in selected high barrier-to-entry markets where we believe we can:

- apply sufficient market and management presence to enhance revenue growth;
- reduce operating expenses; and
- leverage management talent.

To effect this increased concentration, we adopted an aggressive capital redeployment strategy and are selling assets in markets where our current presence is limited. We intend to redeploy the proceeds from sales to develop and redevelop communities currently under construction or reconstruction. Pending such redeployment, the proceeds from the sale of these communities will be used to repay amounts outstanding under our variable rate unsecured credit facility. Accordingly, we sold seven communities with an aggregate of 2,039 apartment homes in connection with our capital redeployment strategy in 1998. The net proceeds from these sales totaled $73,900,000. In 1999, we sold 16 communities with an aggregate of 4,464 apartment homes. Net proceeds from these sales totaled $255,618,000. In addition, during 1999 we sold a participating mortgage note secured by an apartment home community for net proceeds of $25,300,000. Since January 1, 2000, we have sold one additional community containing 360 apartment homes in connection with our capital redeployment strategy. The net proceeds from the sale of this community were approximately $29,325,000. We intend to dispose of additional assets as described more fully under "Future Financing and Capital Needs."

Development, Redevelopment and Acquisition Activities. We began the development of eight new communities during 1999. These communities are expected to contain a total of 2,246 apartment homes upon completion, and the total investment, including land acquisition costs, is projected to be approximately $366,100,000. Also, we completed the development of ten new communities containing a total of 2,335 apartment homes for a total investment of $391,600,000.

We also acquired three land parcels during 1999 on which construction has not yet commenced. We expect to develop three new communities containing a total of 878 apartment homes on these parcels. The total investment in these communities, including land acquisition costs of $22,078,000, is projected to be approximately $111,300,000.

We completed the redevelopment of thirteen communities during 1999 for a total investment in redevelopment (i.e. excluding acquisition costs) of $77,300,000.

We acquired one community, containing 224 apartment homes, during 1999 for approximately $25,750,000, including 117,178 units of limited partnership in a DownREIT partnership valued at $4,614,000. We acquired this community in connection with a forward purchase agreement signed in 1997 with an unaffiliated party.

The development and redevelopment of communities involves risks that the investment will fail to perform in accordance with expectations. See “Risks of Development and Redevelopment” in Part I of our Form 10-K filed with the Securities and Exchange Commission on March 10, 2000 for our discussion of these and other risks inherent in developing or redeveloping communities.

RESULTS OF OPERATIONS

Historically, the changes in our operating results from period-to-period have been primarily the result of increases in the number of apartment homes owned. Where appropriate, period-to-period comparisons of the number of occupied apartment homes are made on a weighted average basis to adjust for changes in the number of apartment homes during the period. For Stabilized Communities, excluding communities owned by unconsolidated joint ventures, all occupied apartment homes are included in the calculation of weighted average occupied apartment homes for each reporting period. For communities in the initial lease-up phase, only apartment homes of communities that are completed and occupied are included in the weighted average number of occupied apartment homes calculation for each reporting period.

A comparison of our operating results for the years ended December 31, 1999 and December 31, 1998 as well as a comparison of our operating results for the years ended December 31, 1998 and December 31, 1997 follows.

COMPARISON OF YEAR ENDED DECEMBER 31, 1999 TO YEAR ENDED DECEMBER 31, 1998

Net income available to common stockholders increased $37,094,000 (38.9%) to $132,497,000 for the year ended December 31, 1999 compared to $95,403,000 for the preceding year. Excluding non-recurring charges, gain on sale of communities and extraordinary items, net income available to common stockholders increased by $31,808,000 for the year ended December 31, 1999 compared to the preceding year. The increase in net income, as adjusted, for the year ended December 31, 1999 is primarily attributable to additional operating income from additional communities attributable to the

Rental income increased $133,187,000 (36.0%) to $503,132,000 for the year ended December 31, 1999 compared to $369,945,000 for the preceding year. The increase is primarily attributable to additional revenue from additional communities attributable to the merger and secondarily to newly developed and redeveloped communities, partially offset by the sale of communities in 1998 and 1999.

- **Overall Portfolio—**The $133,187,000 increase in rental income is primarily due to increases in the weighted average number of occupied apartment homes as well as an increase in the weighted average monthly rental income per occupied apartment home. The weighted average number of occupied apartment homes increased from 28,333 apartment homes for the year ended December 31, 1998 to 33,726 apartment homes for the year ended December 31, 1999 primarily as a result of the additional apartment homes from additional communities attributable to the merger being part of the portfolio for all of 1999 and the development, redevelopment and acquisition of new communities, offset by the sale of communities in 1998 and 1999. For the year ended December 31, 1999, the weighted average monthly revenue per occupied apartment home increased $160 (14.8%) to $1,242 compared to $1,082 for the preceding year, which is primarily attributable to the development of new upscale apartment communities in premium locations, the sale of communities with lower average rents as well as the merger. These apartment communities were funded in part from the proceeds of communities sold in markets where rental rates are lower.

- **Established Communities, on a pro forma basis, assuming the merger had occurred on January 1, 1998—**Rental revenue increased $10,114,000 (4.1%) for the year ended December 31, 1999 compared to the preceding year. The increase is due to market conditions that allowed for higher average rents that were partially offset by lower economic occupancy levels. For the year ended December 31, 1999, weighted average monthly revenue per occupied apartment home increased $52 (4.4%) to $1,226 compared to $1,174 for the preceding year. The average economic occupancy decreased from 96.9% for the year ended December 31, 1998 to 96.6% for the year ended December 31, 1999. Regions showing occupancy gains include the Mid-Atlantic, with an increase from 96.8% for the year ended December 31, 1998 to 97.1% for the year ended December 31, 1999, and the Midwest, with an increase from 97.1% for the year ended December 31, 1998 to 97.2% for the year ended December 31, 1999. Occupancy decreased in Northern California from 97.1% for the year ended December 31, 1998 to 96.2% for the year ended December 31, 1999 primarily due to softening in sub-markets dependent on Silicon Valley employment.

Management fees decreased $201,000 to $1,176,000 for the year ended December 31, 1999 compared to $1,377,000 for the preceding year. Management fees represent revenue from third-party contracts. We anticipate that management and development fees will increase over the next several years due to the receipt of fees pursuant to joint venture arrangements.

Operating expenses, excluding property taxes increased $29,826,000 (28.6%) to $134,172,000 for the year ended December 31, 1999 compared to $104,346,000 for the preceding year.

- **Overall Portfolio—**The increase for the year ended December 31, 1999 is primarily due to additional operating expenses from additional communities attributable to the merger and secondarily due to the addition of newly developed, redeveloped and acquired apartment homes, partially offset by the sale of communities in 1998 and 1999. Maintenance, insurance and other costs associated with Development and Redevelopment Communities are expensed as communities move from the initial construction and lease-up phase to the stabilized operating phase.

- **Established Communities, on a pro forma basis, assuming the merger had occurred on January 1, 1998—**Operating expenses increased $1,821,000 (3.7%) to $50,912,000 for the year ended December 31, 1999 compared to $49,091,000 for the preceding year. The net changes are the result of higher redecorating, maintenance, payroll and administrative costs offset by lower utility, marketing, and insurance costs.

PROPERTY TAXES increased $10,926,000 (34.4%) to $42,701,000 for the year ended December 31, 1999 compared to $31,775,000 for the preceding year.

- **Overall Portfolio—**The increase for the year ended December 31, 1999 is primarily due to additional expenses from additional communities attributable to the merger and secondarily due to the addition of newly developed, redeveloped or acquired apartment homes, partially offset by the sale of communities in 1998 and 1999. Property taxes on Development and Redevelopment Communities are expensed as communities move from the initial construction and lease-up phase to the stabilized operating phase.

- **Established Communities, on a pro forma basis, assuming the merger had occurred on January 1, 1998—**Property taxes decreased $30,000 (0.1%) to $21,197,000 for the year ended December 31, 1999 compared to $21,227,000 for the preceding year. The decrease is primarily a result of revised base year tax assessments for previously renovated communities which resulted in supplemental taxes that were lower than those than originally projected.

INTEREST EXPENSE increased $20,049,000 (36.7%) to $74,699,000 for the year ended December 31, 1999 compared to $54,650,000 for the preceding year. The increase is primarily attributable to approximately $600 million of debt assumed in connection with the merger and the issuance of $625,000,000 of unsecured notes during 1999 and 1998, offset by an increase in capitalized interest.

DEPRECIATION AND AMORTIZATION increased $32,385,000 (41.9%) to $109,759,000 for the year ended December 31, 1999 compared to $77,374,000 for the preceding year. The increase is attributable primarily to additional expense from additional communities attributable to the merger and secondarily to newly developed and redeveloped communities, partially offset by the sale of communities in 1998 and 1999.

GENERAL AND ADMINISTRATIVE increased $378,000 (4.1%) to $9,502,000 for the year ended December 31, 1999 compared to $9,124,000 for the preceding year. The increase is impacted by additional overhead from the combination of the two companies and related organizational structures, partially offset by a reorganization in February 1999 that reduced the management structure of the merged company.

EQUITY IN INCOME OF UNCONSOLIDATED JOINT VENTURES increased $229,000 (8.7%) to $2,867,000 for the year ended December 31, 1999 compared to $2,638,000 for the preceding year. Equity in income of unconsolidated joint ventures represents our share of income from joint ventures.

INTEREST INCOME increased $3,854,000 (109.9%) to $7,362,000 for the year ended December 31, 1999 compared to $3,508,000 for the preceding year. These increases are primarily from an increase in interest from participating mortgage notes, including the Fairlane Woods participating mortgage note acquired in the third quarter of 1998. The Fairlane Woods promissory note was sold in the fourth quarter of 1999.

GAIN ON SALE OF COMMUNITIES increased $21,823,000 to $47,093,000 for the year ended December 31, 1999 compared to $25,270,000 for the preceding year. The increase is due to an increase in the number of communities sold during 1999 as compared to 1998 as a result of the disposition strategy we implemented in the third quarter of 1998.

COMPARISON OF YEAR ENDED DECEMBER 31, 1998 TO YEAR ENDED DECEMBER 31, 1997

NET INCOME AVAILABLE TO COMMON STOCKHOLDERS increased $50,143,000 (110.8%) to $95,403,000 for the year ended December 31, 1998 compared to $45,260,000 for the preceding year. Excluding gain on sale of communities and extraordinary items, net income available to common stockholders increased by $24,612,000 (53.8%) for the year ended December 31, 1998 compared to the preceding year. The increase in net income, as adjusted, for the year ended December 31, 1998 is attributable primarily to gains from increased community sales, additional operating income from additional communities attributable to the merger, and additional operating income from communities developed, redeveloped or acquired during 1998 and 1997 as well as growth in operating income from Established Communities.

RENTAL INCOME increased $200,503,000 (118.3%) to $369,945,000 for the year ended December 31, 1998 compared to $169,442,000 for the preceding year. The increase is attributable primarily to additional revenue from additional communities attributable to the merger and secondarily to developed, redeveloped and acquired communities in 1998 and 1997.

- Overall Portfolio—The $200,503,000 increase in rental income is primarily due to increases in the weighted average number of occupied apartment homes as well as an increase in the weighted average monthly rental income per occupied apartment home. The weighted average number of occupied apartment homes increased from 13,949 apartment homes for the year ended December 31, 1997 to 28,333 apartment homes for the year ended December 31, 1998 primarily as a result of additional apartment homes from additional communities attributable to the merger, as well as the development, redevelopment and acquisition of new communities. For the year ended December 31, 1998, the weighted average monthly revenue per occupied apartment home increased $74 (7.3%) to $1,082 compared to $1,008 for the preceding year.

- Established Communities, on a pro forma basis, assuming the merger had occurred on January 1, 1997—Rental revenue increased $11,318,000 (6.2%) for the year ended December 31, 1998 compared to the preceding year. The increase is due to market conditions that allowed for higher average rents, with relatively stable economic occupancy levels. For the year ended December 31, 1998, weighted average monthly revenue per occupied apartment home increased $61 (6.2%) to $1,048 compared to $987 for the preceding year. Beginning in October 1998, the Northern California sub-markets that are primarily dependent on Silicon Valley employment softened. These sub-markets have experienced reduced rental rate growth and occupancy declines as compared to other Northern California sub-markets and our other markets as a whole.

MANAGEMENT FEES increased $348,000 (33.8%) to $1,377,000 for the year ended December 31, 1998 compared to $1,029,000 for the preceding year. Management fees represent revenue from third-party contracts. The increase is primarily due to certain third-party management contracts acquired in connection with the purchase of a portfolio of assets in December 1997.

OPERATING EXPENSES, EXCLUDING PROPERTY TAXES increased $57,067,000 (120.7%) to $104,346,000 for the year ended December 31, 1998 compared to $47,279,000 for the preceding year.

- Overall Portfolio—The increase for the year ended December 31, 1998 is primarily due to additional operating expenses from additional communities attributable to the merger and secondarily due to the addition of newly developed, redeveloped and acquired apartment homes. Maintenance, insurance and other costs associated with Development and Redevelopment Communities are expensed as communities move from the initial construction and lease-up phase to the stabilized operating phase.

- **Established Communities, on a pro forma basis, assuming the merger had occurred on January 1, 1997—**Operating expenses increased $1,711,000 (4.2%) to $42,395,000 for the year ended December 31, 1998 compared to $40,684,000 for the preceding year. The net changes are the result of higher payroll and maintenance costs, offset by lower utility, administrative and insurance costs. Lower insurance costs are directly attributable to better pricing and risk sharing provided by the merger.

PROPERTY TAXES increased $17,346,000 (120.2%) to $31,775,000 for the year ended December 31, 1998 compared to $14,429,000 for the preceding year.

- **Overall Portfolio—**The increase for the year ended December 31, 1998 is primarily due to additional expense from additional communities attributable to the merger and secondarily to the addition of newly developed, redeveloped or acquired apartment homes. Property taxes on Development and Redevelopment Communities are expensed as communities move from the initial construction and lease-up phase to the stabilized operating phase.

- **Established Communities, on a pro forma basis, assuming the merger had occurred on January 1, 1997—**Property taxes increased $535,000 (3.6%) to $15,265,000 for the year ended December 31, 1998 compared to $14,730,000 for the preceding year. The increase is primarily the result of increased assessments of property values and increased property tax rates on the Mid-Atlantic, Northeast and Midwest communities as well as lower than estimated property tax assessments for our Northern and Southern California communities that resulted in a reduction in 1997 of previously accrued expenses.

