ASSOCIATED ESTATES REALTY CORP
Form DEF 14A
March 26, 2004

SCHEDULE 14A
(RULE 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant þ

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Check the appropriate box:

o Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
þ Definitive Proxy Statement
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ASSOCIATED ESTATES REALTY CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement)

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ASSOCIATED ESTATES REALTY CORPORATION

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To our Shareholders:

The 2004 annual meeting of shareholders of Associated Estates Realty Corporation will be held at The Forum, One Cleveland Center, 1375 E. Ninth St., Cleveland, Ohio 44114, on Wednesday, May 5, 2004, at 10:00 a.m., local time, for the following purposes:

1. To elect seven directors, each to hold office for a one-year term and until his successor has been duly elected and qualified; and

2. To transact all other business that properly comes before the meeting.

Only shareholders of record at the close of business on March 19, 2004, will be entitled to notice of and to vote at the meeting or any adjournment thereof. Shareholders are urged to complete, date and sign the enclosed proxy card and return it in the enclosed envelope. The principal address of Associated Estates Realty Corporation is 5025 Swetland Court, Richmond Heights, Ohio 44143.

By order of the Board of Directors,

Martin A. Fishman
Secretary

Dated: March 26, 2004

YOUR VOTE IS IMPORTANT. PLEASE SIGN, DATE AND RETURN YOUR PROXY CARD.

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ASSOCIATED ESTATES REALTY CORPORATION

5025 Swetland Court
Richmond Heights, Ohio 44143

PROXY STATEMENT

Our Board of Directors is sending you this proxy statement to ask for your vote as a shareholder of Associated Estates Realty Corporation on certain matters to be voted on at the upcoming annual meeting of shareholders, which will be held at The Forum, One Cleveland Center, 1375 E. Ninth St., Cleveland, Ohio 44114, on Wednesday, May 5, 2004, at 10:00 a.m., local time. We are mailing this proxy statement and the accompanying notice and proxy, along with our Annual Report to Shareholders, on or about March 26, 2004.

ABOUT THE MEETING

What Is the Purpose of the Annual Meeting?

At the Company s annual meeting, shareholders will act upon matters outlined in the accompanying notice of meeting, including the election of seven directors. We are not aware of any other matter that will be presented for your vote at the meeting.

Who Is Entitled to Vote?

Only shareholders of record at the close of business on the record date, March 19, 2004, are entitled to receive notice of and to vote the common shares that they held on the record date at the meeting, or any postponement or adjournment of the meeting. Each outstanding common share entitles its holder to cast one vote on each matter to be voted on. As of the record date, the Company had outstanding 19,582,346 common shares.

Who Can Attend the Meeting?

Only shareholders as of the record date, or their duly appointed proxies, may attend the meeting. Please note that if you hold your shares in street name (that is, through a broker or other nominee), your name does not appear in the Company s records, and you will need to bring a copy of your brokerage statement reflecting your ownership of common shares as of the record date.

When and Where Is the Meeting?

The meeting will be held at The Forum, One Cleveland Center, 1375 E. Ninth St., Cleveland, Ohio 44114, on Wednesday, May 5, 2004, at 10:00 a.m., local time. Parking is available at One Cleveland Center. You can enter the parking garage from both St. Clair Ave. and Rockwell Ave. There will be a fee of approximately $9.00 charged for parking in that garage. If that garage is full, there are other parking facilities within walking distance of One Cleveland Center.

What Constitutes a Quorum?

The presence at the annual meeting, either in person or by proxy, of the holders of a majority of the common shares outstanding on the record date will represent a quorum, permitting the conduct of business at the meeting. Proxies received by the Company but marked as abstentions or broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting for purposes of establishing a quorum. Abstentions and broker non-votes will not count for or against any nominee for director.

What Vote Is Required for the Election of Directors?

Assuming a quorum is represented, the seven director nominees who receive the greatest number of affirmative votes will be elected directors.

How Do I Vote?

If you sign, date and return the enclosed proxy card, the common shares represented by your proxy will be voted as you specify in the proxy. If you return a signed and dated proxy, but do not make any such specification, the common shares represented by your proxy will be voted to elect the directors set forth under the caption ELECTION OF DIRECTORS.

You may revoke or change your vote at any time before your proxy has been exercised by filing a written notice of revocation or a duly executed proxy bearing a later date with the Company at the Company s principal address indicated on the attached Notice of Annual Meeting, or by giving notice of revocation to the Company in open meeting. However, your presence at the annual meeting alone will not be sufficient to revoke your previously granted proxy.

