VORNADO REALTY TRUST
Form 10-Q
November 01, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: **September 30, 2012**

Or

o **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: **001-11954**

<u>VORNADO REALTY TRUST</u>

(Exact name of registrant as specified in its charter)

Maryland	**22-1657560**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
888 Seventh Avenue, New York, New York	**10019**
(Address of principal executive offices)	(Zip Code)

(212) 894-7000

(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 such filing requirements for the past 90 days. Yes x No o

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

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

x Large Accelerated Filer	o Accelerated Filer
o Non-Accelerated Filer (Do not check if smaller reporting company)	o Smaller Reporting Company

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

As of September 30, 2012, 186,143,105 of the registrant's common shares of beneficial interest are outstanding.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

VORNADO REALTY TRUST
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(Amounts in thousands, except share and per share amounts) **ASSETS**	**September 30, 2012**	**December 31, 2011**
Real estate, at cost:		
Land	$ 4,143,581	$ 4,416,613
Buildings and improvements	11,851,152	12,041,054
Development costs and construction in progress	865,953	119,540
Leasehold improvements and equipment	128,168	126,712
Total	16,988,854	16,703,919
Less accumulated depreciation and amortization	(3,034,815)	(2,901,203)
Real estate, net	13,954,039	13,802,716
Cash and cash equivalents	465,884	606,553
Restricted cash	391,794	98,068
Marketable securities	485,001	741,321
Accounts receivable, net of allowance for doubtful accounts of $38,351 and $43,241	181,242	171,798
Investments in partially owned entities	1,319,710	1,233,650
Investment in Toys "R" Us	549,421	506,809
Real Estate Fund investments	482,442	346,650
Mezzanine loans receivable	131,585	133,948
Receivable arising from the straight-lining of rents, net of allowance of $4,448 and $3,290	755,866	701,827
Deferred leasing and financing costs, net of accumulated amortization of $220,846 and $237,766	389,155	364,855
Identified intangible assets, net of accumulated amortization of $362,516 and $347,039	252,683	295,432
Assets related to discontinued operations	537,938	1,049,153
Due from officers	-	13,127
Other assets	501,056	380,580
	$ 20,397,816	$ 20,446,487
LIABILITIES, REDEEMABLE NONCONTROLLING INTERESTS AND EQUITY		
Notes and mortgages payable	$ 7,852,657	$ 8,065,576
Senior unsecured notes	1,357,921	1,357,661
Revolving credit facility debt	600,000	138,000
Exchangeable senior debentures	-	497,898
Convertible senior debentures	-	10,168
Accounts payable and accrued expenses	442,644	423,512
Deferred revenue	465,929	511,959
Deferred compensation plan	103,003	95,457

Deferred tax liabilities	15,432	13,315
Liabilities related to discontinued operations	478,980	518,319
Other liabilities	396,897	145,498
Total liabilities	11,713,463	11,777,363
Commitments and contingencies		
Redeemable noncontrolling interests:		
Class A units - 11,714,978 and 12,160,771 units outstanding	949,499	934,677
Series D cumulative redeemable preferred units - 1,800,001 and 9,000,001 units outstanding	46,000	226,000
Total redeemable noncontrolling interests	995,499	1,160,677
Vornado shareholders' equity:		
Preferred shares of beneficial interest: no par value per share; authorized 110,000,000 shares; issued and outstanding 51,184,609 and 42,186,709 shares	1,237,699	1,021,660
Common shares of beneficial interest: $.04 par value per share; authorized 250,000,000 shares; issued and outstanding 186,143,105 and 185,080,020 shares	7,415	7,373
Additional capital	7,136,090	7,127,258
Earnings less than distributions	(1,319,118)	(1,401,704)
Accumulated other comprehensive (loss) income	(160,107)	73,729
Total Vornado shareholders' equity	6,901,979	6,828,316
Noncontrolling interests in consolidated subsidiaries	786,875	680,131
Total equity	7,688,854	7,508,447
	$ 20,397,816	$ 20,446,487

See notes to consolidated financial statements (unaudited).

VORNADO REALTY TRUST
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(Amounts in thousands, except per share amounts)	For the Three Months Ended September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
REVENUES:				
Property rentals	$ 518,141	$ 530,192	$ 1,564,168	$ 1,592,867
Tenant expense reimbursements	80,497	85,757	224,287	237,945
Cleveland Medical Mart development project	72,651	35,135	184,014	108,203
Fee and other income	39,688	36,776	106,018	111,813
Total revenues	710,977	687,860	2,078,487	2,050,828
EXPENSES:				
Operating	264,487	262,837	764,018	773,331
Depreciation and amortization	124,335	126,935	386,974	373,380
General and administrative	48,742	46,121	151,142	154,359
Cleveland Medical Mart development project	70,431	33,419	177,127	101,637
Acquisition related costs and tenant buy-outs	1,070	2,288	4,314	22,455
Total expenses	509,065	471,600	1,483,575	1,425,162
Operating income	201,912	216,260	594,912	625,666
(Loss) income applicable to Toys "R" Us	(8,585)	(9,304)	88,696	80,794
Income from partially owned entities	21,268	13,140	53,491	55,035
Income from Real Estate Fund (of which $4,787 and $3,675 in each three-month period, respectively, and $25,026 and $15,703 in each nine-month period, respectively, are attributable to noncontrolling interests)	5,509	5,353	37,572	25,491
Interest and other investment income (loss), net	10,523	(30,011)	(22,984)	95,086
Interest and debt expense (including amortization of deferred financing costs of $5,725 and $4,670, in each three-month period, respectively, and $17,204 and $14,093 in each nine-month period, respectively)	(120,770)	(131,998)	(377,600)	(394,192)
Net gain on disposition of wholly owned and partially owned assets	-	1,298	4,856	7,975
Income before income taxes	109,857	64,738	378,943	495,855