INTEREST EXPENSE increased $37,673,000 (221.9%) to $54,650,000 for the year ended December 31, 1998 compared to $16,977,000 for the preceding year. The increase is primarily attributable to $600 million of debt assumed in connection with the merger and secondarily to the issuance of unsecured notes in 1998 and 1997.

DEPRECIATION AND AMORTIZATION increased $48,261,000 (165.8%) to $77,374,000 for the year ended December 31, 1998 compared to $29,113,000 for the preceding year. The increase is primarily attributable to additional expense from additional communities attributable to the merger and secondarily to developed, redeveloped and acquired communities in 1998 and 1997.

GENERAL AND ADMINISTRATIVE increased $4,031,000 (79.1%) to $9,124,000 for the year ended December 31, 1998 compared to $5,093,000 for the preceding year. The increase is primarily due to the combination of the two companies and related increase in portfolio size.

EQUITY IN INCOME OF UNCONSOLIDATED JOINT VENTURES decreased $3,051,000 (53.6%) to $2,638,000 for the year ended December 31, 1998 compared to $5,689,000 for the preceding year. Equity in income of unconsolidated joint ventures represents our share of income from joint ventures. The decrease is primarily due to non-recurring income from the Avalon Grove joint venture in which we were allocated 100% of the lease-up period income prior to the formation of the partnership in December 1997.

INTEREST INCOME increased $2,162,000 (160.6%) to $3,508,000 for the year ended December 31, 1998 compared to $1,346,000 for the preceding year. The increase is primarily due to an increase in interest from participating mortgage notes, including the Fairlane Woods promissory note acquired in August 1998.

GAIN ON SALE OF COMMUNITIES increased $24,593,000 to $25,270,000 for the year ended December 31, 1999 compared to $677,000 for the preceding year. The increase in the gain on sale of communities is a result of the disposition strategy we implemented in the third quarter of 1998.

CAPITALIZATION OF FIXED ASSETS AND COMMUNITY IMPROVEMENTS

Our policy with respect to capital expenditures is generally to capitalize only non-recurring expenditures. We capitalize improvements and upgrades only if the item:

- exceeds $15,000;
- extends the useful life of the asset; and
- is not related to making an apartment home ready for the next resident.

Under this policy, virtually all capitalized costs are non-recurring, as recurring make-ready costs are expensed as incurred. Recurring make-ready costs include the following:

- carpet and appliance replacements;
- floor coverings;
- interior painting; and
- other redecorating costs.

We capitalize purchases of personal property, such as computers and furniture, only if the item is a new addition and the item exceeds $2,500. We generally expense purchases of personal property made for replacement purposes. The application of these policies for the year ended December 31, 1999 resulted in non-revenue generating capitalized expenditures for Stabilized Communities of approximately $207 per apartment home. For the year ended December 31, 1999, we charged to maintenance expense, including carpet and appliance replacements, a total of approximately $32,411,000 for Stabilized Communities or $1,213 per apartment home. We anticipate that capitalized costs per apartment home will gradually rise as the average age of our communities increases.

LIQUIDITY AND CAPITAL RESOURCES

LIQUIDITY. The primary source of liquidity is our cash flows from operations. Operating cash flows have historically been determined by:

- the number of apartment homes;
- rental rates;
- occupancy levels; and
- our expenses with respect to these apartment homes.

The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, particularly to changes in interest rates that are charged to us as changes in interest rates affect our decision as to whether to issue debt securities, borrow money and invest in real estate. Thus, changes in the capital markets environment will affect our plans for the undertaking of construction and development as well as acquisition activity.

Cash and cash equivalents decreased from $8,890,000 at December 31, 1998 to $7,621,000 at December 31, 1999 due to the excess of cash used in investing and financing activities over cash provided by operating activities.

- Net cash provided by operating activities increased by $56,588,000 from $193,478,000 for the year ended December 31, 1998 to $250,066,000 for the year ended December 31, 1999. The increase is primarily from additional operating cash flow from additional communities attributable to the merger, which were part of our portfolio for all of 1999 and the development, redevelopment and acquisition of new communities, offset by the loss of cash flow from communities sold in 1998 and 1999.

- Net cash used in investing activities decreased by $353,066,000 from $617,685,000 for the year ended December 31, 1998 to $264,619,000 for the year ended December 31, 1999. This decrease in expenditures reflects increased sales of communities and decreased acquisitions, offset by increased construction and reconstruction activity. The decrease in acquisitions is attributable to a shift in our investment focus away from acquisitions and towards development opportunities that offer higher projected yields, primarily in response to the lack of available properties that meet our increased yield requirements combined with a decrease in the availability of cost-effective capital.

- Net cash provided by financing activities decreased by $413,091,000 from $426,375,000 for the year ended December 31, 1998 to $13,284,000 for the year ended December 31, 1999. The decrease is primarily due to our development activities increasingly being funded through the sale of existing communities as opposed to incurring debt or selling equity, which reflects a reduction in our use of debt financing as opposed to other sources of financing in response to market conditions. Also, dividends paid increased as a result of additional common and preferred shares issued in connection with the merger.

Cash and cash equivalents increased from $6,722,000 at December 31, 1997 to $8,890,000 at December 31, 1998 due to the excess of cash provided by financing and operating activities over cash flow used in investing activities.

- Net cash provided by operating activities increased by $99,829,000 from $93,649,000 for the year ended December 31, 1997 to $193,478,000 for the year ended December 31, 1998 primarily due to an increase in operating income from additional communities attributable to the merger as well as increased operating income from existing communities.

- Net cash used in investing activities increased $196,265,000 from $421,420,000 for the year ended December 31, 1997 to $617,685,000 for the year ended December 31, 1998. This increase primarily reflects increased construction and reconstruction activity, offset by community sales.

- Net cash provided by financing activities increased by $106,123,000 from $320,252,000 for the year ended December 31, 1997 to $426,375,000 for the year ended December 31, 1998 primarily due to an increase in our use of debt financing as opposed to other sources of financing to fund acquisitions and construction and reconstruction activity. The increase is also offset by an increase in dividends paid as a result of additional common and preferred shares issued in connection with the merger.

We regularly review our short and long-term liquidity needs and the adequacy of Funds from Operations, as defined below, and other expected liquidity sources to meet these needs. We believe our principal short-term liquidity needs are to fund:

- normal recurring operating expenses;
- debt service payments;
- the distributions required with respect to our series of preferred stock;
- the minimum dividend payments required to maintain our REIT qualification under the Internal Revenue Code of 1986; and
- development and redevelopment activity in which we are currently engaged.

We anticipate that we can fully satisfy these needs from a combination of cash flows provided by operating activities and capacity under the unsecured facility. We anticipate that we can satisfy any short-term liquidity needs not satisfied by current operating cash flows from our unsecured revolving credit facility.

We believe our principal long-term liquidity needs are the repayment of medium and long-term debt, as well as the procurement of long-term debt to refinance construction and other development related short-term debt. We anticipate that no significant portion of the principal of any indebtedness will be repaid prior to maturity. If we do not have funds on hand sufficient to repay our indebtedness, it will be necessary for us to refinance this debt. This refinancing may be accomplished through additional debt financing, which may be collateralized by mortgages on individual communities or groups of communities, by uncollateralized private or public debt offerings or by additional equity offerings. We also anticipate having significant retained cash flow in each year so that when a debt obligation matures, some or all of each maturity can be satisfied from this retained cash. Although we believe we will have the capacity to meet our long-term liquidity needs, we cannot assure you that additional debt financing or debt or equity offerings will be available or, if available, that they will be on terms we consider satisfactory.

Capital Resources. We intend to match the long-term nature of our real estate assets with long-term cost effective capital to the extent permitted by prevailing market conditions. We have raised approximately $950 million, on a pro forma basis to reflect the merger, in capital markets offerings since January 1998. The following table summarizes capital market activity for both Avalon and the Company since January 1, 1998:

Date	Company	Description of Offerings
January 1998	Avalon	$100 million unsecured notes offering
January 1998	Avalon	$26.9 million direct placement of common stock to an institutional investor
January 1998	Bay	$150 million unsecured notes offering
April 1998	Bay	$46.5 million public offering of Common Stock
July 1998	AvalonBay	$250 million unsecured notes offering
October 1998	AvalonBay	$100 million public offering of Series H Cumulative Redeemable Preferred Stock
January 1999	AvalonBay	$125 million medium term notes offering
July 1999	AvalonBay	$150 million medium term notes offering

We follow a focused strategy to help facilitate uninterrupted access to capital. This strategy includes:

1. Hiring, training and retaining associates with a strong resident service focus, which should lead to higher rents, lower turnover and reduced operating costs;

2. Managing, acquiring and developing upscale communities in dense locations where the availability of zoned and entitled land is limited to provide consistent, sustained earnings growth;

3. Operating in markets with growing demand, as measured by household formation and job growth, and high barriers-to-entry. We believe these characteristics generally combine to provide a favorable demand-supply balance, which we believe will create a favorable environment for future rental rate growth while protecting existing and new communities from new supply. We expect this strategy to result in a high level of quality to the revenue stream;

4. Maintaining a conservative capital structure largely comprised of equity and with modest, cost-effective leverage. We generally avoid secured debt except in order to obtain low cost, tax-exempt debt. We believe that such a structure should promote an environment whereby current ratings levels can be maintained;

5. Following accounting practices that provide a high level of quality to reported earnings; and

6. Providing timely, accurate and detailed disclosures to the investment community.

We believe these strategies provide a disciplined approach to capital access to help position AvalonBay to fund portfolio growth.

Capital markets conditions have decreased our access to cost effective capital. See "Future Financing and Capital Needs" for a discussion of our response to the current capital markets environment.

The following is a discussion of specific capital transactions, arrangements and agreements.

UNSECURED FACILITY

Our unsecured revolving credit facility is furnished by a consortium of banks and provides $600,000,000 in short-term credit. We pay these banks an annual facility fee of $900,000 in equal quarterly installments. The unsecured facility bears interest at varying levels tied to the London Interbank Offered Rate (LIBOR) based on ratings levels achieved on our unsecured notes and on a maturity selected by us. The current stated pricing is LIBOR plus 0.6% per annum. The unsecured facility matures in July 2001, however we have two one-year extension options. Therefore, subject to certain conditions, we may extend the maturity to July 2003. A competitive bid option is available for borrowings of up to $400,000,000. This option allows banks that are part of the lender consortium to bid to provide us loans at a rate that is lower than the stated pricing provided by the unsecured facility. The competitive bid option may result in lower pricing if market conditions allow. Pricing under the competitive bid option resulted in average pricing of LIBOR plus 0.5% for balances most recently placed under the competitive bid option. At March 1, 2000, $203,500,000 was outstanding, $75,481,000 was used to provide letters of credit and $321,019,000 was available for borrowing under the unsecured facility. We intend to use borrowings under the unsecured facility for:

- capital expenditures;
- construction, development and redevelopment costs;
- acquisitions of developed or undeveloped communities;
- credit enhancement for tax-exempt bonds; and
- working capital purposes.

INTEREST RATE PROTECTION AGREEMENTS

We are not a party to any long-term interest rate agreements, other than interest rate protection and swap agreements on approximately $190 million of our variable rate tax-exempt indebtedness. We intend, however, to evaluate the need for long-term interest rate protection agreements as interest rate market conditions dictate, and we have engaged a consultant to assist in managing our interest rate risks and exposure.

FINANCING COMMITMENTS/TRANSACTIONS COMPLETED

In January 1999, we issued $125,000,000 of medium-term unsecured notes bearing interest at 6.58% and maturing in February 2004. Semi-annual interest payments are payable on February 15 and August 15. The net proceeds of approximately $124,000,000 were used to repay amounts outstanding under our unsecured facility.

In July 1999, we issued $150,000,000 of unsecured notes bearing interest at 7.50% and maturing in August 2009. Semi-annual interest payments are payable on February 1 and August 1. The net proceeds of approximately $148,400,000 were used to repay amounts outstanding under our unsecured facility.

In October 1999, we completed a refinancing of approximately $18,755,000 of variable rate tax-exempt bonds. The bonds have a maturity date of May 1, 2026, are fully amortizing and are credit enhanced by the Federal National Mortgage Association (Fannie Mae).

During January 2000, the Company entered into a joint venture agreement with an entity controlled by Multi-Employer Development Partners (MEDP) to develop Avalon on the Sound, a 412 apartment high rise community in New Rochelle, New York, with total capitalized costs estimated to be $93,300,000. The terms of the limited liability company operating agreement contemplate a long-term capital structure comprised of 60% equity and 40% debt. Equity contributions will be funded 25% by AvalonBay and 75% by MEDP. Construction financing that converts to long-term financing following completion of construction will provide the debt capital. Operating cash flow will be distributed 25% to AvalonBay and 75% to MEDP until each receives a 9% return on invested capital. Thereafter, operating cash flow will be distributed equally to AvalonBay and MEDP. Upon a sale to a third party, cash is distributed first to each partner until capital contributions are recovered. Thereafter, sales proceeds are distributed based upon achievement of certain internal rate of return levels. Distributions that result in an internal rate of return to MEDP and the Company of 12-15% are made 40% to AvalonBay and 60% to MEDP. Thereafter, sales proceeds are distributed equally to AvalonBay and MEDP. After three years following completion of construction, buy-sell provisions are in effect. AvalonBay will receive construction, development and management fees for services rendered to the joint venture.

REGISTRATION STATEMENTS FILED IN CONNECTION WITH FINANCINGS

On August 18, 1998, we filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission relating to the sale of up to $750,000,000 of securities. The registration statement provides for the issuance of common stock, preferred stock and debt securities.

FUTURE FINANCING AND CAPITAL NEEDS

As of December 31, 1999, we had 21 new communities under construction either by us or by unaffiliated third parties with whom we have entered into forward purchase commitments. As of December 31, 1999, a total estimated cost of $295,071,000 remained to be invested in these communities. In addition, we had four other communities under reconstruction, for which an estimated $71,209,000 remained to be invested as of December 31, 1999.

Substantially all of the capital expenditures necessary to complete the communities currently under construction and reconstruction will be funded from:

- the remaining capacity under our $600,000,000 unsecured credit facility;
- the net proceeds from sales of existing communities;
- retained operating cash; and/or
- the issuance of debt or equity securities.

