ASSOCIATED ESTATES REALTY CORP
Form 10-K
February 28, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

[x] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2006**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to ____Commission File Number 1-12486

Associated Estates Realty Corporation

(Exact name of registrant as specified in its charter)

Ohio	34-1747603
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1 AEC Parkway, Richmond Heights, Ohio	44143-1467
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (216) 261-5000

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Shares, without par value	New York Stock Exchange, Inc.
Depositary Shares, each representing 1/10 of a Share of 8.70% Class B Series II Cumulative Redeemable Preferred Shares, without par value	New York Stock Exchange, Inc.

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirement for the past 90 days. Yes [x] No [ ]

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ]

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, was $172.4 million as of June 30, 2006.

The number of Common Shares outstanding as of February 23, 2007 was 17,262,567.

DOCUMENTS INCORPORATED BY REFERENCE (To The Extent Indicated Herein)

Notice of Annual Meeting and Proxy Statement for the Annual Meeting of Shareholders to be held on May 2, 2007 (in Part III).

ASSOCIATED ESTATES REALTY CORPORATION

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PART I

Except as the context otherwise requires, all references to "we", "our", "us" and the "Company" in this report collectively refer to Associated Estates Realty Corporation ("AERC") and its consolidated subsidiaries.

Item 1. Business

GENERAL DEVELOPMENT OF BUSINESS

We are a self-administered and self-managed equity real estate investment trust ("REIT"). We are publicly traded on the New York Stock Exchange ("NYSE") under the ticker symbol "AEC". Our headquarters is located at 1 AEC Parkway in Richmond Heights, Ohio. The headquarters is comprised of one office building of approximately 41,000 square feet and an adjacent 3.7 acre parcel of land suitable for further development or expansion, both of which we own under a ground lease.

We are a fully integrated multifamily real estate company engaged in property acquisition, advisory, development, management, disposition, operation and ownership activities. We own three taxable REIT subsidiaries that provide management and other services to us and to third parties (collectively the "Service Companies"). As of December 31, 2006, we owned or property managed 99 apartment communities in nine states consisting of 20,558 units. See Item 2 for a state-by-state listing of our portfolio. We own, either directly or indirectly through subsidiaries, or hold ownership interests in 66 of the 99 apartment communities containing 15,355 units in eight states. Twelve of those owned or partially owned apartment communities, consisting of 1,254 units, are Affordable Housing communities. We also property manage 33 communities in which we do not have an ownership interest, consisting of 5,203 units. Additionally, we asset manage a 186-unit apartment community and one commercial property containing approximately 145,000 square feet. Large pension funds, non-profit organizations, and affiliated or non-affiliated third parties own the managed properties. In January 2007, we assumed property management responsibilities for a 200-unit Affordable Housing property located in Pennsylvania. In February 2007 we completed the sale of a 120-unit congregate care property located in Northeast Ohio. Our consolidated financial statements include the accounts of all subsidiaries and qualified REIT subsidiaries, which include but are not limited to, separate legal entities that were formed in connection with project specific, nonrecourse mortgage refinancing for which records, books of accounts and depository accounts must be maintained separately and apart from any other person or entity; the Service Companies, each of which is taxed as a Taxable REIT Subsidiary ("TRS") under the REIT Modernization Act ("RMA") implemented in 1999, certain variable interest entities of which we are the primary beneficiary and holder of a majority voting interest, and an Operating Partnership structured as a DownREIT, of which we own 97.4%.

BUSINESS SEGMENTS

We have four reportable segments: (1) Acquisition/Disposition multifamily properties, (2) Same Community Market-Rate ("Market-Rate") multifamily properties, (3) Affordable Housing multifamily properties, and (4) Management and Service Operations. We have identified these segments based upon types of property and services. All of our segments are located in the United States.

See Note 19 of the Notes to the Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 10-K for the segment financial information.

Acquisition/Disposition. The Acquisition/Disposition properties represent acquired or developed properties which have not yet reached stabilization (we consider a property stabilized when its occupancy rate reaches 93.0% and we have owned the property for one year) and properties that have been sold or are classified as held for sale in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

Market-Rate. The Market-Rate properties are wholly owned conventional multifamily residential properties that we have owned for the entirety of the comparison periods.

Affordable Housing. The Affordable Housing properties are multifamily properties for which the rents are subsidized and certain aspects of the operations are regulated by U.S. Department of Housing and Urban Development ("HUD") in compliance with Section 8 of the National Housing Act of 1937.

Management and Service Operations. The Management and Service Operations provide management and advisory services to the Acquired, Market-Rate and Affordable Housing properties that we own or have an investment in, as well as to non-owned properties that we manage. This segment also includes the results from our painting subsidiary, Merit Painting Services.

