

ESSEX PROPERTY TRUST INC
Form 10-K/A
March 01, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K/A
(Amendment No. 1)

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____
Commission file number 1-13106

Essex Property Trust, Inc
(Exact name of Registrant as Specified in its Charter)

Maryland
(State or Other Jurisdiction of Incorporation or
Organization)

77-0369576
(IRS Employer Identification Number)

925 East Meadow Drive
Palo Alto, California 94303
(Address of Principal Executive Offices including Zip Code)
(650) 494-3700
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

As of June 30, 2011, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$4,357,742,310. The aggregate market value was computed with reference to the closing price on the New York Stock Exchange on such date Shares of common stock held by executive officers, directors and holders of more than ten percent of the outstanding common stock have been excluded from this calculation because such persons may be deemed to be affiliates. This exclusion does not reflect a determination that such persons are affiliates for any other purposes.

As of February 23, 2012, 34,809,580 shares of common stock (\$.0001 par value) were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

The following document is incorporated by reference in Part III of the Annual Report on Form 10-K: Proxy statement for the annual meeting of stockholders of Essex Property Trust, Inc to be held May 15, 2012.

Explanatory Paragraph

This Amendment No. 1 on Form 10-K/A amends and restates the Annual Report on Form 10-K of Essex Property Trust, Inc. for the fiscal year ended December 31, 2011 as originally filed with the Securities and Exchange Commission (the “SEC”) on February 27, 2011 (the “Original Filing”). This Form 10-K/A amends the Original Filing to replace in its entirety the information provided due to the Company’s third-party service provider filing an incorrect version of the Original Filing. The Company has changed the Earnings Per Share Data included on the Consolidated Statements of Operations to include decimal points that were excluded in the Original Filing. In addition, the Company has replaced in its entirety the information previously disclosed in Note 10, “Lease Agreements.”

Except for the changes regarding the decimal points for Earnings Per Share Data and Note 10, as described above, we have not materially modified or updated disclosures presented in the Original Filing in this Form 10-K/A. Accordingly, this Form 10-K/A does not reflect events occurring after the filing of the Original Filing or modify or update those disclosures affected by subsequent events. Information not affected by this amendment remains unchanged and reflects the disclosures made at the time the Original Filing was filed.

Essex Property Trust, Inc
2011 ANNUAL REPORT ON FORM 10-K
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PART I

Forward Looking Statements

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

Item 1 Business

OVERVIEW

Essex Property Trust, Inc. ("Essex" or the "Company") is a Maryland corporation that operates as a self-administered and self-managed real estate investment trust ("REIT"). The Company owns all of its interest in its real estate investments directly or indirectly through Essex Portfolio, L.P. (the "Operating Partnership"). The Company is the sole general partner of the Operating Partnership and as of December 31, 2011 owns a 93.8% general partnership interest. In this report, the terms "Essex" or the "Company" also refer to Essex Property Trust, Inc., its Operating Partnership and the Operating Partnership's subsidiaries.

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

The Company is engaged primarily in the ownership, operation, management, acquisition, development and redevelopment of predominantly apartment communities. As of December 31, 2011, the Company owned or held an interest in 159 communities, aggregating 32,753 units, located along the West Coast, as well as five commercial buildings (totaling approximately 315,900 square feet), and five active development projects with 1,235 units in various stages of development (collectively, the "Portfolio").

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

BUSINESS STRATEGIES

The following is a discussion of the Company's business strategies in regards to real estate investment and management

Business Strategies

Research Driven Approach –

The Company believes that successful real estate investment decisions and portfolio growth begin with extensive regional economic research and local market knowledge.

Utilizing a proprietary research model that the Company has developed over the last three decades, the Company continually assesses markets where the Company operates, as well as markets where the Company considers future investment opportunities by evaluating the following:

- Focus on markets in major metropolitan areas that have regional population in excess of one million;
- Constraints on new supply driven by: (i) low availability of developable land sites where competing housing could be economically built; (ii) political growth barriers, such as protected land, urban growth boundaries, and potential lengthy and expensive development permit processes; and (iii) natural limitations to development, such as mountains or waterways;

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- Rental demand is enhanced by affordability of rents relative to costs of for-sale housing; and
- Housing demand that is based on proximity to jobs, high median incomes, the quality of life and related commuting factors, as well as potential job growth

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

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

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

CURRENT BUSINESS ACTIVITIES

Acquisitions of Real Estate

Acquisitions are an important component of the Company’s business plan, and during 2011, the Company acquired ownership interest in eleven communities totaling \$533 million. The following is a summary of its 2011 acquisitions:

- 1) In March, the Company acquired Santee Village, a 73-unit vacant condominium community that is operated as a rental community located in downtown Los Angeles for \$17.0 million. This community is adjacent to Santee Court apartments which the Company acquired in 2010.
- 2) Also in March, the Company purchased 1000 Kiely (formerly Family Tree Apartments), a 121-unit garden-style community located in Santa Clara, California for \$31.4 million.
- 3) In June, the Company acquired Bellerive, a recently constructed 63-unit vacant condominium project that is operated as a rental community located in West Los Angeles for \$27.0 million.
- 4) In May, the Company entered into a 50/50 programmatic joint venture, Wesco I, LLC (“Wesco I”), with an institutional partner for a total equity commitment of \$200 million. Wesco I’s first acquisition was Arbors at Parc Rose, a 373-unit community located in Oxnard, California, for \$92.0 million.
- 5) In July, Wesco I acquired Reveal (formerly Millennium at Warner Center), a 438-unit community located in the Canoga Park area of Los Angeles. The property, which was completed in 2010, was acquired for \$132.9 million.
- 6)

In September, the Company acquired the Bernard, a 63-unit community located in the Lower Queen Anne district of Seattle, Washington for \$13.8 million.

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- 7) In September, Wesco I acquired Redmond Hill East and Redmond Hill West, a group of communities built between 1985 and 2003 totaling 882-units in Redmond, Washington. The properties are operated as two separate communities and the total purchase price was \$151.3 million.
- 8) In November, Wesco I acquired Briarwood for \$27.8 million. The property is a 160-unit community located in Fremont, California that was built in 1979.
- 9) Also in November, Wesco I acquired The Woods for \$25.2 million. The property is a 160-unit community built in 1978 and located less than a half mile from Briarwood, in Fremont, California.
- 10) In December, the Company acquired Delano, a 66-unit community located in Redmond, Washington for \$14.1 million.

Dispositions of Real Estate

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

During 2011, the Company sold one apartment community, Woodlawn Colonial, and one office building, Clarendon for a total of \$23.4 million resulting in a gain of \$8.4 million.

Marketable Securities

During the year ended December 31, 2011, the proceeds from sales of available for sale securities totaled \$33.0 million, which resulted in gains, which totaled \$5.0 million.

Development Pipeline

The Company defines development activities as new communities that are in various stages of active development, or the community is in lease-up and phases of the project are not completed. As of December 31, 2011, the Company had five joint venture development projects comprised of 1,235 units for an estimated cost of \$422.6 million, of which \$282.6 million remains to be expended.

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

Development Pipeline	Location	Ownership		Units	As of 12/31/11 (\$ in millions)		
					Incurred Project Cost	Estimated Remaining Cost	Estimated Project Cost(1)
Development Projects - Joint Venture							
Queen Anne	Seattle, WA	50	%	275	\$ 33.5	\$ 45.6	\$ 79.1
Epic (formerly Cadence) Phase I	San Jose, CA	55	%	280	36.7	61.9	98.6
West Dublin	Dublin, CA	55	%	309	23.1	71.4	94.5
Fountain at La Brea	West Hollywood,	50	%	187	27.0	48.0	75.0

	CA						
	West						
Santa Monica at La Brea	Hollywood, CA	50	%	184	19.7	55.7	75.4
				1,235	140.0	\$ 282.6	\$ 422.6
Predevelopment project - joint venture	San Jose, CA	55	%	481	42.8		
Land held for future development or sale	various			298	44.3		
Development Pipeline				2,014	\$ 227.1		

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

The Company defines the predevelopment pipeline as proposed communities in negotiation or in the entitlement process with a high likelihood of becoming entitled development projects. As of December 31, 2011, the Company had one joint venture development project aggregating 481 units that was classified as a predevelopment project, with cost incurred of \$42.8 million. The Company may also acquire land for future development purposes or sale. The Company had incurred \$44.3 million in costs related to land held for future development or sale aggregating 298 units as of December 31, 2011.

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Redevelopment Pipeline

The Company defines redevelopment communities as existing properties owned or recently acquired, which have been targeted for additional investment by the Company with the expectation of increased financial returns through property improvement. During redevelopment, apartment units may not be available for rent and, as a result, may have less than stabilized operations. As of December 31, 2011, the Company had ownership interests in six redevelopment communities aggregating 1,444 apartment units with estimated redevelopment costs of \$96.4 million, of which approximately \$43.1 million remains to be expended.

Secured Debt

During 2011, the Company paid off construction loans, tax-exempt bonds, and mortgage loans totaling \$116.1 million with an average interest rate of 3.3%, and obtained fixed rate secured mortgage loans totaling \$51.9 million with an average interest rate of 5.4%. In conjunction with obtaining the new mortgage loans, the Company settled the remaining \$20.0 million of forward-starting swap contracts which increased the average effective interest rate of the new mortgage loans to 6.2%.