How Will the Proxy Solicitation Be Conducted?

This solicitation of proxies is made by and on behalf of the Board of Directors. The cost of the solicitation of your proxy will be borne by the Company. In addition to solicitation of proxies by mail and electronically, officers and regular employees of the Company may solicit proxies in person, by telephone or facsimile. These officers and employees will not receive any additional compensation for their participation in the solicitation.

PROPOSAL ONE: ELECTION OF DIRECTORS

At the annual meeting, unless you specify otherwise, the common shares represented by your proxy will be voted to re-elect Messrs. Adams, Delaney, Friedman, McDonough, Milstein, Mosier and Schwarz. Each director elected will serve until the next annual meeting and until his successor is elected and qualified.

If for any reason any of the nominees is not a candidate at the time of the election (which is not expected), the common shares represented by your proxy will be voted for the election of a substitute nominee designated by the Board of Directors as recommended by the Nominating and Corporate Governance Committee.

The following table contains information with respect to each nominee:

Nominees for Election at the Annual Meeting

Name	Age	Principal Occupation	Director Since
Albert T. Adams	53	Partner, Baker & Hostetler LLP	1996
James M. Delaney	69	Consultant	1999
Jeffrey I. Friedman	52	Chairman of the Board, President and Chief Executive Officer of the Company	1993
Gerald C. McDonough	75	Retired	1993
Mark L. Milstein	41	Project Manager for J. Holden Construction	1993
Frank E. Mosier	73	Retired	1993
Richard T. Schwarz	52	Partner, Sycamore Partners LLC	1994

BUSINESS EXPERIENCE OF DIRECTORS

Albert T. Adams has been a partner of the law firm of Baker & Hostetler LLP in Cleveland, Ohio, since 1984, and has been associated with the firm since 1977. Mr. Adams is a director of the following real estate investment trusts: Boykin Lodging Company and Developers Diversified Realty Corporation.

James M. Delaney has served as a consultant to Deloitte & Touche LLP, a certified public accounting firm, and AON Risk Services, a risk management firm, since 1997. Mr. Delaney served as office managing partner of Deloitte & Touche, Cleveland, Ohio, from 1989 until his retirement in June 1997, having joined its predecessor firm in 1958.

Jeffrey I. Friedman has been Chairman of the Board and Chief Executive Officer of the Company since its organization in July 1993, and served as the Company s President from the Company s organization to February 2000 and again since December 12, 2002. Mr. Friedman joined the Company s predecessor, Associated Estates Corporation, an owner and manager of multifamily residential apartment facilities, in 1974. Mr. Friedman is the brother-in-law of Mark L. Milstein.

Gerald C. McDonough served as Chairman and Chief Executive Officer of Leaseway Transportation Corp., a highway transportation company, from 1982 until his retirement in July 1988. Mr. McDonough serves as the Chairman of the Board of Directors of York International Corporation, a designer and manufacturer of heating, ventilating, air conditioning and refrigeration products.

Mark L. Milstein has been a project manager for J. Holden Construction, a construction company, since 1999. Mr. Milstein was President of Adam Construction Company, a general contractor, from 1993 to 1999 and from 1988 to 1993 was a Senior Project Manager for Adam Construction Company. Mr. Milstein is the brother-in-law of Jeffrey I. Friedman.

Frank E. Mosier served as Vice Chairman of the Advisory Board of BP America Inc., a producer and refiner of petroleum products, from 1991 to 1993. Mr. Mosier was Vice Chairman of BP America Inc. from 1988 until his retirement in 1991 and President and Chief Operating Officer of BP America Inc. from 1986 to 1988.

Richard T. Schwarz has been a partner in Sycamore Partners LLC, a private investment firm focused on investments in specialty chemical companies, since 1997. Mr. Schwarz was President and Chairman of Carbinol Industries, an investment company, from September 1997 to January 1998 and was President of Laurel Industries, Inc., a privately held chemical manufacturer and a subsidiary of Occidental Petroleum Corporation, from September 1996 to September 1997.

How Often Did the Board Meet During 2003?

The Board of Directors held 10 meetings in 2003. In 2003, each member of the Board of Directors attended at least 75 percent of the meetings of the Board of Directors and the committees of which he was a member. The Company has established a formal policy requiring director attendance at all Board meetings, absent unusual circumstances. The Company expects its directors to attend the annual meeting of shareholders (which is usually held the same day as a meeting of the Board of Directors), and all of the Company s directors attended the 2003 annual meeting of shareholders.

