

9. Segment Reporting

The Company's reportable operating segments include Established Communities, Other Stabilized Communities, and Development/Redevelopment Communities. Annually as of January 1st, the Company determines which of its communities fall into each of these categories and maintains that classification, unless disposition plans regarding a community change, throughout the year for the purpose of reporting segment operations.

- *Established Communities (also known as Same Store Communities)* are communities where a comparison of operating results from the prior year to the current year is meaningful, as these communities were owned and had stabilized occupancy and operating expenses as of the beginning of the prior year. For the year 2010, the Established Communities are communities that are consolidated for financial reporting purposes, had stabilized occupancy and operating expenses as of January 1, 2009, are not conducting or planning to conduct substantial redevelopment activities and are not held for sale or planned for disposition within the current year. A community is considered to have stabilized occupancy at the earlier of (i) attainment of 95% physical occupancy or (ii) the one-year anniversary of completion of development or redevelopment.
- *Other Stabilized Communities* includes all other completed communities that have stabilized occupancy, as defined above. Other Stabilized Communities do not include communities that are conducting or planning to conduct substantial redevelopment activities within the current year.
- *Development/Redevelopment Communities* consists of communities that are under construction and have not received a final certificate of occupancy, communities where the Company owns a majority interest and where substantial redevelopment is in progress or is planned to begin during the current year and communities under lease-up that had not reached stabilized occupancy, as defined above, as of January 1, 2010.

In addition, the Company owns land for future development and has other corporate assets that are not allocated to an operating segment.

The Company's segment disclosures present the measure(s) used by the chief operating decision maker for purposes of assessing such segments' performance. The Company's chief operating decision maker is comprised of several members of its executive management team who use NOI as the primary financial measure for Established Communities and Other Stabilized Communities. NOI is defined by the Company as total revenue less direct property operating expenses. Although the Company considers NOI a useful measure of a community's or communities' operating performance, NOI should not be considered an alternative to net income or net cash flow from operating activities, as determined in accordance with GAAP. NOI excludes a number of income and expense categories as detailed in the reconciliation of NOI to net income.

A reconciliation of NOI to net income for years ended December 31, 2010, 2009 and 2008 is as follows:

	For the year ended		
	12-31-10	12-31-09	12-31-08
Net income	\$ 174,079	\$ 154,274	\$ 410,746
Indirect operating expenses, net of corporate income	30,246	30,315	33,010
Investments and investment management expense	3,824	3,844	4,787
Expensed development and other pursuit costs	2,741	5,842	12,511
Interest expense, net	175,209	150,323	114,910
(Gain) loss on extinguishment of debt, net	--	25,910	(1,839)
General and administrative expense	26,846	28,748	42,781
Equity in income of unconsolidated entities	(762)	(1,441)	(4,566)
Depreciation expense	232,571	209,260	183,266
Impairment loss - land holdings	--	21,152	57,899
Gain on sale of real estate assets	(74,074)	(68,717)	(284,901)
Income from discontinued operations	(1,937)	(13,437)	(26,767)
Net operating income	<u>\$ 568,743</u>	<u>\$ 546,073</u>	<u>\$ 541,837</u>

The primary performance measure for communities under development or redevelopment depends on the stage of completion. While under development, management monitors actual construction costs against budgeted costs as well as lease-up pace and rent levels compared to budget.

The following table provides details of the Company's segment information as of the dates specified. The segments are classified based on the individual community's status as of the beginning of the given calendar year. Therefore, each year the composition of communities within each business segment is adjusted. Accordingly, the amounts between years are not directly comparable. Segment information for the years ended December 31, 2010, 2009 and 2008 have been adjusted for the communities that were sold from January 1, 2008 through December 31, 2010, or otherwise qualify as discontinued operations as of December 31, 2010, as described in Note 7, "Real Estate Disposition Activities."