OPERATING STRATEGY AND BUSINESS OBJECTIVES

See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report on Form 10-K for additional discussion of 2007 outlook and strategy.

Acquisition/Disposition. Our objective is to systematically migrate our portfolio to higher growth markets such as Florida, Atlanta, and the Baltimore/Washington, DC/Northern Virginia corridor, and to reduce the number of markets in which we operate. In doing so, we expect to continue to sell non-core properties located in the Midwest while evaluating potential acquisition opportunities in the markets noted above and other markets that we believe will offer an acceptable return on our investment. We continually monitor the profitability of all of our properties and therefore we may also consider opportunistic sales of properties in any market, including our targeted growth markets, if we determine that the proceeds from such sales would provide a greater return on equity and increased cash flow when invested in other properties or used to reduce debt or repurchase our shares. During 2006, we sold eight properties totaling 2,040 units, seven of which were located in Ohio and one property located in North Carolina, which was the only property that we owned or managed in that market. Strong competition for the acquisition of apartment communities in our targeted growth markets during 2006 resulted in acquisition prices that did not meet our investment criteria, thus impeding our ability to execute new property acquisitions. During 2007, we expect to sell five properties located in Ohio and the one property we own in Texas, and reinvest the sale proceeds in the higher growth markets that we have identified, provided we are able to acquire properties in accordance with our investment criteria and to pay off debt.

Property Operations: Market-Rate Properties. We operate in many different markets and sub-markets. Each of these markets may have economic characteristics that differ from other markets, and as a result, the degree to which we can increase rents may vary between markets. However, our goal is to maximize Market-Rate property operating income in all of our markets through a combination of increasing net collected rents and by continual efforts to contain controllable operating expenses. Strategies to increase rents include constant monitoring of our markets, providing superior resident service and desirable communities in which to live, and the implementation of new programs such as utility and refuse reimbursements. Our AEC Academy for Career Development provides training and support for our employees, which we believe results in high quality personnel at the communities and aids in employee retention. Additionally, we attempt to minimize controllable operating expenses through strategies such as the negotiation of centralized purchasing contracts benefitting multiple properties and through diligent upkeep and regular maintenance at our apartment communities.

Property Operations: Affordable Housing Properties. We wholly own 11 Affordable Housing properties comprised of 1,146 units, which have been part of the portfolio since 1993. While these properties' rent growth is limited, due to regulatory restrictions, they have provided a stabilizing influence on the portfolio. We have developed detailed systems and processes to effectively operate these properties, which by their nature, exist within a complex, highly regulated environment. Economic efficiencies are realized in conjunction with the management of another 30 Affordable Housing properties (4,804 units) owned by third parties and one property (108 units) in which we are a joint venture partner.

Fee Management/Advisory Business. We apply our management approach to the management of properties for third parties. We believe that third party property management broadens our knowledge of a market, creates opportunities for future acquisitions, enhances purchasing power and provides a network for new personnel while at the same time generating fee income.

Financing and Capital. Our overall investment goal is to maximize the return on our investments in order to increase shareholder value. Proceeds received from new debt, debt refinancing, property sales, or equity issuances are invested based upon the expected return and the impact on our balance sheet. The reduction of overall interest costs and an increase in the number of unencumbered assets are two of our objectives. During 2006, we focused on reducing our total debt in order to reduce our debt to real estate assets ratio (on an undepreciated basis). We believe that this is an important measure of our long term liquidity. Proceeds received from debt refinancings and the sale of eight properties in 2006 and one property at the end of 2005 were used to defease/prepay 19 mortgage loans totaling $201.8 million, pay $14.4 million in related defeasement and other prepayment costs, and to repurchase $10.2 million of our common shares. Our ratio of total debt to real estate assets (on an undepreciated basis) was reduced to 56.8% at December 31, 2006 compared to 60.7% at December 31, 2005. We expect to further reduce this ratio during 2007. We estimate the fair value of our unencumbered assets at December 31, 2006 to currently be in excess of $200.0 million. Additionally, in January 2007, we prepaid a $15.2 million mortgage loan and incurred $1.6 million in related prepayment costs. We estimate the fair value of this asset to be approximately $29.0 million.

INCOME TAXES

See Note 1 of the Notes to the Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 10-K.

COMPETITIVE CONDITIONS

See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report on Form 10-K.

CUSTOMERS

Our business, taken as a whole, is not dependent upon any single customer or a few customers.

EMPLOYEES

At February 21, 2007, we employed approximately 650 people. Satisfactory relations have generally prevailed between us and our employees.

