



---

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

- (X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007
- ( ) 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: 1-13136

---

**HOME PROPERTIES, INC.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MARYLAND  
(State of incorporation)

16-1455126  
(I.R.S. Employer Identification No.)

---

850 Clinton Square, Rochester, New York 14604  
(Address of principal executive offices)(Zip Code)

---

(585) 546-4900  
(Registrant's telephone number, including area code)

---

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 the filing requirements for at least the past 90 days.

Yes X No \_\_\_\_\_

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

Large accelerated filer X Accelerated filer \_\_\_\_\_ Non-accelerated filer \_\_\_\_\_

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes \_\_\_\_\_ No X

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes \_\_\_\_\_ No \_\_\_\_\_

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock  
\$.01 par value

Outstanding at July 31, 2007  
33,565,557

---

---

HOME PROPERTIES, INC.

TABLE OF CONTENTS

	<u>PAGE</u>
 <b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements (Unaudited)	
Consolidated Balance Sheets – June 30, 2007 and December 31, 2006	4
Consolidated Statements of Operations – Three months ended June 30, 2007 and 2006	5
Consolidated Statements of Operations – Six months ended June 30, 2007 and 2006	6
Consolidated Statement of Stockholders' Equity and Comprehensive Income - Six months ended June 30, 2007	7
Consolidated Statements of Cash Flow – Six months ended June 30, 2007 and 2006	8
Notes to Consolidated Financial Statements	9-16
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	17-28
Item 3. Quantitative and Qualitative Disclosures About Market Risk	29
Item 4. Controls and Procedures	30
 <b>PART II. OTHER INFORMATION</b>	
Item 1A. Risk Factors	31
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	31
Item 4. Submission of Matter to a Vote of Security Holders	32
Item 6. Exhibits	32
Signatures	33

PART I – FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

HOME PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS  
JUNE 30, 2007 AND DECEMBER 31, 2006  
(Dollars in thousands, except share and per share data)

	<u>2007</u> (Unaudited)	<u>2006</u> (Note 1)
<b>ASSETS</b>		
Real estate:		
Land	\$ 518,298	\$ 493,017
Construction in progress, including land	51,950	1,409
Buildings, improvements and equipment	<u>3,114,789</u>	<u>2,957,336</u>
	3,685,037	3,451,762
Less: accumulated depreciation	<u>(504,327)</u>	<u>(450,129)</u>
Real estate, net	3,180,710	3,001,633
Cash and cash equivalents	5,350	118,212
Cash in escrows	32,723	74,069
Accounts receivable	10,802	9,287
Prepaid expenses	11,250	15,059
Deferred charges	13,003	13,619
Other assets	<u>5,847</u>	<u>8,539</u>
Total assets	<u>\$ 3,259,685</u>	<u>\$ 3,240,418</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Mortgage notes payable	\$ 1,963,368	\$ 1,924,313
Exchangeable senior notes	200,000	200,000
Line of credit	39,000	-
Accounts payable	18,346	20,797
Accrued interest payable	10,815	10,473
Accrued expenses and other liabilities	24,689	24,697
Security deposits	<u>23,555</u>	<u>21,979</u>
Total liabilities	<u>2,279,773</u>	<u>2,202,259</u>
Commitments and contingencies		
Minority interest	<u>281,585</u>	<u>282,542</u>
Stockholders' equity:		
Cumulative redeemable preferred stock, \$.01 par value; 2,400,000 shares issued and outstanding at December 31, 2006	-	60,000
Common stock, \$.01 par value; 80,000,000 shares authorized; 33,528,222 and 33,103,247 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	335	331
Excess stock, \$.01 par value; 10,000,000 shares authorized; no shares issued or outstanding	-	-
Additional paid-in capital	884,459	852,036
Accumulated other comprehensive income	-	171
Distributions in excess of accumulated earnings	<u>(186,467)</u>	<u>(156,921)</u>
Total stockholders' equity	<u>698,327</u>	<u>755,617</u>
Total liabilities and stockholders' equity	<u>\$ 3,259,685</u>	<u>\$ 3,240,418</u>

The accompanying notes are an integral part of these consolidated financial statements.

HOME PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED JUNE 30, 2007 AND 2006  
(Unaudited, dollars in thousands, except share and per share data)

	<u>2007</u>	<u>2006</u>
Revenues:		
Rental income	\$ 119,884	\$ 103,879
Property other income	9,796	6,698
Interest income	83	119
Other income	58	504
Total revenues	<u>129,821</u>	<u>111,200</u>
Expenses:		
Operating and maintenance	52,668	43,610
General and administrative	5,953	6,057
Interest	30,716	26,432
Depreciation and amortization	28,365	23,227
Total expenses	<u>117,702</u>	<u>99,326</u>
Income from operations	12,119	11,874
Minority interest in operating partnerships	(3,480)	(3,271)
Income from continuing operations	<u>8,639</u>	<u>8,603</u>
Discontinued operations:		
Income from operations, net of \$72 and \$625 in 2007 and 2006, respectively, allocated to minority interest	178	1,389
Gain (loss) on disposition of property, net of (\$46) and \$1,064 in 2007 and 2006, respectively, allocated to minority interest	(115)	2,361
Discontinued operations	<u>63</u>	<u>3,750</u>
Net income	8,702	12,353
Preferred dividends	-	(1,350)
Net income available to common shareholders	<u>\$ 8,702</u>	<u>\$ 11,003</u>
Basic earnings per share data:		
Income from continuing operations	\$ 0.26	\$ 0.22
Discontinued operations	-	0.11
Net income available to common shareholders	<u>\$ 0.26</u>	<u>\$ 0.33</u>
Diluted earnings per share data:		
Income from continuing operations	\$ 0.26	\$ 0.22
Discontinued operations	-	0.11
Net income available to common shareholders	<u>\$ 0.26</u>	<u>\$ 0.33</u>
Weighted average number of shares outstanding:		
Basic	<u>33,255,898</u>	<u>32,936,880</u>
Diluted	<u>33,985,283</u>	<u>33,598,725</u>
Dividends declared per share	<u>\$ 0.65</u>	<u>\$ 0.64</u>

The accompanying notes are an integral part of these consolidated financial statements.

HOME PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
(Unaudited, dollars in thousands, except share and per share data)

	<u>2007</u>	<u>2006</u>
Revenues:		
Rental income	\$ 235,622	\$ 205,981
Property other income	20,582	12,777
Interest income	1,290	210
Other income	833	1,021
Total revenues	<u>258,327</u>	<u>219,989</u>
Expenses:		
Operating and maintenance	108,530	95,414
General and administrative	11,471	11,096
Interest	59,845	52,336
Depreciation and amortization	55,962	45,930
Total expenses	<u>235,808</u>	<u>204,776</u>
Income from operations	22,519	15,213
Minority interest in operating partnerships	(5,550)	(3,963)
Income from continuing operations	<u>16,969</u>	<u>11,250</u>
Discontinued operations:		
Income from operations, net of \$102 and \$2,140 in 2007 and 2006, respectively, allocated to minority interest	251	4,230
Gain (loss) on disposition of property, net of (\$100) and \$1,064 in 2007 and 2006, respectively, allocated to minority interest	(248)	2,361
Discontinued operations	<u>3</u>	<u>6,591</u>
Net income	16,972	17,841
Preferred dividends	(1,290)	(2,700)
Preferred stock issuance costs write-off	<u>(1,902)</u>	<u>-</u>
Net income available to common shareholders	<u>\$ 13,780</u>	<u>\$ 15,141</u>
Basic earnings per share data:		
Income from continuing operations	\$ 0.42	\$ 0.27
Discontinued operations	-	0.20
Net income available to common shareholders	<u>\$ 0.42</u>	<u>\$ 0.47</u>
Diluted earnings per share data:		
Income from continuing operations	\$ 0.41	\$ 0.26
Discontinued operations	-	0.20
Net income available to common shareholders	<u>\$ 0.41</u>	<u>\$ 0.46</u>
Weighted average number of shares outstanding:		
Basic	<u>33,161,446</u>	<u>32,101,587</u>
Diluted	<u>33,958,962</u>	<u>32,722,174</u>
Dividends declared per share	<u>\$ 1.30</u>	<u>\$ 1.28</u>

The accompanying notes are an integral part of these consolidated financial statements.

HOME PROPERTIES, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME  
FOR THE SIX MONTHS ENDED JUNE 30, 2007

(Unaudited, dollars in thousands, except share and per share data)

	Preferred Stock at Liquidation Preference	<u>Common Stock</u> <u>Shares</u>	<u>Amount</u>	Additional Paid-In Capital	Distributions in Excess of Accumulated Earnings	Accumulated Other Comprehensive Income	<u>Totals</u>
Balance, December 31, 2006	\$ 60,000	33,103,247	\$ 331	\$ 852,036	\$(156,921)	\$ 171	\$ 755,617
Comprehensive income:							
Net income	-	-	-	-	16,972	-	16,972
Change in fair value of hedge instruments, net of minority interest	-	-	-	-	-	(171)	(171)
Comprehensive income							<u>16,801</u>
Issuance of common stock, net	-	178,784	2	7,654	-	-	7,656
Repurchase of common stock	-	(135,091)	(1)	(7,578)	-	-	(7,579)
Redemption of preferred stock	(60,000)	-	-	1,902	(1,902)	-	(60,000)
Conversion of UPREIT Units for stock	-	381,282	3	21,611	-	-	21,614
Adjustment of minority interest	-	-	-	8,834	-	-	8,834
Preferred dividends	-	-	-	-	(1,290)	-	(1,290)
Dividends paid (\$1.30 per share)	-	-	-	-	(43,326)	-	(43,326)
Balance, June 30, 2007	<u>\$ -</u>	<u>33,528,222</u>	<u>\$ 335</u>	<u>\$ 884,459</u>	<u>\$(186,467)</u>	<u>\$ -</u>	<u>\$ 698,327</u>

The accompanying notes are an integral part of these consolidated financial statements.