	Total revenue	NOI	% NOI change from prior year	Gross real estate (1)
For the year ended December 31, 2010				
Established				
New England	\$ 143,564	\$ 89,712	(0.3%)	\$ 1,109,016
Metro NY/NJ	181,639	121,033	(1.5%)	1,386,850
Mid-Atlantic/Midwest	120,160	73,813	0.7%	752,020
Pacific Northwest	26,352	16,775	(11.8%)	240,093
Northern California	118,791	80,466	(6.2%)	1,118,324
Southern California	58,888	37,703	(6.7%)	470,162
Total Established (2)	649,394	419,502	(2.8%)	5,076,465
Other Stabilized	122,404	74,609	n/a	1,580,910
Development / Redevelopment	116,114	74,632	n/a	1,736,880
Land Held for Future Development	n/a	n/a	n/a	184,150
Non-allocated (3)	7,354	n/a	n/a	82,806
Total	\$ 895,266	\$ 568,743	4.2%	\$ 8,661,211
For the year ended December 31, 2009				
Established				
New England	\$ 121,455	\$ 75,766	(7.5%)	\$ 858,858
Metro NY/NJ	155,468	103,558	(7.4%)	1,048,636
Mid-Atlantic/Midwest	122,001	74,983	(3.5%)	775,979
Pacific Northwest	28,184	19,101	(9.3%)	239,215
Northern California	98,529	70,819	(7.9%)	857,321
Southern California	62,751	42,900	(9.7%)	428,241
Total Established (2)	588,388	387,127	(7.1%)	4,208,250
Other Stabilized	125,691	81,568	n/a	1,411,395
Development / Redevelopment	129,700	77,378	n/a	2,264,590
Land Held for Future Development	n/a	n/a	n/a	237,095
Non-allocated (3)	7,328	n/a	n/a	62,118
Total	\$ 851,107	\$ 546,073	0.8%	\$ 8,183,448
For the year ended December 31, 2008				
Established				
New England	\$ 115,834	\$ 75,180	2.3%	\$ 748,824
Metro NY/NJ	133,501	91,376	2.1%	814,523
Mid-Atlantic/Midwest	119,194	75,256	1.9%	725,471
Pacific Northwest	21,525	15,493	7.5%	175,504
Northern California	123,204	91,547	7.9%	1,000,952
Southern California	61,449	44,048	1.1%	377,841
Total Established (2)	574,707	392,900	3.5%	3,843,115
Other Stabilized	102,752	68,813	n/a	948,968
Development / Redevelopment	129,737	80,124	n/a	2,502,820
Land Held for Future Development	n/a	n/a	n/a	239,456
Non-allocated (3)	6,568	n/a	n/a	132,702
Total	\$ 813,764	\$ 541,837	12.6%	\$ 7,667,061

- (1) Does not include gross real estate assets held for sale of \$176,643 and \$335,405 as of December 31, 2009 and 2008, respectively.
- (2) Gross real estate for the Company's established communities includes capitalized additions of approximately \$38,670, \$10,783 and \$15,534 in 2010, 2009 and 2008, respectively.
- (3) Revenue represents third-party management, accounting and developer fees and miscellaneous income which are not allocated to a reportable segment.

10. Stock-Based Compensation Plans

On May 21, 2009, the stockholders of the Company, upon the recommendation of the Board of Directors, approved the AvalonBay Communities, Inc. 2009 Stock Option and Incentive Plan (the "2009 Plan"). The 2009 Plan includes an authorization to issue up to 4,199,822 shares of the Company's common stock, par value \$0.01 per share, (2,930,000 newly authorized shares plus 1,269,822 shares that were available for grant as of May 21, 2009 under the Company's 1994 Stock Option and Incentive Plan (the "1994 Plan")), pursuant to awards under the 2009 Plan. In addition, any awards that were outstanding under the 1994 Plan on May 21, 2009 that are subsequently forfeited, canceled, surrendered or terminated (other than by exercise) will become available for awards under the 2009 Plan. The 2009 Plan provides for various types of equity awards to employees, officers, non-employee directors and other key personnel of the Company and its subsidiaries. The types of awards that may be granted under the 2009 Plan include restricted and deferred stock, stock options that qualify as incentive stock options ("ISOs") under Section 422 of the Code, non-qualified stock options, and stock appreciation rights. The 2009 Plan will expire on May 21, 2019.

Information with respect to stock options granted under the 2009 and 1994 Plan is as follows:

	2009 Plan shares	Weighted average exercise price per share	1994 Plan shares	Weighted average exercise price per share	Avalon 1995 and Avalon 1993 Plan shares	Weighted average exercise price per share
Options Outstanding, December 31, 2007	--	N/A	2,321,715	\$ 83.15	768	\$ 36.61
Exercised	--	--	(154,523)	46.15	(768)	36.61
Granted	--	--	401,212	89.06	--	--
Forfeited	--	--	(23,413)	112.51	--	--
Special Dividend Option Adjustment (1)	--	--	78,144	N/A	--	--
Options Outstanding, December 31, 2008	--	N/A	2,623,135	\$ 83.49	--	N/A
Exercised	--	--	(115,675)	44.20	--	--
Granted	--	--	344,801	48.60	--	--
Forfeited	--	--	(16,007)	98.83	--	--
Options Outstanding, December 31, 2009	--	N/A	2,836,254	\$ 80.76	--	N/A
Exercised	--	--	(729,381)	57.87	--	--
Granted	126,484	74.20	--	--	--	--
Forfeited	--	--	(34,656)	100.02	--	--
Options Outstanding, December 31, 2010	126,484	\$ 74.20	2,072,217	\$ 88.50	--	N/A
Options Exercisable:						
December 31, 2008 (1)	--	N/A	1,711,508	\$ 72.97	--	N/A
December 31, 2009	--	N/A	2,127,829	\$ 81.90	--	N/A
December 31, 2010	3,417	\$ 74.20	1,730,978	\$ 93.60	--	N/A

- (1) In accordance with the applicable equity award plan documents, the number and exercise price of outstanding awards have been adjusted as a result of the special dividend declared in the fourth quarter of 2008, to maintain their value.