AVAILABLE INFORMATION

Shareholders may obtain, free of charge from our Internet site at http://www.aecrealty.com, a copy of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act of 1934, as amended, as soon as reasonably practicable after we file such material electronically with, or furnish it to, the Securities and Exchange Commission ("SEC").

REPORTS TO SECURITY HOLDERS

We issue annual reports to our security holders which contain financial statements.

Item 1A. Risk Factors

We are subject to certain risks and uncertainties as described below. These risks and uncertainties are not the only ones we face and there may be additional risks that we do not presently know of or that we currently consider immaterial. All of these risks could adversely affect our business, financial condition, results of operations and cash flows. Our ability to pay dividends on, and the market price of, our equity securities may be adversely affected if any of such risks are realized.

We are subject to risks inherent in the ownership of real estate. We own and manage multifamily apartment communities that are subject to varying degrees of risk generally incident to the ownership of real estate. Our financial condition, the value of our properties and our ability to make distributions to our shareholders will be dependent upon our ability to operate our properties in a manner sufficient to generate income in excess of operating expenses and debt service charges, which may be affected by the following risks, some of which are discussed in more detail below:

- changes in the economic climate in the markets in which we own and manage properties, including interest rates, our ability to consummate the sale of properties pursuant to our current plan, the overall level of economic activity, the availability of consumer credit and mortgage financing, unemployment rates and other similar factors;
- a lessening of demand for the multifamily units that we own or manage;
- competition from other available multifamily units and changes in market rental rates;
- increases in property and liability insurance costs;
- unanticipated increases in real estate taxes and other operating expenses (e.g., cleaning, utilities, repair and maintenance costs, insurance and administrative costs, security, landscaping, staffing and other general costs);
- weather conditions that adversely affect operating expenses;
- expenditures that cannot be anticipated, such as utility rate and usage increases, unanticipated repairs and real estate tax valuation reassessments or millage rate increases;
- our inability to control operating expenses or achieve increases in revenue;
- the results of litigation filed or to be filed against us;

changes in tax legislation;

risks of personal injury claims and property damage related to mold claims because of diminished insurance coverage;

catastrophic property damage losses that are not covered by our insurance;

risks associated with property acquisitions such as environmental liabilities, among others;

changes in government regulations affecting properties the rents of which are subsidized and certain aspects of which are regulated by the United States Department of Housing and Urban Development ("HUD") and other properties we own;

- our inability to renew current contracts with HUD for rent-subsidized properties at existing rents;
- changes in or termination of contracts relating to our third party management and advisory business;
- risks related to our joint ventures;
- the perception of residents and prospective residents as to the attractiveness, convenience and safety of our properties or the neighborhoods in which they are located; and

our ability to acquire properties at prices consistent with our investment criteria.

We are dependent on rental income from our multifamily apartment communities. If we are unable to attract and retain residents or if our residents are unable to pay their rental obligations, our financial condition and funds available for distribution to our shareholders will be adversely affected.

Our multifamily apartment communities are subject to competition. Our apartment communities are located in developed areas that include other apartment communities. Our apartment communities also compete with other housing alternatives, such as condominiums, single and multifamily rental homes and owner occupied single and multifamily homes, in attracting residents. In certain markets, such as Florida, failed condominium conversions are reverting back to apartment rentals creating increasing competition in those markets. Such competition may affect our ability to attract and retain residents and to increase or maintain rental rates.

The properties we own are primarily concentrated in Ohio, Michigan, Indiana, Maryland, Pennsylvania, Florida and Georgia. As of December 31, 2006, approximately 50%, 20%, 6%, 5%, 3%, 9% and 6% of the units in properties we own are located in Ohio, Michigan, Indiana, Maryland, Pennsylvania, Florida and Georgia, respectively. Our performance, therefore, is linked to economic conditions and the market for available rental housing in these states and, more importantly, their respective sub-markets. The decline in the market for apartment housing in the various sub-markets in Ohio, or to a lesser extent, the sub-markets in the other states, may adversely affect our financial condition, results for third parties of operations and ability to make distributions to our shareholders.

We own or manage properties that are subject to government programs. As of December 31, 2006, we own directly or through subsidiaries or joint ventures 12 properties with 1,254 units and manage, for third parties with one or more of our affiliates, 29 properties with approximately 4,604 units, which benefit from some form of interest rate or rental subsidy subject to governmental programs administered by HUD. As a condition to the receipt of assistance under HUD programs, many of the properties must comply with various HUD requirements, which typically include maintenance of decent, safe and sanitary housing, HUD approval of rent adjustments, and, in the case of a HUD insured mortgage, approval of a transfer of the property. We can give no assurance that we will be able to renew current agreements with HUD at existing or higher rents. HUD requirements, and other current and future laws regarding the provision of affordable housing and any changes to existing law making it more difficult to meet such requirements, could adversely affect our results of operations, financial condition and ability to make distributions to our shareholders.