## HOME PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
(Unaudited, dollars in thousands)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Net income	\$ 16,972	\$ 17,841
Adjustments to reconcile net income to net cash provided by operating activities:		
Income allocated to minority interest	5,552	7,167
Depreciation and amortization	55,877	51,144
Loss (gain) on disposition of property from discontinued operations	348	(3,425)
Issuance of restricted stock, compensation cost of stock options and deferred compensation	2,456	2,287
Changes in assets and liabilities:		
Cash held in escrows	380	17
Other assets	4,996	8,093
Accounts payable and accrued liabilities	(6,058)	(375)
Total adjustments	<u>63,551</u>	<u>64,908</u>
Net cash provided by operating activities	<u>80,523</u>	<u>82,749</u>
Cash flows from investing activities:		
Purchase of properties and other assets, net	(144,163)	(20,164)
Additions to properties	(39,356)	(50,825)
Proceeds (loss) from sale of properties	(348)	235,145
Withdrawals from (additions to) funds held in escrow, net	<u>40,636</u>	<u>(40,309)</u>
Net cash provided by (used in) investing activities	<u>(143,231)</u>	<u>123,847</u>
Cash flows from financing activities:		
Proceeds from sale of common stock, net	5,200	13,806
Repurchase of Series F preferred stock	(60,000)	-
Repurchase of common stock	(7,579)	(86,356)
Proceeds from mortgage notes payable	100,515	122,980
Payments of mortgage notes payable	(65,051)	(155,515)
Proceeds from line of credit	166,500	210,800
Payments on line of credit	(127,500)	(245,800)
Payments of deferred loan costs	(878)	(1,369)
Withdrawals from cash escrows, net	366	193
Dividends and distributions paid	<u>(61,727)</u>	<u>(63,546)</u>
Net cash used in financing activities	<u>(50,154)</u>	<u>(204,807)</u>
Net increase (decrease) in cash and cash equivalents	(112,862)	1,789
Cash and cash equivalents:		
Beginning of year	118,212	5,391
End of period	<u>\$ 5,350</u>	<u>\$ 7,180</u>
<u>Supplemental disclosure of non-cash operating, investing and financing activities:</u>		
Mortgage loans assumed associated with property acquisitions	\$ 3,742	\$ 13,151
Issuance of UPREIT Units associated with property and other acquisitions	27,475	-
Increase in real estate associated with the exchange of UPREIT Units	13,611	99,559
Exchange of UPREIT Units for common shares	8,003	59,173
Additions to properties included in accounts payable	4,058	-
Fair value of hedge instruments	(206)	357
Preferred stock issuance costs write-off	1,902	-

The accompanying notes are an integral part of these consolidated financial statements.



## HOME PROPERTIES, INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

#### 1. Unaudited Interim Financial Statements

The interim consolidated financial statements of Home Properties, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the applicable rules and regulations of the Securities and Exchange Commission. Accordingly, certain disclosures that would accompany annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America are omitted. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments, consisting solely of normal recurring adjustments, necessary for the fair statement of the consolidated financial statements for the interim periods have been included. The current period's results of operations are not necessarily indicative of results which ultimately may be achieved for the year. The interim consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2006.

#### 2. Organization and Basis of Presentation

##### *Organization*

The Company was formed in November 1993, as a Maryland corporation and is engaged primarily in the ownership, management, acquisition, rehabilitation and development of residential apartment communities primarily in select Northeast, Mid-Atlantic and Southeast Florida regions of the United States. The Company conducts its business through Home Properties, L.P. (the "Operating Partnership"), a New York limited partnership. As of June 30, 2007, the Company operated 130 apartment communities with 39,671 apartments. Of this total, the Company owned 127 communities, consisting of 38,209 apartments, managed as general partner one partnership that owned 868 apartments, and fee managed two communities, consisting of 594 apartments, for third parties.

The Company elected to be taxed as a Real Estate Investment Trust ("REIT") under the Internal Revenue Code, as amended, for all periods presented. A corporate REIT is a legal entity which holds real estate interests and must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its adjusted taxable income to stockholders. As a REIT, the Company generally will not be subject to corporate level tax on taxable income it distributes currently to its stockholders. Management believes that all such conditions for the avoidance of income taxes have been met for the periods presented.

##### *Basis of Presentation*

The accompanying consolidated financial statements include the accounts of the Company and its 71.6% (71.4% at December 31, 2006) interest in the Operating Partnership. Such interest has been calculated as the percentage of outstanding common shares divided by the total outstanding common shares and Operating Partnership Units ("UPREIT Units") outstanding. The remaining 28.4% (28.6% at December 31, 2006) is reflected as Minority Interest in these consolidated financial statements. The Company owns a 1.0% general partner interest in the Operating Partnership and the remainder of its interest as a limited partner indirectly through its wholly owned subsidiary, Home Properties I, LLC, which owns 100% of the limited partner, Home Properties Trust. Home Properties Trust was formed in September 1997, as a Maryland real estate trust and as a qualified REIT subsidiary ("QRS") and owns the Company's share of the limited partner interests in the Operating Partnership. For financing purposes, the Company has formed a limited liability company (the "LLC") and a partnership (the "Financing Partnership"), which beneficially own certain apartment communities encumbered by mortgage indebtedness. The LLC is wholly owned by the Operating Partnership. The Financing Partnership is owned 99.9% by the Operating Partnership and 0.1% by the QRS.

## HOME PROPERTIES, INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

#### 2. Organization and Basis of Presentation (continued)

The accompanying consolidated financial statements include the accounts of Home Properties Resident Services, Inc. (the "Management Company"). The Management Company is a wholly owned subsidiary of the Company. In addition, the Company consolidates one affordable housing limited partnership in accordance with FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 – Consolidated Financial Statements* ("FIN 46R"). All significant inter-company balances and transactions have been eliminated in these consolidated financial statements.

#### *Reclassifications*

Certain reclassifications have been made to the 2006 consolidated financial statements to conform to the 2007 presentation.

#### 3. Recent Accounting Pronouncements

On January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48 addresses the recognition and measurement of assets and liabilities associated with tax positions taken or expected to be taken in a tax return. The Company reviewed its current tax positions for any potential uncertain tax positions that would qualify under FIN 48. The adoption of FIN 48 did not have a material impact on the Company's results of operations, financial position or liquidity.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements; the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to adopt SFAS 157 in the first quarter of 2008. Management is currently evaluating the impact, if any, that SFAS 157 will have on the Company's results of operations, financial position or liquidity.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ("SFAS 159"). SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Under SFAS 159, entities are now permitted to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis under a fair value option granted in SFAS 159. Excluded from the scope of SFAS 159 are real estate assets and interests in VIE's. Management is currently evaluating the impact, if any, this pronouncement will have on the Company's results of operations, financial position or liquidity.

# HOME PROPERTIES, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

### 4. Earnings Per Common Share

Basic earnings per share ("EPS") is computed as net income available to common shareholders divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock-based compensation including stock options (using the treasury stock method), restricted stock and phantom shares under the Company's incentive compensation plan. The exchange of an UPREIT Unit for common stock will have no effect on diluted EPS as Unitholders and stockholders effectively share equally in the net income of the Operating Partnership. Income from continuing operations is the same for both the basic and diluted calculation.

The reconciliation of the basic and diluted earnings per share for the three and six months ended June 30, 2007 and 2006 follows:

	<u>Three Months</u>		<u>Six Months</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Income from continuing operations	\$ 8,639	\$ 8,603	\$ 16,969	\$ 11,250
Less: Preferred dividends	-	(1,350)	(1,290)	(2,700)
Less: Preferred stock issuance costs write-off	-	-	(1,902)	-
Basic and Diluted – Income from continuing operations applicable to common shareholders	8,639	7,253	13,777	8,550
Discontinued operations	<u>63</u>	<u>3,750</u>	<u>3</u>	<u>6,591</u>
Net income available to common shareholders	<u>\$ 8,702</u>	<u>\$ 11,003</u>	<u>\$ 13,780</u>	<u>\$ 15,141</u>
Basic weighted average number of shares outstanding	33,255,898	32,936,880	33,161,446	32,101,587
Effect of dilutive stock options	586,098	598,898	650,830	556,685
Effect of phantom and restricted shares	<u>143,287</u>	<u>62,947</u>	<u>146,686</u>	<u>63,902</u>
Diluted weighted average number of shares outstanding	<u>33,985,283</u>	<u>33,598,725</u>	<u>33,958,962</u>	<u>32,722,174</u>
Basic earnings per share data:				
Income from continuing operations	\$ 0.26	\$ 0.22	\$ 0.42	\$ 0.27
Discontinued operations	-	0.11	-	0.20
Net income available to common shareholders	<u>\$ 0.26</u>	<u>\$ 0.33</u>	<u>\$ 0.42</u>	<u>\$ 0.47</u>
Diluted earnings per share data:				
Income from continuing operations	\$ 0.26	\$ 0.22	\$ 0.41	\$ 0.26
Discontinued operations	-	0.11	-	0.20
Net income available to common shareholders	<u>\$ 0.26</u>	<u>\$ 0.33</u>	<u>\$ 0.41</u>	<u>\$ 0.46</u>

Unexercised stock options to purchase shares of the Company's common stock of 547,515 and 531,930 for the three months ended June 30, 2007 and 2006, and 12,000 and 531,930 for the six months ended June 30, 2007 and 2006, respectively, were excluded in the computation of diluted EPS as the options' exercise prices were greater than the average market price of the Company's stock during each period.

## HOME PROPERTIES, INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

#### 5. Variable Interest Entities

Effective March 31, 2004, the Company adopted FASB Interpretation No. 46R – *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 – Consolidated Financial Statements* ("FIN 46R"). The interpretation addresses consolidation by businesses of special purpose entities (variable interest entities, "VIE").

The Company is the general partner in one VIE syndicated using low income housing tax credits under Section 42 of the Internal Revenue Code. As general partner, the Company manages the day-to-day operations of the partnership for a management fee. In addition, the Company has an operating deficit guarantee and tax credit guarantee to its limited partners (as discussed in Note 13). The Company is responsible to fund operating deficits to the extent there are any and can receive operating incentive awards when cash flows reach certain levels. The effect on the consolidated balance sheet as of June 30, 2007 is an increase in "Total assets" of \$19,555, an increase in "Total liabilities" of \$17,489, and an increase in "Minority interest" of \$2,066. Of the \$17,489 increase in "Total liabilities," \$16,645 represents non-recourse mortgage debt.

#### 6. Interest Capitalized

Capitalized interest associated with communities under development or rehabilitation totaled \$895 and \$346 for the three months ended June 30, 2007 and 2006, and \$1,499 and \$659 for the six months ended June 30, 2007 and 2006, respectively.