Income tax expense	(3,015)	(6,959)	(17,319)	(18,548)
Income from continuing operations	106,842	57,779	361,624	477,307
Income from discontinued operations	157,314	8,444	241,024	165,706
Net income	264,156	66,223	602,648	643,013
Less net income attributable to noncontrolling interests in:				
Consolidated subsidiaries	(6,610)	(5,636)	(30,928)	(20,643)
Operating Partnership, including unit distributions	(16,240)	(6,825)	(40,595)	(47,364)
Net income attributable to Vornado	241,306	53,762	531,125	575,006
Preferred share dividends	(20,613)	(17,627)	(56,187)	(47,743)
Discount on preferred unit redemptions	11,700	5,000	11,700	5,000
NET INCOME attributable to common shareholders	$ 232,393	$ 41,135	$ 486,638	$ 532,263
INCOME PER COMMON SHARE - BASIC:				
Income from continuing operations, net	$ 0.45	$ 0.18	$ 1.40	$ 2.04
Income from discontinued operations, net	0.80	0.04	1.22	0.85
Net income per common share	$ 1.25	$ 0.22	$ 2.62	$ 2.89
Weighted average shares outstanding	185,924	184,398	185,656	184,220
INCOME PER COMMON SHARE - DILUTED:				
Income from continuing operations, net	$ 0.45	$ 0.18	$ 1.39	$ 2.02
Income from discontinued operations, net	0.79	0.04	1.22	0.84
Net income per common share	$ 1.24	$ 0.22	$ 2.61	$ 2.86
Weighted average shares outstanding	186,655	186,065	186,399	186,039
DIVIDENDS PER COMMON SHARE	$ 0.69	$ 0.69	$ 2.07	$ 2.07

See notes to consolidated financial statements (unaudited).

VORNADO REALTY TRUST
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

(Amounts in thousands)	For the Three Months Ended September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
Net income	$ 264,156	$ 66,223	$ 602,648	$ 643,013
Other comprehensive income (loss):				
Change in unrealized net gain (loss) on securities available-for-sale	18,358	(161,178)	(202,167)	(120,334)
Pro rata share of other comprehensive (loss) income of nonconsolidated subsidiaries	(12,607)	112	(38,861)	26,477
Change in value of interest rate swap	(2,866)	(24,424)	(8,868)	(42,458)
Other	(30)	(69)	343	(5,114)
Comprehensive income (loss)	267,011	(119,336)	353,095	501,584
Less comprehensive income attributable to noncontrolling interests	(23,027)	(400)	(55,806)	(59,050)
Comprehensive income (loss) attributable to Vornado	$ 243,984	$ (119,736)	$ 297,289	$ 442,534

See notes to consolidated financial statements (unaudited).

VORNADO REALTY TRUST
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)

(Amounts in thousands)	Preferred Shares		Common Shares		Additional	Earnings Less Than	Accumulated Other Comprehensive Income	Non-controlling	Total
	Shares	Amount	Shares	Amount	Capital	Distributions	(Loss)	Interests	Equity
Balance, December 31, 2010	32,340	$ 783,088	183,662	$ 7,317	$ 6,932,728	$ (1,480,876)	$ 73,453	$ 514,695	$ 6,830,405
Net income	-	-	-	-	-	575,006	-	20,643	595,649
Dividends on common shares	-	-	-	-	-	(381,382)	-	-	(381,382)
Dividends on preferred shares	-	-	-	-	-	(47,905)	-	-	(47,905)
Issuance of Series J preferred shares	9,850	239,037	-	-	-	-	-	-	239,037
Common shares issued:									
Upon redemption of Class A units, at redemption value	-	-	435	17	38,203	-	-	-	38,220
Under employees' share option plan	-	-	369	15	21,603	(397)	-	-	21,221
Under dividend reinvestment plan	-	-	15	1	1,329	-	-	-	1,330
Contributions:									
Real Estate Fund	-	-	-	-	-	-	-	109,241	109,241
Other	-	-	-	-	-	-	-	364	364
Distributions:									
Real Estate Fund	-	-	-	-	-	-	-	(22,713)	(22,713)
Other	-	-	-	-	-	-	-	(15,604)	(15,604)

Conversion of Series A preferred shares to common shares	(3)	(165)	5	-	165	-	-	-	-
Deferred compensation shares and options	-	-	10	-	7,866	-	-	-	7,866
Change in unrealized net gain (loss) on securities available-for-sale	-	-	-	-	-	-	(120,334)	-	(120,334)
Pro rata share of other comprehensive income of nonconsolidated subsidiaries	-	-	-	-	-	-	26,477	-	26,477
Change in value of interest rate swap	-	-	-	-	-	-	(42,458)	-	(42,458)
Adjustments to carry redeemable Class A units at redemption value	-	-	-	-	114,628	-	-	-	114,628
Redeemable noncontrolling interests' share of above adjustments	-	-	-	-	-	-	8,957	-	8,957
Discount on redemption of preferred units	-	-	-	-	-	5,000	-	-	5,000
Other	-	(105)	-	-	(4,518)	149	(5,114)	4,558	(5,030)
Balance, September 30, 2011	42,187	$ 1,021,855	184,496	$ 7,350	$ 7,112,004	$ (1,330,405)	$ (59,019)	$ 611,184	$ 7,362,969

See notes to consolidated financial statements (unaudited).