Our insurance may not be adequate to cover certain risks. There are certain types of risks, generally of a catastrophic nature, such as earthquakes, floods, windstorms, act of war and terrorist attacks that may be uninsurable, or are not economically insurable, or are not fully covered by insurance. Moreover, certain risks, such as mold and environmental exposures, generally are not covered by our insurance. Any such uninsured loss could have a material adverse effect on our business, financial condition and results of operations.

Debt financing could adversely affect our performance. A majority of our assets are encumbered by project specific, non-recourse, and except for five properties non-cross-collateralized mortgage debt. There is a risk that these properties may not have sufficient cash flow from operations to pay required principal and interest. We may not be able to refinance these loans at an amount equal to the loan balance and the terms of any refinancing may not be as favorable as the terms of existing indebtedness. If we are unable to make required payments on indebtedness that is secured by a mortgage, the property securing the mortgage may be foreclosed with a consequent loss of income and value to us.

Real estate investments are generally illiquid, and we may not be able to sell our properties when it is economically or strategically advantageous to do so. Real estate investments generally cannot be sold quickly, and our ability to sell properties may be affected by market conditions. We may not be able to diversify or vary our portfolio promptly in accordance with our strategies or in response to economic or other conditions. In addition, provisions of the Internal Revenue Code of 1986, as amended (the "Code") limit the ability of a REIT to sell its properties in some situations when it may be economically advantageous to do so, thereby potentially adversely affecting our ability to make distributions to our shareholders.

Our access to public debt markets is limited. Substantially all of our debt financings are secured by mortgages on our properties because of our limited access to public debt markets.

Revenue from third party management may further decline. We could lose a significant portion of our third party management revenue if a client failed to renew or terminated our management agreements. Sixty-seven percent of the properties we manage for third parties are owned or controlled by a single client. The asset advisory and property management contracts with pension funds and non-affiliated third party owners are generally terminable upon 30 days notice.

Litigation that may result in unfavorable outcomes. Like many real estate operators, we are frequently involved in lawsuits involving premises liability claims, housing discrimination claims and alleged violations of landlord-tenant laws, which may give rise to class action litigation or governmental investigations. Any material litigation not covered by insurance, such as a class action, could result in substantial costs being incurred.

Our financial results may be adversely impacted if we are unable to sell properties and employ the proceeds in accordance with our strategic plan. Our ability to pay down debt, reduce our interest costs, buy back stock and acquire properties is impacted by our ability to sell the properties we have selected for disposition at the prices and within the deadlines we have established for each respective property. Moreover, if we are unable to acquire properties at prices consistent with our investment criteria, we may reduce or discontinue selling properties.

The costs of complying with laws and regulations could adversely affect our cash flow and ability to make distributions to our shareholders. Our properties must comply with Title III of the Americans with Disabilities Act (the "ADA") to the extent that they are "public accommodations" or "commercial facilities" as defined in the ADA. The ADA does not consider apartment communities to be public accommodations or commercial facilities, except for portions of such communities that are open to the public. In addition, the Fair Housing Amendments Act of 1988 (the "FHAA") requires apartment communities first occupied after March 13, 1990, to be accessible to the handicapped. Other laws also require apartment communities to be handicap accessible. Noncompliance with these laws could result in the imposition of fines or an award of damages to private litigants. We have been subject to lawsuits alleging violations of handicap design laws in connection with certain of our developments. If compliance with these laws involves substantial expenditures or must be made on an accelerated basis, our ability to make distributions to our shareholders could be adversely affected.

Under various federal, state and local laws, an owner or operator of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances on, under or in the property. This liability may be imposed without regard to whether the owner or operator knew of, or was responsible for, the presence of the substances. Other law imposes on owners and operators certain requirements regarding conditions and activities that may affect human health or the environment. Failure to comply with applicable requirements could complicate our ability to lease or sell an affected property and could subject us to monetary penalties, costs required to achieve compliance and potential liability to third parties. We are not aware of any material noncompliance, liability or claim relating to hazardous or toxic substances or other environmental matters in connection with any of our properties. Nonetheless, it is possible that material environmental contamination or conditions exist, or could arise in the future in the apartment communities or on the land upon which they are located.

We are subject to the risks associated with investments through joint ventures. Two of our properties are owned by joint ventures in which we do not have a controlling interest. We may enter into joint ventures, including joint ventures that we do not control, in the future. Any joint venture investment involves risks such as the possibility that the co-venturer may seek relief under federal or state insolvency laws, or have economic or business interests or goals that are inconsistent with our business interests or goals. While the bankruptcy or insolvency of our co-venturer generally should not disrupt the operations of the joint venture, we could be forced to purchase the co-venturer's interest in the joint venture or the interest could be sold to a third party. We also may guarantee the indebtedness of our joint ventures. If we do not have control over a joint venture, the value of our investment may be affected adversely by a third party that may have different goals and capabilities than ours.