Unsecured Debt

During 2011, the Company issued \$265.0 million of unsecured bonds through private placement offerings, \$150.0 million at 4.4% with a maturity date of March 2016, \$40.0 million at 4.5% with a maturity date of September 2017, and \$75.0 million at 4.92% with a maturity date of December 2019. The proceeds from the bond offerings were used primarily to repay outstanding mortgages, redeem the Series F Preferred Stock, and pay down the Company's line of credit. During the fourth quarter of 2011, the Company closed a five-year, \$200 million unsecured term loan. The term loan has a variable interest rate of LIBOR plus 1.425%. In conjunction with this transaction the Company has entered into interest rate swap contracts for a term of five years with a total notional amount of \$150 million. The interest rate swaps effectively convert the borrowing rate on \$150 million of the \$200 million variable rate unsecured term to a fixed rate of 2.66%.

Lines of Credit

The Company entered into a new unsecured line of credit agreement during the third quarter of 2011 which has a \$425.0 million limit with an accordion option to \$500.0 million. As of December 31, 2011 there was a \$150.0 million balance on this unsecured line. The underlying interest rate on the \$425.0 million line is based on a tiered rate structure tied to Fitch and S&P ratings on the credit facility and the rate was LIBOR plus 1.25% as of December 31, 2011. This facility matures in December 2014 with two one-year extensions, exercisable by the Company.

The Company also had a \$250.0 million credit facility from Freddie Mac, which was secured by eleven apartment communities. The Company terminated the line of credit in the fourth quarter of 2011 and accordingly wrote-off the related deferred finance charges totaling \$0.6 million for year ended December 31, 2011.

Preferred Securities

During the second quarter of 2011, the Company issued 2,950,000 shares of 7.125% Series H Cumulative Redeemable Preferred Stock ("Series H") at a price of \$25.00 per share for net proceeds of \$71.2 million, net of costs and original issuance discounts. Net proceeds from the Series H offering were used to redeem all of the 7.875% Series B Cumulative Redeemable Preferred Units of Essex Portfolio, L.P. ("Series B") with a liquidation value of \$80.0 million. The Company also redeemed its 7.8125% Series F Preferred Stock ("Series F") at liquidation value for \$25.0 million.

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Equity Transactions

During 2011, the Company issued 2.5 million shares of common stock at an average share price of \$133.29 for \$323.9 million, net of fees and commissions. The Company used the net proceeds from the stock offerings to pay down debt, fund redevelopment and development pipelines, fund acquisitions, and for general corporate purposes.

ESSEX APARTMENT VALUE FUND II

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

Fund II has eight institutional investors, and the Company, with combined partner equity contributions of \$265.9 million. The Company contributed \$75.0 million to Fund II, which represents a 28.2% interest as general partner and limited partner, and the Company uses the equity method of accounting for its investment in Fund II. Fund II utilized leverage equal to approximately 55% upon the initial acquisition of the underlying real estate. Fund II invested in apartment communities in the Company's targeted West Coast markets and, as of December 31, 2011, owned fourteen apartment communities. The Company records revenue for its asset management, property management, development and redevelopment services when earned, and promote income when realized if Fund II exceeds certain financial return benchmarks.

WESCO I, LLC

In 2011, the Company entered into a 50/50 programmatic joint venture, Wesco I, LLC ("Wesco I"), with an institutional partner for a total equity commitment of \$200.0 million. Each partner's equity commitment is \$100.0 million, and Wesco I will utilize leverage equal to approximately 50% to 60%. The Company has contributed \$78.3 million to Wesco, and as of December 31, 2011, Wesco I owned six apartment communities with 2,013 units with an aggregate purchase price of \$429.2 million. Investments must meet certain criteria to qualify for inclusion in the joint venture and both partners must approve any new acquisitions and material dispositions. The joint venture has an investment period of up to two years. The Company receives asset and property management fees, and may earn a promoted interest.

OFFICES AND EMPLOYEES

The Company is headquartered in Palo Alto, California, and has regional offices in Woodland Hills, California; Irvine, California; San Diego, California and Bellevue, Washington. As of December 31, 2011, the Company had 1,099 employees.

INSURANCE

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

The Company believes it has a proactive approach to its potential earthquake losses. The Company utilizes third-party seismic consultants for its acquisitions and may perform seismic upgrades to those acquisitions that are determined to have a higher level of potential loss from an earthquake. The Company utilizes third-party loss models

to help to determine its exposure. The majority of the communities are lower density garden-style apartments which may be less susceptible to material earthquake damage. The Company will continue to monitor third-party earthquake insurance pricing and conditions and may consider obtaining third-party coverage if it deems it cost effective.

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

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COMPETITION

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

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

WORKING CAPITAL

The Company believes that cash flows generated by its operations, existing cash and marketable securities balances, availability under existing lines of credit, access to capital markets and the ability to generate cash from the disposition of real estate are sufficient to meet all of its reasonably anticipated cash needs during 2012. The timing, source and amounts of cash flows provided by financing activities and used in investing activities are sensitive to changes in interest rates and other fluctuations in the capital markets environment, which can affect its plans for acquisitions, dispositions, development and redevelopment activities.