VORNADO REALTY TRUST
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY - CONTINUED
(UNAUDITED)

(Amounts in thousands)	Preferred Shares		Common Shares		Additional	Earnings Less Than	Accumulated Other Comprehensive Income (Loss)	Non-controlling	Total
	Shares	Amount	Shares	Amount	Capital	Distributions		Interests	Equity
Balance, December 31, 2011	42,187	$ 1,021,660	185,080	$ 7,373	$ 7,127,258	$ (1,401,704)	$ 73,729	$ 680,131	$ 7,508,447
Net income	-	-	-	-	-	531,125	-	30,928	562,053
Dividends on common shares	-	-	-	-	-	(384,353)	-	-	(384,353)
Dividends on preferred shares	-	-	-	-	-	(56,187)	-	-	(56,187)
Issuance of Series K preferred shares	12,000	291,144	-	-	-	-	-	-	291,144
Redemption of Series E preferred shares	(3,000)	(75,000)	-	-	-	-	-	-	(75,000)
Common shares issued:									
Upon redemption of Class A units, at redemption value	-	-	624	25	51,191	-	-	-	51,216
Under employees' share option plan	-	-	414	16	8,915	(16,389)	-	-	(7,458)
Under dividend reinvestment plan	-	-	15	1	1,269	-	-	-	1,270
Contributions:									
	-	-	-	-	-	-	-	120,606	120,606

Real Estate Fund									
Other	-	-	-	-	-	-	-	140	140
Distributions:									
Real Estate Fund	-	-	-	-	-	-	-	(44,910)	(44,910)
Other	-	-	-	-	-	-	-	(10)	(10)
Conversion of Series A preferred shares to common shares	(2)	(105)	3	-	105	-	-	-	-
Deferred compensation shares and options	-	-	7	-	11,009	(339)	-	-	10,670
Change in unrealized net gain (loss) on securities available-for-sale	-	-	-	-	-	-	(202,167)	-	(202,167)
Pro rata share of other comprehensive loss of nonconsolidated subsidiaries	-	-	-	-	-	-	(38,861)	-	(38,861)
Change in value of interest rate swap	-	-	-	-	-	-	(8,868)	-	(8,868)
Adjustments to carry redeemable Class A units at redemption value	-	-	-	-	(63,657)	-	-	-	(63,657)
Redeemable noncontrolling interests' share of above adjustments	-	-	-	-	-	-	15,717	-	15,717
Discount on redemption of preferred units	-	-	-	-	-	11,700	-	-	11,700

Other	-		-	-		-		-		(2,971)		343	(10)	(2,638)
Balance, September 30, 2012	51,185	$	1,237,699	186,143	$	7,415	$	7,136,090	$	(1,319,118)	$	(160,107)	$ 786,875	$ 7,688,854

See notes to consolidated financial statements (unaudited).

VORNADO REALTY TRUST
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(Amounts in thousands)	For the Nine Months Ended September 30, 2012	2011
Cash Flows from Operating Activities:		
Net income	$ 602,648	$ 643,013
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization (including amortization of deferred financing costs)	419,007	414,992
Net gains on sale of real estate	(203,801)	(51,623)
Equity in net income of partially owned entities, including Toys “R” Us	(142,187)	(135,829)
Return of capital from Real Estate Fund investments	61,052	-
Distributions of income from partially owned entities	59,322	75,612
Straight-lining of rental income	(55,553)	(38,262)
Loss from the mark-to-market of J.C. Penney derivative position	53,343	27,136
Amortization of below-market leases, net	(39,693)	(49,988)
Other non-cash adjustments	39,360	20,261
Net unrealized gain on Real Estate Fund investments	(33,537)	(19,209)
Gain on sale of Canadian Trade Shows	(31,105)	-
Impairment losses	13,511	-
Net gain on disposition of wholly owned and partially owned assets	(4,856)	(7,975)
Net gain on extinguishment of debt	-	(83,907)
Mezzanine loans loss reversal and net gain on disposition	-	(82,744)
Changes in operating assets and liabilities:		
Real Estate Fund investments	(163,307)	(97,785)
Accounts receivable, net	(9,444)	11,292
Prepaid assets	(52,895)	(68,558)
Other assets	(43,103)	(44,617)
Accounts payable and accrued expenses	34,546	32,227
Other liabilities	7,338	22,635
Net cash provided by operating activities	510,646	566,671
Cash Flows from Investing Activities:		
Proceeds from sales of real estate and related investments	408,856	135,762
Additions to real estate	(138,060)	(109,963)
Funding of J.C. Penney derivative collateral	(121,117)	(33,850)
Investments in partially owned entities	(116,264)	(440,865)
Development costs and construction in progress	(106,502)	(52,816)
Return of J.C. Penney derivative collateral	89,850	28,700

Acquisitions of real estate and other	(73,069)	-
Restricted cash	(62,813)	121,463
Proceeds from sales of marketable securities	58,460	19,301
Proceeds from the sale of Canadian Trade Shows	52,504	-
Distributions of capital from partially owned entities	26,665	274,283
Proceeds from the repayment of loan to officer	13,123	-
Proceeds from sales and repayments of mezzanine loans and other	2,379	100,525
Investments in mezzanine loans receivable	-	(44,215)
Net cash provided by (used in) investing activities	34,012	(1,675)

See notes to consolidated financial statements (unaudited).

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VORNADO REALTY TRUST
CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED
(UNAUDITED)

	For the Nine Months Ended September 30,	
	2012	**2011**
(Amounts in thousands)		
Cash Flows from Financing Activities:		
Repayments of borrowings	$ (2,070,295)	$ (2,666,610)
Proceeds from borrowings	1,773,000	2,184,167
Dividends paid on common shares	(384,353)	(381,382)
Proceeds from the issuance of preferred shares	291,144	239,037
Purchases of outstanding preferred units and shares	(243,300)	(28,000)
Contributions from noncontrolling interests	120,746	109,605
Distributions to noncontrolling interests	(80,994)	(77,330)
Dividends paid on preferred shares	(54,034)	(43,675)
Repurchase of shares related to stock compensation agreements and/or related tax withholdings	(30,034)	(747)
Debt issuance and other costs	(17,417)	(28,614)
Proceeds received from exercise of employee share options	10,210	22,947
Net cash used in financing activities	(685,327)	(670,602)
Net decrease in cash and cash equivalents	(140,669)	(105,606)
Cash and cash equivalents at beginning of period	606,553	690,789
Cash and cash equivalents at end of period	$ 465,884	$ 585,183
Supplemental Disclosure of Cash Flow Information:		
Cash payments for interest, excluding capitalized interest of $7,884 and $0	$ 368,018	$ 388,938
Cash payments for income taxes	$ 19,222	$ 10,299
Non-Cash Investing and Financing Activities:		
Change in unrealized net loss on securities available-for-sale	$ (202,167)	$ (120,334)
Adjustments to carry redeemable Class A units at redemption value	(63,657)	114,628
L.A. Mart seller financing	35,000	-
Common shares issued upon redemption of Class A units, at redemption value	51,216	38,220
Contribution of mezzanine loan receivable to a joint venture	-	73,750
Marriott Marquis Times Square - retail and signage capital lease:		
Asset (included in development costs and construction in progress)	240,000	-
Liability (included in other liabilities)	(240,000)	-
Like-kind exchange of real estate	230,913	45,625
Decrease in assets and liabilities resulting from deconsolidation of discontinued operations:		