How Are Directors Compensated?

Employees of the Company who are also directors are not paid any director fees. Beginning in 2003, compensation for non-employee directors included the following:

An annual retainer fee of $30,000, paid on a quarterly basis;

The respective Chairs of the Audit, Executive Compensation, and the Nominating and Corporate Governance Committees are paid an annual retainer fee of $5,000, paid on a quarterly basis either in cash or through the issuance of the Company s common shares(1); and

Reimbursement of expenses related to attending Board and committee meetings.

Directors are also eligible for restricted share grants and option grants, which may be awarded from time to time by the Board of Directors. Each of the directors (except for Mr. Friedman) received restricted share grants of 4,000 shares on August 28, 2003.

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(1) The number of shares comprising each quarterly payment that was payable through the issuance of the Company s common shares is calculated as of the close of the market on the business day of or immediately prior to the date of the quarterly board meeting.

Non-employee directors may defer all or a portion of their fees (and restricted share grants) under the Company s Directors Deferred Compensation Plan. The plan is unfunded and participants contributions are converted to units, which fluctuate in value according to the market value of the Company s common shares. As of December 31, 2003, Mr. Adams held 28,232.5 units, Mr. Schwarz held 19,847.4 units and Mr. Delaney held 12,362.3 units under the plan valued at $206,379.58, $145,084.49 and $90,368.41, respectively.

In 2002, the Company adopted share ownership guidelines for members of the Board. The guidelines provide that each director own Company common shares or common share equivalents having a value at least equal to approximately one times such director s annual retainer (including committee retainers) and that once achieved such guidelines shall be deemed to have been satisfied without regard to any fluctuation in value in the Company s common shares. All directors of the Board have met this ownership guideline.

CORPORATE GOVERNANCE

The Board of Directors adopted Corporate Governance Guidelines to assist the Board of Directors in the exercise of its responsibilities and to serve the best interests of the Company and its shareholders. A copy of the Company s Corporate Governance Guidelines is posted on the Company s website, www.aecrealty.com, under About Us.

Codes of Ethics

Code of Ethics for Senior Financial Officers. The Company has a Code of Ethics for Senior Financial Officers that applies to the principal executive officer, principal financial officer and principal accounting officer or controller (collectively, Senior Financial Officers) of the Company. The code requires Senior Financial Officers to act with honesty and integrity; to endeavor to provide information that is full, fair, accurate, timely and understandable in all reports and documents that the Company files with, or submits to, the Securities and Exchange Commission (SEC) and other public filings or communications made by the Company; to endeavor to comply faithfully with all laws, rules and regulations of federal, state and local governments and all applicable private or public regulatory agencies; to proactively promote ethical behavior among peers and subordinates in the workplace; and to promptly report to the Audit Committee any violation or suspected violation of this code. The code is posted on the Company s website, www.aecrealty.com, under About Us. Any waiver of any provision of the code granted to a Senior Financial Officer may only be made by the Audit Committee or the Board of Directors, and will be promptly disclosed in a filing on Form 8-K with the SEC or, subject to satisfaction of any conditions established by the SEC, posted on the Company s website.

Code of Business Conduct and Ethics. The Company has a Code of Ethics that applies to all employees, officers and directors of the Company. The Code of Ethics includes provisions covering compliance with laws and regulations, insider trading practices, conflicts of interest, privacy and confidentiality, protection and proper use of Company assets, accuracy of business records, corporate opportunities, fair competition and fair dealing, business gifts and entertainment, political activity, fair housing, anti-discrimination and non-harassment policies and the reporting of illegal or unethical behavior. The Code of Ethics is posted on the Company s website, www.aecrealty.com, under About Us . Any waiver of any provision of the code granted to an executive officer or director may only be made by the Board of Directors or a Committee of the Board authorized to do so and will be promptly disclosed on the Company s website, www.aecrealty.com, under About Us .