ENVIRONMENTAL CONSIDERATIONS

See the discussion under the caption, "The Company's Portfolio may have unknown environmental liabilities" in Item 1A, Risk Factors, for information concerning the potential effect of environmental regulations on its operations, which discussion under the caption "The Company's Portfolio may have unknown environmental liabilities" is incorporated by reference into this Item 1.

OTHER MATTERS

Certain Policies of the Company

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

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

Item 1A. Risk Factors

The Company's business, operating results, cash flows and financial condition are subject to various risks and uncertainties, including, without limitation, those set forth below, any one of which could cause the Company's actual results to vary materially from recent results or from the Company's anticipated future results.

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

Capital and credit market conditions may affect the Company's access to sources of capital and/or the cost of capital, which could negatively affect the Company's business, results of operations, cash flows and financial condition. In periods when the capital and credit markets experience significant volatility, the amounts, sources and cost of capital available to the Company may be adversely affected. The Company's strong balance sheet, the debt capacity available on the unsecured line of credit with a bank group and access to the private placement market and Fannie Mae and Freddie Mac secured debt financing provides some insulation from volatile markets. The Company has benefited from borrowing from Fannie Mae and Freddie Mac, and there are no assurances that these entities will lend to the Company in the future. To the extent that the Company's access to capital and credit is at a higher cost than the Company has experienced in recent years (reflected in higher interest rates for debt financing or a lower stock price for equity financing) the Company's ability to make acquisitions, develop communities, obtain new financing, and refinance existing borrowing at competitive rates could be adversely impacted.

Debt financing has inherent risks. At December 31, 2011, the Company had approximately \$2.36 billion of indebtedness (including \$593.7 million of variable rate indebtedness, of which \$150.0 million is subject to interest rate swaps effectively fixing the interest rate and \$187.8 million is subject to interest rate protection agreements). The Company is subject to the risks normally associated with debt financing, including the following:

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

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

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

As of December 31, 2011, the Company had 68 of its 138 consolidated communities encumbered by debt. With respect to the 68 communities encumbered by debt, 61 of them are secured by deeds of trust relating solely to those communities. With respect to the remaining 7 communities, there is a cross-collateralized mortgage secured by the 7 communities. The holders of this indebtedness will have rights with respect to these communities and lenders may seek foreclosure of communities which would reduce the Company's income and net asset value.

Rising interest rates may affect the Company's costs of capital and financing activities and results of operation. Interest rates could increase rapidly, which could result in higher interest expense on the Company's variable rate indebtedness. Prolonged interest rate increases could negatively impact the Company's ability to make

acquisitions and develop apartment communities with positive economic returns on investment and the Company's ability to refinance existing borrowings.

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

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Bond compliance requirements may limit income from certain communities. At December 31, 2011, the Company had approximately \$202.7 million of variable rate tax-exempt financing relating to the following apartment communities: Inglenook Court, Wandering Creek, Boulevard, Camarillo Oaks, Fountain Park, Anchor Village, Hidden Valley and Belmont Station. This tax-exempt financing subjects these communities to certain deed restrictions and restrictive covenants. The Company expects to engage in tax-exempt financings in the future. The Internal Revenue Code and rules and regulations thereunder impose various restrictions, conditions and requirements excluding interest on qualified bond obligations from gross income for federal income tax purposes. The Internal Revenue Code also requires that at least 20% of apartment units be made available to residents with gross incomes that do not exceed a specified percentage, generally 50%, of the median income for the applicable family size as determined by the Housing and Urban Development Department of the federal government. In addition to federal requirements, certain state and local authorities may impose additional rental restrictions. These restrictions may limit income from the tax-exempt financed communities if the Company is required to lower rental rates to attract residents who satisfy the median income test. If the Company does not reserve the required number of apartment homes for residents satisfying these income requirements, the tax-exempt status of the bonds may be terminated, the obligations under the bond documents may be accelerated and the Company may be subject to additional contractual liability.

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

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

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

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

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

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Acquisitions of communities may fail to meet expectations. The Company intends to continue to acquire apartment communities. However, there are risks that acquisitions will fail to meet the Company's expectations. The Company's estimates of future income, expenses and the costs of improvements or redevelopment that is necessary to allow the Company to market an acquired apartment community as originally intended may prove to be inaccurate. The Company expects to finance future acquisitions, in whole or in part, under various forms of secured or unsecured financing or through the issuance of partnership units by the Operating Partnership or related partnerships or additional equity by the Company. The use of equity financing, rather than debt, for future developments or acquisitions could dilute the interest of the Company's existing stockholders. If the Company finances new acquisitions under existing lines of credit, there is a risk that, unless the Company obtains substitute financing, the Company may not be able to secure further lines of credit for new development or such lines of credit may be not available on advantageous terms.

