

ASSOCIATED ESTATES REALTY CORP
Form 11-K
June 29, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

ANNUAL REPORT PURSUANT TO SECTION 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ending December 31, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____
Commission file number 333-27429

THE AERC 401(K) SAVINGS PLAN AND TRUST

(Exact name of Plan)

001
Plan Number

ASSOCIATED ESTATES REALTY CORPORATION

(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction of

34-1747603

(I.R.S. Employer
incorporation or organization)

Identification No.)

5025 Swetland Court, Cleveland, Ohio

44143-1467

(Address of principal executive offices)

(Zip Code)

(216) 261-5000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year,

if changed since last report)

THE AERC 401(K) SAVINGS PLAN AND TRUST

December 31, 2003

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Independent Auditors' Report

To the Trustees

The AERC 401(K) Savings Plan and Trust

We have audited the financial statements of the AERC 401(K) Savings Plan and Trust (the "Plan") as of December 31, 2003 and 2002 and for the year ended December 31, 2003 and the supplemental schedule as of December 31, 2003, as listed in the accompanying contents. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for plan benefits of the AERC 401(K) Savings Plan and Trust as of December 31, 2003 and 2002, and the changes in net assets available for plan benefits for the year ended December 31, 2003.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of assets held for investment as of December 31, 2003, is presented for the purpose of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedule has

been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ Reznick, Fedder & Silverman

Bethesda, Maryland

April 23, 2004, except for Note H as to which the date is May 1, 2004.

The AERC 401(K) Savings Plan and Trust

STATEMENTS OF NET ASSETS AVAILABLE FOR PLAN BENEFITS

December 31, 2003 and December 31, 2002

| | <u>2003</u> | <u>2002</u> |
|--|----------------|----------------|
| ASSETS | | |
| Investments, at fair value | | |
| Participant directed investments | | |
| Stable Value fund | \$ 1,240,696 | \$ 1,101,326 |
| Income fund | 717,292 | 778,827 |
| Moderate portfolio | 704,686 | 534,347 |
| Stock Index fund | 1,974,796 | 1,547,086 |
| Growth and Income fund | 1,424,566 | 1,060,886 |
| Associated Estates Realty Corporation (AERC) | | |
| Stock fund | 346,719 | 276,820 |
| International fund | 79,598 | 30,027 |
| 21st Century Growth Fund | 114,794 | 44,575 |
| Participant notes receivable | <u>223,291</u> | <u>246,827</u> |
| Net assets available for plan benefits | \$ 6,826,438 | \$ 5,620,721 |

The accompanying notes are an integral part of this statement.

The AERC 401(K) Savings Plan and Trust

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR PLAN BENEFITS

Year ended December 31, 2003

| | | |
|---|----------------|------------------|
| Additions to net assets attributed to: | | |
| Investment income | | |
| Net appreciation in fair value of investments | | \$ 1,026,539 |
| Realized loss | | (124,975) |
| Interest and dividends | | 145,503 |
| Contributions | | |
| Employer | \$ 152,079 | |
| Participants | <u>875,008</u> | <u>1,027,087</u> |
| Total additions | | <u>2,074,154</u> |
| Deductions from net assets attributed to: | | |
| Benefits paid to participants | | 866,968 |
| Expenses paid | | <u>1,469</u> |
| Total deductions | | <u>868,437</u> |
| NET INCREASE | | <u>1,205,717</u> |
| Net assets available for plan benefits | | |
| Beginning of year | | <u>5,620,721</u> |
| End of year | | \$ 6,826,438 |

The accompanying notes are an integral part of this statement.

The AERC 401(K) Savings Plan and Trust

NOTES TO FINANCIAL STATEMENTS

December 31, 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the AERC 401(K) Savings Plan and Trust have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to profit-sharing trusts and in accordance with the terms of the Trust Agreement. A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows:

1. Investment Valuation and Income Recognition

Participant notes receivable are valued at cost, which approximates fair value. The Plan's investments are stated at fair value. Shares of registered investment companies are valued at quoted market prices, which represents the net asset value of shares held by the Plan at year end.

Purchases and sales of investments are recorded on a trade date basis. Investment income is recorded as earned and reinvested in the Plan.

2. Federal Income Taxes

The Plan has received a favorable determination letter from the Internal Revenue Service ("IRS") which classified the Plan as a qualified employee benefit plan, exempt from income taxes, under the Employee Retirement Income Security Act of 1994 ("ERISA").

3. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

4. Payment of Benefits

Benefits are recorded when paid.

The AERC 401(K) Savings Plan and Trust

NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2003

NOTE B - DESCRIPTION OF PLAN

The following description of the AERC 401(K) Savings Plan and Trust provides only general information. Participants should refer to the Plan agreement for a more complete description of the Plan's provisions.