#### 7. Line of Credit

As of June 30, 2007, the Company had an unsecured line of credit agreement with M&T Bank for \$140,000 which expires September 1, 2008. The Company's outstanding balance as of June 30, 2007, was \$39,000. Provided that no event of default under this agreement has occurred, the Company may request on or before September 1, 2007 that the lender increase the line of credit to an amount not to exceed \$190,000. The Company has had no occurrences of default as of June 30, 2007. Borrowings under the line of credit bear interest at 0.75% over the one-month LIBOR rate of 5.32% at June 30, 2007. Accordingly, increases in interest rates will increase the Company's interest expense and as a result will affect the Company's results of operations and financial condition.

#### 8. Preferred Stock

In March 2002, the Company issued 2,400,000 shares of its 9.00% Series F Cumulative Redeemable Preferred Stock ("Series F Preferred Shares"), with a \$25.00 liquidation preference per share. This offering generated net proceeds of approximately \$58,098. Each Series F Preferred share received an annual dividend equal to 9.00% of the liquidation preference per share (equivalent to a fixed annual amount of \$2.25 per share). The Series F Preferred Shares were redeemed by the Company on March 26, 2007 at a redemption price of \$25.00 per share, plus accrued and unpaid dividends of \$390. In accordance with the SEC's clarification of EITF Abstracts, Topic No. D-42, *The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock*, the initial offering costs of \$1,902 associated with the issuance of the Series F Preferred Shares were written-off in the first quarter of 2007, and are reflected as a reduction of net income available to common stockholders in determining earnings per share for the six months ended June 30, 2007.

# HOME PROPERTIES, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

### 9. Segment Reporting

The Company is engaged in the ownership and management of market rate apartment communities. Each apartment community is considered a separate operating segment. Each segment on a stand alone basis is less than 10% of the revenues, net operating income, and assets of the combined reported operating segments and meets all of the aggregation criteria under Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* ("SFAS 131"). The operating segments are aggregated as Core and Non-core properties.

Non-segment revenue to reconcile to total revenue consists of interest income and other income. Non-segment assets to reconcile to total assets include cash and cash equivalents, cash in escrows, accounts receivable, prepaid expenses, deferred charges and other assets.

Core properties consist of all apartment communities which have been owned more than one full calendar year. Therefore, the Core properties represent communities owned as of January 1, 2006. Non-core properties consist of apartment communities acquired during 2006 and 2007, such that full year comparable operating results are not available.

The Company assesses and measures segment operating results based on a performance measure referred to as net operating income. Net operating income is defined as total revenues less operating and maintenance expenses. The accounting policies of the segments are the same as those described in Notes 1 and 2 of the Company's Form 10-K for the year ended December 31, 2006.

The revenues, net operating income and assets for each of the reportable segments for the three and six months ended June 30, 2007 and 2006 are summarized as follows:

	<u>Three Months</u>		<u>Six Months</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<u>Revenues</u>				
Apartments owned				
Core properties	\$ 113,087	\$ 108,775	\$ 226,034	\$ 215,526
Non-core properties	16,593	1,802	30,170	3,232
Reconciling items	<u>141</u>	<u>623</u>	<u>2,123</u>	<u>1,231</u>
Total revenues	<u>\$ 129,821</u>	<u>\$ 111,200</u>	<u>\$ 258,327</u>	<u>\$ 219,989</u>
<u>Net operating income</u>				
Apartments owned				
Core properties	\$ 67,296	\$ 66,133	\$ 130,278	\$ 122,497
Non-core properties	9,716	834	17,396	847
Reconciling items	<u>141</u>	<u>623</u>	<u>2,123</u>	<u>1,231</u>
Net operating income, including reconciling items	77,153	67,590	149,797	124,575
General and administrative expenses	(5,953)	(6,057)	(11,471)	(11,096)
Interest expense	(30,716)	(26,432)	(59,845)	(52,336)
Depreciation and amortization	(28,365)	(23,227)	(55,962)	(45,930)
Minority interest in operating partnership	<u>(3,480)</u>	<u>(3,271)</u>	<u>(5,550)</u>	<u>(3,963)</u>
Income from continuing operations	<u>\$ 8,639</u>	<u>\$ 8,603</u>	<u>\$ 16,969</u>	<u>\$ 11,250</u>
<u>Assets - As of June 30, 2007 and December 31, 2006</u>				
Apartments owned				
Core properties	\$ 2,577,996	\$ 2,580,032		
Non-core properties	602,714	421,601		
Reconciling items	<u>78,975</u>	<u>238,785</u>		
Total assets	<u>\$ 3,259,685</u>	<u>\$ 3,240,418</u>		

## HOME PROPERTIES, INC.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

#### 10. Derivative Financial Instruments

The Company enters into financial derivative instruments only for the purpose of minimizing risk and, thereby, protecting income. Derivative instruments utilized as part of the Company's risk management strategy may include interest rate swaps and caps. All derivatives are recognized on the balance sheet at fair value. The Company does not employ leveraged derivative instruments, nor does it enter into derivative instruments for trading or speculative purposes.

The Company had four interest rate swaps that effectively converted variable rate debt to fixed rate debt. On May 29, 2007, these interest rate swaps were terminated and the Company received a termination fee of \$27. The accumulated other comprehensive income of \$84 was reclassified into earnings. The related variable rate debt was repaid on June 13, 2007. For the entire term of these interest rate swap agreements, as the critical terms of the interest rate swaps and the hedged items are the same, no ineffectiveness was recorded in the consolidated statements of operations. All components of the interest rate swaps were included in the assessment of hedge effectiveness.

#### 11. Acquisitions

On April 30, 2007, the Company acquired Westwoods, a 35 unit apartment community located in Randolph, MA, for \$3,995, including closing costs. Consideration for the purchase was the assumption of an existing \$3,919 fixed rate mortgage at an interest rate of 5.6% maturing on June 1, 2034 (fair market value of \$3,742) with the balance paid in cash.

#### 12. Disposition of Property and Discontinued Operations

The Company reports its property dispositions as discontinued operations as prescribed by the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). Pursuant to the definition of a component of an entity in SFAS 144, assuming no significant continuing involvement by the former owner after the sale, the sale of an apartment community is considered a discontinued operation. In addition, apartment communities classified as held for sale are also considered discontinued operations. The Company generally considers assets to be held for sale when all significant contingencies surrounding the closing have been resolved, which often corresponds with the actual closing date.

Included in discontinued operations for the three and six months ended June 30, 2006 are the operating results, net of minority interest, of 39 apartment communities sold during the year ended December 31, 2006 ("2006 Disposed Communities"). Included in discontinued operations for the three and six months ended June 30, 2007 are the operating results, net of minority interest, of the 2006 Disposed Communities. For purposes of the discontinued operations presentation, the Company only includes interest expense and losses from early extinguishment of debt associated with specific mortgage indebtedness of the properties that are sold or held for sale.

# HOME PROPERTIES, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

### 12. Disposition of Property and Discontinued Operations (continued)

The operating results of discontinued operations for the three and six months ended June 30, 2007 and 2006 are summarized as follows:

	<u>Three Months</u>		<u>Six Months</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Revenues:				
Rental income	\$ 49	\$ 19,411	\$ 88	\$ 39,383
Property other income	<u>3</u>	<u>1,769</u>	<u>44</u>	<u>3,663</u>
Total revenues	<u>52</u>	<u>21,180</u>	<u>132</u>	<u>43,046</u>
Operating and maintenance	(198)	11,270	(221)	23,823
Interest expense	-	5,531	-	8,108
Depreciation and amortization	-	2,365	-	4,745
Total expenses	<u>(198)</u>	<u>19,166</u>	<u>(221)</u>	<u>36,676</u>
Income from discontinued operations before minority interest and loss on disposition of property	250	2,014	353	6,370
Minority interest in operating partnerships	<u>(72)</u>	<u>(625)</u>	<u>(102)</u>	<u>(2,140)</u>
Income from discontinued operations	<u>\$ 178</u>	<u>\$ 1,389</u>	<u>\$ 251</u>	<u>\$ 4,230</u>

### 13. Commitments and Contingencies

#### *Contingencies*

The Company is not a party to any legal proceedings which are expected to have a material adverse effect on the Company's liquidity, financial position or results of operations. The Company is subject to a variety of legal actions for personal injury or property damage arising in the ordinary course of its business, most of which are covered by liability and property insurance. Various claims of employment and resident discrimination are also periodically brought. While the resolution of these matters cannot be predicted with certainty, management believes that the final outcome of such legal proceedings and claims will not have a material adverse effect on the Company's liquidity, financial position or results of operations.

In connection with various UPREIT transactions, the Company has agreed to maintain certain levels of nonrecourse debt for a period of 5 to 10 years associated with the contributed properties acquired. In addition, the Company is restricted in its ability to sell certain contributed properties (52% by number of apartment communities of the owned portfolio) for a period of 7 to 15 years except through a tax deferred like-kind exchange. The remaining terms on the sale restrictions range from 1 to 9 years.

#### *Guarantees*

As of June 30, 2007, the Company, through its general partnership interest in an affordable property limited partnership, has guaranteed the Low Income Housing Tax Credits to limited partners for a remaining period of seven years totaling approximately \$3,000. As of June 30, 2007, there were no known conditions that would make such payments necessary relating to these guarantees. In addition, the Company, acting as general partner in this partnership, is obligated to advance funds to meet partnership operating deficits.

HOME PROPERTIES, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollars in thousands, except share and per share data)

14. Subsequent Events

On July 12, 2007, the Company sold Brittany Place Apartments, with a total of 591 units, in Greenbelt, Maryland for \$74,102. A gain on sale of approximately \$21,000 (before the allocation of minority interest) will be recorded in the third quarter related to this sale.

On August 2, 2007, the Board of Directors approved a dividend of \$0.65 per share on the Company's common stock for the quarter ended June 30, 2007. This is the equivalent of an annual distribution of \$2.60 per share. The dividend is payable August 24, 2007 to shareholders of record on August 13, 2007.



## HOME PROPERTIES, INC.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (Unaudited, dollars in thousands, except share and per share data)

The following discussion should be read in conjunction with the accompanying consolidated financial statements and notes thereto.