We expect to continue to fund deferred development costs related to future developments from retained operating cash and borrowings under the unsecured facility. We believe these sources of capital will be adequate to take the proposed communities to the point in the development cycle where construction can begin.

We have observed and been impacted by a reduction in the availability of cost effective capital beginning in the third quarter of 1998. We cannot assure you that cost effective capital will be available to meet future expenditures required to begin planned reconstruction activity or the construction of the Development Rights. Before planned reconstruction activity or the construction of a Development Right begins, we intend to arrange adequate capital sources to complete these undertakings, although we cannot assure you that we will be able to obtain such financing. In the event that financing cannot be obtained, we may have to abandon Development Rights, write-off associated pursuit costs and forego reconstruction activity; in such event, we will not realize the increased revenues and earnings that we expected from such pursuits, and the related write-off of costs will increase current period expenses and reduce FFO.

To meet the balance of our liquidity needs, we will need to arrange additional capacity under our existing unsecured facility, sell additional existing communities and/or issue additional debt or equity securities. While we believe we have the financial position to expand our short term credit capacity and support our capital markets activity, we cannot assure you that we will be successful in completing these arrangements, offerings or sales. The failure to complete these transactions on a cost-effective basis could have a material adverse impact on our operating results and financial condition, including the abandonment of deferred development costs and a resultant charge to earnings.

During 1998, the Company determined that it would pursue a disposition strategy for certain assets in markets that did not meet its long-term strategic direction. Under this program, we solicit competing bids from unrelated parties for these individual assets, and consider the sales price and tax ramifications of each proposal. In connection with this disposition program, we disposed of seven communities in 1998 for aggregate net proceeds of approximately $73,900,000. We have disposed of an additional 17 communities and a participating mortgage note since January 1, 1999. The net proceeds from the sale of these assets were approximately $310,243,000. We intend to actively seek buyers for the remaining communities held for sale. However, we cannot assure you that these assets can be sold on terms that we consider satisfactory.

The remaining assets that we have identified for disposition include land, buildings and improvements and furniture, fixtures and equipment. Total real estate, net of accumulated depreciation, of all communities identified for sale at December 31, 1999 totaled $164,758,000. Certain individual assets are secured by mortgage indebtedness which may be assumed by the purchaser or repaid from our net sales proceeds. Our Consolidated Statements of Operations include net income from the communities held for sale of $11,361,000 for the year ended December 31, 1999. Our Consolidated Statements of Operations include net income from the communities held for sale for the year ended December 31, 1998 of $10,262,000, or $10,724,000 on a pro forma basis assuming the merger had occurred on January 1, 1998.

Because the proceeds from the sale of communities are used initially to reduce borrowings under our unsecured facility, the immediate effect of a sale of a community is to reduce Funds from Operations. This is because the yield on a community that is sold exceeds the interest rate on the borrowings that are repaid from such net proceeds. Therefore, changes in the number and timing of dispositions, and the redeployment of the resulting net proceeds, may have a material and adverse effect on our Funds from Operations.

INFLATION

Substantially all of the leases at the Current Communities are for a term of one year or less. This may enable us to realize increased rents upon renewal of existing leases or the beginning of new leases. Short-term leases generally minimize our risk from the adverse effects of inflation, although these leases generally permit residents to leave at the end of the lease term without penalty. We believe that short-term leases combined with relatively consistent demand allow rents, and therefore cash flow, from our portfolio of apartments to provide an attractive inflation hedge.

YEAR 2000 COMPLIANCE

The Year 2000 compliance issue arose out of concerns that computer systems would be unable to accurately calculate, store or use a date after December 31, 1999. It was widely believed that this inability could result in a system failure causing disruptions of operations or creating erroneous results. The Year 2000 issue affected virtually all companies and organizations, and could have potentially affected both information technology and non-information technology systems.

In the normal course of business, we completed the replacement and upgrade of our existing hardware and software information systems, resulting in Year 2000 compliance. The vendor that provided our previous accounting software has a compliant version of its product, but growth in our operations required a general ledger system with scope and functionality that is not present in either the system we previously used or the Year 2000 compliant version of that system. Accordingly, we replaced that general ledger system with an enhanced system that provides increased functionality. The implementation of the new general ledger system was completed July 1, 1999, and there have been no apparent effects from the Year 2000 issue. We have not treated the cost of this new system as a Year 2000 expense because the implementation date was not accelerated due to Year 2000 compliance concerns. The cost of the new general ledger system, after considering anticipated efficiencies provided by the new system, has not had a material effect, either beneficial or adverse, on our financial condition or results of operations.

We also took action to ensure the compliance of our non-information embedded systems, such as security, heating and cooling, and fire and elevator systems, at each community. We are not aware of any non-information embedded systems at our communities that have functioned improperly as a result of the Year 2000 issue.

The total costs incurred to become Year 2000 compliant for all potentially affected systems was approximately $706,000, which was less than our budgeted cost of completion.

We did not delay any information technology or non-information technology projects due to our Year 2000 compliance efforts.

FUNDS FROM OPERATIONS

For the year ended December 31, 1999, FFO increased to $212,840,000 from $148,487,000 for the year ended December 31, 1998. FFO for the year ended December 31, 1998 reflects the operating results for Avalon through June 4, 1998 and for the combined company after that date.

We generally consider Funds from Operations, or FFO, to be an appropriate measure of our operating performance because it helps investors understand our ability to incur and service debt and to make capital expenditures. We believe that to understand our operating results, FFO should be examined with net income as presented in the consolidated financial statements included elsewhere in this report. FFO is determined based on a definition adopted by the Board of Governors of the National Association of Real Estate Investment Trusts and is defined as:

- net income or loss computed in accordance with GAAP, except that excluded from net income or loss are gains or losses from debt restructuring, other non-recurring items and sales of property;
- plus depreciation of real estate assets; and
- after adjustments for unconsolidated partnerships and joint ventures.

FFO does not represent cash generated from operating activities in accordance with GAAP. Therefore it should not be considered an alternative to net income as an indication of our performance. FFO should also not be considered an alternative to net cash flows from operating activities as determined by GAAP as a measure of liquidity. Additionally, it is not necessarily indicative of cash available to fund cash needs. Further, FFO as calculated by other REITs may not be comparable to our calculation of FFO.

For the year ended December 31, 1999, FFO increased to $212,840,000 from $148,487,000 for the preceding year. This increase is primarily from additional communities attributable to the merger and secondarily due to the completion of new development and redevelopment communities. Growth in earnings from Established Communities also contributed to the increase.

MANAGEMENT INFORMATION SYSTEMS

We believe that an innovative management information systems infrastructure will be an important element in managing our future growth. This is because timely and accurate collection of financial and resident profile data will enable us to maximize revenue through careful leasing decisions and financial management. We currently employ a proprietary company-wide intranet using a digital network with high-speed digital lines. This network connects all of our communities and offices to central servers in Alexandria, Virginia, providing access to our associates and to AvalonBay's corporate information throughout the country from all locations.

We are currently engaged in the development of an innovative on-site property management system and a leasing automation system to enable management to capture, review and analyze data to a greater extent than is possible using existing commercial software. We have entered into a formal joint venture agreement, in the form of a limited liability company agreement, with United Dominion Realty Trust, Inc., another public multifamily real estate company, to continue development of these systems and system software, which are collectively referred to in this discussion as the "system." The system development process is currently managed by our employees, who have significant related project management experience, and the employees of the joint venturer. The actual programming and documentation of the system is being conducted by our employees, the employees of our joint venturer and third party consultants under the supervision of these experienced project managers. We currently expect that the total development costs over a three-year period will be approximately $7.5 million including hardware costs and expenses, the costs of employees and related overhead, and the costs of engaging third party consultants. These development costs will be shared on an equal basis by us and our joint venturer. Once developed, we intend to use the property management system in place of current property management information software for which we pay a license fee to third parties, and we intend to use the leasing automation system to make the lease application process easier for residents and more efficient for us to manage. We currently project that the property management system will undergo an on-site test (i.e., a "beta test") during the third quarter of 2000 and that the system will be functional and implemented during 2001. The leasing automation system is currently in beta testing at two communities.

We believe that when implemented the system will result in cost savings due to increased data reliability and efficiencies in management time and overhead, and that these savings will largely offset the expense associated with amortizing the system development costs and maintaining the software. We also believe that it is possible that other real estate companies may desire to use the system concept and system software that we are developing and that therefore there may be an opportunity to recover, in the future, a portion of our investment by licensing the system to others. However, at the present time these potential cost savings and ancillary revenue are speculative, and we cannot assure that the system will provide sufficient benefits to offset the cost of development and maintenance.

We have never before engaged in the development of systems or system software on this scale and have never licensed a system concept or system software to others. There are a variety of risks associated with the development of the system, both for internal use and for potential sale or licensing to third parties. Among the principal risks associated with this undertaking are the following:

- we may not be able to maintain the schedule or budget that we have projected for the development and implementation of the system;
- we may be unable to implement the system with the functionality and efficiencies we desire on commercially reasonable terms;
- we may decide not to endeavor to license the system to other enterprises, the system may not be attractive to other enterprises, and we may not be able to effectively manage the licensing of the system to other enterprises; and
- the system may not provide AvalonBay with meaningful cost savings or a meaningful source of ancillary revenues.

The occurrence of any of the events described above could prevent us from achieving increased efficiencies, realizing revenue growth produced by ancillary revenues or recovering our initial investment.

INDEPENDENT PUBLIC ACCOUNTANTS

On November 11, 1998, PricewaterhouseCoopers LLP was dismissed and Arthur Andersen LLP was engaged as the principal independent public accountant for the Company. The decision to change accountants was unanimously approved by the Company's Board of Directors.

The report of PricewaterhouseCoopers LLP on the financial statements of the Company for the year ended December 31, 1997 did not contain any adverse opinion or disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope, or accounting principles. During the Company's fiscal year ended December 31, 1997, and the subsequent interim period through November 11, 1998, there were no disagreements with PricewaterhouseCoopers LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of PricewaterhouseCoopers LLP, would have caused them to make reference thereto in their report on the financial statements for such year.

During the Company's fiscal year ended December 31, 1997, and the subsequent interim period through November 11, 1998, Arthur Andersen LLP was not engaged as an independent accountant to audit either the Company's financial statements or the financial statements of any of its subsidiaries, nor was it consulted regarding the application of the Company's accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's financial statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain financial market risks, the most predominant being fluctuations in interest rates. Interest rate fluctuations are monitored by us as an integral part of our overall risk management program, which recognizes the unpredictability of financial markets and seeks to reduce the potentially adverse effect on our results of operations. The effect of interest rate fluctuations historically has been small relative to other factors affecting operating results, such as rental rates and occupancy. The specific market risks and the potential impact on our operating results are described below.

Our operating results are affected by changes in interest rates as a result of borrowing under our variable rate unsecured credit facility as well as issuing bonds with variable interest rates. If interest rates under the variable rate unsecured credit facility and other variable rate indebtedness had been one percent higher throughout 1999, our annual interest costs would have increased by approximately $3,300,000, based on balances outstanding during the year ending December 31, 1999. Changes in interest rates also impact the fair value of our fixed rate debt. If the market interest rate applicable to fixed rate indebtedness with maturities similar to our fixed rate indebtedness had been one percent higher, the fair value of our fixed rate indebtedness on December 31, 1999 would have decreased by approximately $67,000,000, based on balances outstanding at December 31, 1999.

We currently use interest rate swap agreements to reduce the impact of interest rate fluctuations on certain variable rate indebtedness. Under swap agreements, (A) we agree to pay to a counterparty the interest that would have been incurred on a fixed principal amount at a fixed interest rate (generally, the interest rate on a particular treasury bond on the date the agreement is entered into, plus a fixed increment), and (B) the counterparty agrees to pay to us the interest that would have been incurred on the same principal amount at an assumed floating interest rate tied to a particular market index. As of December 31, 1999, the effect of swap agreements is to fix the interest rate on approximately $190 million of our variable rate tax-exempt debt. The swap agreements were not electively entered into by us but, rather, were a requirement of either the bond issuer or the credit enhancement provider related to certain of our tax-exempt bond financings. In addition, because the counterparties providing the swap agreements are major financial institutions with AAA credit ratings by the Standard & Poor's Ratings Group and the interest rates fixed by the swap agreements are significantly higher than current market rates for such agreements, we do not believe there is exposure at this time to a default by a counterparty provider.

Consolidated Balance Sheets

(Dollars in thousands, except share data)	**12-31-99**	12-31-98
Assets		
Real estate:		
Land	**$ 663,007**	$ 643,562
Buildings and improvements	**2,942,866**	2,656,674
Furniture, fixtures and equipment	**82,467**	80,401
	3,688,340	3,380,637
Less accumulated depreciation	**(206,962)**	(120,771)
Net operating real estate	**3,481,378**	3,259,866
Construction in progress (including land)	**395,187**	413,822
Communities held for sale	**164,758**	195,394
Total real estate, net	**4,041,323**	3,869,082
Cash and cash equivalents	**7,621**	8,890
Cash in escrow	**8,801**	8,453
Resident security deposits	**14,113**	10,383
Investments in unconsolidated joint ventures	**10,702**	9,192
Deferred financing costs, net	**14,056**	13,461
Deferred development costs	**12,938**	15,489
Participating mortgage notes	**21,483**	45,483
Prepaid expenses and other assets	**23,625**	24,580
Total assets	**$ 4,154,662**	$ 4,005,013
Liabilities and Stockholders' Equity		
Variable rate unsecured credit facility	**$ 178,600**	$ 329,000
Unsecured notes	**985,000**	710,000
Notes payable	**430,047**	445,371
Dividends payable	**44,139**	43,323
Payables for construction	**18,874**	48,150
Accrued expenses and other liabilities	**40,226**	42,354
Accrued interest payable	**28,134**	20,664
Resident security deposits	**23,980**	19,501
Total liabilities	**1,749,000**	1,658,363
Minority interest of unitholders in consolidated partnerships	**35,377**	32,213
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value; $25 liquidation value; 50,000,000 shares authorized at both December 31, 1999 and 1998; 18,322,700 shares outstanding at both December 31, 1999 and 1998	**183**	183
Common stock, $.01 par value; 140,000,000 shares authorized at both December 31, 1999 and 1998; 65,758,009 and 63,887,126 shares outstanding at December 31, 1999 and December 31, 1998, respectively	**658**	639
Additional paid-in capital	**2,442,510**	2,386,087
Deferred compensation	**(3,559)**	(4,356)
Dividends in excess of accumulated earnings	**(69,507)**	(68,116)
Total stockholders' equity	**2,370,285**	2,314,437
Total liabilities and stockholders' equity	**$ 4,154,662**	$ 4,005,013

See accompanying notes to consolidated financial statements.