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

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

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

The geographic concentration of the Company's communities and fluctuations in local markets may adversely impact the Company's financial condition and operating results. The Company generated significant amounts of rental revenues for the year ended December 31, 2011, from the Company's communities concentrated in Southern California (Los Angeles, Orange, Santa Barbara, San Diego, and Ventura counties), Northern California (the San Francisco Bay Area), and the Seattle metropolitan area. For the year ended December 31, 2011, 82% of the Company's rental revenues were generated from communities located in California. This geographic concentration could present risks if local property market performance falls below expectations. The economic condition of these markets could affect occupancy, property revenues, and expenses, from the communities and their underlying asset values. The financial results of major local employers also may impact the cash flow and value of certain of the communities. This could have a negative impact on the Company's financial condition and operating results, which could affect the Company's ability to pay expected dividends to its stockholders.

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

The price per share of the Company's stock may fluctuate significantly. The market price per share of the Company's common stock may fluctuate significantly in response to many factors, including without limitation:

- regional, national and global economic conditions;
- actual or anticipated variations in the Company's quarterly operating results or dividends;

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- changes in the Company's funds from operations or earnings estimates;
- issuances of common stock, preferred stock or convertible debt securities;
- publication of research reports about the Company or the real estate industry;
- the general reputation of real estate investment trusts and the attractiveness of their equity securities in comparison to other equity securities (including securities issued by other real estate based companies);
- general stock and bond market conditions, including changes in interest rates on fixed income securities, that may lead prospective purchasers of the Company's stock to demand a higher annual yield from dividends;
 - availability to capital markets and cost of capital;
 - a change in analyst ratings or the Company's credit ratings;
- terrorist activity may adversely affect the markets in which the Company's securities trade, possibly increasing market volatility and causing erosion of business and consumer confidence and spending; and
 - Natural disasters such as earthquakes.

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

The Company's future issuances of common stock, preferred stock or convertible debt securities could adversely affect the market price of the Company's common stock. In order to finance the Company's acquisition and development activities, the Company has issued and sold common stock, preferred stock and convertible debt securities. For example, during 2011 and 2010, the Company issued and sold 2.5 million and 2.4 million shares of common stock for \$323.9 million and \$251.4 million, net of fees and commissions, respectively. The Company may in the future sell further shares of common stock, including pursuant to its equity distribution programs with Cantor Fitzgerald & Co., KeyBanc Capital Markets Inc., Barclays Capital Inc., BMO Capital Markets Corp., Liquidnet, Inc., and Mitsubishi UFJ Securities (USA), Inc. In 2011, the Company issued 2,950,000 shares of 7.125% Series H Cumulative Redeemable Preferred Stock at a price of \$25.00 per share for net proceeds of \$71.2 million, net of costs and original issuance discounts.

In 2010, the Company filed a new shelf registration statement with the SEC, allowing the Company to sell an undetermined number of equity and debt securities as defined in the prospectus. Future sales of common stock, preferred stock or convertible debt securities may dilute stockholder ownership in the Company and could adversely affect the market price of the common stock.

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

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

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The influence of executive officers, directors and significant stockholders may be detrimental to holders of common stock. As of December 31, 2011, George M. Marcus, the Chairman of the Company's Board of Directors, wholly or partially owned 1.6 million shares of common stock (including shares issuable upon exchange of limited partnership interests in the Operating Partnership and certain other partnerships and assuming exercise of all vested options). This represents approximately 4.4% of the outstanding shares of the Company's common stock. Mr. Marcus currently does not have majority control over the Company. However, he currently has, and likely will continue to have, significant influence with respect to the election of directors and approval or disapproval of significant corporate actions. Consequently, his influence could result in decisions that do not reflect the interests of all the Company's stockholders.

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

The voting rights of preferred stock may allow holders of preferred stock to impede actions that otherwise benefit holders of common stock. Essex currently has outstanding shares of 7.125% Series H Cumulative Redeemable Preferred Stock ("Series H Preferred Stock"). In general, the holders of the Company's outstanding shares of Series H Preferred Stock do not have any voting rights. However, if full distributions are not made on outstanding Series H Preferred Stock for six quarterly distributions periods, the holders of Series H Preferred Stock, together with holders of other series of preferred stock upon which like voting rights have been conferred, will have the right to elect two additional directors to serve on Essex's Board of Directors.

These voting rights continue until all distributions in arrears and distributions for the current quarterly period on the Series H Preferred Stock have been paid in full. At that time, the holders of the Series H Preferred Stock are divested of these voting rights, and the term of office of the directors so elected immediately terminates.

While any shares of the Company's Series H Preferred Stock are outstanding, the Company may not, without the consent of the holders of two-thirds of the outstanding shares of Series H Preferred Stock:

- authorize or create any class or series of stock that ranks senior to the Series H Preferred Stock with respect to the payment of dividends, rights upon liquidation, dissolution or winding-up of the Company's business; or
- amend, alter or repeal the provisions of the Company's Charter, including by merger or consolidation, that would materially and adversely affect the rights of the Series H Preferred Stock; provided that in the case of a merger or consolidation, so long as the Series H Preferred Stock remains outstanding with the terms thereof materially unchanged or the holders of shares of Series H Preferred Stock receive shares of stock or other equity securities with rights, preferences, privileges and voting powers substantially similar to that of the Series H Preferred Stock, the occurrence of such merger or consolidation shall not be deemed to materially and adversely affect the rights of the holders of the Series H Preferred Stock.