#### Forward-Looking Statements

This discussion contains forward-looking statements. Historical results and percentage relationships set forth in the consolidated financial statements, including trends which might appear, should not be taken as indicative of future operations. The Company considers portions of the information to be "forward-looking statements" within the meaning of Section 27A of the Securities Exchange Act of 1933 and Section 21E of the Securities Exchange Act of 1934, both as amended, with respect to the Company's expectations for future periods. Some examples of forward-looking statements include statements related to acquisitions (including any related pro forma financial information), future capital expenditures, financing sources and availability, and the effects of environmental and other regulations. Although the Company believes that the expectations reflected in those forward-looking statements are based upon reasonable assumptions, it can give no assurance that its expectations will be achieved. Factors that may cause actual results to differ include general economic and local real estate conditions, the weather and other conditions that might affect operating expenses, the timely completion of repositioning activities and development within anticipated budgets, the actual pace of future development, acquisitions and sales, and continued access to capital to fund growth. For this purpose, any statements contained in this report that are not statements of historical fact should be considered to be forward-looking statements. Some of the words used to identify forward-looking statements include "believes", "anticipates", "plans", "expects", "seeks", "estimates", and similar expressions. Readers should exercise caution in interpreting and relying on forward-looking statements since they involve known and unknown risks, uncertainties and other factors which are, in some cases, beyond the Company's control and could materially affect the Company's actual results, performance or achievements.

#### Liquidity and Capital Resources

The Company's principal liquidity demands are expected to be distributions to the common stockholders and holders of UPREIT Units, capital improvements and repairs and maintenance for the properties, acquisition and development of additional properties, stock repurchases and debt repayments. The Company may also acquire equity ownership in other public or private companies that own and manage portfolios of apartment communities. Management anticipates the acquisition of communities of approximately \$300 million in 2007, \$129 million of which were closed during the first half of 2007, although there can be no assurance that additional acquisitions will actually occur.

The Company intends to meet its short-term liquidity requirements through net cash flows provided by operating activities and its existing bank line of credit, described below. The Company considers its ability to generate cash to be adequate to meet all operating requirements, including availability to pay dividends to its stockholders and make distributions to its Unitholders in accordance with the provisions of the Internal Revenue Code, as amended, applicable to REITs.

As of June 30, 2007, the Company had an unsecured line of credit agreement with M&T Bank of \$140 million which expires September 1, 2008. Provided that no event of default under this agreement has occurred, the Company may request on or before September 1, 2007 that the lenders increase the line of credit to an amount not to exceed \$190 million. The Company has had no occurrences of default as of June 30, 2007. The Company's outstanding balance as of June 30, 2007, was \$39.0 million. Borrowings under the line of credit bear interest at 0.75% over the one-month LIBOR rate of 5.32% at June 30, 2007. Accordingly, increases in interest rates will increase the Company's interest expense and as a result will affect the Company's results of operations and financial condition.

To the extent that the Company does not satisfy its long-term liquidity requirements through net cash flows provided by operating activities and its unsecured credit facility, it intends to satisfy such requirements through

property debt financing, proceeds from the sale of properties, the issuance of UPREIT Units, proceeds from its Dividend Reinvestment and Stock Purchase Plan ("DRIP"), or the issuance of additional debt and equity securities. As of June 30, 2007, the Company owned 24 properties with 5,387 apartment units which were unencumbered by debt.

During the first quarter of 2007, the Company repaid debt on two mortgages in the amount of \$20.5 million. The retired debt included a \$17.0 million mortgage which bore an interest rate of 8.7% and a \$3.5 million mortgage with a rate of 6.125%. During the second quarter of 2007, the Company repaid one mortgage of \$4.6 million which bore an interest rate of 7.88%. In addition, the Company repaid four loans on a single property totaling \$27.3 million. The loans were part of a swap transaction that mitigated credit risk by effectively converting the variable rate mortgages to fixed rates. A new eleven-year mortgage in the amount of \$53.5 million was placed on the property with interest only payments for the first ten years at a fixed rate of 5.49% and a variable rate thereafter. Finally, the Company entered into a new mortgage for a previously unencumbered property for \$47.0 million with interest only payments for ten years at an interest rate of 5.61%.

On April 4, 2007, the Company filed a Form S-3 universal shelf registration statement with the SEC that registers the issuance, from time to time, of common stock, preferred stock or debt securities. The Company may offer and sell securities issued pursuant to the universal shelf registration statement after a prospectus supplement, describing the type of security and amount being offered, is filed with the SEC.

During 2006, the Company sold 39 communities for a total sales price of \$495.3 million. The Company was able to sell these properties at an average capitalization rate of 7.6% and reinvest in the acquisition of properties with more growth potential at an expected first year cap rate of 6.4%. Management has included in its operating plan that the Company will strategically dispose of assets totaling approximately \$100 million in 2007, \$74 million of which were closed during the first seven months of 2007, although there can be no assurance that additional dispositions will actually occur.

The issuance of UPREIT Units for property acquisitions continues to be a source of capital for the Company. During the first quarter of 2007, the Company issued \$27.5 million in 453,311 UPREIT Units as consideration for two acquired properties. During 2006, the Company issued \$20.4 million in 343,393 UPREIT Units as consideration for two acquired properties.

The Company's DRIP provides the stockholders of the Company an opportunity to automatically invest their cash dividends in additional shares of common stock. In addition, eligible participants may make monthly payments or other voluntary cash investments in shares of common stock. The maximum monthly investment permitted without prior Company approval is currently \$10,000. In the fourth quarter of 2004, the Company began meeting share demand under the DRIP through share repurchases by the transfer agent in the open market on the Company's behalf instead of new share issuance. As of December 27, 2006, the Company switched back to meeting demand by issuing new shares.

Management monitors the relationship between the Company's stock price and its estimated net asset value ("NAV"). During times when the difference between these two values is small, resulting in little "dilution" of NAV by common stock issuances, the Company can choose to issue new shares. At times when the gap between NAV and stock price is greater, the Company has the flexibility to satisfy the demand for DRIP shares with stock repurchased in the open market. In addition, the Company can issue waivers to DRIP participants to provide for investments in excess of the \$10,000 maximum monthly investment. No such waivers were granted during the six months ended June 30, 2007 or the year ended December 31, 2006.

In October 2006, the Company issued \$200 million of exchangeable senior notes with a coupon rate of 4.125%, which generated net proceeds of \$195.8 million. The net proceeds were used to repurchase 933,000 shares of common stock for a total of \$58 million, pay down \$70 million on the line of credit, with the balance used for redemption of the Series F Preferred Shares and property acquisitions. The exchange terms and conditions are more fully described under Contractual Obligations and Other Commitments, below.

In March 2002, the Company issued 2,400,000 shares of its 9.00% Series F Cumulative Redeemable Preferred Stock ("Series F Preferred Shares"), with a \$25.00 liquidation preference per share. This offering generated net proceeds of approximately \$58.1 million. The net proceeds were used to fund the Series B preferred stock

repurchase, property acquisitions, and property upgrades. Each Series F Preferred share received an annual dividend equal to 9.00% of the liquidation preference per share (equivalent to a fixed annual amount of \$2.25 per share). The Series F Preferred Shares were redeemed by the Company on March 26, 2007 at a redemption price of \$25.00 per share, plus accrued and unpaid dividends of \$390. In accordance with the SEC's clarification of EITF Abstracts, Topic No. D-42, *The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock*, the initial offering costs of \$1.9 million associated with the issuance of the Series F Preferred Shares were written-off in the first quarter of 2007, and are reflected as a reduction of net income available to common stockholders in determining earnings per share for the six months ended June 30, 2007.

In 1997, the Company's Board of Directors approved a stock repurchase program under which the Company may repurchase shares of its common stock or UPREIT Units ("Company Program"). The shares/units may be repurchased through open market or privately negotiated transactions at the discretion of Company management. The Board's action did not establish a target stock price or a specific timetable for repurchase. During the three months ended March 31, 2007, 109,000 shares were repurchased for \$6 million by the Company. There were no share repurchases under the Company Program during the three months ended June 30, 2007. At June 30, 2007, the Company had authorization to repurchase an additional 2,497,448 shares/units. The Company will continue to monitor stock prices, the published net asset value, and acquisition/development alternatives to determine the current best use of capital between the two major uses of capital – stock buybacks and acquisitions/development.

As of June 30, 2007, the weighted average rate of interest on the Company's total indebtedness of \$2.2 billion was 5.6% with staggered maturities averaging approximately seven years. Approximately 97% of total indebtedness is at fixed rates. This limits the exposure to changes in interest rates, minimizing the effect of interest rate fluctuations on the Company's results of operations and cash flows.

The Company's cash provided by operating activities was \$81 million for the six months ended June 30, 2007 compared to \$83 million for the same period in 2006. The change is primarily due to higher income from continuing operations in the 2007 period, more than offset by reductions in accounts payable and accrued expenses resulting from the timing differences in cash disbursements between periods.

Cash used in investing activities was \$143 million for the six months ended June 30, 2007 compared to \$124 million provided by investing activities for the same period in 2006. The change of \$267 million is primarily due to the sale of an 19 property portfolio in the 2006 period resulting in proceeds of \$230 million, an increase of \$124 million used for purchase of properties in 2007; partially offset by \$12 million lower normal capital expenditures on owned properties in 2007 and an \$81 million change in the funds held in escrow account between periods.

Cash used in financing activities was \$50 million for the six months ended June 30, 2007 compared to \$205 million for the same period in 2006. The \$155 million decrease between periods is primarily due to \$79 million lower stock buybacks, proceeds from net mortgage activity that were \$69 million higher, a \$74 million increase in the net draw down on the line of credit; partially offset by \$60 million of cash used to repurchase the Series F Preferred Shares and a \$9 million decrease in cash provided by the exercise of stock options in 2007.

#### Variable Interest Entities

Effective March 31, 2004, the Company adopted FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 – Consolidated Financial Statements* ("FIN 46R"). The interpretation addresses consolidation by businesses of special purpose entities (variable interest entities, "VIE").

The Company is the general partner in one VIE syndicated using low income housing tax credits under Section 42 of the Internal Revenue Code. As general partner, the Company manages the day-to-day operations of the partnership for a management fee. In addition, the Company has an operating deficit guarantee and tax credit guarantee to its limited partner. The Company is responsible to fund operating deficits to the extent there are any and can receive operating incentive awards when cash flows reach certain levels. The effect on the consolidated balance sheet as of June 30, 2007 is an increase in "Total assets" of \$19.6 million, an increase in "Total liabilities" of \$17.5 million, and an increase in "Minority interest" of \$2.1 million. Of the \$17.5 million increase in "Total liabilities," \$16.6 million represents non-recourse mortgage debt.