Independent Directors

The Board has determined that all of the directors, except for Messrs. Friedman and Milstein, are independent directors within the meaning of the New York Stock Exchange (NYSE) listing standards. Albert T. Adams is a partner in the law firm of Baker & Hostetler LLP, which has provided (and is expected to continue providing) legal services to the Company; however, the Board affirmatively determined that Mr. Adams is an independent director within the meaning of the NYSE listing standards and that his relationship with Baker & Hostetler LLP does not interfere with his exercise of independent judgment as a director. James M. Delaney is a consultant to Aon Risk Management Services, which is a vendor of the Company, and a consultant to Deloitte & Touche LLP, which is an accounting firm that provides accounting services to two joint ventures in which the Company has ownership interests; however, the Board affirmatively determined that Mr. Delaney is an independent director within the meaning of the NYSE listing standards and that his relationships with Aon Risk Management Services and Deloitte & Touche LLP do not interfere with his exercise of independent judgment as a director.

Executive Session

Beginning with the December 12, 2002 Board meeting, the non-management directors of the Board have met in executive session without management following most Board meetings. In 2004, the non-management directors appointed Richard T. Schwarz as the director to preside over these executive sessions in the future. In 2003, these meetings were chaired by certain non-management members of the Board (Messrs. Adams, Delaney, Mosier, McDonough and Schwarz) on a rotating basis.

What Committees Has the Board Established?

The Board of Directors has a Nominating and Corporate Governance Committee, an Audit Committee, an Executive Committee and an Executive Compensation Committee. All of the members of the Board s Audit, Executive Compensation and Nominating and Corporate Governance Committees are independent directors under the NYSE listing standards.

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee, comprised of Messrs. Adams (Chairman), McDonough and Schwarz, held two meetings during 2003. This committee was formed: to assist the Board of Directors in identifying individuals qualified to become Board members; to recommend Board committee structure, membership and operations; to develop and recommend to the Board a set of effective corporate governance policies and procedures; and to lead the Board in its annual review of the Board s performance.

The committee will consider suggestions forwarded by shareholders to the Secretary of the Company concerning qualified candidates for election as directors. To recommend a prospective nominee for the Nominating and Corporate Governance Committee s consideration, a shareholder may submit the candidate s name and qualifications to the Company s Secretary, Martin A. Fishman, at the following address: 5025 Swetland Court, Richmond Heights, Ohio 44143. The Nominating and Corporate Governance Committee has not established specific minimum qualifications a candidate must have in order to be recommended to the Board of Directors. However, in determining qualifications for new directors, it will consider potential members qualification as independent under the NYSE listing standards, as well as age, skill and experience in the context of the needs of the Board of Directors. The committee will recommend a slate of nominees to the Board of Directors to be voted on at the annual meeting of the Company s shareholders. Although the Nominating and Corporate Governance Committee may retain a Board search consultant to supplement the pool of Board candidates, it has not engaged a consultant at this time.

A current copy of the committee s charter is available to shareholders on the Company s website, www.aecrealty.com, under About Us.

AUDIT COMMITTEE

Composition of the Audit Committee. The Audit Committee is comprised of Messrs. Delaney (Chairman), McDonough, Mosier and Schwarz, all of whom are independent as required by Section 10A of the Securities Exchange Act of 1934. Mr. Delaney, a consultant to and retired partner of Deloitte & Touche LLP, chairs the Committee. The Board has determined that Messrs. Delaney and McDonough are financial experts within the meaning of Item 401 of Regulation S-K under the federal securities laws. The Audit Committee held two meetings during 2003.

The Board of Directors has a written Audit Committee Charter, which is attached hereto as Appendix A. The Audit Committee is responsible for assisting the Board in overseeing the following primary areas: (i) the integrity of the financial statements of the Company, (ii) the Company s compliance with legal and regulatory requirements, (iii) the Company s independent accountant s qualifications and independence, and (iv) the performance of the Company s internal audit function and independent accountants.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee reviews the Company s financial reporting practices on behalf of the Board of Directors. Management is responsible for the financial statements and the reporting process, including the system of internal controls. The independent accountants are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles.

The Audit Committee has:

Reviewed and discussed with the Company s management and the Company s independent accountants the audited financial statements of the Company contained in the Annual Report on Form 10-K for the year ended December 31, 2003;

Discussed with the Company s independent accountants the matters required to be discussed pursuant to Statement of Accounting Standards No. 61 (Codification of Statements on Auditing Standards, AU Section 380), which includes, among other items, matters related to the conduct of the audit of the Company s financial statements; and

Received and reviewed the written disclosures and the letter from the Company s independent accountants required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and discussed with the independent accountants the independent accountants independence.

Based on the reviews and discussions described in the preceding bulleted paragraphs, the Audit Committee recommended to the Board of Directors that the audited financial statements for the year ended December 31, 2003, be included in the Company s Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission.