These voting rights of the holders of the Series H Preferred Stock and of other preferred stock may allow such holders to impede or veto actions that would otherwise benefit the holders of the Company's common stock.

The Maryland business combination law may not allow certain transactions between the Company and its affiliates to proceed without compliance with such law. Under Maryland law, "business combinations" between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset

transfer or issuance or reclassification of equity securities. An interested stockholder is defined as any person (and certain affiliates of such person) who beneficially owns ten percent or more of the voting power of the then-outstanding voting stock. The law also requires a supermajority stockholder vote for such transactions. This means that the transaction must be approved by at least:

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

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

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Anti-takeover provisions contained in the Operating Partnership agreement, charter, bylaws, and certain provisions of Maryland law could delay, defer or prevent a change in control. While the Company is the sole general partner of the Operating Partnership, and generally has full and exclusive responsibility and discretion in the management and control of the Operating Partnership, certain provisions of the Operating Partnership agreement place limitations on the Company's ability to act with respect to the Operating Partnership. Such limitations could delay, defer or prevent a transaction or a change in control that might involve a premium price for the Company's stock or otherwise be in the best interest of the stockholders or that could otherwise adversely affect the interest of the Company's stockholders. The partnership agreement provides that if the limited partners own at least 5% of the outstanding units of partnership interest in the Operating Partnership, the Company cannot, without first obtaining the consent of a majority-in-interest of the limited partners in the Operating Partnership, transfer all or any portion of the Company's general partner interest in the Operating Partnership to another entity. Such limitations on the Company's ability to act may result in the Company's being precluded from taking action that the Board of Directors believes is in the best interests of the Company's stockholders. As of December 31, 2011, the limited partners held or controlled approximately 6.2% of the outstanding units of partnership interest in the Operating Partnership, allowing such actions to be blocked by the limited partners.

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

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

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

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

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

The Company's joint ventures and joint ownership of communities and partial interests in corporations and limited partnerships could limit the Company's ability to control such communities and partial interests. Instead of purchasing and developing apartment communities directly, the Company has invested and may continue to invest in joint ventures. Joint venture partners often have shared control over the development and operation of the joint venture assets. Therefore, it is possible that a joint venture partner in an investment might become bankrupt, or have economic or business interests or goals that are inconsistent with the Company's business interests or goals, or be in a position to take action contrary to the Company's instructions or requests, or its policies or objectives. Consequently, a joint venture partners' actions might subject property owned by the joint venture to additional risk. Although the Company seeks to maintain sufficient influence over any joint venture to achieve its objectives, the Company may be unable to take action without its joint venture partners' approval, or joint venture partners could take actions binding on the joint venture without its consent. Should a joint venture partner become bankrupt, the Company could become liable for such partner's share of joint venture liabilities. In some instances, the Company and the joint venture partner may each have the right to trigger a buy-sell arrangement, which could cause the Company to sell its interest, or acquire a partner's interest, at a time when the Company otherwise would have not have initiated such a transaction.

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

There are risks that Fund II may operate in ways that may adversely impact the Company's interests. The Company is the general partner of Essex Apartment Value Fund II, L.P. ("Fund II"), and with Fund II there are the following risks:

- the Company's partners in Fund II might remove the Company as the general partner of Fund II;
- the Company's partners in Fund II might have economic or business interests or goals that are inconsistent with the Company's business interests or goals; or

- the Company's partners in Fund II might fail to approve decisions regarding Fund II that are in the Company's best interest.

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

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

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

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

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

Investments in real property create a potential for environmental liabilities on the part of the owner of such real property. The Company carries certain limited insurance coverage for this type of environmental risk. The Company has conducted environmental studies which revealed the presence of groundwater contamination at certain communities. Such contamination at certain of these apartment communities was reported to have migrated on-site from adjacent industrial manufacturing operations. The former industrial users of the communities were identified as the source of contamination. The environmental studies noted that certain communities are located adjacent to or possibly down gradient from sites with known groundwater contamination, the lateral limits of which may extend onto

such apartment communities. The environmental studies also noted that at certain of these apartment communities, contamination existed because of the presence of underground fuel storage tanks, which have been removed. In general, in connection with the ownership, operation, financing, management and development of apartment communities, the Company may be potentially liable for removal or clean-up costs, as well as certain other costs and environmental liabilities. The Company may also be subject to governmental fines and costs related to injuries to persons and property.