Assets related to discontinued operations	-	(145,333)
Liabilities related to discontinued operations	-	(232,502)
Write-off of fully depreciated assets	(151,496)	(58,279)

See notes to consolidated financial statements (unaudited).

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VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Organization

Vornado Realty Trust ("Vornado") is a fully integrated real estate investment trust ("REIT") and conducts its business through, and substantially all of its interests in properties are held by, Vornado Realty L.P., a Delaware limited partnership (the "Operating Partnership"). Accordingly, Vornado's cash flow and ability to pay dividends to its shareholders is dependent upon the cash flow of the Operating Partnership and the ability of its direct and indirect subsidiaries to first satisfy their obligations to creditors. Vornado is the sole general partner of, and owned approximately 93.8% of the common limited partnership interest in the Operating Partnership at September 30, 2012. All references to "we," "us," "our," the "Company" and "Vornado" refer to Vornado Realty Trust and its consolidated subsidiaries, including the Operating Partnership.

2. Basis of Presentation

The accompanying consolidated financial statements are unaudited and include the accounts of Vornado, and the Operating Partnership and its consolidated partially owned entities. All intercompany amounts have been eliminated. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and changes in cash flows have been made. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. These condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q of the Securities and Exchange Commission (the "SEC") and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2011, as filed with the SEC.

We have made estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the operating results for the full year. Certain prior year balances have been reclassified in order to conform to current year presentation.

3. Recently Issued Accounting Literature

In May 2011, the Financial Accounting Standards Board ("FASB") issued Update No. 2011-04, *Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* ("ASU No. 2011-04"). ASU No. 2011-04 provides a uniform framework for fair value measurements and related disclosures between GAAP and International Financial Reporting Standards ("IFRS") and requires additional disclosures, including: (i) quantitative information about unobservable inputs used, a description of the valuation processes used, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs, for Level 3 fair value measurements; (ii) fair value of financial instruments not measured at fair value but for which disclosure of fair value is required, based on their levels in the fair value hierarchy; and (iii) transfers between Level 1 and Level 2 of the fair value hierarchy. The adoption of this update on January 1, 2012 did not have a material impact on our consolidated financial statements, but resulted in additional fair value measurement disclosures (see Note 14 – Fair Value Measurements).

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

4. Acquisitions

On July 5, 2012, we entered into an agreement to acquire a retail condominium located at 666 Fifth Avenue at 53rd Street for $707,000,000. The property has 126 feet of frontage on Fifth Avenue and contains 114,000 square feet, 39,000 square feet in fee and 75,000 square feet by long-term lease from the 666 Fifth Avenue office condominium, which is 49.5% owned by Vornado. The acquisition will be funded with proceeds from asset sales and property level debt and is expected to close in the fourth quarter, subject to customary closing conditions.

On July 30, 2012, we entered into a lease with Host Hotels & Resorts, Inc. (NYSE: HST) (“Host”), under which we will redevelop the retail and signage components of the Marriott Marquis Times Square Hotel. The Marriott Marquis with over 1,900 rooms is one of the largest hotels in Manhattan. It is located in the heart of the bow-tie of Times Square and spans the entire block front from 45th Street to 46th Street on Broadway. The Marriott Marquis is directly across from our 1540 Broadway iconic retail property leased to Forever 21 and Disney flagship stores. We plan to spend as much as $140,000,000 to redevelop and substantially expand the existing retail space, including converting the below grade parking garage into retail, and creating six-story, 300 foot wide block front, dynamic LED signs. During the term of the lease we will pay fixed rent equal to the sum of $12,500,000 plus a portion of the property’s net cash flow, after we receive a 5.2% preferred return on our invested capital. The lease contains put/call options which, if exercised, would lead to our ownership. Host can exercise the put option during defined periods following the conversion of the project to a condominium. We can exercise our call option under the same terms, at any time after the fifteenth year of the lease term. We are accounting for this lease as a “capital lease” and have recorded a $240,000,000 capital lease asset and liability, which are included as a component of “development and construction in progress” and “other liabilities,” respectively, on our consolidated balance sheet. Although we have commenced paying the annual rent, there will be no income statement activity until the redevelopment is substantially complete.

5. Vornado Capital Partners Real Estate Fund (the “Fund”)

In February 2011, the Fund’s subscription period closed with an aggregate of $800,000,000 of capital commitments, of which we committed $200,000,000. We are the general partner and investment manager of the Fund, which has an eight-year term and a three-year investment period. During the investment period, which concludes in July 2013, the

Fund is our exclusive investment vehicle for all investments that fit within its investment parameters, as defined. The Fund is accounted for under the AICPA Investment Company Guide and its investments are reported on its balance sheet at fair value, with changes in value each period recognized in earnings. We consolidate the accounts of the Fund into our consolidated financial statements, retaining the fair value basis of accounting.

On April 26, 2012, the Fund acquired 520 Broadway, a 112,000 square foot office building located in Santa Monica, California for $59,650,000 and subsequently placed a $30,000,000 mortgage loan on the property. The three-year loan bears interest at LIBOR plus 2.25% and has two one-year extension options.

On July 2, 2012, the Fund acquired 1100 Lincoln Road, a 167,000 square foot retail property, the western anchor of the Lincoln Road Shopping District in Miami Beach, Florida, for $132,000,000. The purchase price consisted of $66,000,000 in cash and a $66,000,000 mortgage loan. The three-year loan bears interest at LIBOR plus 2.75% and has two one-year extension options.