Audit Committee

James M. Delaney, Chairman
Gerald C. McDonough
Frank E. Mosier
Richard T. Schwarz

Executive Committee

The Executive Committee, which consists of Messrs. Adams, Friedman (Chairman) and Milstein, possesses the power of the Board in the management of the business and affairs of the Company (other than filling vacancies on the Board or any Board committees) during intervals between meetings of the Board. The Executive Committee held two meetings during 2003.

EXECUTIVE COMPENSATION COMMITTEE

The members of the Executive Compensation Committee of the Company s Board of Directors (the Committee) are Albert T. Adams, James M. Delaney, Gerald C. McDonough, Frank E. Mosier (Chairman) and Richard T. Schwarz. The Executive Compensation Committee held two meetings during 2003.

REPORT OF THE EXECUTIVE COMPENSATION COMMITTEE

The Committee s responsibilities include the following:

i. Reviewing and approving the goals and objectives relevant to the compensation of the Chief Executive Officer and the Company s other executive officers.

ii. Reviewing, at least annually, the Company s executive and employee compensation plans in light of the Company s goals and objectives with respect to such plans.

iii. Evaluating, on an annual basis, the performance of the Chief Executive Officer in light of the goals and objectives of the Company s executive compensation plans, and setting his compensation level based upon this evaluation.

iv. Reviewing and approving salary, incentive payments and long-term compensation to the executive officers.

v. Reviewing and approving grants and awards to the executive officers and other participants under the Company s equity-based compensation plans.

vi. Reviewing and approving any employment agreements and severance agreements to be made with any existing or prospective executive officer of the Company.

vii. Reviewing other human resources programs for broad-based employees as deemed appropriate by the Chief Executive Officer or requested by the Board.

In fulfilling its responsibilities, the Committee has the authority to engage independent advisors and also works closely with the Company s Vice President of Human Resources.

What Is the Company s Philosophy of Executive Officer Compensation?

Executive compensation decisions are guided by the Company s commitments to:

Create shareholder value and achieve performance objectives;

Attract and retain top organizational contributors and link their pay to their ability to influence financial and organizational objectives; and

Focus attention on the Company s current priorities and long-term goals.

What Are the Key Components of Executive Officer Compensation?

The key components of the Company s executive compensation program are base salary, annual incentives, longer-term, share-based incentives and retirement and welfare benefits. Each of these components operates within an integrated total compensation program to ensure that executives are compensated equitably. The total compensation mix attributable to the weighting of each of these components will reflect the competitive market and may be adjusted from time to time to best support the Company s business objectives.

The integrated total compensation package is intended to compensate the Company s executive officers between the median and the 75th percentile of the competitive peer group labor market and provide the opportunity for executives to earn incentive-based compensation driven by the accomplishment of performance expectations. The members of the competitive peer group, Associated Estates Peer Index, are listed on

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page 12. The Committee believes the executive compensation program, in total, reflects the competitive market practices of the peer group.

Base Salary. Base salary serves as the cornerstone for the executive compensation program and recognizes the relative value that an individual s contribution brings to the Company. Executives base salaries are reviewed annually and adjusted, as appropriate, to reflect changes in the competitive peer group labor market as well as individual performance, range of responsibilities relative to the Company s business plan, demonstrated competencies, value, contribution to the organization, experience and professional growth and development. Base salary adjustments are also influenced by overall Company performance. Based upon projected Company performance (and consistent with the budgets established) for 2003, no base salary increases for 2003 were approved for the executive officers; however, a market adjustment was made to Mr. Fatica s salary.

Annual Incentives. Annual incentives emphasize pay for performance and serve as a key means of driving current objectives and priorities. Executives are rewarded for increases in the Company s short-term financial performance and achievement of established corporate objectives. In 2003, annual incentive opportunities for all officers (including executive officers) were 100 percent linked to performance relative to a company-wide property net operating income (NOI) benchmark. NOI is determined by deducting property operating and maintenance expenses from total property revenues. Target annual incentive opportunities are set at the beginning of each plan year for eligible participants and, for 2003, ranged from 40 percent to 80 percent of base salary for the executive officers. Award payouts are delivered in a combination of cash and restricted shares that vest over a three-year period. In 2003, the Company did not reach its NOI goal, and no annual incentive compensation was paid to the executive officers under this program.