The Company, through its general partnership interest in the VIE, has guaranteed the low income housing tax credits to the limited partners totaling approximately \$3 million. With respect to the low income housing credits, the Company believes the property's operations conform to the applicable requirements and does not anticipate any payment on the guarantee.

#### Acquisitions and Dispositions

On April 30, 2007, the Company acquired Westwoods, a 35 unit apartment community located in Randolph, MA, for \$4.0 million, including closing costs. Consideration for the purchase was the assumption of an existing \$3.9 million fixed rate mortgage at an interest rate of 5.6% maturing on June 1, 2034 (fair market value of \$3.7 million) with the balance paid in cash.

There were no dispositions during the second quarter of 2007.

#### Contractual Obligations and Other Commitments

The primary obligations of the Company relate to its borrowings under the line of credit, exchangeable senior notes and mortgage notes payable. The Company's line of credit matures in September 2008 and had \$39.0 million outstanding at June 30, 2007. The \$2.0 billion in mortgage notes payable have varying maturities ranging from 1 to 35 years. The weighted average interest rate of the Company's secured fixed rate notes was 5.77% both at June 30, 2007 and December 31, 2006, respectively. The weighted average interest rate of the Company's variable rate notes and credit facility was 5.60% and 4.95% at June 30, 2007 and December 31, 2006, respectively.

In October 2006, the Company issued \$200 million of exchangeable senior notes with a coupon rate of 4.125%. The notes are exchangeable into cash equal to the principal amount of the notes and, at the Company's option, cash or common stock for the exchange value (to the extent that the market price of common stock exceeds the initial exchange price of \$73.34 per share) subject to adjustment. Upon an exchange of the notes, the Company will settle any amounts up to the principal amount of the notes in cash and the remaining exchange value, if any, will be settled, at the Company's option, in cash, common stock or a combination of both. The notes are not redeemable at the option of the Company for five years, except to preserve the status of the Company as a REIT. Holders of the notes may require the Company to repurchase the notes upon the occurrence of certain designated events. In addition, prior to November 1, 2026, the holders may require the Company to repurchase the notes on November 1, 2011, 2016 and 2021. The notes will mature on November 1, 2026, unless previously redeemed, repurchased or exchanged in accordance with their terms prior to that date.

The Company leases its corporate office space from an affiliate and the office space for its regional offices from non-affiliated third parties. The corporate office space requires an annual base rent plus a pro-rata portion of property improvements, real estate taxes, and common area maintenance. The regional office leases require an annual base rent plus a pro-rata portion of real estate taxes.

As discussed in the section entitled "Variable Interest Entities," the Company, through its general partnership interest in an affordable property limited partnership, has guaranteed low income housing tax credits to limited partners totaling approximately \$3 million. With respect to the guarantee of the low income housing tax credits, the Company believes the property's operations conform to the applicable requirements and does not anticipate any payment on the guarantees. In addition, the Company, acting as general partner in this partnership, is obligated to advance funds to meet partnership operating deficits.

## Capital Improvements

Effective January 1, 2007, the Company has updated its estimate of the amount of recurring, non-revenue enhancing capital expenditures incurred on an annual basis for a standard garden style apartment. The Company now estimates that the annual amount is \$760 per apartment unit compared to \$525 in the prior year. This new amount better reflects current actual costs and the effects of inflation since the last update.

The Company's policy is to capitalize costs related to the acquisition, development, rehabilitation, construction and improvement of properties. Capital improvements are costs that increase the value and extend the useful life of an asset. Ordinary repair and maintenance costs that do not extend the useful life of the asset are expensed as incurred. Costs incurred on a lease turnover due to normal wear and tear by the resident are expensed on the turn. Recurring capital improvements typically include: appliances, carpeting and flooring, HVAC equipment, kitchen/bath cabinets, new roofs, site improvements and various exterior building improvements. Non-recurring, revenue generating capital improvements include, among other items: community centers, new windows, and kitchen/bath apartment upgrades. Revenue generating capital improvements will directly result in rental earnings or expense savings. The Company capitalizes interest and certain internal personnel costs related to the communities under rehabilitation and construction.

The Company estimates that on an annual basis \$760 and \$525 per unit is spent on recurring capital expenditures in 2007 and 2006, respectively. During the three months ended June 30, 2007 and 2006, approximately \$190 per unit and \$131 per unit, respectively, was estimated to be spent on recurring capital expenditures. For the six months ended June 30, 2007 and 2006, approximately \$380 per unit and \$263 per unit, respectively, was estimated to be spent on recurring capital expenditures. The table below summarizes the actual total capital improvements incurred by major categories for the three and six months ended June 30, 2007 and 2006 and an estimate of the breakdown of total capital improvements by major categories between recurring and non-recurring, revenue generating capital improvements for the three and six months ended June 30, 2007 as follows:

For the three months ended June 30, (in thousands, except per unit data)								
2007							2006	
	Recurring Cap Ex	Per Unit <sup>(a)</sup>	Non- Recurring Cap Ex	Per Unit <sup>(a)</sup>	Total Capital Improvement	Per Unit <sup>(a)</sup>	Total Capital Improvements	Per Unit <sup>(a)</sup>
					\$			
New buildings	\$ -	\$ -	\$ 712	\$ 19	\$ 712	\$ 19	\$ 109	\$ 3
Major building improvements	1,046	28	4,242	112	5,288	140	4,832	143
Roof replacements	397	10	1,056	28	1,453	38	712	21
Site improvements	408	11	1,421	37	1,829	48	2,572	76
Apartment upgrades	1,248	33	3,530	93	4,778	126	3,389	100
Appliances	897	24	-	-	897	24	882	26
Carpeting/flooring	2,335	61	393	10	2,728	71	1,985	59
HVAC/mechanicals	655	17	2,216	58	2,871	75	2,119	63
Miscellaneous	228	6	651	17	879	23	852	25
Totals	<u>\$7,214</u>	<u>\$ 190</u>	<u>\$ 14,221</u>	<u>\$ 374</u>	<u>\$ 21,435</u>	<u>\$564</u>	<u>\$ 17,452</u>	<u>\$516</u>

<sup>(a)</sup> Calculated using the weighted average number of units owned, including 33,685 core units, 2006 acquisition units of 3,067 and 2007 acquisition units of 1,218 for the three months ended June 30, 2007; and 33,685 core units and 2006 acquisition units of 89 for the three months ended June 30, 2006.

**For the six months ended June 30,  
(in thousands, except per unit data)**

	<b>2007</b>						<b>2006</b>	
	<b>Recurring Cap Ex</b>	<b>Per Unit<sup>(b)</sup></b>	<b>Non- Recurring Cap Ex</b>	<b>Per Unit<sup>(b)</sup></b>	<b>Total Capital Improvement</b>	<b>Per Unit<sup>(b)</sup></b>	<b>Total Capital Improvements</b>	<b>Per Unit<sup>(b)</sup></b>
					<u>\$</u>			
New buildings	\$ -	\$ -	\$ 1,122	\$ 30	\$ 1,122	\$ 30	\$ 1,528	\$ 45
Major building improvements	2,231	60	5,649	151	7,880	211	9,125	271
Roof replacements	619	17	1,057	28	1,676	45	1,455	43
Site improvements	806	21	2,063	55	2,869	76	3,509	104
Apartment upgrades	2,461	66	6,025	161	8,486	227	7,122	211
Appliances	1,775	47	2	-	1,777	47	1,817	54
Carpeting/flooring	4,611	123	402	11	5,013	134	3,966	118
HVAC/mechanicals	1,293	34	3,579	95	4,872	129	4,949	147
Miscellaneous	450	12	1,357	36	1,807	48	1,661	49
Totals	<u>\$14,246</u>	<u>\$ 380</u>	<u>\$ 21,256</u>	<u>\$ 567</u>	<u>\$ 35,502</u>	<u>\$947</u>	<u>\$ 35,132</u>	<u>\$1,042</u>

<sup>(b)</sup> Calculated using the weighted average number of units owned, including 33,685 core units, 2006 acquisition units of 3,067 and 2007 acquisition units of 739 for the six months ended June 30, 2007; and 33,685 core units and 2006 acquisition units of 45 for the six months ended June 30, 2006.

The schedule below summarizes the breakdown of total capital improvements between core and non-core as follows:

**For the three months ended June 30,  
(in thousands, except per unit data)**

	<b>2007</b>						<b>2006</b>	
	<b>Recurring Cap Ex</b>	<b>Per Unit<sup>(c)</sup></b>	<b>Non- Recurring Cap Ex</b>	<b>Per Unit<sup>(c)</sup></b>	<b>Total Capital Improvements</b>	<b>Per Unit<sup>(c)</sup></b>	<b>Total Capital Improvements</b>	<b>Per Unit<sup>(c)</sup></b>
Core Communities	\$ 6,400	\$ 190	\$ 12,484	\$ 371	\$ 18,884	\$561	\$ 17,367	\$ 516
2007 Acquisition Communities	231	190	19	16	250	205	-	-
2006 Acquisition Communities	<u>583</u>	<u>190</u>	<u>1,718</u>	<u>560</u>	<u>2,301</u>	<u>750</u>	<u>85</u>	<u>955</u>
Sub-total	7,214	190	14,221	374	21,435	564	17,452	516
2007 Disposed Communities	-	-	-	-	-	-	-	-
2006 Disposed Communities	-	-	-	-	-	-	2,738	288
Corporate office expenditures <sup>(1)</sup>	-	-	-	-	677	-	893	-
Totals	<u>\$ 7,214</u>	<u>\$ 190</u>	<u>\$ 14,221</u>	<u>\$ 374</u>	<u>\$ 22,112</u>	<u>\$564</u>	<u>\$ 21,083</u>	<u>\$ 466</u>

<sup>(1)</sup> No distinction is made between recurring and non-recurring expenditures for corporate office. Corporate office expenditures includes principally computer hardware, software and office furniture and fixtures.