Amounts for 1998 have been revised to conform with the 1999 presentation (see note 2).

Consolidated Statements of Operations

(Dollars in thousands, except per share data)	Year ended 12-31-99	12-31-98	12-31-97
Revenue:			
Rental income	**$ 503,132**	$ 369,945	$ 169,442
Management fees	**1,176**	1,377	1,029
Other income	**236**	81	633
Total revenue	**504,544**	371,403	171,104
Expenses:			
Operating expenses, excluding property taxes	**134,172**	104,346	47,279
Property taxes	**42,701**	31,775	14,429
Interest expense	**74,699**	54,650	16,977
Depreciation and amortization	**109,759**	77,374	29,113
General and administrative	**9,502**	9,124	5,093
Non-recurring charges	**16,782**	—	—
Total expenses	**387,615**	277,269	112,891
Equity in income of unconsolidated joint ventures	**2,867**	2,638	5,689
Interest income	**7,362**	3,508	1,346
Minority interest in consolidated partnerships	**(1,975)**	(1,770)	174
Income before gain on sale of communities and extraordinary item	**125,183**	98,510	65,422
Gain on sale of communities	**47,093**	25,270	677
Income before extraordinary item	**172,276**	123,780	66,099
Extraordinary item	**—**	(245)	(1,183)
Net income	**172,276**	123,535	64,916
Dividends attributable to preferred stock	**(39,779)**	(28,132)	(19,656)
Net income available to common stockholders	**$ 132,497**	$ 95,403	$ 45,260
Per common share:			
Income before extraordinary item—basic	**$ 2.02**	$ 1.87	$ 1.64
Income before extraordinary item—diluted	**$ 2.00**	$ 1.84	$ 1.63
Extraordinary item—basic and diluted	**$ —**	$ (0.00)	$ (0.04)
Net income—basic	**$ 2.02**	$ 1.87	$ 1.60
Net income—diluted	**$ 2.00**	$ 1.84	$ 1.59

See accompanying notes to consolidated financial statements.

Amounts for 1998 and 1997 have been revised to conform with the 1999 presentation (see note 2).

Consolidated Statements of Stockholders' Equity

(Dollars in thousands, except share data)	Shares issued: Preferred Stock	Shares issued: Common Stock	Amount: Preferred Stock	Amount: Common Stock	Additional paid-in capital	Deferred compensation	Dividends in excess of accumulated earnings	Stockholders' equity
Balance at 12-31-96	8,755,000	25,655,068	$ 88	$ 256	$ 752,237	$ (1,699)	$ (12,894)	$ 737,988
Net income	—	—	—	—	—	—	64,916	64,916
Dividends declared to common and preferred stockholders	—	—	—	—	—	—	(75,795)	(75,795)
Issuance of Common Stock, net of offering costs	—	6,594,509	—	66	235,401	(3,569)	—	231,898
Amortization of deferred compensation	—	—	—	—	—	2,003	—	2,003
Balance at 12-31-97	8,755,000	32,249,577	88	322	987,638	(3,265)	(23,773)	961,010
Net income	—	—	—	—	—	—	123,535	123,535
Dividends declared to common and preferred stockholders	—	—	—	—	—	—	(167,878)	(167,878)
Issuance of Common Stock, net of offering costs	—	1,273,554	—	13	45,267	(4,346)	—	40,934
Issuance of Preferred Stock, net of offering costs	4,000,000	—	40	—	96,195	—	—	96,235
Stock acquired in connection with the Merger of Bay and Avalon	6,922,786	29,008,909	69	290	1,256,987	—	—	1,257,346
Conversion of Preferred Stock to Common Stock	(1,355,086)	1,355,086	(14)	14	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	3,255	—	3,255
Balance at 12-31-98	18,322,700	63,887,126	183	639	2,386,087	(4,356)	(68,116)	2,314,437
Net income	**—**	**—**	**—**	**—**	**—**	**—**	**172,276**	**172,276**
Dividends declared to common and preferred stockholders	**—**	**—**	**—**	**—**	**—**	**—**	**(173,667)**	**(173,667)**
Issuance of Common Stock	**—**	**1,870,883**	**—**	**19**	**56,423**	**(3,167)**	**—**	**53,275**
Amortization of deferred compensation	**—**	**—**	**—**	**—**	**—**	**3,964**	**—**	**3,964**
Balance at 12-31-99	**18,322,700**	**65,758,009**	**$ 183**	**$ 658**	**$ 2,442,510**	**$ (3,559)**	**$ (69,507)**	**$ 2,370,285**

See accompanying notes to consolidated financial statements.

Amounts for 1998 and 1997 have been revised to conform with the 1999 presentation (see note 2).

Consolidated Statements of Cash Flows

(Dollars in thousands)	For the year ended 12-31-99	12-31-98	12-31-97
Cash flows from operating activities:			
Net income	**$ 172,276**	$ 123,535	$ 64,916
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	**109,759**	77,374	29,113
Amortization of deferred compensation	**3,964**	3,255	2,003
Decrease (increase) in investments in unconsolidated joint ventures	**(1,510)**	1,139	65
Income allocated to minority interest in consolidated partnerships	**1,975**	1,770	(174)
Gain on sale of communities	**(47,093)**	(25,270)	(677)
Extraordinary item	**—**	245	1,183
Decrease (increase) in cash in escrow	**(348)**	2,172	966
Increase in resident security deposits, accrued interest on participating mortgage notes, prepaid expenses and other assets	**(310)**	(14,383)	(7,575)
Increase in accrued expenses, other liabilities and accrued interest payable	**11,353**	23,641	3,829
Net cash provided by operating activities	**250,066**	193,478	93,649
Cash flows used in investing activities:			
Increase (decrease) in construction payables	**(29,276)**	26,052	3,698
Proceeds from sale of communities, net of selling costs	**255,618**	118,025	16,577
Sale (acquisition) of participating mortgage note	**25,300**	(24,000)	—
Merger costs and related activities	**—**	(24,562)	—
Investment in unconsolidated joint venture	**—**	—	(7,980)
Proceeds received from joint venture partner	**—**	—	37,700
Purchase and development of real estate	**(516,261)**	(713,200)	(471,415)
Net cash used in investing activities	**(264,619)**	(617,685)	(421,420)
Cash flows from financing activities:			
Issuance of common and preferred stock, net of offering costs	**53,275**	137,169	231,898
Dividends paid	**(172,333)**	(126,247)	(75,795)
Proceeds from sale of unsecured notes	**275,000**	350,000	—
Payment of deferred financing costs	**(3,654)**	(4,435)	(3,901)
Repayments of notes payable	**(3,934)**	(2,391)	(25,341)
Borrowings under notes payable	**—**	—	121,891
Refinancings of notes payable	**18,755**	—	—
Net borrowings under (repayments of) unsecured facilities	**(150,400)**	75,695	71,500
Distributions to minority partners	**(3,425)**	(3,416)	—
Net cash provided by financing activities	**13,284**	426,375	320,252
Net increase (decrease) in cash	**(1,269)**	2,168	(7,519)
Cash and cash equivalents, beginning of year	**8,890**	6,722	14,241
Cash and cash equivalents, end of year	**$ 7,621**	$ 8,890	$ 6,722
Cash paid during period for interest, net of amount capitalized	**$ 60,705**	$ 31,405	$ 17,371

See accompanying notes to consolidated financial statements.

Amounts for 1998 and 1997 have been revised to conform with the 1999 presentation (see footnote 2).

Supplemental disclosures of non-cash investing and financing activities (dollars in thousands):

During the year ended December 31, 1997, the Company assumed $27,305 of debt and issued 464,966 units of limited partnership in DownREIT partnerships, valued at $18,157, in connection with acquisitions.

In June 1998, Avalon Properties, Inc. merged into Bay Apartment Communities, whereupon Avalon ceased to exist and Bay legally succeeded to all of the assets and liabilities of Avalon. In these financial statements, the merger was accounted for under the purchase method of accounting whereby Bay, as the surviving legal entity, adopted the historical financial statements of Avalon, and therefore the historical financial statements for Avalon are presented prior to the merger and Bay's assets were recorded in the historical financial statements of Avalon, as of the date of the merger, at an amount equal to Bay's debt outstanding at that time plus the value of capital stock retained by the Bay stockholders, which approximates fair value. As a result, the financial statements presented reflect that, in connection with the merger, the following was assumed or acquired: debt of $604,663; net other liabilities of $25,239; cash and cash equivalents of $1,419; and a minority interest of $9,020.

During the year ended December 31, 1998, the Company assumed $10,400 of debt and issued 104,222 units of limited partnership in DownREIT partnerships, valued at $3,851, in connection with acquisitions. A total of 6,818 units of limited partnership were presented for redemption to the DownREIT partnership that issued such units and were acquired by the Company for an equal number of shares of the Company's Common Stock. Additionally, 950,064 shares of Series A Preferred Stock and 405,022 shares of Series B Preferred Stock were converted into an aggregate of 1,355,086 shares of Common Stock.

During the year ended December 31, 1999, 117,178 units of limited partnership in DownREIT partnerships, valued at $4,614, were issued in connection with an acquisition for cash and units pursuant to a forward purchase agreement signed in 1997 with an unaffiliated party. Also during the year ended December 31, 1999, 22,623 units of limited partnership were presented for redemption to the DownREIT partnership that issued such units and were acquired by the Company for an equal number of shares of the Company's Common Stock.

Common and preferred dividends declared but not paid as of December 31, 1999, 1998 totaled $44,139 and $43,323, respectively. There were no dividends declared that were not paid as of December 31, 1997.

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Recent Developments. AvalonBay Communities, Inc. (the "Company," which term is often used to refer to AvalonBay Communities, Inc. together with its subsidiaries) is a Maryland corporation that has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. The Company focuses on the ownership and operation of institutional-quality apartment communities in high barrier-to-entry markets of the United States. These markets include Northern and Southern California and selected markets in the Mid-Atlantic, Northeast, Midwest and Pacific Northwest regions of the country.

The Company is the surviving corporation from the merger (the "Merger") of Bay Apartment Communities, Inc. ("Bay") and Avalon Properties, Inc. (sometimes hereinafter referred to as "Avalon" before the Merger) on June 4, 1998, where Avalon shareholders received 0.7683 share of common stock of the Company for each share owned of Avalon common stock. The merger was accounted for under the purchase method of accounting, with the historical financial statements for Avalon presented prior to the Merger. At that time, Avalon ceased to legally exist, and Bay as the surviving legal entity adopted the historical financial statements of Avalon, with Bay's assets recorded in the historical financial statements of Avalon at an amount equal to Bay's debt outstanding at that time plus the value of capital stock retained by the Bay stockholders, which approximates fair value. All disclosures related to 1997 share and per share information of Avalon have been revised to reflect the 0.7683 share conversion ratio used in the Merger. In connection with the Merger, the Company changed its name from Bay Apartment Communities, Inc. to AvalonBay Communities, Inc.

At December 31, 1999, the Company owned or held a direct or indirect ownership interest in 122 operating apartment communities containing 36,008 apartment homes in twelve states and the District of Columbia, of which four communities containing 1,455 apartment homes were under reconstruction. The Company also owned 12 communities with 3,173 apartment homes under construction and rights to develop an additional 30 communities that, if developed as expected, will contain an estimated 8,624 apartment homes.

During the period January 1, 1998 through June 4, 1998, Avalon acquired four communities containing a total of 1,084 apartment homes from unrelated third parties for an aggregate acquisition price of approximately $75,335. One of these communities had been sold as of December 31, 1999. The cumulative capitalized cost of the remaining three communities at December 31, 1999 was $47,124. During the period subsequent to the Merger through December 31, 1998, the Company acquired three communities containing a total of 1,433 apartment homes from unrelated third parties for an aggregate acquisition price of approximately $201,800 (cumulative capitalized cost of $205,214 as of December 31, 1999). The Company also acquired a participating mortgage note for $24,000 which was sold by the Company for a gross sales price of $25,300 in October 1999.

During the year ended December 31, 1999, the Company acquired one community containing 224 apartment homes through a DownREIT partnership for an acquisition price of approximately $25,750, including 117,178 units of limited partnership in the DownREIT partnership valued at $4,614. The community was acquired in connection with a forward purchase agreement signed in 1997 with an unaffiliated party.

During 1999, the Company completed development of ten communities, containing 2,335 apartment homes for a total investment of approximately $391,600. Also, during 1999, the Company completed redevelopment of thirteen communities, containing 4,051 apartment homes for a total investment in redevelopment (i.e., excluding acquisition costs) of $77,300.

In 1998, the Company adopted a strategy of disposing of certain assets in markets that did not meet its long-term strategic direction. In connection with this strategy, the Company sold seven communities in 1998 containing a total of 2,039 apartment homes for net proceeds of approximately $73,900. During 1999, the Company also sold 16 communities containing 4,464 apartment homes and a participating mortgage note secured by a community for net proceeds of approximately $280,918. This disposition strategy is also enabling redeployment of capital; the net proceeds from these dispositions will be redeployed to develop and redevelop communities currently under construction or reconstruction. Pending such redeployment, the proceeds from the sale of these communities were used to repay amounts outstanding under the Company's variable rate unsecured credit facility.

PRINCIPLES OF CONSOLIDATION. The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned partnerships and two joint venture partnerships in addition to four subsidiary partnerships structured as DownREITs. All significant intercompany balances and transactions have been eliminated in consolidation.

In each of the four partnerships structured as DownREITs, either AvalonBay or one of our wholly-owned subsidiaries is the general partner, and there are one or more limited partners whose interest in the partnership is represented by units of limited partnership interest. For each DownREIT partnership, limited partners are entitled to receive distributions before any distribution is made to the general partner. Although the partnership agreements for each of the DownREITs are different, generally the distributions paid to the holders of units of limited partnership interests approximate the current AvalonBay common stock dividend rate. Each DownREIT partnership has been structured so that it is unlikely the limited partners will be entitled to a distribution greater than the initial distribution provided for in the partnership agreement. The holders of units of limited partnership interest have the right to present each unit of limited partnership interest for redemption for cash equal to the fair market value of a share of AvalonBay common stock on the date of redemption. In lieu of a cash redemption of a unit by a partner, we may elect to acquire any unit presented for redemption for one share of common stock.