Long-Term Incentives. Long-term incentive compensation is delivered through the Equity-Based Incentive Compensation Plan and the Year 2001 Equity Incentive Plan. All executive officers are eligible to participate in both of these plans. There were no long-term incentive grants made to executive officers under the Equity-Based Incentive Compensation Plan or the Year 2001 Equity Incentive Plan in 2003. The 1993 Share Incentive Plan expired September 30, 2003, and no additional grants will be made from this Plan.

The Equity-Based Incentive Compensation Plan provides executive officers and other key employees of the Company the opportunity to earn equity-based incentives including common shares. As part of the total compensation program, the Committee believes that equity-based awards serve as an important means of attracting and retaining executives who are in a position to most directly influence the long-term success of the Company. The Committee also believes that equity-based awards align executives interests with those of shareholders by reinforcing the risk of ownership and the importance of providing competitive long-term, total returns to shareholders. Awards made under the plans may be in the form of share options, restricted shares or other equity-based awards. Share options are granted at no less than 100 percent of the current fair market value of the Company s shares on the date of the grant and will only be of value to the extent the Company s share price increases over time. Generally, share options and restricted share awards will vest in installments over no less than a three-year period. In determining whether and in what amounts to make grants under the plans, the Committee considers, among other factors, competitive long-term incentive award levels and the scope of responsibility, the anticipated performance and the contribution to the Company of the proposed award recipient.

The Company s Year 2001 Equity Incentive Plan (the EIP) is administered by the Committee and is substantially similar in its operation to the Equity-Based Incentive Compensation Plan. The EIP allows for participation by directors as well as employees, but does not allow for the grant of incentive stock options. Shares issued under the EIP consist solely of treasury shares. The EIP authorizes the issuance of up to two million treasury shares.

Executive Deferred Compensation Plan. Subject to the terms of the Executive s Deferred Compensation Plan, the Company provides executive officers the option of deferring compensation payable to them by the Company for their services. Deferred amounts are converted to Company common share equivalents based on the fair market value of the shares on the date compensation would have normally been paid. Distributions under the plan are paid in common shares, which are subject to the terms of the Company s Equity-Based

Incentive Compensation Plan. At December 31, 2003, there were no executives deferring compensation under this plan.

Supplemental Executive Retirement Plan. The Company s Supplemental Executive Retirement Plan (the SERP) was adopted by the Board of Directors on January 1, 1997, and is administered by the Committee. This non-qualified, unfunded, defined contribution plan extends to executive officers of the Company and other officers as recommended by the Chief Executive Officer and approved by the Committee. The SERP provides for the Company to make a contribution to the account of each of the participating officers at the end of each plan year. The contribution, which is a percentage of eligible earnings (including base salary and payments under the annual incentive plan), is set by the Committee at the beginning of each plan year. The contribution is treated by the Company as an unfunded liability until the benefits are paid. The account balances earn interest each year at a rate that is set by the Committee at the beginning of each plan year. All contributions to the SERP were suspended for the 2003 plan year. Contributions were reinstated for the 2004 plan year at a contribution rate of 6 percent and an earnings rate of 9.4 percent. Each participant s SERP account is scheduled to vest when the participant turns 55. Within 30 days of a Change in Control (as defined in the plan), the Company must make a cash contribution to an irrevocable rabbi trust in an amount necessary to fully fund the SERP accounts.

How Is the Company s Chief Executive Officer s Compensation Determined?

The base compensation for Jeffrey I. Friedman was established and is administered pursuant to an employment agreement entered into between Mr. Friedman and the Company as of January 1, 1996. The three-year term of the employment agreement is automatically extended for an additional year at the end of each year of the agreement, subject to the right of either party to terminate by giving one year s prior written notice. In 2003, Mr. Friedman earned a base salary of $376,400. No base salary increases were approved for the executive officers (including Mr. Friedman) for 2003, based upon projected Company performance (and consistent with the budgets established) for 2003.

Mr. Friedman s employment agreement provides for an annual performance bonus based upon the Company reaching certain financial objectives. For 2003, 100 percent of Mr. Friedman s performance bonus was based upon annual performance benchmarks tied to NOI, consistent with the annual incentive plan in which the other executive officers participate. Mr. Friedman did not earn a bonus payment under the performance benchmarks tied to NOI for 2003.