<sup>(c)</sup> Calculated using the weighted average number of units owned, including 33,685 core units, 2006 acquisition units of 3,067 and 2007 acquisition units of 1,218 for the three months ended June 30, 2007; and 33,685 core units, 2006 acquisition units of 89 and 2006 disposed units of 9,506 for the three months ended June 30, 2006.

**For the six months ended June 30,  
(in thousands, except per unit data)**

	<b>2007</b>						<b>2006</b>	
	<b>Recurring</b>		<b>Non- Recurring</b>		<b>Total Capital</b>		<b>Total Capital</b>	
	<b>Cap Ex</b>	<b>Per Unit<sup>(d)</sup></b>	<b>Cap Ex</b>	<b>Per Unit<sup>(d)</sup></b>	<b>Improvements</b>	<b>Per Unit<sup>(d)</sup></b>	<b>Improvements</b>	<b>Per Unit<sup>(d)</sup></b>
Core Communities	\$12,800	\$ 380	\$ 18,922	\$ 562	\$ 31,722	\$ 942	\$ 35,047	\$1,040
2007 Acquisition Communities	281	380	1	1	282	381	-	-
2006 Acquisition Communities	<u>1,165</u>	<u>380</u>	<u>2,333</u>	<u>761</u>	<u>3,498</u>	<u>1,141</u>	<u>85</u>	<u>1,910</u>
Sub-total	14,246	380	21,256	567	35,502	947	35,132	1,042
2007 Disposed Communities	-	-	-	-	-	-	-	-
2006 Disposed Communities	-	-	-	-	-	-	5,444	567
Corporate office expenditures <sup>(1)</sup>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,712</u>	<u>-</u>	<u>1,963</u>	<u>-</u>
Totals	<u>\$14,246</u>	<u>\$ 380</u>	<u>\$ 21,256</u>	<u>\$ 567</u>	<u>\$ 37,214</u>	<u>\$ 947</u>	<u>\$ 42,539</u>	<u>\$ 936</u>

<sup>(1)</sup> No distinction is made between recurring and non-recurring expenditures for corporate office. Corporate office expenditures includes principally computer hardware, software and office furniture and fixtures.

<sup>(d)</sup> Calculated using the weighted average number of units owned, including 33,685 core units, 2006 acquisition units of 3,067 and 2007 acquisition units of 739 for the six months ended June 30, 2007; and 33,685 core units, 2006 acquisition units of 45 and 2006 disposed units of 9,605 for the six months ended June 30, 2006.

## Results of Operations

### *Summary of Core Properties*

The Company had 113 apartment communities with 33,685 units which were owned during the three and six months being presented (the "Core Properties"). The Company has acquired/developed an additional 14 apartment communities with 4,524 units during 2007 and 2006 (the "Acquisition Communities"). The Company disposed of 39 apartment communities with a total of 9,705 units during 2006 (the "2006 Disposed Communities"). The results of these disposed properties have been classified as discontinued operations and are not included in the table below. The inclusion of the Acquisition Communities generally accounted for the significant changes in operating results for the three and six months ended June 30, 2007. In addition, the reported income from operations include the results of one investment where the Company is the managing general partner that has been determined to be a VIE and consolidated with the Company.

A summary of the net operating income from Core Properties is as follows (in thousands):

	<u>Three Months</u>				<u>Six Months</u>			
	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Rent	\$104,305	\$102,127	\$2,178	2.1%	\$207,263	\$202,817	\$4,446	2.2%
Utility recovery revenue	<u>4,290</u>	<u>1,965</u>	<u>2,325</u>	<u>118.3%</u>	<u>9,824</u>	<u>3,786</u>	<u>6,038</u>	<u>159.5%</u>
Rent including recoveries	108,595	104,092	4,503	4.3%	217,087	206,603	10,484	5.1%
Property other income	<u>4,492</u>	<u>4,683</u>	<u>(191)</u>	<u>(4.1%)</u>	<u>8,947</u>	<u>8,923</u>	<u>24</u>	<u>0.3%</u>
Total revenue	113,087	108,775	4,312	4.0%	226,034	215,526	10,508	4.9%
Operating and maintenance	<u>(45,791)</u>	<u>(42,642)</u>	<u>(3,149)</u>	<u>(7.4%)</u>	<u>(95,756)</u>	<u>(93,029)</u>	<u>(2,727)</u>	<u>(2.9%)</u>
Net operating income	<u>\$ 67,296</u>	<u>\$ 66,133</u>	<u>\$1,163</u>	<u>1.8%</u>	<u>\$130,278</u>	<u>\$122,497</u>	<u>\$7,781</u>	<u>6.4%</u>

A summary of the net operating income from continuing operations is as follows (in thousands):

	Three Months				Six Months			
			\$	%			\$	%
	<u>2007</u>	<u>2006</u>	<u>Change</u>	<u>Change</u>	<u>2007</u>	<u>2006</u>	<u>Change</u>	<u>Change</u>
Rent	\$119,884	\$103,879	\$16,005	15.4%	\$235,622	\$205,981	\$29,641	14.4%
Utility recovery revenue	<u>4,685</u>	<u>1,967</u>	<u>2,718</u>	<u>138.2%</u>	<u>10,643</u>	<u>3,791</u>	<u>6,852</u>	<u>180.7%</u>
Rent including recoveries	124,569	105,846	18,723	17.7%	246,265	209,772	36,493	17.4%
Property other income	<u>5,111</u>	<u>4,731</u>	<u>380</u>	<u>8.0%</u>	<u>9,939</u>	<u>8,986</u>	<u>953</u>	<u>10.6%</u>
Total revenue	129,680	110,577	19,103	17.3%	256,204	218,758	37,446	17.1%
Operating and maintenance	<u>(52,668)</u>	<u>(43,610)</u>	<u>(9,058)</u>	<u>(20.8%)</u>	<u>(108,530)</u>	<u>(95,414)</u>	<u>(13,116)</u>	<u>(13.7%)</u>
Net operating income	<u>\$ 77,012</u>	<u>\$ 66,967</u>	<u>\$10,045</u>	<u>15.0%</u>	<u>\$147,674</u>	<u>\$123,344</u>	<u>\$24,330</u>	<u>19.7%</u>

Net operating income ("NOI") may fall within the definition of "non-GAAP financial measure" set forth in Item 10(e) of Regulation S-K and, as a result, the Company may be required to include in this report a statement disclosing the reasons why management believes that presentation of this measure provides useful information to investors. The Company believes that NOI is helpful to investors as a supplemental measure of the operating performance of a real estate company because it is a direct measure of the actual operating results of the Company's apartment properties. In addition, the apartment communities are valued and sold in the market by using a multiple of NOI. The Company also uses this measure to compare its performance to that of its peer group.

#### *Comparison of three months ended June 30, 2007 to the same period in 2006*

Of the \$18,723 increase in rental income including utility recoveries, \$14,220 is attributable to the Acquired Communities; and \$4,503 is from the Core Properties, as the result of an increase of 4.3% in weighted average rental rates (including utility reimbursements), with no variation in occupancy which was 95.0% for both periods. Occupancy is defined as total possible rental income, net of vacancy, as a percentage of total possible rental income. Total possible rental income is determined by valuing occupied units at contract rates and vacant units at market rents. Included in the Core increase is \$2,325 which represents increased utility recovery charges compared to 2006 attributable to the Company's water & sewer and heat & electric recovery programs, which were initiated in the second quarter of 2005 and are being phased in through the second quarter of 2007.

The remaining property other income, which consists primarily of income from operation of laundry facilities, late charges, administrative fees, garage and carport charges, revenue from corporate apartments, cable revenue, pet charges, and miscellaneous charges to residents increased by \$380. Of this increase, \$571 is attributable to the Acquired Communities and partially offset by a \$191 decrease in Core Properties. The decrease in Core Properties is due primarily to a reduction of corporate apartments in the Long Island region.

Interest income decreased \$36 due to a lower level of interest-bearing deposits compared to 2006.

Other income, which primarily reflects management and other real estate service fees recognized by the Company, decreased by \$446. This is primarily due to a reduction in management fee income resulting from the acquisition of Mount Vernon Square at the end of 2006, which was previously being managed by the Company.

Of the \$9,058 increase in operating and maintenance expenses, \$5,909 is attributable to the Acquired Communities and \$3,149 is attributable to the Core Properties. The Core Properties increase is driven by increases in property insurance, personnel costs, real estate taxes, repairs & maintenance, and natural gas heating costs partially offset by a reduction to water & sewer costs. Property insurance had a negative variance of \$892, or 56.4%. The current quarter included an additional charge from increasing the self-insurance reserves by \$287, with no reserve adjustments a year ago. Therefore the normal increase was still 38.2%, consistent with the 40% experienced in the first quarter before any reserve adjustments. Personnel costs are up \$787, or 8.8%. The increase was due in part to health insurance and workers compensation self-insurance reserves which were decreased a net \$26 in 2007. In 2006, we were able to decrease our health insurance reserve by \$483, netting out to a \$457 difference between periods. Before reserve adjustments, personnel costs were up only 3.5%. Real estate taxes were up \$729, or 7.4%. The contributing factor was \$555 in refunds received in the second quarter of 2006 from successful tax assessment appeals which did not repeat in the 2007 period. Without the impact of refunds, taxes would have been up only \$174, or 1.7%, which reflects continued efforts in 2007 to reduce assessments. Repairs & maintenance is up \$470,



or 6.6%, over the prior year period due in part to timing differences in the current year whereby the first quarter was slightly below the prior period and the second quarter spending was slightly higher than the same period of 2006. When taken together, the year to date spending is very similar between 2007 and 2006. Natural gas heating costs were up \$223, or 7.4%, from a year ago, due mostly from increases in natural gas pricing and overall consumption due to the 2006 second quarter experiencing above normal temperatures compared to the 2007 quarter's more normal weather; partially offset by a \$267 refund of sales and use tax recognized during the 2007 quarter. For the second quarter 2007 our natural gas weighted average cost was \$9.18 per decatherm compared to \$8.71 for the 2006 period, a 5.4% increase. Water & sewer costs were down \$212, or 7.0%, from a year ago due to two properties realizing refunds of \$223 during the second quarter of 2007 relating to metering issues corrected in the current period.