REAL ESTATE. Significant expenditures which improve or extend the life of an asset are capitalized. The operating real estate assets are stated at cost and consist of land, buildings and improvements, furniture, fixtures and equipment, and other costs incurred during their development, redevelopment and acquisition. Expenditures for maintenance and repairs are charged to operations as incurred.

The capitalization of costs during the development of assets (including interest and related loan fees, property taxes and other direct and indirect costs) begins when active development commences and ends when the asset is delivered and a final certificate of occupancy is issued. Cost capitalization during redevelopment of assets (including interest and related loan fees, property taxes and other direct and indirect costs) begins when an apartment home is taken out-of-service for redevelopment and ends when the apartment home redevelopment is completed and the apartment home is placed in-service. The accompanying consolidated financial statements include a charge to expense for unrecoverable deferred development costs related to pre-development communities that are unlikely to be developed.

Depreciation is calculated on buildings and improvements using the straight-line method over their estimated useful lives, which range from seven to thirty years. Furniture, fixtures and equipment are generally depreciated using the straight-line method over their estimated useful lives, which range from three years (computer related equipment) to seven years.

Lease terms for apartment homes are generally one year or less. Rental income and operating costs incurred during the initial lease-up or post-redevelopment lease-up period are fully recognized as they accrue.

If there is an event or change in circumstance that indicates an impairment in the value of a community, the Company's policy is to assess any impairment in value by making a comparison of the current and projected operating cash flows of the community over its remaining useful life, on an undiscounted basis, to the carrying amount of the community. If such carrying amounts are in excess of the estimated projected operating cash flows of the community, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value. The Company has not recognized an impairment loss in 1999, 1998 or 1997 on any of its real estate.

INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES. Investments in unconsolidated real estate joint ventures are accounted for under the equity method as the Company does not control the significant operating and financial decisions of the joint ventures. The joint venture agreements require that a majority voting interest of the partners approve potential sales, liquidations, significant refinancings, as well as operating budget and capital and financing plans.

INCOME TAXES. The Company elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended, for the year ended December 31, 1994 and has not revoked such election. A corporate REIT is a legal entity which holds real estate interests and, if certain conditions are met (including but not limited to the payment of a minimum level of dividends to stockholders), the payment of federal and state income taxes at the corporate level is avoided or reduced. Management believes that all such conditions for the avoidance of taxes have been met for the periods presented. Accordingly, no provision for federal and state income taxes has been made.

The following summarizes the tax components of the Company's common dividends declared for the years ended December 31, 1999, 1998 and 1997:

	% of common dividends declared for:					
	(AvalonBay) 1999	(AvalonBay, post Merger) 1998	(Avalon, prior to Merger) 1998	(Bay, prior to Merger)(1) 1998	(Avalon) 1997	(Bay)(1) 1997
Ordinary income	**76%**	77%	56%	77%	80%	100%
20% rate gain	**11%**	9%	—	9%	1%	—
Unrecaptured ß1250 gain	**13%**	14%	—	14%	2%	—
Non-taxable return of capital	**—**	—	44%	—	17%	—

(1) Information presented for Bay for periods prior to Merger is unaudited.

Dividends declared on all series of the Company's preferred stock in 1999 represented 76.0% of ordinary income, 11.0% of twenty percent rate gain and 13.0% of unrecaptured Section 1250 gain. Dividends declared on all series of the Company's preferred stock subsequent to the Merger through December 31, 1998 represented ordinary income. Dividends declared on all series of Bay's preferred stock during 1998 prior to the Merger and in 1997 represented ordinary income. Dividends declared on all series of Avalon's preferred stock during 1998 prior to the Merger represented ordinary income. Dividends declared on all series of Avalon's preferred stock in 1997 represented 97.0% of ordinary income, 1.0% of twenty percent rate gain and 2.0% of unrecaptured Section 1250 gain.

(Dollars in thousands, except per share data)

Development Costs of Software for Internal Use. The Company has entered into a formal joint venture cost sharing agreement with another public multifamily real estate company to develop a new on-site property management system and a leasing automation system to enable the Company to capture, review and analyze data to a greater degree than the Company found currently possible with third-party software products. The software development process is currently being managed by Company employees who oversee a project team of employees and third-party consultants. Development costs associated with the software project include computer hardware costs, direct labor costs and third-party consultant costs related to programming and documenting the system. The project began in January 1998 and is expected to be fully implemented by March 2001, although no assurance can be provided in this regard. The Company will continue to develop these systems through the joint venture agreement and the total cost of development will be shared equally between the Company and the joint venture partner. Once developed, the Company and the joint venture partner intend to use the property management and leasing systems in place of their respective systems currently in use for which fees are generally paid to third party vendors.

Costs associated with the project are accounted for in accordance with the American Institute of Certified Public Accountants' Statement of Position 98-1 ("SOP 98-1") "Accounting for Costs of Computer Software Developed or Obtained for Internal Use." Under SOP 98-1, costs of acquiring hardware and costs of coding, documenting and testing the software are capitalized during the application development stage. Following implementation, capitalized development costs are amortized over the system's estimated useful life and other costs such as training and application maintenance are expensed as incurred.

Deferred Financing Costs. Deferred financing costs include fees and costs incurred to obtain debt financing and are amortized on a straight-line basis, which approximates the effective interest method, over the shorter of the term of the loan or the related credit enhancement facility, if applicable. Unamortized financing costs are written-off when debt is retired before the maturity date.

Cash and Cash Equivalents. Cash and cash equivalents include all cash and liquid investments with an original maturity of three months or less from the date acquired. The majority of the Company's cash, cash equivalents, and cash in escrows is held at major commercial banks.

Earnings per Common Share. In accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share", basic earnings per share for the years ended December 31, 1999, 1998 and 1997 is computed by dividing earnings available to common shares (net income less preferred stock dividends) by the weighted average number of shares and Units outstanding during the period. Additionally, other potentially dilutive common shares are considered when calculating earnings per share on a diluted basis. The Company's basic and diluted weighted average shares outstanding for the years ended December 31, 1999, 1998 and 1997 are as follows:

	Year Ended		
	12-31-99	12-31-98	12-31-97
Weighted average common shares outstanding—basic	**64,724,799**	50,387,258	28,244,845
Weighted average Units outstanding	**933,122**	725,948	469
Weighted average common shares and Units outstanding—basic	**65,657,921**	51,113,206	28,245,314
Effect of dilutive securities	**452,743**	658,041	186,509
Weighted average common shares and Units outstanding—diluted	**66,110,664**	51,771,247	28,431,823

Certain options to purchase shares of common stock in the amount of 2,282,192, 2,643,190 and 899,679 were outstanding during 1999, 1998 and 1997, respectively but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

NON-RECURRING CHARGES. In February 1999, the Company announced certain management changes including (i) the departure of three senior officers (including the former President of Avalon) who became entitled to severance benefits in accordance with the terms of their employment agreements with the Company dated as of March 9, 1998 and (ii) elimination of duplicate accounting functions and related employee departures. The Company recorded a non-recurring charge of approximately $16,100 in the first quarter of 1999 related to the expected costs associated with this management realignment and certain related organizational adjustments.

Because a plan of management realignment was not in existence on June 4, 1998, the date of the Merger, this charge is not considered a cost of the Merger. Accordingly, the expenses associated with the management realignment have been treated as a non-recurring charge. The charge includes severance and benefits expenses, costs to eliminate duplicate accounting functions and legal fees. Certain former employees have elected to receive their severance benefits in an installment basis for up to twelve months. Accordingly, the Company had a remaining liability of approximately $1,457 at December 31, 1999 related to severance benefits after payments of $14,019 made for the year ended December 31, 1999.

The non-recurring charge also includes Year 2000 remediation costs of $706 that has been incurred for the year ended December 31, 1999.

Selected information relating to the non-recurring charge is summarized below:

	Severance benefits	Elimination of duplicate accounting costs	Legal fees	Total
Total non-recurring charge(1)	$ 15,476	$ 250	$ 350	$ 16,076
Cash payments	(14,019)	(250)	(252)	(14,521)
Restructuring liability as of December 31, 1999	$ 1,457	$ —	$ 98	$ 1,555

(1) Excludes Y2K costs of $706.

USE OF ESTIMATES. The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires Management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

RECLASSIFICATIONS. Certain reclassifications have been made to amounts in prior years' financial statements to conform with current year presentations.

RECENTLY ISSUED ACCOUNTING STANDARDS. In June 1997, the Financial Accounting Standards Board issued SFAS No. 131 "Disclosure about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for determining an entity's operating segments and the type and level of financial information to be disclosed. SFAS No. 131 became effective for the Company for the fiscal year ending December 31, 1998. The Company adopted SFAS No. 131 effective with the December 31, 1998 reporting period.

In March 1998, the Emerging Issues Task Force of the Financial Accounting Standards Board issued Ruling 97-11 entitled "Accounting for Internal Costs Relating to Real Estate Property Acquisitions," which requires that internal costs of identifying and acquiring operating property be expensed as incurred. Costs associated with the acquisition of non-operating property may still be capitalized. The ruling is effective for acquisitions completed subsequent to March 19, 1998. At December 31, 1999, this ruling does not have a material effect on the Company's consolidated financial statements.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This pronouncement establishes accounting and reporting standards requiring that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. In June 1999, the Financial Accounting Standards Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective date of SFAS No. 133." SFAS No. 137 delays the effective date of SFAS No. 133 for one year, to fiscal years beginning after June 15, 2000. The Company currently plans to adopt this pronouncement effective January 1, 2001, and will determine both the method and impact of adoption, which is expected to be immaterial, prior to that date.

2. MERGER BETWEEN BAY AND AVALON AND REVISED FINANCIAL PRESENTATION

Prior to December 31, 1999, the Company accounted for the Merger between Avalon and Bay under the purchase method of accounting, using the historical financial statements of Bay prior to and after the merger. Based on discussions with the Securities and Exchange Commission, the Company agreed to revise its financial presentation as of and for the years ended December 31, 1998 and 1997 to present the merger whereby the historical financial statements for Avalon are presented prior to the Merger. At that time, Avalon ceased to legally exist and Bay as the surviving legal entity adopted the historical financial statements of Avalon, with Bay's assets recorded in the historical financial statements of Avalon at an amount equal to Bay's debt outstanding at that time plus the value of capital stock retained by the Bay stockholders, which approximates fair value. Unaudited quarterly data for the years ended December 31, 1999 and 1998, as shown in Note 12, has also been revised. Except as otherwise stated herein, all information presented in the consolidated financial statements and related notes includes all such revisions.

Adjustments have been made in the revised financial statements to reflect the following:

- The financial statements presented for 1997 and the period from January 1, 1998 through the date of the Merger are the historical financial statements of Avalon after giving effect to the number of shares outstanding based on the Merger exchange ratio.
- Assets and liabilities of Avalon as of the Merger date are recorded at historical cost.
- Assets and liabilities of Bay as of the Merger date are recorded at an amount equal to Bay's debt outstanding plus the value of capital stock retained by Bay, which approximates fair value; write-downs of assets or additional accruals have been recorded as additional purchase price.
- The results of operations of the Company for the year ended December 31, 1998 reflect the historical operations of Avalon prior to the Merger and operations of the combined company after the merger date through December 31, 1998.

These revisions increased (decreased) previously reported total assets, total stockholders' equity, net income and earnings per share for the years ended December 31, 1998 and 1997 as follows:

	1998	1997
Total assets	$ (25,191)	$ 212,053
Total stockholders' equity	$ (25,016)	$ 168,315
Income before extraordinary item	$ 29,346	$ 27,158
Extraordinary item	$ (245)	$ (1,183)
Net income	$ 29,101	$ 25,975
Net income available to common stockholders	$ 26,843	$ 13,799
Per common share:		
Income before extraordinary item—basic	$ 0.48	$ 0.24
Income before extraordinary item—diluted	$ 0.47	$ 0.23
Extraordinary item—basic and diluted	$ —	$ (0.04)
Net income—basic	$ 0.48	$ 0.20
Net income—diluted	$ 0.47	$ 0.19

The following unaudited pro forma information has been prepared as if the Merger and related transactions had occurred on January 1, 1998. The pro forma financial information is presented for informational purposes only and is not necessarily indicative of what actual results would have been nor does it purport to represent the results of operations for future periods had the Merger been consummated on January 1, 1998.

	Year Ended (Unaudited) 12-31-98
Pro forma total revenue	$ 449,085
Pro forma net income available to common stockholders	$ 111,114
Per common share:	
Pro forma net income-basic	$ 1.74
Pro forma net income-diluted	$ 1.73

3. INTEREST CAPITALIZED

Capitalized interest associated with communities under development or redevelopment totaled $21,888, $14,724 and $9,024 for the years ended December 31, 1999, 1998 and 1997, respectively.

(Dollars in thousands, except per share data)

4. NOTES PAYABLE, UNSECURED NOTES AND CREDIT FACILITY

The Company's notes payable, unsecured notes and credit facility are summarized as follows:

	12-31-99	12-31-98
Fixed rate mortgage notes payable (conventional and tax-exempt)	**$ 362,087**	$ 388,106
Variable rate mortgage notes payable (tax-exempt)	**67,960**	57,265
Fixed rate unsecured notes	**985,000**	710,000
Total notes payable and unsecured notes	**1,415,047**	1,155,371
Variable rate unsecured credit facility	**178,600**	329,000
Total notes payable, unsecured notes and credit facility	**$ 1,593,647**	$ 1,484,371

Mortgage notes payable are collateralized by certain apartment communities and mature at various dates from May 2001 through December 2036. The weighted average interest rate of the Company's variable rate notes and credit facility was 6.9% at December 31, 1999. The weighted average interest rate of the Company's fixed rate notes (conventional and tax-exempt) was 6.9% and 6.7% at December 31, 1999 and 1998, respectively.

The maturity schedule for the Company's unsecured notes consists of the following:

Year of Maturity	Principal	Interest Rate
2002	$ 100,000	7.375%
2003	$ 50,000	6.25%
	$ 100,000	6.5%
2004	$ 125,000	6.58%
2005	$ 100,000	6.625%
	$ 50,000	6.5%
2006	$ 150,000	6.8%
2007	$ 110,000	6.875%
2008	$ 50,000	6.625%
2009	$ 150,000	7.5%

The Company's unsecured notes contain a number of financial and other covenants with which the Company must comply, including, but not limited to, limits on the aggregate amount of total and secured indebtedness the Company may have on a consolidated basis and limits on the Company's required debt service payments.