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There have been a number of lawsuits in recent years against owners and managers of apartment communities alleging personal injury and property damage caused by the presence of mold in residential real estate. Some of these lawsuits have resulted in substantial monetary judgments or settlements. The Company has been sued for mold related matters and has settled some, but not all, of such matters. Insurance carriers have reacted to mold related liability awards by excluding mold related claims from standard policies and pricing mold endorsements at prohibitively high rates. The Company has, however, purchased pollution liability insurance, which includes some coverage for mold. The Company has adopted policies for promptly addressing and resolving reports of mold when it is detected, and to minimize any impact mold might have on residents of the property. The Company believes its mold policies and proactive response to address any known existence, reduces its risk of loss from these cases. There can be no assurance that the Company has identified and responded to all mold occurrences. Liabilities resulting from such mold related matters are not expected to have a material adverse effect on the Company's financial condition, results of operations or cash flows. As of December 31, 2011, potential liabilities for mold and other environmental liabilities are not considered probable or the loss cannot be quantified or estimated.

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

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

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

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

Although the Company may carry insurance for potential losses associated with its communities, employees, residents, and compliance with applicable laws, it may still incur losses due to uninsured risks, deductibles,

co-payments or losses in excess of applicable insurance coverage and those losses may be material. In the event of a substantial loss, insurance coverage may not be able to cover the full replacement cost of the Company's lost investment, or the insurance carrier may become insolvent and not be able to cover the full amount of the insured losses. Changes in building codes and ordinances, environmental considerations and other factors might also affect the Company's ability to replace or renovate an apartment community after it has been damaged or destroyed.

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

Adverse changes in laws may affect our liability relating to our properties and our operations. Increases in real estate taxes and income, service and transfer taxes cannot always be passed through to residents or users in the form of higher rents, and may adversely affect our cash available for distribution and our ability to make distributions to our shareholders and pay amounts due on our debt. Similarly, changes in laws increasing the potential liability for environmental conditions existing on properties or increasing the restrictions on discharges or other conditions, as well as changes in laws affecting development, construction and safety requirements, may result in significant unanticipated expenditures, which could have a material adverse effect on us and our ability to make distributions to our shareholders and pay amounts due on our debt. In addition, future enactment of rent control or rent stabilization laws or other laws regulating multifamily housing may reduce rental revenues or increase operating costs.

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

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

The Company has established several taxable REIT subsidiaries ("TRSs"). Despite its qualification as a REIT, the Company's TRSs must pay U.S. federal income tax on their taxable income. While the Company will attempt to

ensure that its dealings with its TRSs do not adversely affect its REIT qualification, it cannot provide assurance that it will successfully achieve that result. Furthermore, it may be subject to a 100% penalty tax, or its TRSs may be denied deductions, to the extent its dealings with its TRSs are not deemed to be arm's length in nature. No assurances can be given that the Company's dealings with its TRSs will be arm's length in nature.

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

The U.S. federal tax rate on certain corporate dividends paid to individuals and other non-corporate taxpayers is at a reduced rate of 15% (until December 31, 2012). It is uncertain whether this reduced rate will be continued beyond the scheduled expiration date. Dividends paid by REITs to individuals and other non-corporate stockholders are not eligible for the reduced 15% rate. This may cause investors to view REIT investments to be less attractive than investments in non-REIT corporations, which in turn may adversely affect the value of stock in REITs, including the Company's stock.

Item 1b. Unresolved Staff Comments

None.

Item 2. Properties

The Company's Portfolio as of December 31, 2011 (including communities owned by unconsolidated joint ventures, but excluding communities underlying preferred equity investments) was comprised of 159 apartment communities (comprising 32,753 apartment units), of which 15,114 units are located in Southern California, 10,001 units are located in the San Francisco Bay Area, and 7,638 units are located in the Seattle metropolitan area. The Company's apartment communities accounted for 97.5% of the Company's revenues for the year ended December 31, 2011.

Occupancy Rates

The Company's average financial occupancies for the Company's stabilized communities or "2011/2010 Same-Properties" (stabilized properties consolidated by the Company for the years ended December 31, 2011 and 2010) decreased 50 basis points to 96.4% for the year ended December 31, 2011 from 96.9% for the year ended December 31, 2010. Financial occupancy is defined as the percentage resulting from dividing actual rental revenue by total possible rental revenue. When calculating actual rents for occupied units and market rents for vacant units, delinquencies and concessions are not taken into account. Total possible rental revenue represents the value of all apartment units, with occupied units valued at contractual rental rates pursuant to leases and vacant units valued at estimated market rents. The Company believes that financial occupancy is a meaningful measure of occupancy because it considers the value of each vacant unit at its estimated market rate. Financial occupancy may not completely reflect short-term trends in physical occupancy and financial occupancy rates as disclosed by other REITs may not be comparable to the Company's calculation of financial occupancy. Market rates are determined using a variety of factors such as effective rental rates at the property based on recently signed leases and asking rates for comparable properties in the market. The recently signed effective rates at the property are used as the starting point in the determination of the market rates of vacant units. The Company then increases or decreases these rates based

on the supply and demand in the apartment community's market. The Company will check the reasonableness of these rents based on its position within the market and compare the rents against the asking rents by comparable properties in the market.