On August 20, 2012, the Fund acquired 501 Broadway, a 9,000 square foot retail property in New York for $31,000,000. The purchase price consisted of $11,000,000 in cash and a $20,000,000 mortgage loan. The three-year loan bears interest at LIBOR plus 2.75% with a floor of 3.50%, and has two one-year extension options.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

5. Vornado Capital Partners Real Estate Fund (the "Fund") - continued

At September 30, 2012, the Fund had eight investments with an aggregate fair value of approximately $482,442,000, or $45,818,000 in excess of cost, and had remaining unfunded commitments of $314,371,000, of which our share was $78,592,750. Below is a summary of income from the Fund for the three and nine months ended September 30, 2012 and 2011.

(Amounts in thousands)	For the Three Months Ended September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
Operating (loss) income	$ (49)	$ (286)	$ 4,035	$ 3,197
Net realized gain	-	-	-	3,085
Net unrealized gains	5,558	5,639	33,537	19,209
Income from Real Estate Fund	5,509	5,353	37,572	25,491
Less (income) attributable to noncontrolling interests	(4,787)	(3,675)	(25,026)	(15,703)
Income from Real Estate Fund attributable to Vornado [1]	$ 722	$ 1,678	$ 12,546	$ 9,788

(1) Excludes management, leasing and development fees of $681 and $638 for the three months ended September 30, 2012 and 2011, respectively, and $2,025 and $1,803 for the nine months ended September 30, 2012 and 2011, respectively, which are included as a component of "fee and other income" on our consolidated statements of income.

6. Marketable Securities and Derivative Instruments

Marketable Securities

Our portfolio of marketable securities is comprised of debt and equity securities that are classified as available for sale. Available for sale securities are presented on our consolidated balance sheets at fair value. Gains and losses resulting from the mark-to-market of these securities are included in “other comprehensive income (loss).” Gains and losses are recognized in earnings only upon the sale of the securities and are recorded based on the weighted average cost of such securities.

In the nine months ended September 30, 2012 and 2011, we sold certain marketable securities for aggregate proceeds of $58,460,000 and $19,301,000, resulting in net gains of $3,582,000 and $2,139,000, respectively.

Below is a summary of our marketable securities portfolio as of September 30, 2012 and December 31, 2011.

	As of September 30, 2012				As of December 31, 2011			
	Maturity	**Fair Value**	**GAAP Cost**	**Unrealized (Loss) Gain**	**Maturity**	**Fair Value**	**GAAP Cost**	**Unrealized Gain**
Equity securities:								
J.C. Penney	n/a	$ 451,406	$ 591,214	$ (139,808)	n/a	$ 653,228	$ 591,069	$ 62,159
Other	n/a	33,595	14,228	19,367	n/a	30,568	14,585	15,983
Debt securities	n/a	-	-	-	04/13 - 10/18	57,525	53,941	3,584
		$ 485,001	$ 605,442	$ (120,441)		$ 741,321	$ 659,595	$ 81,726

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

6. Marketable Securities and Derivative Instruments - continued

Investment in J.C. Penney Company, Inc. ("J.C. Penney") (NYSE: JCP)

We own 23,400,000 J.C. Penney common shares, or 10.7% of its outstanding common shares. Below are the details of our investment.

We own 18,584,010 common shares at an average economic cost of $25.76 per share, or $478,677,000 in the aggregate. As of September 30, 2012, these shares have an aggregate fair value of $451,406,000, based on J.C. Penney's closing share price of $24.29 per share. Unrealized gains and losses from the mark-to-market of these shares are included in "other comprehensive income (loss)." The three and nine months ended September 30, 2012 include $18,213,000 of unrealized gains and $201,967,000 of unrealized losses, respectively. The three and nine months ended September 30, 2011 include unrealized losses of $144,212,000 and $102,920,000, respectively.

We also own an economic interest in 4,815,990 common shares through a forward contract at a weighted average strike price of $29.01 per share, or $139,723,000 in the aggregate. The forward contract was amended on October 8, 2012, such that, among other things, the contract may be settled, at our election, in cash or common shares, in whole or in part, at any time prior to October 8, 2022. The counterparty may accelerate settlement, in whole or in part, on October 8, 2014, or any anniversary thereof, or in the event we were to receive a credit downgrade. The forward contract strike price per share increases at an annual rate of LIBOR plus 95 basis points during the first two years of the contract and LIBOR plus 80 basis points thereafter. The contract is a derivative instrument that does not qualify for hedge accounting treatment. Gains and losses from the mark-to-market of the underlying common shares are recognized in "interest and other investment income (loss), net" on our consolidated statements of income. In the three and nine months ended September 30, 2012 we recognized income of $4,344,000 and a loss of $53,343,000, respectively, from the mark-to-market of the underlying common shares, and as of September 30, 2012, have funded $31,267,000 in connection with this derivative position. In the three and nine months ended September 30, 2011, we recognized losses of $37,537,000 and $27,136,000, respectively, from the mark-to-market of the underlying common shares.

At September 30, 2012, the aggregate economic net loss on our investment in J.C. Penney, after dividends, was $20,667,000, based on our economic cost of $26.43 per share.

7. Investments in Partially Owned Entities

Toys "R" Us ("Toys")

As of September 30, 2012, we own 32.5% of Toys. The business of Toys is highly seasonal. Historically, Toys' fourth quarter net income accounts for more than 80% of its fiscal year net income. We account for our investment in Toys under the equity method and record our 32.5% share of Toys net income or loss on a one-quarter lag basis because Toys' fiscal year ends on the Saturday nearest January 31, and our fiscal year ends on December 31. As of September 30, 2012, the carrying amount of our investment in Toys does not differ materially from our share of the equity in the net assets of Toys on a purchase accounting basis.