Scheduled maturities of notes payable and unsecured notes are as follows for the years ending December 31:

2000	$ 3,595
2001	14,654
2002	103,880
2003	158,846
2004	166,297
Thereafter	967,775
Total notes payable	$ 1,415,047

The Company has a $600,000 variable rate unsecured credit facility (the "Unsecured Facility") with Morgan Guaranty Trust Company of New York, Union Bank of Switzerland and Fleet National Bank, serving as co-agents for a syndicate of commercial banks. The Unsecured Facility bears interest at a spread over the London Interbank Offered Rate ("LIBOR") based on rating levels achieved on the Company's unsecured notes and on a maturity selected by the Company. The current stated pricing is LIBOR plus 0.6% per annum (7.1% at December 31, 1999). In addition, the Unsecured Facility includes a competitive bid option (which allows banks that are part of the lender consortium to bid to make loans to the Company at a rate that is lower than the stated rate provided by the Unsecured Facility) for up to $400,000. The Company is subject to certain customary covenants under the Unsecured Facility, including, but not limited to, maintaining certain maximum leverage ratios, a minimum fixed charges coverage ratio, minimum unencumbered assets and equity levels and restrictions on paying dividends in amounts that exceed 95% of the Company's Funds from Operations, as defined therein. The Unsecured Facility matures in July 2001 and has two, one-year extension options.

5. STOCKHOLDERS' EQUITY

As of December 31, 1999 and 1998, the Company had authorized for issuance 140,000,000 and 50,000,000 of Common and Preferred Stock, respectively. Dividends on the Series C, Series D, Series F, Series G and Series H Preferred Stock are cumulative from the date of original issue and are payable quarterly in arrears on or before the 15th day of each month as stated in the table below. None of the series of Preferred Stock are redeemable prior to the date stated in the table below, but on or after the stated date, may be redeemed for cash at the option of the Company in whole or in part, at a redemption price of $25 per share, plus all accrued and unpaid dividends, if any. The series of Preferred Stock have no stated maturity and are not subject to any sinking fund or mandatory redemptions. In addition, the series of Preferred Stock are not convertible into any other securities of the Company and may be redeemed solely from proceeds of other capital stock of the Company, which may include shares of other series of preferred stock.

Series	Shares outstanding December 31, 1999	Payable quarterly	Annual rate	Liquidation preference	Non-redeemable prior to
C	2,300,000	March, June, September, December	8.50%	$25	June 20, 2002
D	3,267,700	March, June, September, December	8.00%	$25	December 15, 2002
F	4,455,000	February, May, August, November	9.00%	$25	February 15, 2001
G	4,300,000	February, May, August, November	8.96%	$25	October 15, 2001
H	4,000,000	March, June, September, December	8.70%	$25	October 15, 2008

The Company also has 1,000,000 shares of Series E Junior Participating Cumulative Preferred Stock authorized for issuance pursuant to the Company's Shareholder Rights Agreement. As of December 31, 1999, there were no shares of Series E Preferred Stock outstanding.

(Dollars in thousands, except per share data)

6. INVESTMENTS IN UNCONSOLIDATED JOINT VENTURES

At December 31, 1999, the Company's investments in unconsolidated joint ventures consisted of a 50% general partnership interest in Falkland Partners, a 49% general partnership interest in Avalon Run and a 50% limited liability company membership interest in Avalon Grove. Also during 1999, the Company entered into a joint venture to develop an on-site property management system and a leasing automation system; the Company's joint venture interest consists of a 60% limited liability company membership interest. The following is a combined summary of the financial position of these joint ventures as of the dates presented.

		Unaudited
	12-31-99	12-31-98
Assets:		
Real estate, net	**$ 94,644**	$ 96,419
Other assets	**10,666**	4,532
Total assets	**$ 105,310**	$ 100,951
Liabilities and partners' equity:		
Mortgage notes payable	**$ 26,000**	$ 26,000
Other liabilities	**6,479**	4,933
Partners' equity	**72,831**	70,018
Total liabilities and partners' equity	**$ 105,310**	$ 100,951

The following is a combined summary of the operating results of these joint ventures for the periods presented:

	Year ended	(Unaudited)	
	12-31-99	12-31-98	12-31-97
Rental income	**$ 20,781**	$ 19,799	$ 16,497
Other income	**26**	26	44
Operating and other expenses	**(6,051)**	(5,591)	(5,020)
Mortgage interest expense	**(773)**	(833)	(893)
Depreciation and amortization	**(3,091)**	(3,044)	(1,869)
Net income	**$ 10,892**	$ 10,357	$ 8,759

7. COMMUNITIES HELD FOR SALE

During 1998, the Company completed a strategic planning effort resulting in a decision to pursue a disposition strategy for certain assets in markets that did not meet its long-term strategic direction. In connection with this strategy, the Company solicits competing bids from unrelated parties for individual assets, and considers the sales price and tax ramifications of each proposal. The Company sold seven communities with a total of 2,039 apartment homes in connection with this strategy in 1998. The aggregate gross sales price for these assets was $126,200, with total net proceeds of $73,900. A portion of the gross sales price was used to repay $50,030 of debt secured by assets sold. The communities sold during 1999 and the respective sales price and net proceeds are summarized on the following page:

Communities	Location	Period of sale	Apartment homes	Debt	Gross sales price	Net proceeds
Blairmore	Rancho Cordova, CA	1Q99	252	$ —	$ 13,250	$ 12,991
Avalon at Park Center	Alexandria, VA	2Q99	492	—	44,250	43,820
Avalon at Lake Arbor	Mitchellville, MD	2Q99	209	—	14,160	13,800
Avalon Station	Fredricksburg, VA	2Q99	223	—	12,734	12,500
Avalon Gayton	Richmond, VA	2Q99	328	—	18,418	18,210
Avalon at Boulders	Richmond, VA	2Q99	284	—	16,075	15,840
The Pointe (1)	Fairfield, CA	3Q99	296	—	24,350	23,833
Avalon at Willow Lake	Indianapolis, IN	3Q99	230	—	14,350	14,055
Avalon at Geist	Lawrence, IN	3Q99	146	—	10,300	10,006
Avalon at Montgomery	Cincinnati, OH	4Q99	264	—	15,600	15,379
Avalon at Oxford Hill	Creve Coeur, MO	4Q99	480	—	29,900	29,443
Avalon Heights	Madison Heights, MI	4Q99	225	—	15,150	15,115
Rivershore	Bay Pointe, CA	4Q99	245	10,035	13,300	2,205
Avalon at Hampton I	Hampton, VA	4Q99	187	8,060	10,547	1,961
Avalon at Hampton II	Hampton, VA	4Q99	231	11,550	13,028	848
Avalon Park	Manassas, VA	4Q99	372	—	25,800	25,612
Fairlane Woods (2)	Detroit, MI	4Q99	N/A	—	25,300	25,300
			4,464	$ 29,645	$ 316,512	$ 280,918

(1) Proceeds from The Pointe were deposited into an escrow account to facilitate a like-kind exchange transaction.

(2) Fairlane Woods was a participating mortgage note, not an owned community.

In addition to assets disposed of in connection with this disposition strategy, the Company disposed of two communities in July 1998 in connection with an agreement executed by Avalon in March 1998 which provided for the buyout of certain limited partners in DownREIT V Limited Partnership. Net proceeds from the sale of the two communities, containing an aggregate of 758 apartment homes, were approximately $44,000.

(Dollars in thousands, except per share data)

The following unaudited pro forma information has been prepared as if the communities sold in connection with the disposition strategy during 1999 and 1998 had been sold as of January 1, 1998. The pro forma financial information is presented for informational purposes only and is not necessarily indicative of what actual results would have been nor does it purport to represent the results of operations for future periods had the dispositions occurred as of January 1, 1998.

	Year Ended (Unaudited)	Year Ended (Unaudited)
	12-31-99	12-31-98
Pro forma revenue	**$ 481,190**	$ 320,027
Pro forma net income available to common stockholders	**$ 123,841**	$ 79,525
Per common share: Pro forma net income—basic	**$ 1.89**	$ 1.56
Pro forma net income—diluted	**$ 1.87**	$ 1.54

Management intends to market additional communities for sale during 2000. However, there can be no assurance that such assets will be sold, or that such sales will prove to be beneficial to the Company. The assets targeted for sale include land, buildings and improvements and furniture, fixtures and equipment, and are recorded at the lower of cost or fair value less estimated selling costs. The Company has not recognized a write-down in its real estate to arrive at net realizable value, although there can be no assurance that the Company can sell these assets for amounts that equal or exceed its estimates of net realizable value. At December 31, 1999 and 1998, total real estate, net of accumulated depreciation, subject to sale totaled $164,758 and $195,394, respectively. Certain individual assets are secured by mortgage indebtedness which may be assumed by the purchaser or repaid by the Company from the net sales proceeds.

The Company's consolidated statements of operations include net income of the communities held for sale at December 31, 1999 of $11,361, $10,262 and $9,146 for the years ended December 31, 1999, 1998 and 1997, respectively.

8. COMMITMENTS AND CONTINGENCIES

Presale Commitments. The Company occasionally enters into forward purchase commitments with unrelated third parties which allows the Company to purchase communities upon completion of construction. As of December 31, 1999, the Company has an agreement to purchase nine communities with an estimated 2,753 homes for an estimated aggregate purchase price of $347,052. The Company expects these acquisitions to close at different times through 2002. However, there can be no assurance that such acquisitions will be consummated or consummated on the schedule currently contemplated. As of December 31, 1999 and 1998, the Company had provided interim construction financing of $145,241 and $67,129, respectively, for these communities.

Employment Agreements and Arrangements. The Company has entered into employment agreements with five executive officers. In addition, during 2000 and prior to March 1, 2000, three other senior officers entered into employment agreements, which are generally similar in structure to those entered into with executive officers but which do not provide for the same level of severance payments. The employment agreements provide for severance payments in the event of a termination of employment (except for a termination by the Company with cause or a voluntary termination by the employee). The initial term of these agreements ends on dates that vary between June 4, 2001 and March 29, 2002. The employment agreements provide for one-year automatic renewals after the initial term unless an advance notice of non-renewal is provided by either party. Upon a change in control, the agreements provide for an automatic extension of three years (two years in the case of senior officers). The employment agreements provide for base salary and incentive compensation in the form of cash awards, stock options and stock grants subject to the discretion of, and attainment of performance goals established by, the Compensation Committee of the Board of Directors.

The employment agreements of the executive officers also provide that base salary may be increased during the initial term in amounts determined by the Compensation Committee, and that during any renewal term base salary increases will be equal to the greater of 5% of the prior year's base salary, a factor based on increases in the consumer price index, or an amount determined at the discretion of the Compensation Committee.

During the fourth quarter of 1999, the Company adopted an Officer Severance Program (the "Program") for the benefit of those officers of the Company who do not have employment agreements. Under the Program, in the event an officer who is not otherwise covered by a severance arrangement is terminated without cause in connection with a change in control (as defined) of the Company, such officer will generally receive a cash lump sum payment equal to one times the amount of such officer's base salary and cash bonus.

CONTINGENCIES. The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, Management believes the final outcome of such matters will not have a material adverse effect on the financial position or results of operations of the Company.

9. VALUE OF FINANCIAL INSTRUMENTS

The Company has historically used interest rate swap agreements (the "Swap Agreements") to reduce the impact of interest rate fluctuations on its variable rate tax-exempt bonds. The Swap Agreements are held for purposes other than trading. The amortization of the cost of the Swap Agreements is included in interest expense. The remaining unamortized cost of the Swap Agreements is included in prepaid expenses and other assets and is amortized over the remaining life of the agreements. As of December 31, 1999, the effect of these Swap Agreements is to fix $190,765 of the Company's tax-exempt debt at an average interest rate of 6.1% with an average maturity of 7 years.

The off-balance-sheet risk in these contracts includes the risk of a counterparty not performing under the terms of the contract. The counterparties to these contracts are major financial institutions with AAA credit ratings by the Standard & Poor's Ratings Group. The Company monitors the credit ratings of counterparties and the amount of the Company's debt subject to swap agreements with any one party. Therefore, the Company believes the likelihood of realizing material losses from counterparty nonperformance is remote.

The Company has not entered into any interest rate hedge agreements or treasury locks for its conventional unsecured debt.

Cash and cash equivalent balances are held with various financial institutions and may at times exceed the applicable Federal Deposit Insurance Corporation limit. The Company monitors credit ratings of these financial institutions and the concentration of cash and cash equivalent balances with any one financial institution and believes the likelihood of realizing material losses from the excess of cash and cash equivalent balances over insurance limits is remote.

The following estimated fair values of financial instruments were determined by Management using available market information and established valuation methodologies, including discounted cash flows. Accordingly, the estimates presented are not necessarily indicative of the amounts the Company could realize on disposition of the financial instruments. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

- Cash equivalents, rents receivable, accounts payable and accrued expenses, and other liabilities are carried at their face amounts, which reasonably approximate their fair values.

- The Company's unsecured credit facility with an aggregate carrying value of $178,600 and $329,000 at December 31, 1999 and 1998, respectively approximates fair value.

Bond indebtedness and notes payable with an aggregate carrying value of $1,415,047 and $1,155,371 had an estimated aggregate fair value of $1,346,288 and $1,137,411 at December 31, 1999 and 1998, respectively.

10. SEGMENT REPORTING

The Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," during 1998. SFAS No. 131 established standards for reporting financial and descriptive information about operating segments in annual financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision making group consists primarily of the Company's senior officers.

The Company's reportable operating segments include Stable Communities, Developed Communities and Redeveloped Communities:

- Stable Communities are communities that 1) have attained stabilized occupancy levels (at least 95% occupancy) and operating costs since the beginning of the prior calendar year (these communities are also known as Established Communities); or 2) were acquired after the beginning of the previous calendar year but were stabilized in terms of occupancy levels and operating costs at the time of acquisition, and remained stabilized throughout the end of the current calendar year. Stable Communities do not include communities where planned redevelopment or development activities have not yet commenced. The primary financial measure for this business segment is Net Operating Income

("NOI"), which represents total revenue less operating expenses and property taxes. With respect to Established Communities, an additional financial measure of performance is NOI for the current year as compared against the prior year and against current year budgeted NOI. With respect to other Stable Communities, performance is primarily based on reviewing growth in NOI for the current period as compared against prior periods within the calendar year and against current year budgeted NOI.