Executive Compensation Committee

Frank E. Mosier, Chairman
Albert T. Adams
James M. Delaney
Gerald C. McDonough
Richard T. Schwarz

Summary Compensation Table

The following table summarizes the compensation earned by or paid to the Company s Chief Executive Officer and each of the Company s other named executive officers who served during fiscal year 2003.

	Annual Compensation				Long-Term Compensation Awards		
Name and Principal Positions	**Fiscal Year**	**Salary ($)**	**Bonus ($)**	**Other Annual Compensation ($)(1)**	**Restricted Stock Awards ($)(2)**	**Stock Options (#)(3)**	**All Other Compensation ($)(4)**
Jeffrey I. Friedman	2003	376,400	0	0	0	0	0
Chairman, President and	2002	376,400	0	0	127,977	0	73,578
Chief Executive Officer	2001	376,400	128,000	0	0	300,000	86,886
Martin A. Fishman	2003	210,000	0	0	0	0	0
Vice President, Secretary and	2002	210,000	33,600	0	34,865	0	36,179
General Counsel	2001	210,000	35,000	0	0	200,000	49,318
Lou Fatica	2003	165,673	0	0	0	0	2,485
Treasurer, Vice President and	2002	150,000	24,000	0	20,248	0	14,172
Chief Financial Officer(5)	2001	133,332	15,000	0	0	100,000	17,783

(1) The perquisites provided to each of the executive officers, if any, do not exceed the disclosure threshold under SEC rules and are not included in this total.

(2) On February 27, 2002, grants of 12,862, 3,504 and 2,035 restricted common shares were awarded, respectively, to Messrs. Friedman, Fishman and Fatica. The closing market price of the Company s common shares on the date of the February grant was $9.95 and these shares vest in one-third annual increments beginning February 27, 2003. Dividends are payable on all of the restricted shares.
The number of unvested restricted shares held by Messrs. Friedman, Fishman and Fatica as of December 31, 2003, was 22,887, 9,007 and 2,358, respectively, and the aggregate value of these restricted shares as of December 31, 2003, was $167,304, $65,841 and $17,237, respectively.

(3) On February 28, 2001, all executive officers received a front-loaded, non-qualified option grant at an exercise price of $8.69. These grants vest five years from the grant date through continued service; however, vesting may be fully accelerated at the end of three or four years under a predetermined formula tied to certain strategic business objectives.

(4) For 2003, the entry for Mr. Fatica includes the Company matching contribution under its 401(k) plan of $2,485. For 2002, the entries for Messrs Friedman, Fishman and Fatica include SERP contributions in the amounts of $36,402, $16,526 and $9,900, respectively, plus interest accrued on the account balance year to date in the amounts of $37,176, $19,653 and $800, respectively, and the entry for Mr. Fatica also includes the Company matching contribution under its 401(k) plan of $3,472. For 2001, the entries for Messrs Friedman and Fishman reflect the last of five installments of the initial contribution to Messrs. Friedman and Fishman under the SERP in the amounts of $28,201 and $17,973, respectively. For 2001, the contributions to the SERP for Mr. Friedman and Mr. Fishman were $27,378 and $14,828, respectively, plus interest accrued on the account balance year to date in the amounts of $31,307 and $16,517, respectively. For 2001, the entry for Mr. Fatica includes a contribution under the SERP of $8,000, the Company matching contribution under its 401(k) plan of $4,127 and payment for earned (but unused) vacation time in the amount of $2,656 prior to Mr. Fatica becoming an executive officer.

(5) Mr. Fatica became an employee of the Company in May of 1999, and was elected Treasurer, Vice President and Chief Financial Officer of the Company, effective March 15, 2001.

Option Grants in 2003

There were no option grants to executive officers named in the Summary Compensation Table in 2003.

Aggregated Option Exercises in 2003 and 2003 Year-End Option Values

The following table summarizes the stock options exercised during 2003 by the executive officers named in the Summary Compensation Table and the number and value of options held on December 31, 2003.

	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Unexercised Options at 2003 Year-End (#) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options at 2003 Year-End ($) Exercisable/ Unexercisable(1)
Jeffrey I. Friedman	0	N/A	353,000/354,000	0/0
Martin A. Fishman	0	N/A	124,500/228,000	0/0
Lou Fatica	0	N/A	11,000/100,000	490/0

(1) Based upon a December 31, 2003 closing price of $7.31.