The Plan is a plan of a controlled group of corporations which became effective April 1, 1990 by execution of the counterparts to the National City Bank Master Savings Plan and Trust Adoption Agreement. On July 1, 1997, an adoption agreement was executed whereby Scudder, Stevens & Clark ("Scudder") replaced National City Bank as Trustee of the Plan.

Employees are eligible to participate in the Plan with elective deferrals after six months of service provided that they have reached the age of 21. Twelve months of service is required for a participant to receive an employer matching contribution of 50% of the participant's contribution up to a maximum participant contribution of 6% of their gross wages. Effective May 1, 2002, the Plan was amended to reduce the employer matching contribution to 25% of the participant's contribution up to a maximum participant contribution of 6% of their gross wages. Participants may elect to contribute up to 15% of their gross wages and have the option of investing their accounts between eight different investment funds. Participants are immediately vested in the portion of their investment account which includes participant contributions plus actual earnings thereon. Employees hired prior to May 1, 2002 are also immediately vested in the portion of their investment account which includes employer matching contributions plus actual earnings thereon. Employees hired subsequent to May 1, 2002 are subject to a vesting schedule which provides for 100% vesting in employer matching contributions, plus actual earnings thereon after three years of service. Forfeiture of employer matching contributions are to be applied to offset the employer's obligation to make employer matching contributions for the year during which the forfeiture occurs. Forfeitures of \$4,569 from 2002 were applied to offset a portion of the employer's matching contribution in 2003.

On termination of service, a participant may elect to receive either a lump sum amount equal to the value of his or her account, monthly payments over a period equal to the shorter of 120 months or the life expectancy of the participant and/or his or her beneficiary, installment payments of a fixed amount to be made until the balance of the participant's account is exhausted, distribution in kind (securities issued by Associated Estates Realty Corporation only), or any reasonable combination of the foregoing or any reasonable time or manner of distribution within the above stated limitations.

The AERC 401(K) Savings Plan and Trust

NOTES TO FINANCIAL STATEMENTS (Continued)**December 31, 2003****NOTE C - INVESTMENTS**

The Plan's investments are held by Scudder. The following table presents the fair value of the investments. Investments that represent 5 percent or more of the Plan's net assets are separately identified.

| <u>Market Value of Investments</u> | December 31, 2003 <u>Fair Value</u> | December 31, 2002 <u>Fair Value</u> |
|---|---|---|
| Investment at fair value as determined by Scudder | | |
| Stable Value fund | \$ 1,240,696 | \$ 1,101,326 |
| Income fund | 717,292 | 778,827 |
| Moderate portfolio | 704,686 | 534,347 |
| Stock Index fund | 1,974,796 | 1,547,086 |
| Growth and Income fund | 1,424,566 | 1,060,886 |
| Associated Estates Realty Corporation Stock fund | 346,719 | * - |
| Other | <u>417,683</u> | <u>598,249</u> |
| | \$ 6,826,438 | \$ 5,620,721 |

*Investment does not represent 5% or more of the Plan's net assets at December 31, 2002.

During the year ended December 31, 2003, the Plan's investments (including investments bought, sold and held during the year) appreciated in value by \$1,026,539.

NOTE D - ACTIVITY BY FUND

The following table presents the changes in investments for the year ended December 31, 2003 by investment fund based on options available to participants.

| | Stable Value <u>Fund</u> | Income <u>Fund</u> | Moderate Portfolio <u>Portfolio</u> | Stock Index <u>Fund</u> | Growth & Income <u>Fund</u> | AERC Stock <u>Fund</u> | Inter- national <u>national</u> | 21st Century Growth <u>Growth</u> | Participant Notes Receivable <u>Receivable</u> | <u>Total</u> |
|--------------------------------------|--------------------------------|-----------------------|---|-------------------------------|-----------------------------------|------------------------------|---------------------------------------|--|---|----------------|
| Net assets available for plan | | | | | | | | | | |
| benefits as of January 1, 2003 | \$ 1,101,326 | \$ 778,827 | \$ 534,347 | \$ 1,547,086 | \$ 1,060,886 | \$ 276,820 | \$ 30,027 | \$ 44,575 | \$ 246,827 | \$ 5,620,721 |
| Investment income | | | | | | | | | | |
| Net appreciation (depreciation) | | | | | | | | | | |
| in fair value of investments | - | 2,467 | 107,064 | 490,554 | 343,290 | 47,992 | 14,404 | 20,768 | - | 1,026,539 |
| Realized gain (loss) | - | 4,107 | (13,449) | (38,941) | (58,189) | (21,444) | (72) | 3,013 | - | (124,975) |
| Interest and dividends | 49,804 | 30,449 | 14,624 | - | 7,325 | 29,900 | 867 | - | 12,534 | 145,503 |
| Contributions | | | | | | | | | | |
| Employer | 16,305 | 18,665 | 31,773 | 39,077 | 31,645 | 8,984 | 2,711 | 2,919 | - | 152,079 |
| Participants | 121,942 | 101,523 | 168,166 | 236,336 | 168,945 | 47,210 | 14,676 | 16,210 | - | 875,008 |
| Transfers from other plan | - | - | - | - | - | - | - | - | - | - |
| Benefits paid to participants and | | | | | | | | | | |
| fund transfers | (47,781) | (218,639) | (137,545) | (299,197) | (129,299) | (42,731) | 16,985 | 27,309 | (36,070) | (866,968) |
| Expenses paid | <u>(900)</u> | <u>(107)</u> | <u>(294)</u> | <u>(119)</u> | <u>(37)</u> | <u>(12)</u> | = | = | = | <u>(1,469)</u> |
| Net assets available for plan | | | | | | | | | | |
| benefits as of December 31, 2003 | \$ 1,240,696 | \$ 717,292 | \$ 704,686 | \$ 1,974,796 | \$ 1,424,566 | \$ 346,719 | \$ 79,598 | \$ 114,794 | \$ 223,291 | \$ 6,826,438 |