General and administrative expense decreased in 2007 by \$104, or 1.7%. General and administrative expenses as a percentage of total revenues were 4.6% for both 2007 and 2006. The overall cost decrease included a \$117, or 32.6%, decrease in the external costs incurred for auditing, tax and consultation expense, including costs to comply with Section 404 of Sarbanes-Oxley. In addition, the Company experienced a \$70 net decrease in charges for stock-based compensation in 2007. Finally, in support of the Company's growing investment in constructing new apartment communities, the ramp-up of the development department accounted for a \$68 increase between periods.

Interest expense increased by \$4,284 in 2007 primarily as a result of interest expense on the exchangeable senior notes as well as new debt on the Acquisition Communities.

Depreciation and amortization expense increased \$5,138 due to the depreciation on the Acquisition Communities and the capital additions to the Core Properties.

Included in discontinued operations for the three months ended June 30, 2007 are the residual operating results, net of minority interest, of the 2006 Disposed Communities that were sold in December 2006. Included in discontinued operations for the three months ended June 30, 2006 are the operating results, net of minority interest, of the 2006 Disposed Communities. For purposes of the discontinued operations presentation, the Company only includes interest expense and losses from early extinguishment of debt associated with specific mortgage indebtedness of the properties that are sold or held for sale.

#### *Comparison of six months ended June 30, 2007 to the same period in 2006*

Of the \$36,493 increase in rental income including utility recoveries, \$26,009 is attributable to the Acquired Communities; and \$10,484 is from the Core Properties, as the result of an increase of 5.3% in weighted average rental rates (including utility reimbursements), partially offset by a decrease in occupancy from 94.9% to 94.7%. Included in the Core increase is \$6,038 which represents increased utility recovery charges compared to 2006 attributable to the Company's water & sewer and heat & electric recovery programs, which were initiated in the second quarter of 2005 and are being phased in through the second quarter of 2007.

The remaining property other income, which consists primarily of income from operation of laundry facilities, late charges, administrative fees, garage and carport charges, revenue from corporate apartments, cable revenue, pet charges, and miscellaneous charges to residents increased by \$953. Of this increase, \$929 is attributable to the Acquired Communities and a \$24 increase in Core Properties.

Interest income increased \$1,080 due to a higher level of invested excess cash on hand available from sale proceeds of the 2006 Disposed Communities and proceeds from exchangeable senior notes awaiting reinvestment into replacement property, both occurring in the first quarter of 2007.

Other income, which primarily reflects management and other real estate service fees recognized by the Company, decreased by \$188. This is primarily due to a reduction in management fee income resulting from the acquisition of Mount Vernon Square at the end of 2006, which was previously being managed by the Company.

Of the \$13,116 increase in operating and maintenance expenses, \$10,747 is attributable to the Acquired Communities and \$2,727 is attributable to the Core Properties; partially offset by a \$358 decrease attributable to the consolidation of the VIE reflecting a one-time property tax adjustment that occurred in the first quarter of 2006. The Core Properties increase is driven by increases in personnel costs, real estate taxes, property insurance and

snow removal costs. Personnel costs are up \$1,720, or 9.4%. The increase was due in part to health insurance and workers compensation reserves which were increased by \$711 in 2007 over 2006 levels. Before reserve adjustments, personnel costs were up 5.5%, of which 3.1% represents the overall increase in salary and wage rates between periods. Real estate taxes were up \$661, or 3.2%. The contributing factor was \$555 in refunds received all in the second quarter of 2006 from successful tax assessment appeals which did not occur in the 2007 period. Without the impact of refunds, taxes would have been up only \$106, or 0.5%, which reflects continued efforts in 2007 to reduce assessments. Property insurance had a negative variance of \$541, or 14.7%. The current period included an overall decrease in self-insurance reserves of \$168 as compared to a \$522 increase to the reserves a year ago. Therefore the normal increase was \$1,231, or 39.1%, which is consistent with the 40% experienced in the first quarter before any reserve adjustments. Snow removal costs were up \$196, or 41.1%. The first six months of 2007 produced normal to above normal snowfalls compared to below normal snowfalls in 2006.

General and administrative expense increased in 2007 by \$375, or 3.4%. General and administrative expenses as a percentage of total revenues were 4.5% for 2007, compared to 4.3% for 2006. Stock-based compensation was down a net of \$115 in 2007 as compared to 2006. Additionally, the ramp-up of the development department accounted for a \$187 increase. A decrease of \$211, or 25.1%, was realized in the external costs incurred for auditing, tax and consultation expense, including costs to comply with Section 404 of Sarbanes-Oxley.

Interest expense increased by \$7,509 in 2007 primarily a result of new debt on the Acquisition Communities as well as interest expense on the exchangeable senior notes.

Depreciation and amortization expense increased \$10,032 due to the depreciation on the Acquisition Communities and the capital additions to the Core Properties.

Included in discontinued operations for the six months ended June 30, 2007 are the residual operating results, net of minority interest, of the 2006 Disposed Communities that were sold in December 2006. Included in discontinued operations for the six months ended June 30, 2006 are the operating results, net of minority interest, of the 2006 Disposed Communities. For purposes of the discontinued operations presentation, the Company only includes interest expense and losses from early extinguishment of debt associated with specific mortgage indebtedness of the properties that are sold or held for sale.

#### Funds From Operations

Pursuant to the revised definition of Funds From Operations ("FFO") adopted by the Board of Governors of the National Association of Real Estate Investment Trusts ("NAREIT"), FFO is defined as net income (computed in accordance with accounting principles generally accepted in the United States of America ("GAAP")) excluding gains or losses from sales of property, minority interest, extraordinary items and cumulative effect of change in accounting principle plus depreciation from real property including adjustments for unconsolidated partnerships and joint ventures less dividends from non-convertible preferred shares. Because of the limitations of the FFO definition as published by NAREIT as set forth above, the Company has made certain interpretations in applying the definition. The Company believes all adjustments not specifically provided for are consistent with the definition.

Management believes that in order to facilitate a clear understanding of the combined historical operating results of the Company, FFO should be considered in conjunction with net income as presented in the consolidated financial statements included elsewhere herein. Management believes that by excluding gains or losses related to dispositions of property and excluding real estate depreciation (which can vary among owners of similar assets in similar condition based on historical cost accounting and useful life estimates), FFO can help one compare the operating performance of a company's real estate between periods or as compared to different companies. FFO does not represent cash generated from operating activities in accordance with GAAP and is not necessarily indicative of cash available to fund cash needs. FFO does not include the cost incurred for capital improvements (including capitalized interest) reflected as an increase to real estate assets. The Company's total capital improvements include an annual reserve for anticipated recurring, non-revenue generating capitalized costs of \$760 and \$525 per apartment unit for 2007 and 2006, respectively. Please refer to the "Capital Improvements" section above. FFO should not be considered as an alternative to net income as an indication of the Company's performance or to cash flow as a measure of liquidity.

The calculation of FFO and reconciliation to GAAP net income available to common shareholders for the three and

six months ended June 30, 2007 and 2006 are presented below (in thousands):

	<u>Three Months</u>		<u>Six Months</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Net income available to common shareholders	\$ 8,702	\$ 11,003	\$ 13,780	\$ 15,141
Real property depreciation and amortization	28,094	25,041	55,170	49,539
Minority interest	3,480	3,271	5,550	3,963
Minority interest – income from discontinued operations	72	625	102	2,140
Loss (gain) on disposition of discontinued operations	<u>115</u>	<u>(2,361)</u>	<u>248</u>	<u>(2,361)</u>
FFO – Basic as defined above	40,463	37,579	74,850	68,422
Loss from early extinguishment of debt in connection with sale of real estate	<u>-</u>	<u>2,970</u>	<u>-</u>	<u>2,970</u>
FFO – Basic as adjusted by the Company	40,463	40,549	74,850	71,392
Convertible preferred dividends <sup>(2)</sup>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
FFO – Diluted	<u>\$ 40,463</u>	<u>\$ 40,549</u>	<u>\$ 74,850</u>	<u>\$ 71,392</u>
Weighted average common shares/units outstanding <sup>(1)</sup> :				
Basic	<u>46,713.0</u>	<u>47,788.1</u>	<u>46,581.8</u>	<u>47,853.3</u>
Diluted <sup>(2)</sup>	<u>47,442.4</u>	<u>48,450.0</u>	<u>47,379.3</u>	<u>48,473.9</u>

(1) The calculation assumes the conversion of dilutive common stock equivalents including convertible preferred stock and the conversion of all UPREIT Units to common shares.

(2) There was no convertible preferred stock outstanding during the periods presented.

All REITs may not be using the same definition for FFO. Accordingly, the above presentation may not be comparable to other similarly titled measures of FFO of other REITs.

#### Covenants

The Credit Agreement relating to the Company's line of credit provides for the Company to maintain certain financial ratios and measurements. The Company was in compliance with these financial covenants for the period ended June 30, 2007. The line of credit has not been used for long-term financing but adds a certain amount of flexibility, especially in meeting the Company's acquisition goals. Many times it is easier to temporarily finance an acquisition or stock repurchases by short-term use of the line of credit, with long-term secured financing or other sources of capital replenishing the line of credit availability.

#### Economic Conditions

Substantially all of the leases at the Company's apartment communities are for a term of one year or less, which enables the Company to seek increased rents upon renewal of existing leases or commencement of new leases. These short-term leases minimize the potential adverse effect of inflation on rental income, although residents may leave without penalty at the end of their lease terms and may do so if rents are increased significantly.

Historically, real estate has been subject to a wide range of cyclical economic conditions, which affect various real estate sectors and geographic regions with differing intensities and at different times. Starting in 2001 and continuing into 2004 many regions of the United States had experienced varying degrees of economic recession and certain recessionary trends, such as a temporary reduction in occupancy and reduced pricing power limiting the ability to aggressively raise rents. Starting in the second half of 2004 and continuing into 2007, we have seen a reversal of these recessionary trends. In light of this, we will continue to review our business strategy; however, we believe that given our property type and the geographic regions in which we are located, we do not anticipate any changes in our strategy or material effects on financial performance.

#### Declaration of Dividend

On August 2, 2007, the Board of Directors approved a dividend of \$0.65 per share on the Company's common

stock for the quarter ended June 30, 2007. This is the equivalent of an annual distribution of \$2.60 per share. The dividend is payable August 24, 2007 to shareholders of record on August 13, 2007.