Employment and Severance Agreements

The Company has an employment agreement with Jeffrey I. Friedman to serve as the Company s President and Chief Executive Officer. This agreement, dated January 1, 1996, as amended, had an initial term of three years and is automatically extended for an additional year at the end of each year of the agreement, subject to the right of either party to terminate by giving one year s prior written notice. Under the agreement, Mr. Friedman must devote his entire business time to the Company and may participate in real estate activities only through the Company, excluding investments held by Mr. Friedman at the time of the Company s initial public offering. In addition, Mr. Friedman is prohibited from competing with the Company for a period of three years following termination of employment. The agreement provides for an annual base salary, which was $376,400 in 2003, and the use of an automobile, membership in a golf club and a business club, an allowance of up to $10,000 annually for financial planning and tax return preparation service. The agreement provides for an annual performance bonus of up to 100 percent of Mr. Friedman s annual base salary based on the Company achieving certain benchmarks. The agreement contains a provision that upon a Change in Control (defined identically to the change in control provision in the Supplemental Executive Retirement Plan), Mr. Friedman is entitled to severance pay in a lump sum equal to the greater of the amount of unpaid base salary for the then unexpired term of his employment agreement or one year s base salary at the then effective annual rate of salary, plus, in either case, pro rata bonus amounts and accrued benefits.

The Company has a policy of paying severance to each of the executive officers named in the Summary Compensation Table and certain other non-elected officers, other than the CEO, if the Company terminates such officer without cause. Under the severance policy, upon the officer s termination, he or she will receive as severance compensation an amount equal to one year s salary, a prorated portion of the officer s bonus, payment of his health benefits for one year and outplacement services. In consideration for this severance compensation, the Company enters into a standard severance agreement and release with the officer.

Executive Compensation Committee Interlocks and Insider Participation

The members of the Executive Compensation Committee are Albert T. Adams, James M. Delaney, Gerald C. McDonough, Frank E. Mosier (Chairman) and Richard T. Schwarz. Mr. Adams is a partner of Baker & Hostetler LLP. Baker & Hostetler LLP has been retained by the Company to perform legal services on its behalf, and the Company expects that Baker & Hostetler LLP will continue to provide such services during 2004.

Performance Graph

A line graph comparing the cumulative total return of a hypothetical investment in the Company s common shares with the cumulative total return of a hypothetical investment in each of (a) the Standard & Poor s Composite 500 Index, (b) the NAREIT All Equity REIT Index, and (c) a peer group, shown in the graph as Associated Estates Peer Index, of multifamily equity REITs identified by the Company to include those multifamily equity REITs that have equity market capitalization within the range of approximately $400 million to $1.4 billion. The comparison of cumulative total return is based on the respective market prices of each investment on the dates shown below, assuming an initial investment of $100 on December 31, 1998, and the reinvestment of dividends.

	12/31/98	12/31/99	12/31/00	12/31/01	12/31/02	12/31/03
Associated Estates Realty Corporation	100.00	74.02	88.87	113.05	93.35	112.43
S&P 500	100.00	121.11	110.34	97.32	75.75	97.51
NAREIT All Equity REIT Index	100.00	95.38	120.53	137.32	142.57	195.51
Associated Estates Peer Index*	100.00	108.61	145.03	167.17	174.06	228.74

**The Associated Estates Peer Index consists of Associated Estates Realty Corp., Amli Residential Properties, BRE Properties, Inc., Camden Property Trust, Essex Property Trust, Gables Residential Trust, Home Properties of New York, Mid-America Apartment, Summit Properties, Inc., Town and Country Trust, and United Dominion Realty Trust.*

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table contains certain information regarding the beneficial ownership of the Company s common shares as of February 15, 2004, by: (a) the Company s Chief Executive Officer and the other executive officers named in the Summary Compensation Table; (b) the Company s directors; (c) each other person (and such person s address) who is known by the Company to be the beneficial owner of more than 5 percent of the outstanding common shares (based on information filed with the Securities and Exchange Commission); and (d) the Company s executive officers and directors as a group. The persons named in the table, except as otherwise described in the notes below, have sole voting power and sole investment power with respect to all common shares set forth opposite their names.

Name and Address of Beneficial Owner	Number of Common Shares Beneficially Owned	Number of Common Shares Subject to Options Currently Exercisable or Exercisable Within 60 Days	Total Number of Shares	Percent of Class
Albert T. Adams	2,000	30,000	32,000	*
James M. Delaney	9,394	20,000	29,394	*
Lou Fatica	6,164	11,000	17,164	*
Martin A. Fishman	29,814	124,500	154,314	