We are subject to risks associated with development, acquisition and expansion of multifamily apartment communities. Development projects and acquisitions and expansions of apartment communities are subject to a number of risks, including:

- availability of acceptable financing;
- competition with other entities for investment opportunities;
- failure by our properties to achieve anticipated operating results;
- construction costs of a property exceeding original estimates;
- delays in construction; and
- expenditure of funds on, and the devotion of management time to, transactions that may not come to fruition.

We may fail to qualify as a REIT and you may incur tax liability as a result. Commencing with our taxable year ending December 31, 1993, we have operated in a manner so as to permit us to qualify as a REIT under the Code, and we intend to continue to operate in such a manner. Although we believe that we will continue to operate as a REIT, no assurance can be given that we will remain qualified as a REIT. If we were to fail to qualify as a REIT in any taxable year, we would not be allowed a deduction for distributions to our shareholders in computing our taxable income and would be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates. Unless we are entitled to relief under certain Code provisions, we also would be disqualified from treatment as a REIT for the four taxable years following the year during which REIT qualification was lost. As a result, the cash available for distribution to our shareholders could be reduced or eliminated for each of the years involved.

Our ownership limit may discourage takeover attempts. With certain limited exceptions, our Second Amended and Restated Articles of Incorporation, as amended and supplemented to date, prohibit the ownership of more than 4.0% of the outstanding common shares and more than 9.8% of the shares of any series of any class of our preferred shares by any person. These restrictions are likely to have the effect of precluding acquisition of control of us without our consent even if a change in control is in the interests of shareholders.

We are subject to control by our directors and officers. Our directors and executive officers and some members of their respective families owned approximately 18.0% of our common shares as of December 31, 2006. Accordingly, those persons have substantial influence over us and the outcome of matters submitted to our shareholders for approval.

We depend on our key personnel. Our success depends to a significant degree upon the continued contribution of key members of our management team, who may be difficult to replace. The loss of services of these executives could have a material adverse effect on us. There can be no assurance that the services of such personnel will continue to be available to us. Mr. Jeffrey I. Friedman, Associated Estates' Chairman of the Board, President and Chief Executive Officer, is a party to an employment agreement with Associate Estates. We do not hold key-man life insurance on any of our key personnel.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our Portfolio. The following table represents our portfolio as of December 31, 2006, which consists of properties we owned, directly or indirectly, properties in which we are a joint venture partner and properties we manage.

	Total Number of Properties at December 31, 2006	Total Number of Units at December 31, 2006
Wholly Owned Properties		
Market-Rate Properties:		
Florida	3	956
Georgia	2	706
Indiana	3	836
Maryland	3	667
Michigan	11	2,888
Ohio	26	6,029
Pennsylvania	1	468
Texas	1	104
	50	12,654
Affordable Housing Properties:		
Ohio	11	1,146
Acquisition/Disposition Properties:		
Florida	1	316
Georgia	1	168
Ohio	1	120
	3	604
Total wholly owned properties	64	14,404
Joint Ventures:		
Market-Rate Property:		
49.0% owned - Georgia	1	843
Affordable Housing Property:		
50.0% owned - Ohio	1	108
Total joint ventures	2	951

Managed for Pension Fund Clients:		
Market-Rate Properties:		
Colorado	1	258
Managed for Other Third Parties:		
Affordable Housing Properties:		
Florida	2	200
Ohio	23	3,908
Pennsylvania	4	496
	29	4,604
Market-Rate Properties:		
Ohio	3	341
	32	4,945
Total managed properties	33	5,203
Total Portfolio	**99**	**20,558**
Other Properties:		**Units/Square Feet**
Asset Managed for Third Parties:		
Multifamily:		
Texas	1	186
Commercial:		
California	1	145,000
	2	

Wholly Owned and Joint Venture Properties	**Total Number of Units at December 31, 2006**	**Age of Owned Properties at December 31, 2006[(a)]**
Wholly Owned Properties		
Market-Rate Properties:		
Florida		
Courtney Chase	288	3
Cypress Shores	300	15
Windsor Pines	368	8
	956	
Georgia		
The Falls	520	20
Morgan Place	186	17
	706	
Indiana		
Residence at White River	228	15
Steeplechase	264	8
Waterstone Apartments	344	9
	836	
Maryland		
Annen Woods	131	19
Hampton Point	352	20
Reflections	184	21
	667	