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For communities that are development properties in lease-up without stabilized occupancy figures, the Company believes the physical occupancy rate is the appropriate performance metric. While a community is in the lease-up phase, the Company's primary motivation is to stabilize the property which may entail the use of rent concessions and other incentives, and thus financial occupancy which is based on contractual revenue is not considered the best metric to quantify occupancy.

Communities

The Company's communities are primarily suburban garden-style communities and town homes comprising multiple clusters of two and three-story buildings situated on three to fifteen acres of land. As of December 31, 2011, the Company's communities include 109 garden-style, 45 mid-rise, and 5 high-rise communities. The communities have an average of approximately 206 units, with a mix of studio, one, two and some three-bedroom units. A wide variety of amenities are available at the Company's communities, including covered parking, fireplaces, swimming pools, clubhouses with fitness facilities, volleyball and playground areas and tennis courts.

The Company selects, trains and supervises on-site service and maintenance personnel. The Company believes that the following primary factors enhance the Company's ability to retain tenants:

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

Commercial Buildings

The Company's corporate headquarters is located in two office buildings with approximately 31,900 square feet located at 925/935 East Meadow Drive, Palo Alto, California. The Company owns an office building with approximately 110,000 square feet located in Irvine, California, of which the Company occupies approximately 7,150 square feet at December 31, 2011. The Company owns Essex-Hollywood, a 35,000 square foot commercial building as a future development site that is currently 100% leased as a production studio.

During 2011, the Company purchased a retail site in Santa Clara for \$20.6 million. The plans for this project are to entitle the site for 494 apartment units. The site is currently improved with a 139,000 square foot retail space that is 100% leased.

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The following tables describe the Company's Portfolio as of December 31, 2011. The first table describes the Company's communities and the second table describes the Company's other real estate assets. (See Note 7 of the Company's consolidated financial statements for more information about the Company's secured mortgage debt and Schedule III for a list of secured mortgage loans related to the Company's Portfolio.)

Communities (1)	Location	Units	Rentable Square Footage	Year Built	Year Acquired	Occupancy(2)
Southern California						
Alpine Country	Alpine, CA	108	81,900	1986	2002	95%
Alpine Village	Alpine, CA	301	254,400	1971	2002	97%
Anavia	Anaheim, CA	250	312,343	2009	2010	92%
Barkley, The(3)(4)	Anaheim, CA	161	139,800	1984	2000	97%
Bonita Cedars	Bonita, CA	120	120,800	1983	2002	96%
Camarillo Oaks	Camarillo, CA	564	459,000	1985	1996	96%
Camino Ruiz						
Square	Camarillo, CA	160	105,448	1990	2006	98%
Cielo (5)	Chatsworth, CA	119	125,400	2009	2009	96%
Cambridge	Chula Vista, CA	40	22,100	1965	2002	96%
Mesa Village	Clairemont, CA	133	43,600	1963	2002	98%
Parcwood(5)	Corona, CA	312	270,000	1989	2004	95%
Tierra del Sol/Norte	El Cajon, CA	156	117,000	1969	2002	97%
Regency at Encino	Encino, CA	75	78,487	1989	2009	96%
Valley Park(6)	Fountain Valley, CA	160	169,700	1969	2001	97%
Capri at Sunny						
Hills(6)	Fullerton, CA	100	128,100	1961	2001	97%
Wilshire						
Promenade	Fullerton, CA	149	128,000	1992	1997	97%
Montejo(6)	Garden Grove, CA	124	103,200	1974	2001	96%
CBC Apartments	Goleta, CA	148	91,538	1962	2006	96%
Chimney Sweep						
Apartments	Goleta, CA	91	88,370	1967	2006	83%
416 on Broadway	Glendale, CA	115	126,782	2009	2010	93%
Hampton Court	Glendale, CA	83	71,500	1974	1999	97%
Hampton Place	Glendale, CA	132	141,500	1970	1999	97%
Devonshire	Hemet, CA	276	207,200	1988	2002	94%
Huntington						
Breakers	Huntington Beach, CA	342	241,700	1984	1997	96%
Axis 2300	Irvine, CA	115	170,714	2010(7)	2010	96%
Hillsborough Park	La Habra, CA	235	215,500	1999	1999	97%
Trabuco Villas	Lake Forest, CA	132	131,000	1985	1997	97%
Marbrisa	Long Beach, CA	202	122,800	1987	2002	97%
Pathways		296	197,700	1975(8)	1991	96%

	Long Beach, CA					
Belmont Station	Los Angeles, CA	275	225,000	2008	2008	97%
Bellerive	Los Angeles, CA	63	79,296			