Below is a summary of Toys' latest available financial information on a purchase accounting basis:

(Amounts in thousands)			Balance as of	
Balance Sheet:			**July 28, 2012**	**October 29, 2011**
Assets			$ 11,680,000	$ 13,221,000
Liabilities			9,836,000	11,530,000
Noncontrolling interests			39,000	-
Toys "R" Us, Inc. equity			1,805,000	1,691,000
	For the Three Months Ended		**For the Nine Months Ended**	
Income Statement:	**July 28, 2012**	**July 30, 2011**	**July 28, 2012**	**July 30, 2011**
Total revenues	$ 2,552,000	$ 2,648,000	$ 11,089,000	$ 11,256,000
Net (loss) income attributable to Toys	(34,000)	(36,000)	249,000	227,000

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. Investments in Partially Owned Entities – continued

Alexander's, Inc. ("Alexander's") (NYSE: ALX)

As of September 30, 2012, we own 1,654,068 Alexander's common shares, or approximately 32.4% of Alexander's common equity. We manage, lease and develop Alexander's properties pursuant to agreements which expire in March of each year and are automatically renewable. As of September 30, 2012, Alexander's owed us $39,794,000 in fees under these agreements.

As of September 30, 2012, the market value of our investment in Alexander's, based on Alexander's September 30, 2012 closing share price of $427.49, was $707,098,000, or $520,384,000 in excess of the carrying amount on our consolidated balance sheet. As of September 30, 2012, the carrying amount of our investment in Alexander's, excluding amounts owed to us, exceeds our share of the equity in the net assets of Alexander's by approximately $57,292,000. The majority of this basis difference resulted from the excess of our purchase price for the Alexander's common stock acquired over the book value of Alexander's net assets. Substantially all of this basis difference was allocated, based on our estimates of the fair values of Alexander's assets and liabilities, to real estate (land and buildings). We are amortizing the basis difference related to the buildings into earnings as additional depreciation expense over their estimated useful lives. This amortization is not material to our share of equity in Alexander's net income. The basis difference related to the land will be recognized upon disposition of our investment.

On October 21, 2012, Alexander's entered into an agreement to sell its Kings Plaza Regional Shopping Center located in Brooklyn, New York, for $751,000,000. Upon completion of the sale, we will recognize a financial statement gain of approximately $181,000,000. Alexander's expects to distribute the taxable gain to its stockholders as a special long-term capital gain dividend, of which our share is approximately $202,000,000 and we expect to pay this amount to our common shareholders as a special long-term capital gain dividend. The sale, which is subject to customary closing conditions, is expected to be completed in the fourth quarter.

Below is a summary of Alexander's latest available financial information:

(Amounts in thousands)			Balance as of	
			September 30, 2012	December 31, 2011
Balance Sheet:				
Assets			$ 1,765,000	$ 1,771,000
Liabilities			1,401,000	1,408,000
Noncontrolling interests			5,000	4,000
Stockholders' equity			359,000	359,000
	For the Three Months Ended		**For the Nine Months Ended**	
Income Statement:	**September 30, 2012**	**September 30, 2011**	**September 30, 2012**	**September 30, 2011**
Total revenues	$ 49,000	$ 47,000	$ 143,000	$ 139,000
Net income attributable to Alexander's	19,000	20,000	57,000	59,000

Lexington Realty Trust ("Lexington") (NYSE: LXP)

As of September 30, 2012, we own 18,468,969 Lexington common shares, or approximately 11.8% of Lexington's common equity. We account for our investment in Lexington under the equity method because we believe we have the ability to exercise significant influence over Lexington's operating and financial policies, based on, among other factors, our representation on Lexington's Board of Trustees and the level of our ownership in Lexington as compared to other shareholders. We record our pro rata share of Lexington's net income or loss on a one-quarter lag basis because we file our consolidated financial statements on Form 10-K and 10-Q prior to the time that Lexington files its consolidated financial statements.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. Investments in Partially Owned Entities – continued

Based on Lexington's September 30, 2012 closing share price of $9.66, the market value of our investment in Lexington was $178,410,000, or $128,139,000 in excess of the September 30, 2012 carrying amount on our consolidated balance sheet. As of September 30, 2012, the carrying amount of our investment in Lexington was less than our share of the equity in the net assets of Lexington by approximately $45,445,000. This basis difference resulted primarily from $107,882,000 of non-cash impairment charges recognized in 2008, partially offset by purchase accounting for our acquisition of an additional 8,000,000 common shares of Lexington in October 2008, of which the majority relates to our estimate of the fair values of Lexington's real estate (land and buildings) as compared to the carrying amounts in Lexington's consolidated financial statements. We are amortizing the basis difference related to the buildings into earnings as additional depreciation expense over their estimated useful lives. This amortization is not material to our share of equity in Lexington's net income or loss. The basis difference related to the land will be recognized upon disposition of our investment. Below is a summary of Lexington's latest available financial information:

(Amounts in thousands)			Balance as of	
Balance Sheet:			**June 30, 2012**	**September 30, 2011**
Assets			$ 3,017,000	$ 3,164,000
Liabilities			1,937,000	1,888,000
Noncontrolling interests			28,000	59,000
Shareholders' equity			1,052,000	1,217,000
	For the Three Months Ended		**For the Nine Months Ended**	
Income Statement:	**June 30, 2012**	**June 30, 2011**	**June 30, 2012**	**June 30, 2011**
Total revenues	$ 84,000	$ 78,000	$ 250,000	$ 238,000
Net income (loss) attributable to Lexington	5,000	(44,000)	22,000	(49,000)

In October 2012, Lexington sold 15,000,000 shares in an underwritten public offering at a public offering price of $9.45 per share. As a result, our ownership in Lexington will decrease to 10.8% and we will record a $12,983,000 net gain in connection with this stock issuance, in the fourth quarter.

LNR Property LLC ("LNR")

As of September 30, 2012, we own a 26.2% equity interest in LNR. We account for our investment in LNR under the equity method and record our 26.2% share of LNR's net income or loss on a one-quarter lag basis because we file our consolidated financial statements on Form 10-K and 10-Q prior to receiving LNR's consolidated financial statements.