Michigan		
Arbor Landings	328	11
Aspen Lakes Apartments	144	25
Central Park Place	216	18
Country Place Apartments	144	17
Clinton Place Apartments	202	18
Georgetown Park Apartments	480	12
Oaks and Woods at Hampton	544	18
The Landings at the Preserve	190	15
Spring Brook Apartments	168	18
Spring Valley Apartments	224	19
Summer Ridge	248	15
	2,888	
Ohio		
St. Andrews at Little Turtle	102	19
Barrington	288	7
Bay Club	96	16
Bedford Commons	112	19
Bradford at Easton	324	10
Country Club Apartments	316	17
The Cloisters	506	16
Hawthorne Hills Apartments	88	33
Heathermoor	280	17

(a) Age of property is determined by subtracting the year the property was built or the year the property was rehabilitated from 2006.

Wholly Owned and Joint Venture Properties	**Total Number of Units at December 31, 2006**	**Age of Owned Properties at December 31, 2006** [(a)]
Wholly Owned Properties		
Ohio (Continued)		
Kensington Grove	76	11
Lake Forest	192	12
Mallard's Crossing	192	16
Muirwood Village at Bennell	164	18
Perimeter Lakes	189	14
Remington Place	234	16
Residence at Christopher Wren	264	13
Residence at Turnberry	216	15
Saw Mill Village	340	19
Sterling Park	128	12
Village at Avon	312	5
North Pointe	949	35

Westchester Townhouses	136	17
Western Reserve	108	8
Westlake Townhouses	7	21
Williamsburg at Greenwood Village	260	16
The Woodlands	150	32
	6,029	
Pennsylvania		
Chestnut Ridge	468	20
Texas		
Fleetwood	104	13
Affordable Housing Properties:		
Ohio		
Ellet	100	28
Puritas Place	100	25
Riverview Towers	98	27
Shaker Park Gardens II	151	42
State Road Apartments	72	29
Statesman II	47	19
Sutliff Apartments	185	27
Tallmadge Acres	125	25
Twinsburg Apartments	100	27
Village Towers	100	27
West High Apartments	68	25
	1,146	

(a) Age of property is determined by subtracting the year the property was built or the year the property was rehabilitated from 2006.

	Total Number of Units December 31, 2006	Age of Owned Properties at December 31, 2006 [(a)]
Acquisition/Disposition Properties:		
Florida		
Vista Lago (Acquired March 2005)	316	3
Georgia		
Cambridge at Buckhead (Acquired October 2005)	168	11
Ohio		
Gates Mills Club (Held for Sale at December 31, 2006)	120	26
Total wholly owned properties	14,404	
Joint Venture Properties		
Market-Rate Property:		
49% Owned - Georgia		
Idlewylde	843	6
Affordable Housing Property:		
50% Owned - Ohio		
Lakeshore Village	108	24

Total joint venture properties	951	

			Anticipated
	Location	**Units**	**Completion**
Undeveloped Land Parcels:		**Acres**	
Aspen Lakes land	Grand Rapids, MI	19.5	On Hold
Landings at the Preserve land	Battle Creek, MI	4.3	On Hold
Westlake land	Westlake, OH	39.0	On Hold
Wyndemere land	Franklin, OH	10.0	On Hold
Total undeveloped land parcels		**72.8**	

(a) Age of property is determined by subtracting the year the property was built or the year the property was rehabilitated from 2006.

Indebtedness Encumbering the Properties. We have financed and, in many cases, refinanced the acquisition, development and rehabilitation of our properties with a variety of sources of mortgage indebtedness. At December 31, 2006, twenty-one of the sixty-four wholly owned properties were unencumbered (eleven of which are Affordable Housing properties and one that was classified as held for sale), thirty-six properties were encumbered by conventional mortgages, five properties were encumbered by cross-collateralized, cross-defaulted mortgage loans, and two properties secured our lines of credit.

Item 3. Legal Proceedings

For information concerning current legal proceedings, see Note 10 of the Notes to Consolidated Financial Statements presented in Part II, Item 8 of this report on Form 10-K.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

Executive Officers of the Registrant and Other Key Employees

The following information regarding our executive officers is provided pursuant to Instruction 3 to Item 401(b) of Regulation S-K.

Name	Age	Position with the Company
Jeffrey I. Friedman	55	Chairman of the Board, President and Chief Executive Officer
Martin A. Fishman	65	Vice President, General Counsel and Secretary
Lou Fatica	40	Vice President, Treasurer and Chief Financial Officer
John T. Shannon	45	Senior Vice President, Operations

Jeffrey I. Friedman has served as our Chairman of the Board and Chief Executive Officer since the Company was organized in 1993 and served as our President from the Company's organization until February 24, 2000. In August 2002, Mr. Friedman reassumed the role of President. Mr. Friedman joined the Company's predecessor, Associated Estates Group, ("AEG"), in 1974 and was the Chief Executive Officer and President of Associated Estates Corporation, a company in the AEG group, from 1979 to 1993.