- Developed Communities are communities which completed development and attained stabilized occupancy and expense levels during the prior calendar year of presentation. The primary financial measure for this business segment is Operating Yield (defined as NOI divided by total capitalized costs). Performance of Developed Communities is based on comparing Operating Yields against projected yields as determined by Management prior to undertaking the development activity.

- Redeveloped Communities are communities that completed redevelopment and attained stabilized occupancy and expense levels during the prior calendar year of presentation. The primary financial measure for this business segment is Operating Yield. Performance for Redeveloped Communities is based on comparing Operating Yields against projected yields as estimated by Management prior to undertaking the redevelopment activity.

Other communities owned by the Company which are not included in the above segments are communities that were under development or redevelopment or lease-up at any point in time during the applicable calendar year. The primary performance measure for these assets depends on the stage of development or redevelopment of the community. While under development or redevelopment, Management monitors actual construction costs against budgeted costs as well as economic occupancy. While under lease-up, the primary performance measures for these assets are projected Operating Yield as defined above, lease-up pace compared to budget and rent levels compared to budget.

Net Operating Income for each community is generally equal to that community's contribution to Funds from Operations ("FFO"), except that interest expense related to indebtedness secured by an individual community and depreciation and amortization on non-real estate assets are not included in the community's NOI although such expenses decrease the Company's consolidated net income and FFO.

The segments are classified based on the individual community's status as of the beginning of the given calendar year. Therefore, each year the composition of communities within each business segment is adjusted. Accordingly, the amounts between years are not directly comparable.

In addition to reporting segments based on the above property types, the Company previously reported results within these segments based on the East and West Coast geographic areas. This disclosure was provided as the East and West Coast geographic areas substantially reflected the operating communities of Avalon and Bay, respectively, prior to the Merger. Management currently reviews its operating segments by geographic regions, including Northern and Southern California, Pacific Northwest, Northeast, Mid-Atlantic and Midwest regions. Because the various locations within each individual region have similar economic and other characteristics, Management finds it useful to review the performance of the Company's communities in those locations on a regional, aggregated basis.

(Dollars in thousands, except per share data)

The accounting policies applicable to the operating segments described above are the same as those described in the summary of significant accounting policies.

	Stable Communities	Developed Communities	Redeveloped Communities	Other	Total
For the year ended December 31, 1999					
Total, All Segments					
Total revenue	**$ 348,212**	**$ 32,820**	**$ 36,476**	**$ 85,088**	**$ 502,596**
Net Operating Income	**$ 243,519**	**$ 24,678**	**$ 25,959**	**$ 55,768**	**$ 349,924**
Gross real estate	**$ 2,386,523**	**$ 225,841**	**$ 288,511**	**$ 1,088,557**	**$ 3,989,432**
Non-allocated operations					
Total revenue	**$ —**	**$ —**	**$ —**	**$ 1,948**	**$ 1,948**
Net Operating Income	**$ —**	**$ —**	**$ —**	**$ 1,697**	**$ 1,697**
Gross real estate	**$ —**	**$ —**	**$ —**	**$ 276,994**	**$ 276,994**
Total, AvalonBay					
Total revenue	**$ 348,212**	**$ 32,820**	**$ 36,476**	**$ 87,036**	**$ 504,544**
Net Operating Income	**$ 243,519**	**$ 24,678**	**$ 25,959**	**$ 57,465**	**$ 351,621**
Gross real estate	**$ 2,386,523**	**$ 225,841**	**$ 288,511**	**$ 1,365,551**	**$ 4,266,426**
For the year ended December 31, 1998					
Total, All Segments					
Total revenue	$ 266,371	$ 13,032	$ 5,907	$ 83,927	$ 369,237
Net Operating Income	$ 183,799	$ 9,572	$ 3,744	$ 54,516	$ 251,631
Gross real estate	$ 2,488,123	$ 77,655	$ 41,271	$ 1,261,922	$ 3,868,971
Non-allocated operations					
Total revenue	$ —	$ —	$ —	$ 2,166	$ 2,166
Net Operating Income	$ —	$ —	$ —	$ 1,915	$ 1,915
Gross real estate	$ —	$ —	$ —	$ 137,485	$ 137,485
Total, AvalonBay					
Total revenue	$ 266,371	$ 13,032	$ 5,907	$ 86,093	$ 371,403
Net Operating Income	$ 183,799	$ 9,572	$ 3,744	$ 56,431	$ 253,546
Gross real estate	$ 2,488,123	$ 77,655	$ 41,271	$ 1,399,407	$ 4,006,456
For the year ended December 31, 1997					
Total, All Segments					
Total revenue	$ 129,149	$ 10,661	$ —	$ 30,102	$ 169,912
Net Operating Income	$ 85,799	$ 7,464	$ —	$ 21,771	$ 115,034
Gross real estate	$ 1,043,662	$ 67,119	$ —	$ 402,515	$ 1,513,296
Non-allocated operations					
Total revenue	$ —	$ —	$ —	$ 1,192	$ 1,192
Net Operating Income	$ —	$ —	$ —	$ 410	$ 410
Gross real estate	$ —	$ —	$ —	$ 21,690	$ 21,690
Total, AvalonBay					
Total revenue	$ 129,149	$ 10,661	$ —	$ 31,294	$ 171,104
Net Operating Income	$ 85,799	$ 7,464	$ —	$ 22,181	$ 115,444
Gross real estate	$ 1,043,662	$ 67,119	$ —	$ 424,205	$ 1,534,986

Operating expenses as reflected on the Consolidated Statements of Operations include $23,950, $18,264 and $6,048 for the years ended December 31, 1999, 1998 and 1997, respectively, of property management overhead costs that are not allocated to individual communities. These costs are not reflected in NOI as shown in the above tables. The amount reflected for "Communities held for sale" on the Consolidated Balance Sheets is net of $18,141 and $16,603 of accumulated depreciation as of December 31, 1999 and 1998, respectively.

In June 1998, the Company completed the Merger. For comparative purposes, the 1998 and 1997 segment information for the Company is presented below on a pro forma basis (unaudited) assuming the Merger had occurred as of January 1, 1997.

	Stable Communities	Developed Communities	Redeveloped Communities	Other	Total
For the year ended 12-31-98					
Total revenue	$ 254,213	$ 51,570	$ 24,173	$ 116,837	$ 446,793
Net Operating Income	$ 173,570	$ 38,895	$ 16,950	$ 75,404	$ 304,819
Current gross real estate	$ 2,107,129	$ 277,958	$ 221,961	$ 1,279,957	$ 3,887,005
For the year ended 12-31-97					
Total revenue	$ 204,696	$ 10,661	$ 2,926	$ 77,851	$ 296,134
Net Operating Income	$ 139,954	$ 7,464	$ 2,210	$ 53,568	$ 203,196
Current gross real estate	$ 1,535,521	$ 67,119	$ 17,797	$ 1,262,942	$ 2,883,379

11. STOCK-BASED COMPENSATION PLANS

The Company has adopted the 1994 Stock Incentive Plan as amended and restated (the "Plan") for the purpose of encouraging and enabling the Company's officers, associates and directors to acquire a proprietary interest in the Company and as a means of aligning management and stockholder interests and expanding management's long-term perspective. Individuals who are eligible to participate in the Plan include officers, other associates, outside directors and other key persons of the Company and its subsidiaries who are responsible for or contribute to the management, growth or profitability of the Company and its subsidiaries. The Plan authorizes (i) the grant of stock options that qualify as incentive stock options under Section 422 of the Internal Revenue Code, (ii) the grant of stock options that do not so qualify, (iii) grants of shares of restricted and unrestricted Common Stock, (iv) grants of deferred stock awards, (v) performance share awards entitling the recipient to acquire shares of Common Stock and (vi) dividend equivalent rights.

Under the Plan, a maximum of 2,500,000 shares of Common Stock, plus 9.9% of any net increase in the total number of shares of Common Stock actually outstanding from time to time after April 13, 1998, may be issued. Notwithstanding the foregoing, the maximum number of shares of stock for which Incentive Stock Options may be issued under the Plan shall not exceed 2,500,000 and no awards shall be granted under the Plan after April 13, 2008. For purposes of this limitation, shares of Common Stock which are forfeited, canceled and reacquired by the Company, satisfied without the issuance of Common Stock or otherwise terminated (other than by exercise) shall be added back to the shares of Common Stock available for issuance under the Plan. Stock Options with respect to no more than 300,000 shares of stock may be granted to any one individual participant during any one calendar year period. Options granted to officers and employees under the Plan vest over periods determined by the Compensation Committee of the Board of Directors and expire ten years from the date of grant. Options granted to non-employee directors under the Plan are subject to accelerated vesting under certain limited circumstances and become exercisable on the first anniversary of the date of grant and expire ten years from the date of grant. Restricted stock granted to officers and employees under the Plan vest over periods determined by the Compensation Committee of the Board of Directors which is generally four years, with 20% vesting immediately on the grant date and the remaining 80% vesting equally over the next four years from the date of grant. Restricted stock granted to non-employee directors vests 20% on the date of issuance and 20% on each of the first four anniversaries of the date of issuance.

(Dollars in thousands, except per share data)

Information with respect to stock options granted under the Plan is as follows:

	Shares	Average Exercise Price Per Share
Options outstanding, December 31, 1996[1]	722,875	$ 21.70
Exercised	(26,251)	21.13
Granted	394,100	36.35
Forfeited	(20,350)	26.43
Options outstanding, December 31, 1997[1]	1,070,374	$ 27.02
Exercised	(164,924)	21.71
Granted	1,225,132	36.81
Forfeited	(244,500)	35.25
Options outstanding, December 31, 1998[1]	1,886,082	$ 32.74
Exercised	(311,989)	25.44
Granted	993,084	32.24
Forfeited	(533,903)	36.25
Options outstanding, December 31, 1999	2,033,274	$ 32.63
Options exercisable:		
December 31, 1997	343,974	$ 20.91
December 31, 1998	656,925	$ 27.26
December 31, 1999	682,110	$ 30.33

(1) Information presented for Bay for periods prior to June 4, 1998 is unaudited.

The following table summarizes information concerning currently outstanding and exercisable options:

Options Outstanding				Options Exercisable	
Exercise Price	Number Outstanding as of December 31, 1999	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 18.38	60,000	5.24	$ 18.38	60,000	$ 18.38
19.25	6,000	5.35	19.25	6,000	19.25
19.63	19,450	5.55	19.63	19,450	19.63
20.00	101,300	4.19	20.00	101,300	20.00
20.50	6,000	4.27	20.50	6,000	20.50
23.38	40,000	6.07	23.38	30,000	23.38
25.38	15,000	6.33	25.38	15,000	25.38
27.75	44,700	6.66	27.75	37,200	27.75
31.50	216,500	9.80	31.50	—	—
31.50	50,000	9.80	31.50	—	—
32.00	458,220	9.13	32.00	—	—
32.25	8,000	9.85	32.25	—	—
32.56	10,000	9.09	32.56	—	—
33.69	1,500	9.55	33.69	—	—
33.75	1,500	8.97	33.75	500	33.75
33.75	6,500	8.97	33.75	2,165	33.75
33.81	6,000	9.78	33.81	—	—
33.94	10,000	9.01	33.94	—	—
34.38	30,000	7.38	34.38	30,000	34.38
34.81	1,500	9.49	34.81	—	—
35.31	768	9.64	35.31	—	—
35.31	768	9.71	35.31	—	—
35.38	4,000	9.69	35.38	—	—
35.44	6,000	9.69	35.44	—	—
35.63	1,500	9.68	35.63	—	—
36.00	70,000	9.36	36.00	—	—
36.06	768	9.36	36.06	—	—
36.13	90,000	8.44	36.13	90,000	36.13
36.31	107,100	8.43	36.13	35,664	36.31
36.31	245,000	8.43	36.31	81,585	36.31
36.31	85,500	8.43	36.31	28,472	36.31
36.63	142,700	7.07	36.63	82,700	36.63
36.63	29,500	8.56	36.63	9,824	36.63
37.94	130,000	8.08	37.94	32,500	37.94
38.81	20,000	7.84	38.81	10,000	38.81
39.63	7,500	7.73	39.63	3,750	39.63
	2,033,274	8.23	$ 32.63	682,110	$ 30.33

(Dollars in thousands, except per share data)

Options to purchase 3,637,724, 4,488,189 and 348,400 shares of Common Stock were available for grant under the Plan at December 31, 1999, 1998 and 1997, respectively.

Before the Merger, Avalon had adopted its 1995 Equity Incentive Plan (the "Avalon 1995 Incentive Plan"). The 1995 Incentive Plan authorized the grant of (i) stock options that qualified as incentive stock options under Section 422 of the Internal Revenue Code, (ii) stock options that did not so qualify, (iii) shares of restricted and unrestricted common stock, (iv) shares of unrestricted common stock and (v) dividend equivalent rights.

Under the Avalon 1995 Incentive Plan, a maximum number of 3,315,054 shares (or 2,546,956 shares as adjusted for the Merger) of common stock were issuable, plus any shares of common stock represented by awards under Avalon's 1993 Stock Option and Incentive Plan (the "Avalon 1993 Plan") that were forfeited, canceled, reacquired by Avalon, satisfied without the issuance of common stock or otherwise terminated (other than by exercise). Options granted to officers, non-employee directors and associates under the Avalon 1995 Incentive Plan generally vested over a three-year term, expire ten years from the date of grant and are exercisable at the market price on the date of grant.

In connection with the Merger, the exercise prices and the number of options under the Avalon 1995 Incentive Plan and the Avalon 1993 Plan were adjusted to reflect the equivalent Bay shares and exercise prices based on the 0.7683 share conversion ratio used in the Merger. Officers, non-employee directors and associates with Avalon 1995 Incentive Plan options may exercise their adjusted number of options for the Company's Common Stock at the adjusted exercise price.