LNR consolidates certain Commercial Mortgage-Backed Securities ("CMBS") and Collateralized Debt Obligation ("CDO") trusts for which it is the primary beneficiary. The assets of these trusts (primarily commercial mortgage loans), which aggregate approximately $83 billion as of June 30, 2012, are the sole source of repayment of the related liabilities, which are non-recourse to LNR and its equity holders, including us. Changes in the fair value of these assets each period are offset by changes in the fair value of the related liabilities through LNR's consolidated income statement. As of September 30, 2012, the carrying amount of our investment in LNR does not materially differ from our share of LNR's equity. Below is a summary of LNR's latest available financial information:

(Amounts in thousands)			**Balance as of**	
Balance Sheet:			**June 30, 2012**	**September 30, 2011**
Assets			$ 83,899,000	$ 128,536,000
Liabilities			83,087,000	127,809,000
Noncontrolling interests			9,000	55,000
LNR Property Corporation equity			803,000	672,000
	For the Three Months Ended		**For the Nine Months Ended**	
Income Statement:	**June 30, 2012**	**June 30, 2011**	**June 30, 2012**	**June 30, 2011**
Total revenues	$ 59,000	$ 73,000	$ 163,000	$ 156,000
Net income attributable to LNR	63,000	52,000	150,000	152,000

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. Investments in Partially Owned Entities – continued

Below is a schedule of our investments in partially owned entities as of September 30, 2012 and December 31, 2011.

(Amounts in thousands)	Percentage Ownership at	Balance as of	
Investments:	**September 30, 2012**	**September 30, 2012**	**December 31, 2011**
Toys	32.5 %[1]	$ 549,421	$ 506,809
Alexander's	32.4 %	$ 186,714	$ 189,775
Lexington	11.8 %[2]	50,271	57,402
LNR	26.2 %	197,231	174,408
India real estate ventures	4.0%-36.5%	94,241	80,499
Partially owned office buildings:			
280 Park Avenue	49.5 %	190,034	184,516
Rosslyn Plaza	43.7%-50.4%	62,272	53,333
West 57th Street properties	50.0 %	57,920	58,529
One Park Avenue	30.3 %	50,275	47,568
666 Fifth Avenue Office Condominium	49.5 %	34,162	23,655
330 Madison Avenue	25.0 %	24,900	20,353
1101 17th Street	55.0 %	22,271	20,407
Warner Building	55.0 %	11,603	2,715
Fairfax Square	20.0 %	5,870	6,343
Other partially owned office buildings	Various	10,042	11,547
Other investments:			
Independence Plaza Partnership [3]	51.0 %	53,545	48,511
Verde Realty Operating Partnership [4]	8.3 %	52,910	59,801
Downtown Crossing, Boston	50.0 %	47,605	46,691
Monmouth Mall	50.0 %	7,373	7,536

Other investments [5]	Various	160,471	140,061
		$ 1,319,710	$ 1,233,650

(1) 32.7% at December 31, 2011.

(2) 12.0% at December 31, 2011.

(3) Represents an investment in mezzanine loans to the property owner entity.

(4) In the third quarter of 2012, we converted our 2,015,151 units in Verde Realty Operating Partnership into 2,015,151 common shares of Verde Realty ("Verde"). Pursuant to a merger agreement which was approved by Verde shareholders on September 14, 2012, we accepted an offer to receive cash of $13.85 per share, or $27,910 in the aggregate; accordingly, we recognized a $4,936 impairment loss in the third quarter. At September 30, 2012, the $52,910 carrying amount of our investment in Verde is comprised of the $27,910 value of the common shares and $25,000 of convertible debentures that are senior to the equity and mature in December 2018. Upon completion of the merger, we will reclassify the convertible debentures to other assets.

(5) Includes interests in 85 10th Avenue, Farley Project, Suffolk Downs, Dune Capital L.P., Fashion Centre Mall and others.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. Investments in Partially Owned Entities - continued

Below is a schedule of income recognized from investments in partially owned entities for the three and nine months ended September 30, 2012 and 2011.

(Amounts in thousands)	Percentage Ownership September 30, 2012	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Our Share of Net Income (Loss):		**2012**	**2011**	**2012**	**2011**
Toys:	32.5 %				
Equity in net (loss) income before income taxes		$ (22,074)	$ (26,773)	$ 99,649	$ 104,049
Income tax benefit (expense)		11,118	15,135	(17,982)	(29,914)
Equity in net (loss) income		(10,956)	(11,638)	81,667	74,135
Management fees		2,371	2,334	7,029	6,659
		$ (8,585)	$ (9,304)	$ 88,696	$ 80,794
Alexander's:	32.4 %				
Equity in net income		$ 7,137	$ 6,437	$ 19,210	$ 18,507
Fee income		1,821	1,758	5,617	5,545
		8,958	8,195	24,827	24,052
Lexington:	11.8 %				
Equity in net (loss) income		(323)	(617)	371	449
Net gain resulting from Lexington's stock issuance		-	-	-	9,760
		(323)	(617)	371	10,209
LNR:	26.2 %				
Equity in net income		16,600	13,656	39,319	24,916
Net gains from asset sales and tax settlement gains		-	-	-	14,997
		16,600	13,656	39,319	39,913
India real estate ventures	4.0%-36.5%	82	(690)	(4,526)	(692)
Partially owned office buildings:					
Warner Building:	55.0 %				
Equity in net loss		(2,839)	(2,783)	(7,438)	(6,308)
Straight-line reserves and write-off of tenant					