Martin A. Fishman has been our Vice President, General Counsel and Secretary since the Company's organization. Mr. Fishman joined AEG in 1986 as Vice President - General Counsel of Associated Estates Corporation, a position he held until the formation of the Company.

Lou Fatica joined the Company in 1999 as Controller, and was promoted to Vice President-Controller during 2000. On March 15, 2001, Mr. Fatica became Vice President, Treasurer and Chief Financial Officer of the Company. Mr. Fatica is a Certified Public Accountant (CPA), a member of the American Institute of Certified Public Accountants (AICPA) and the Ohio Society of CPA's.

John T. Shannon joined the Company in 2004 as Senior Vice President, Operations. Mr. Shannon had previously held the position of Vice President of Operations at The Shelter Group and has 17 years of property management experience.

In addition to the officers named in the table above, the following persons have been appointed as officers of the Company and hold positions in senior management as indicated:

Patrick Duffy joined the Company in 2005 as Vice President of Strategic Marketing. Mr. Duffy plays a key role in our diversification plan by assisting in identifying markets for asset acquisitions and dispositions. In addition, he is responsible for developing property-specific marketing plans and strategies to assist in maximizing top line revenue growth for our Market-Rate properties, while also assisting with pricing and positioning strategies. Mr. Duffy previously held the position of Senior Vice President of Marketing at The Shelter Group. He graduated from Loyola College and holds a Master's Degree in Administrative Sciences from Johns Hopkins University. Mr. Duffy has over 20 years of experience in the real estate industry and is 45 years old.

Kara Florack joined the Company in 2004 as Director of Compensation, and was promoted to Director of Human Resources in November 2005. In January 2007, she became Vice President of Human Resources. Ms. Florack previously held the position of Assistant Manager of Compensation at Charter One Bank where she worked for 3 years. Ms. Florack has a Bachelor's degree from Boston University and is 31 years old.

Jenee McClain-Bankhead joined the Company in 1994. She is currently a Regional Vice President and is responsible for the Company's Affordable Housing portfolio and related Affordable Housing fee management business. Ms. McClain-Bankhead holds the designations of Certified Financial Manager, Certified Occupancy Specialist and Certified Credit Compliance Professional and is 36 years old.

Miria C. Rabideau joined the Company in 1994 as a Property Manager, and was promoted to Regional Manager in 2003. During 2006, she was promoted to Regional Vice President. Ms. Rabideau is responsible for properties in Colorado, Indiana, Michigan, Northwest Ohio and Texas. Ms. Rabideau has 14 years of asset and property management experience. She has a Bachelor's degree from Michigan State University and is 37 years old.

Beth L. Stoll joined the Company in 2004 as a Regional Vice President, and was promoted to Vice President of Operations during 2006. She is responsible for the Market-Rate properties that we own and manage in Georgia, Maryland, Florida and Central Ohio. Ms. Stoll is also responsible for the AEC Academy for Career Development, which provides training and support for our employees. Ms. Stoll previously held the position of Regional Vice President at The Shelter Group. Ms. Stoll has over 20 years of property management experience and is 51 years old.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common shares are traded on the New York Stock Exchange under the trading symbol "AEC."

The following table sets forth for the periods indicated the high and low closing sale prices per common share as reported on the New York Stock Exchange (composite tape) and the dividends declared per common share.

	Price Range				Dividends Declared Per Share	
	2006		2005		2006	2005
	High	Low	High	Low		
First Quarter	$ 11.56	$ 9.16	$ 10.08	$ 9.69	$ 0.17	$ 0.17
Second Quarter	12.40	10.42	10.00	8.65	0.17	0.17
Third Quarter	15.90	12.50	9.92	9.19	0.17	0.17
Fourth Quarter	16.49	13.59	9.78	8.67	0.17	0.17
					$ 0.68	$ 0.68

On February 21, 2007, there were approximately 980 holders of record of our common shares.

For information concerning security ownership of certain beneficial owners and management and related shareholder matters, reference is made to Part III, Item 12 of this report on Form 10-K.

We maintain a dividend reinvestment plan under which shareholders may elect to reinvest their dividends automatically in our common shares. Under the plan, the administrator of the plan will purchase shares directly from us (either treasury shares or newly-issued common shares), in the open market, or in privately negotiated transactions with third parties on behalf of participating shareholders.