The AERC 401(K) Savings Plan and Trust

NOTES TO FINANCIAL STATEMENTS (Continued)

December 31, 2003

NOTE E - PARTICIPANT NOTES RECEIVABLE

During 2003, the Plan made loans to various employees from their respective interests in the Plan. These loans and loans made in prior years bear interest at rates varying from 5% to 10.5%, and are being amortized over the terms of the loans with bi-weekly payments of principal and interest. The notes have maturity dates equal to or less than five years (ten years if the loan funds are utilized to purchase a primary residence) from the date of the notes, face value equal or greater than \$1,000, and do not exceed 50 percent of the present value of the borrowers' interest in the Plan.

NOTE F - PLAN TERMINATION

Although it has not expressed any intent to do so, the companies participating in the Plan have the right to discontinue their matching contributions at any time and to terminate the Plan subject to the provisions of ERISA.

NOTE G - RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

The following is a reconciliation of net assets available for plan benefits per the financial statements to the Form 5500:

| | December 31, <u>2003</u> | December 31, <u>2002</u> |
|---|-----------------------------|-----------------------------|
| Net assets available for plan benefits per the financial statements | \$ 6,826,438 | \$ 5,620,721 |
| Amounts allocated to withdrawing participants | (26,704) | = |
| Net assets available for plan benefits per Form 5500 | \$ 6,799,734 | \$ 5,620,721 |

The following is a reconciliation of benefits paid to participants per the financial statements for the year ended December 31, 2003, to Form 5500:

| | |
|--|---------------|
| Benefits paid to participants per the financial statements | \$ 866,968 |
| Add: Amounts allocated to withdrawing participants at December 31, 2003 | <u>26,704</u> |
| Benefits paid to participants per Form 5500 | \$ 893,672 |

Amounts allocated to withdrawing participants are recorded on the Form 5500 for benefit claims that have been processed and approved for payment prior to December 31, 2003, but have not yet been paid as of that date.

NOTE H - SUBSEQUENT EVENT

Effective May 1, 2004, Prudential Financial, Inc. replaced Scudder as Trustee of the Plan.

SUPPLEMENTAL INFORMATION

THE AERC 401(K) SAVINGS PLAN AND TRUST

FORM 5500 SCHEDULE H - ITEM IV(I)

SCHEDULE OF ASSETS HELD FOR INVESTMENT

DECEMBER 31, 2003

| <u>Identity of Party Involved</u> | <u>Description</u> | <u>Maturity</u> | <u>Interest Rate</u> | <u>Fair Value</u> |
|---------------------------------------|--------------------|-----------------|--------------------------|-----------------------|
|---------------------------------------|--------------------|-----------------|--------------------------|-----------------------|

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| | | | | |
|-------------------|----------------------------|---------|----------|--------------|
| Scudder | Stable Value Fund | N/A | N/A | \$ 1,240,696 |
| Scudder | Income Fund | N/A | N/A | 717,292 |
| Scudder | Pathway Moderate Portfolio | N/A | N/A | 704,686 |
| Scudder | Growth and Income Fund | N/A | N/A | 1,424,566 |
| Scudder | Stock Index Fund | N/A | N/A | 1,974,796 |
| AERC | Stock Fund | N/A | N/A | 346,719 |
| Scudder | International Fund | N/A | N/A | 79,598 |
| Scudder | 21st Century Growth Fund | N/A | N/A | 114,794 |
| Participant loans | Participating loans | Various | 5%-10.5% | 223,291 |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

THE AERC 401(K) SAVINGS

PLAN AND TRUST

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|--------------|---------------|
| <u>/s/ Jeffrey I. Friedman</u> Jeffrey I. Friedman | Trustee | June 29, 2004 |
| <u>/s/ Lou Fatica</u> Lou Fatica | Trustee | June 29, 2004 |
| <u>/s/ Nan Zieleniec</u> | | |

Nan Zieleniec

Trustee

June 29, 2004

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