### Contingency

The Company is not a party to any legal proceedings which are expected to have a material adverse effect on the Company's liquidity, financial position or results of operations. The Company is subject to a variety of legal actions for personal injury or property damage arising in the ordinary course of its business, most of which are covered by liability and property insurance. Various claims of employment and resident discrimination are also periodically brought. While the resolution of these matters cannot be predicted with certainty, management believes that the final outcome of such legal proceedings and claims will not have a material adverse effect on the Company's liquidity, financial position or results of operations.

### Recent Accounting Pronouncements

On January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48 addresses the recognition and measurement of assets and liabilities associated with tax positions taken or expected to be taken in a tax return. The Company reviewed its current tax positions for any potential uncertain tax positions that would qualify under FIN 48. The adoption of FIN 48 did not have a material impact on the Company's results of operations, financial position or liquidity.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements; the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is required to adopt SFAS 157 in the first quarter of 2008. Management is currently evaluating the impact, if any, that SFAS 157 will have on the Company's results of operations, financial position or liquidity.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ("SFAS 159"). SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Under SFAS 159, entities are now permitted to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis under a fair value option granted in SFAS 159. Excluded from the scope of SFAS 159 are real estate assets and interests in VIE's. Management is currently evaluating the impact, if any, this pronouncement will have on the Company's results of operations, financial position or liquidity.

## HOME PROPERTIES, INC.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's primary market risk exposure is interest rate risk. At June 30, 2007 and December 31, 2006, approximately 97% and 99%, respectively, of the Company's debt bore interest at fixed rates. At June 30, 2007 and December 31, 2006, approximately 88% and 89%, respectively, of the Company's debt was secured and bore interest at fixed rates with a weighted average maturity of approximately 6 years and a weighted average interest rate of approximately 5.77%, for both periods, including the \$28 million of secured debt which was swapped to a fixed rate at December 31, 2006. The remainder of the Company's secured debt bears interest at variable rates with a weighted average maturity of approximately 20 and 21 years, respectively, and a weighted average interest rate of 4.95% for both periods. The Company does not intend to utilize a significant amount of permanent variable rate debt to acquire properties in the future. On occasion, the Company may use its line of credit in connection with a property acquisition or stock repurchase with the intention to refinance at a later date. The Company believes, however, that in no event would increases in interest expense as a result of inflation significantly impact the Company's distributable cash flow.

At June 30, 2007 and December 31, 2006, the fair value of the Company's fixed and variable rate secured debt, including the \$28 million of secured debt which was swapped to a fixed rate at December 31, 2006, amounted to a liability of \$1.94 billion and \$1.93 billion, respectively, compared to its carrying amount of \$1.95 billion and \$1.92 billion, respectively. The Company estimates that a 100 basis point increase in market interest rates at June 30, 2007 would have changed the fair value of the Company's fixed and variable rate secured debt to a liability of \$1.86 billion.

The Company intends to continuously monitor and actively manage interest costs on its variable rate debt portfolio and may enter into swap positions based upon market fluctuations. In addition, the Company believes that it has the ability to obtain funds through additional debt and/or equity offerings and/or the issuance of UPREIT Units. Accordingly, the cost of obtaining such interest rate protection agreements in relation to the Company's access to capital markets will continue to be evaluated. The Company has not, and does not plan to, enter into any derivative financial instruments for trading or speculative purposes. As of June 30, 2007, the Company had no other material exposure to market risk.

HOME PROPERTIES, INC.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports filed or submitted by the Company under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the officers who certify the Company's financial reports and to the other members of senior management and the Board of Directors.

The principal executive officer and principal financial officer evaluated, as of June 30, 2007, the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15-d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) and have determined that such disclosure controls and procedures are effective.

There have been no changes in the internal controls over financial reporting identified in connection with that evaluation, or that occurred during the second quarter of the year ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. The Company has not identified any material weaknesses in its internal controls.

# HOME PROPERTIES, INC.

## PART II - OTHER INFORMATION

### ITEM 1A. RISK FACTORS

Refer to the Risk Factors disclosure in the Company's Form 10-K for the year ended December 31, 2006. There have been no material changes in these risk factors during the six months ended June 30, 2007 and through the date of this report.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES; USE OF PROCEEDS FROM REGISTERED SECURITIES

In 1997, the Company's Board of Directors approved a stock repurchase program under which the Company may repurchase shares of its outstanding common stock and UPREIT Units ("Company Program"). The shares/units may be repurchased through open market or privately negotiated transactions at the discretion of Company management. The Board's action does not establish a specific target stock price or a specific timetable for share repurchase. In addition, participants in the Company's Stock Benefit Plan can use common stock of the Company that they already own to pay all or a portion of the exercise price payable to the Company upon the exercise of an option and applicable withholding tax. In such event, the common stock used to pay the exercise price and tax withholding is returned to authorized but unissued status, and for purposes of this table is deemed to have been repurchased by the Company. At December 31, 2006, the Company had authorization to repurchase 2,606,448 shares of common stock and UPREIT Units under the Company Program. During 2007, the Company repurchased 109,000 shares at a cost of \$5,996,199. The following table summarizes the total number of shares/units repurchased by the Company during the three months ended June, 2007:

<u>Period</u>	<u>Total shares/units purchased<sup>(1)</sup></u>	<u>Average price per share/unit</u>	<u>Total shares/units purchased as part of Company Program</u>	<u>Maximum shares/units available under Company Program</u>
Balance April 1, 2007:				2,497,448
April 2007	-	-	-	2,497,448
May 2007	3,777	\$55.50	-	2,497,448
June 2007	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,497,448</u>
Total Second Quarter 2007	<u>3,777</u>	<u>\$55.50</u>	<u>-</u>	<u>2,497,448</u>

<sup>(1)</sup> During the three months ended June 30, 2007, and as permitted by the Company's stock option plans, 3,777 shares of common stock already owned by option holders were used by those holders to pay the exercise price associated with their option exercise and tax withholding. These shares were returned to the status of authorized but unissued shares.

#### ITEM 4. SUBMISSION OF MATTER TO A VOTE OF SECURITY HOLDERS

The annual meeting of the Company's stockholders was held on May 1, 2007. The following is a brief description of each matter voted upon at the meeting and the number of votes cast for, withheld or against, abstentions and the number of broker non-votes, as applicable, with respect to each matter.

The eleven directors proposed by the Company for re-election were elected to one year terms by the following vote:

<u>DIRECTOR NAME</u>	<u>SHARES FOR</u>	<u>SHARES WITHHELD</u>
Josh E. Fidler	15,683,186	13,446,213
Alan L. Gosule	28,672,753	456,646
Leonard F. Helbig, III	28,699,992	429,407
Roger W. Kober	28,666,114	463,285
Norman P. Leenhouts	28,592,377	537,022
Nelson B. Leenhouts	28,592,620	536,779
Edward J. Pettinella	28,679,027	450,372
Clifford W. Smith, Jr.	28,696,841	432,558
Paul L. Smith	28,666,496	462,903
Thomas S. Summer	28,840,630	288,769
Amy L. Tait	26,583,750	2,545,649

The stockholders ratified the appointment of PricewaterhouseCoopers, LLP as the Company's independent registered public accounting firm for 2007.

Shares Voted For:	28,885,763
Shares Voted Against:	190,844
Shares Abstaining:	52,791

#### ITEM 6. EXHIBITS

Exhibit 10.1	Amendment No. Ninety to the Second Amended and Restated Limited Partnership Agreement*
Exhibit 31.1	Section 302 Certification of Chief Executive Officer*
Exhibit 31.2	Section 302 Certification of Chief Financial Officer*
Exhibit 32.1	Section 906 Certification of Chief Executive Officer**
Exhibit 32.2	Section 906 Certification of Chief Financial Officer**

\*Filed herewith

\*\*Furnished herewith



## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HOME PROPERTIES, INC.  
(Registrant)

Date: August 9, 2007

By: /s/ Edward J. Pettinella  
Edward J. Pettinella  
President and Chief Executive Officer

Date: August 9, 2007

By: /s/ David P. Gardner  
David P. Gardner  
Executive Vice President and  
Chief Financial Officer

Home Properties, L.P.  
Amendment No. Ninety to  
Second Amended and Restated  
Agreement of Limited Partnership

The Second Amended and Restated Agreement of Limited Partnership of Home Properties, L.P. (the "Partnership Agreement") is hereby amended effective May 14, 2007 to substitute the "Schedule A" attached hereto for the "Schedule A" currently attached to the Partnership Agreement. "Schedule A" is hereby amended to reflect various changes.

GENERAL PARTNER  
Home Properties, Inc.

/s/ Ann M. McCormick  
Ann M. McCormick  
Secretary

LIMITED PARTNERS LISTED ON ATTACHED SCHEDULE A  
By: Home Properties, Inc.  
as attorney-in-fact

/s/ Ann M. McCormick  
Ann M. McCormick  
Secretary

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO RULE 13a-14 PROMULGATED BY  
THE SECURITIES AND EXCHANGE COMMISSION  
(Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)**

I, Edward J Pettinella, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Home Properties, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Edward J. Pettinella

Edward J. Pettinella  
President and Chief Executive Officer  
August 9, 2007

**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO RULE 13a-14 PROMULGATED BY  
THE SECURITIES AND EXCHANGE COMMISSION  
(Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)**

I, David P. Gardner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Home Properties, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ David P. Gardner

David P. Gardner

Executive Vice President and Chief Financial Officer

August 9, 2007

The following certification is furnished as provided by Rule 13a-14(b) promulgated under the Securities Act of 1934 and Item 601(b)(32)(ii) of Regulation S-K.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Home Properties, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on August 9, 2007 (the "Report"), I, Edward J. Pettinella, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Edward J. Pettinella  
Edward J. Pettinella  
President and Chief Executive Officer  
August 9, 2007

A signed original of this written statement required by Section 906 has been provided to Home Properties, Inc. and will be retained by Home Properties, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**EXHIBIT 32.2**

The following certification is furnished as provided by Rule 13a-14(b) promulgated under the Securities Act of 1934 and Item 601(b)(32)(ii) of Regulation S-K.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Home Properties, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on August 9, 2007 (the "Report"), I, David P. Gardner, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ David P. Gardner  
David P. Gardner  
Executive Vice President and  
Chief Financial Officer  
August 9, 2007

A signed original of this written statement required by Section 906 has been provided to Home Properties, Inc. and will be retained by Home Properties, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.