Our Board of Directors has authorized the repurchase of up to $50.0 million of our common and preferred shares. Additionally, we have a policy which allows employees to pay their portion of the payroll taxes related to restricted share vesting by surrendering a number of shares to us equal in value on the day of vesting to the amount of taxes due. The following table sets forth our repurchase activities for the fourth quarter of 2006:

Issuer Purchases of Equity Securities For the Three Months Ended December 31, 2006

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (in thousands)
October 1 through October 31	496	$ 16.11	-	$ 22,433
November 1 through				

November 30	141	$ 14.82	-	$ 22,433
December 1 through				
December 31	-	-	-	$ 22,433
Total	637	$ 15.83	-	

Item 6. Selected Financial Data

The following tables set forth selected financial and other data for us on a consolidated basis. The historical financial information contained in the tables has been derived from and should be read in conjunction with (i) our consolidated financial statements and notes thereto and (ii) Management's Discussion and Analysis of Financial Condition and Results of Operations both included elsewhere herein.

Associated Estates Realty Corporation					
(Dollars in thousands except per share					
amounts and average monthly net collected rent)					
	2006	2005	2004	2003	2002
Operating Data:					
Revenue					
Property revenue	$ 132,994	$ 123,594	$ 116,145	$ 114,325	$ 113,693
Management and service operations:					
Fees, reimbursements and other	11,689	11,723	13,400	14,310	20,472
Painting services	1,078	1,094	6,147	2,827	1,642
Total revenue	145,761	136,411	135,692	131,462	135,807
Total expenses	(118,505)	(111,071)	(106,627)	(106,600)	(107,619)
Interest income	680	638	309	148	320
Interest expense	(51,991)	(40,070)	(36,846)	(36,990)	(36,851)
(Loss) income before gain on disposition of properties and					
land, gain on disposition of investment, equity in net					
loss of joint ventures, gain on sale of partnership interest,					
minority interest, and income from discontinued operations	(24,055)	(14,092)	(7,472)	(11,980)	(8,343)
Gain on disposition of properties and land	-	-	-	-	227
Gain on disposition of investment	-	150	-	-	-
Equity in net loss of joint ventures	(462)	(644)	(923)	(1,157)	(1,627)
Gain on sale of partnership interest	-	-	-	1,314	-
Minority interest in operating partnership	(61)	(63)	(63)	(75)	(324)
(Loss) income from continuing operations	(24,578)	(14,649)	(8,458)	(11,898)	(10,067)
Income from discontinued operations:					
Operating (loss) income	(2,494)	2,319	2,100	985	1,886
Gain on disposition of properties	54,093	48,536	9,682	-	9,660
Income from discontinued operations	51,599	50,855	11,782	985	11,546
Net income (loss)	27,021	36,206	3,324	(10,913)	1,479
Preferred share dividends	(5,046)	(5,130)	(5,805)	(5,484)	(5,485)
Original issuance costs related to redemption of preferred shares	-	(2,163)	-	-	-
Net income (loss) applicable to common shares	$ 21,975	$ 28,913	$ (2,481)	$ (16,397)	$ (4,006)

Earnings per common share - Basic and Diluted:					
(Loss) income from continuing operations applicable to					
common shares	$ (1.74)	$ (1.14)	$ (.73)	$ (.90)	$ (.80)
Income from discontinued operations	3.03	2.65	.60	.05	.59
Net income (loss) applicable to common shares	$ 1.29	$ 1.51	$ (.13)	$ (.85)	$ (.21)
Weighted average number of common shares outstanding	17,023	19,162	19,519	19,401	19,343
Dividends declared per common share	$ .68	$ .68	$ .68	$ .68	$ .92

	2006	2005	2004	2003	2002
Cash flow data:					
Cash flow provided by operations	$ 17,912	$ 24,376	$ 32,935	$ 30,758	$ 32,897
Cash flow provided by (used for) investing activity	73,935	4,421	(12,745)	(11,509)	13,260
Cash flow (used for) provided by financing activity	(101,570)	(50,798)	37,332	(15,937)	(48,421)

Balance Sheet Data at December 31:					
Real estate assets, net	$ 591,520	$ 645,937	$ 665,268	$ 661,585	$ 683,058
Total assets	648,829	719,242	762,917	704,793	735,303
Total debt	498,634	573,570	557,279	543,496	540,498
Total shareholders' equity	112,051	108,980	163,590	121,428	150,865

Other Data:					
Net operating income (a) (c)	$ 68,613	$ 64,645	$ 64,880	$ 60,117	$ 63,974
Total properties (at end of period) - includes joint ventures	66	74	76	78	79
Total multifamily units (at end of period) - includes joint ventures	15,355				