Information with respect to stock options granted under the Avalon 1995 Incentive Plan and the Avalon 1993 Plan is as follows:

	Shares	Weighted Average Exercise Price Per Share
Options outstanding, December 31, 1996	810,557	$ 26.99
Exercised	(34,814)	26.83
Granted	930,411	38.02
Forfeited	(2,806)	28.89
Options outstanding, December 31, 1997	1,703,348	$ 33.01
Exercised	(49,375)	36.12
Granted	464,227	37.60
Forfeited	(65,946)	38.00
Options outstanding, December 31, 1998	2,052,254	$ 34.05
Exercised	(172,977)	26.97
Granted	—	—
Forfeited	(50,940)	37.61
Options outstanding, December 31, 1999	1,828,337	$ 34.63
Options exercisable:		
December 31, 1997	722,023	$ 26.84
December 31, 1998	1,014,530	$ 30.26
December 31, 1999	1,268,520	$ 33.22

The following table summarizes information concerning currently outstanding and exercisable options under the Avalon 1995 Incentive Plan and the Avalon 1993 Plan:

	Options Outstanding			Options Exercisable	
Exercise Price	Number Outstanding as of December 31, 1999	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 26.19	15,366	5.37	$ 26.19	15,366	$ 26.19
26.68	433,876	3.86	26.68	433,876	26.68
26.68	7,683	3.86	26.68	7,683	26.68
27.33	29,529	5.35	27.33	29,529	27.33
27.33	2,305	6.04	27.33	2,305	27.33
27.33	1,152	7.96	27.33	769	27.33
28.15	21,001	6.48	28.15	21,001	28.15
28.31	15,366	6.37	28.31	15,366	28.31
30.10	4,610	4.37	30.10	4,610	30.10
30.26	4,610	6.69	30.26	4,610	30.26
34.98	9,604	6.96	34.98	9,604	34.98
35.31	30,732	7.36	35.31	30,732	35.31
36.44	1,921	7.68	36.44	1,281	36.44
36.61	50,452	8.41	36.61	16,799	36.61
36.69	1,921	8.32	36.69	640	36.69
37.18	5,762	8.37	37.18	1,919	37.18
37.26	384	8.27	37.26	—	—
37.58	355,000	8.19	37.58	118,215	37.58
37.66	35,726	7.87	37.66	23,829	37.66
38.15	782,898	7.83	38.15	522,193	38.15
38.72	768	7.86	38.72	512	38.72
39.29	3,457	7.96	39.29	2,306	39.29
39.70	1,921	7.80	39.70	1,281	39.70
39.86	12,293	8.01	39.86	4,094	39.86
	1,828,337	6.84	$ 34.63	1,268,520	$ 33.22

As of June 4, 1998, the date of the Merger, options ceased to be granted under the Avalon 1995 Incentive Plan. Accordingly, there were no options to purchase shares of Common Stock available for grant under the Avalon 1995 Incentive Plan at December 31, 1999 or 1998. Options to purchase 561,232 shares of Common Stock were available for grant under the Avalon 1995 Incentive Plan at December 31, 1997.

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its Plans. Accordingly, no compensation expense has been recognized for the stock option portion of the stock-based compensation plan. Had compensation expense for the Company's stock option plan been determined based on the fair value at the grant date for awards under the Plan consistent with the methodology prescribed under SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income and earnings per share would have been reduced to the following pro forma amounts (unaudited):

(Dollars in thousands, except per share data)

	Pro Forma		
	Year ended 12-31-99	Year ended 12-31-98	Year ended 12-31-97
Income before extraordinary items	**$ 171,748**	$ 121,198	$ 65,505
Net income	**$ 171,748**	$ 120,953	$ 64,322
Income before extraordinary item per common share—basic	**$ 2.01**	$ 1.82	$ 1.62
Income before extraordinary item per common share—diluted	**$ 2.00**	$ 1.80	$ 1.61
Net income per share—basic	**$ 2.01**	$ 1.82	$ 1.57
Net income per share—diluted	**$ 2.00**	$ 1.79	$ 1.56

The fair value of the options granted during 1999 is estimated at $3.40 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 6.10%, volatility of 17.04%, risk free interest rates of 5.54%, actual number of forfeitures, and an expected life of approximately 3 years. The fair value of the options granted during 1998 is estimated at $3.72 per share on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield of 5.96%, volatility of 16.77%, risk free interest rates of 5.55%, actual number of forfeitures, and an expected life of approximately 3 years. The fair value of the options granted during 1997 is estimated at $5.13 per share on the date of grant using the Binomial option pricing model with the following assumptions: dividend yield ranging from 5.0% to 5.5%, volatility factor of the expected market price of the Company's Common Stock of .142, risk free interest rate ranging from 5.8% to 6.7% and a weighted-average expected life of the options of 8 years.

In connection with the Merger, the Company adopted the 1996 Non-Qualified Employee Stock Purchase Plan, as amended and restated (the "1996 ESP Plan"). The primary purpose of the 1996 ESP Plan is to encourage Common Stock ownership by eligible directors, officers and associates (the "Participants") in the belief that such ownership will increase each Participant's interest in the success of the Company. Until January 1, 2000, the 1996 ESP Plan provided for two purchase periods per year. A purchase period was a six month period beginning each January 1 and July 1 and ending each June 30 and December 31, respectively. Beginning on January 1, 2000, there will be one purchase period per year, which will begin May 1 and end October 31. Participants may contribute portions of their compensation during a purchase period and purchase Common Stock at the end thereof. One million shares of Common Stock are reserved for issuance under the 1996 ESP Plan. Participation in the 1996 ESP Plan entitles each Participant to purchase Common Stock at a price which is equal to the lesser of 85% of the closing price for a share of stock on the first day of such purchase period or 85% of the closing price on the last day of such purchase period. The Company issued 35,408 and 23,396 shares under the 1996 ESP Plan for the two purchase periods during the years ending December 31, 1999 and 1998, respectively.

12. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following summary represents the quarterly results of operations for the years ended December 31, 1999 and 1998:

	Three months ended			
1999	March 31	June 30	September 30	December 31
Total revenue	$ 118,632	$ 122,822	$ 130,747	$ 132,343
Net income available to common stockholders	$ 6,355	$ 52,977	$ 24,336	$ 48,829
Net income per common share—basic	$ 0.10	$ 0.81	$ 0.37	$ 0.74
Net income per common share—diluted	$ 0.10	$ 0.80	$ 0.37	$ 0.73

	Three months ended			
1998	March 31	June 30	September 30	December 31
Total revenue	$ 56,370	$ 77,297	$ 118,129	$ 119,607
Net income available to common stockholders	$ 13,955	$ 13,815	$ 22,089	$ 45,544
Net income per common share—basic	$ 0.43	$ 0.33	$ 0.34	$ 0.71
Net income per common share—diluted	$ 0.42	$ 0.32	$ 0.34	$ 0.70

The sum of the quarterly net income per common share, basic and diluted, for 1998 are not equal to the full year amounts primarily because of fluctuations in quarterly net income during the year.

13. SUBSEQUENT EVENTS

During January 2000, the Company sold one community, Avalon Chase, a 360 apartment home community located in Marlton, New Jersey. The net proceeds of approximately $29,325 from the sale of this community will be redeployed to development and redevelopment communities. Pending such redeployment, the proceeds from the sale of this community were primarily used to repay amounts outstanding under the Company's Unsecured Facility.

During January 2000, the Company entered into a joint venture agreement with an entity controlled by Multi-Employer Development Partners ("MEDP") to develop Avalon on the Sound, a 412 apartment high rise community in New Rochelle, New York with total capitalized costs estimated to be $93,300. The terms of the limited liability company agreement anticipate a capital structure, after completion of construction, that is comprised of 60% equity and 40% debt. Equity contributions will be funded 25% by the Company and 75% by MEDP. Construction financing that converts to long-term financing following completion will provide the debt capital. Operating cash flow will be distributed 25% to the Company and 75% to MEDP until each receives a 9% return on invested capital. Thereafter, operating cash flow will be distributed equally to the Company and MEDP. Upon a sale to a third party, cash is distributed first to each partner until capital contributions are recovered. Thereafter, sales proceeds are distributed based upon achievement of certain internal rate of return levels ("IRR"). Distributions that result in an IRR to MEDP and the Company of 12-15% are made 40% to the Company and 60% to MEDP. Thereafter, sales proceeds are distributed equally to the Company and MEDP. Following the third year after completion of construction, buy-sell provisions are in effect. The Company will receive construction, development and management fees for services rendered to the joint venture.

Report of Independent Public Accountants

To the Board of Directors and Stockholders of
AvalonBay Communities, Inc.:

We have audited the accompanying consolidated balance sheets of AvalonBay Communities, Inc. (a Maryland corporation, the "Company") and subsidiaries as of December 31, 1999 and 1998 (as revised for 1998—see Note 2), and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended (as revised for 1998—see Note 2). These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of Avalon Properties, Inc. for the year ended December 31, 1997, were audited by other auditors whose report dated January 13, 1998, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AvalonBay Communities, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Vienna, Virginia
March 3, 2000

Market For Registrant's Common Equity and Related Stockholder Matters

Our common stock is traded on the New York Stock Exchange (NYSE) and the Pacific Stock Exchange (PCX) under the ticker symbol AVB. The following table sets forth the quarterly high and low sales prices per share of our common stock on the NYSE for the years ended December 31, 1999 and 1998, as reported by the NYSE. On March 1, 2000, there were 928 holders of record of an aggregate of 65,871,094 shares of our outstanding common stock.

	1999			1998, post merger		
	Sales Price		Dividends	Sales Price		Dividends
	High	Low	Declared	High	Low	Declared
Quarter ended March 31	$ 34.313	$ 30.813	$ 0.51	n/a	n/a	n/a
Quarter ended June 30	$ 37.000	$ 31.000	$ 0.51	n/a	n/a	n/a
Period June 4 through June 30	n/a	n/a	n/a	$ 37.750	$ 35.000	$ 0.51
Quarter ended September 30	$ 35.875	$ 32.563	$ 0.52	$ 38.438	$ 30.500	$ 0.51
Quarter ended December 31	$ 35.000	$ 30.875	$ 0.52	$ 34.313	$ 31.125	$ 0.51

	1998, Avalon prior to merger			1998, Bay prior to merger		
	Sales Price		Dividends	Sales Price		Dividends
	High	Low	Declared	High	Low	Declared
Quarter ended March 31	$ 30.938	$ 27.125	$ 0.39	$ 39.250	$ 36.313	$ 0.42
Period April 1 through June 3	$ 29.250	$ 27.375	n/a	$ 37.875	$ 36.000	n/a

We expect to continue our policy of paying regular quarterly cash dividends. However, dividend distributions will be declared at the discretion of the Board of Directors and will depend on actual funds from operations, our financial condition, capital requirements, the annual distribution requirements under the REIT provisions of the Internal Revenue Code and other factors as the Board of Directors may consider relevant. The Board of Directors may modify our dividend policy from time to time.

We have an optional Dividend Reinvestment and Stock Purchase Plan (DRIP) which provides a simple and convenient method for stockholders to invest cash dividends and optional cash payments in shares of our common stock. All holders of capital stock are eligible to participate in the DRIP, including stockholders whose shares are held in the name of a nominee or broker. These participants in the DRIP may purchase additional shares of common stock by:

- having the cash dividends on all or part of their shares of common stock and preferred stock automatically reinvested;
- receiving directly, as usual, their cash dividends, if and when declared, on their shares of capital stock and investing in the DRIP by making cash payments of not less than $100 or more than $100,000, or such larger amount as we may approve, per quarter; and/or
- investing both their cash dividends and such optional cash payments in shares of common stock.

Common stock acquired pursuant to the DRIP with reinvested dividends may be purchased at a price per share equal to 97% of the closing price on the NYSE for such shares of common stock on the applicable investment date. Common stock purchased with optional cash payments of up to $100,000 per calendar quarter may be purchased at a price per share equal to 100% of the last reported sale price for a share of common stock as reported by the NYSE on the applicable investment date. In addition, common stock purchased with optional cash payments in excess of $100,000 per calendar quarter pursuant to a Request for Waiver may be purchased at a price per share equal to 100% of the average of the daily high and low sales prices of our common stock on the NYSE for the ten trading days immediately preceding the applicable investment date. Generally, no brokerage commissions, fees or service charges are paid by participants in connection with purchases under the DRIP. Stockholders who do not participate in the DRIP continue to receive cash dividends as declared.

Corporate Information

Board of Directors

Bruce A. Choate
Chief Financial Officer
Watson Land Corporation

Michael A. Futterman
Chairman
American Realty Capital

John J. Healy, Jr.
Founder and President
Hyde Street Holdings, Inc.

Gilbert M. Meyer
Chairman of the Board
AvalonBay Communities, Inc.

Richard L. Michaux
Chief Executive Officer and President,
AvalonBay Communities, Inc.

Richard W. Miller
Former Senior Executive Vice President
and Chief Financial Officer,
AT&T

Brenda J. Mixson
Chief Financial Officer,
First Union Real Estate Equity
and Mortgage Investments

Lance R. Primis
Chairman,
PressPoint, Inc.

Allan D. Schuster
Private Investor

Officers

Gilbert M. Meyer
Executive Chairman

Richard L. Michaux
Chief Executive Officer and President

Bryce Blair
Chief Operating Officer

Roberth H. Slater
Executive Vice President

Thomas J. Sargeant
Executive Vice President,
Chief Financial Officer

Samuel B. Fuller
Senior Vice President,
Development and Construction

James R. Liberty
Senior Vice President,
Construction Operations

Timothy J. Naughton
Senior Vice President,
Chief Investment Officer

Charlene Rothkopf
Senior Vice President,
Human Resources

Gwyneth Jones Coté
Regional Vice President,
Property Operations

Lili F. Dunn
Regional Vice President,
Investments

Leo S. Horey
Regional Vice President,
Property Operations

Daniel E. Murphy
Regional Vice President,
Development

Miguel Azua
Vice President,
Controller

David W. Bellman
Vice President,
Construction

Matthew H. Birenbaum
Vice President,
Development

K. Scott Davis
Vice President,
Development

Mark Forlenza
Vice President,
Development

Frederick S. Harris
Vice President,
Development

Dirk Herrman
Vice President,
Chief Marketing Officer

David L. Kirzinger
Vice President,
Development

Lyn Lansdale
Vice President,
Ancillary Services

Joanne M. Lockridge
Vice President,
Finance

William M. McLaughlin
Vice President,
Development

Len J. Moreau
Vice President,
Construction

Rick Morris
Vice President,
Construction

Edward M. Schulman
Vice President,
General Counsel

Timothy J. Stanley
Vice President,
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Gary Steinfield
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Charlotte, North Carolina

Form 10-K

A copy of the Company's annual report on Form 10-K filed with the Securities and Exchange Commission may be obtained without charge by writing:

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Stock Listings

NYSE – AVB
PCX – AVB

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Visit our Web site to learn more about AvalonBay. You can tour our newest apartment home communities, access recent news and review our latest financial results.

AvalonBay COMMUNITIES, INC.

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