improvements		-	-	-	(9,022)
		(2,839)	(2,783)	(7,438)	(15,330)
280 Park Avenue (acquired in May 2011)	49.5 %	(1,717)	(6,461)	(9,267)	(8,645)
666 Fifth Avenue Office Condominium (acquired in December 2011)	49.5 %	1,744	-	5,244	-
330 Madison Avenue	25.0 %	1,224	315	2,036	1,440
1101 17th Street	55.0 %	591	671	1,920	2,094
One Park Avenue (acquired in March 2011)	30.3 %	256	124	890	(1,347)
West 57th Street properties	50.0 %	167	298	732	634
Rosslyn Plaza	43.7%-50.4%	(204)	(60)	99	2,160
Fairfax Square	20.0 %	(33)	(22)	(85)	7
Other partially owned office buildings	Various	505	1,079	1,587	5,165
		(306)	(6,839)	(4,282)	(13,822)
Other investments:					
Verde Realty Operating Partnership [(1)]	8.3 %	(5,388)	2,413	(6,000)	1,204
Independence Plaza Partnership (acquired in June 2011) [(2)]	51.0 %	1,828	1,811	5,243	1,811
Monmouth Mall	50.0 %	347	631	1,007	1,588
Downtown Crossing, Boston	50.0 %	(38)	(408)	(872)	(1,156)
Other investments [(3)]	Various	(492)	(5,012)	(1,596)	(8,072)
		(3,743)	(565)	(2,218)	(4,625)
		$ 21,268	$ 13,140	$ 53,491	$ 55,035

(1) 2012 includes a $4,936 impairment loss (see note 4 on page 16)

(2) Represents an investment in mezzanine loans to the property owner entity.

(3) Includes interests in 85 10th Avenue, Farley Project, Suffolk Downs, Dune Capital L.P., Fashion Centre Mall and others.

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VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. Investments in Partially Owned Entities – continued

Below is a summary of the debt of our partially owned entities as of September 30, 2012 and December 31, 2011, none of which is recourse to us.

(Amounts in thousands)	Percentage Ownership at September 30, 2012	Maturity	Interest Rate at September 30, 2012	100% of Partially Owned Entities' Debt at September 30, 2012	100% of Partially Owned Entities' Debt at December 31, 2011
Toys:	32.5 %(1)				
Notes, loans and mortgages payable		2013-2021	7.40 %	$ 5,423,735	$ 6,047,521
Alexander's:	32.4 %				
Mortgage notes payable		2013-2018	3.50 %	$ 1,319,776	$ 1,330,932
Lexington:	11.8 %(2)				
Mortgage notes payable		2012-2037	5.45 %	$ 1,739,466	$ 1,712,750
LNR:	26.2 %				
Mortgage notes payable		2013-2031	3.89 %	$ 466,882	$ 353,504
Liabilities of consolidated CMBS and CDO trusts		n/a	5.32 %	82,522,220	127,348,336
				$ 82,989,102	$ 127,701,840
Partially owned office buildings:					
666 Fifth Avenue Office Condominium mortgage note payable	49.5 %	02/19	6.76 %	$ 1,090,592	$ 1,035,884
280 Park Avenue mortgage notes payable	49.5 %	06/16	6.65 %	738,009	737,678
Warner Building mortgage note payable	55.0 %	05/16	6.26 %	292,700	292,700
One Park Avenue mortgage note payable	30.3 %	03/16	5.00 %	250,000	250,000
	25.0 %	06/15	1.73 %	150,000	150,000

330 Madison Avenue mortgage note payable							
Fairfax Square mortgage note payable	20.0 %	12/14	7.00 %		70,344		70,974
Rosslyn Plaza mortgage note payable	43.7% to 50.4%	n/a	n/a		-		56,680
West 57th Street properties mortgage note payable	50.0 %	02/14	4.94 %		20,628		21,864
Other	Various	Various	6.38 %		69,839		70,230
				$	2,682,112	$	2,686,010
India Real Estate Ventures:							
TCG Urban Infrastructure Holdings mortgage notes payable	25.0 %	2012-2022	13.13 %	$	241,208	$	226,534
Other:							
Verde Realty Operating Partnership mortgage notes payable	8.3 %	2013-2025	5.52 %	$	503,211	$	340,378
Monmouth Mall mortgage note payable	50.0 %	09/15	5.44 %		160,662		162,153
Other(3)	Various	Various	4.93 %		994,009		992,872
				$	1,657,882	$	1,495,403

(1) 32.7% at December 31, 2011.
(2) 12.0% at December 31, 2011.
(3) Includes interests in Suffolk Downs, Fashion Centre Mall and others.

Based on our ownership interest in the partially owned entities above, our pro rata share of the debt of these partially owned entities was $25,648,473,000 and $37,531,298,000 at September 30, 2012 and December 31, 2011, respectively. Excluding our pro rata share of LNR's liabilities related to consolidated CMBS and CDO trusts, which are non-recourse to LNR and its equity holders, including us, our pro rata share of partially owned entities debt was $4,049,108,000 and $4,199,145,000 at September 30, 2012 and December 31, 2011, respectively.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

8. Discontinued Operations

2012 Activity:

During 2012, we sold or have entered into agreements to sell (i) five Mart properties, (ii) four Washington, DC properties, (iii) 13 non-core strip shopping centers and the Green Acres Mall, for an aggregate of $1,500,000,000. Below are the details of these transactions.

Merchandise Mart Properties

On January 6, 2012, we completed the sale of 350 West Mart Center, a 1.2 million square foot office building in Chicago, Illinois, for $228,000,000 in cash, which resulted in a net gain of $54,911,000.

On June 22, 2012, we completed the sale of L.A. Mart, a 784,000 square foot showroom building in Los Angeles, California for $53,000,000, of which $18,000,000 was cash and $35,000,000 was nine-month seller financing at 6.0%.

On July 5, 2012, we entered into agreements to sell the Washington Design Center, the Boston Design Center and the Canadian Trade Shows, for an aggregate of $175,000,000 in cash. The sales of the Canadian Trade Shows and the Washington Design Center were completed in July 2012 and the sale of the Canadian Trade Shows resulted in an after-tax net gain of $19,657,000. The sale of the Boston Design Center will result in a net gain of approximately $5,300,000 and is expected to be completed in the fourth quarter, subject to customary closing conditions.

Washington, DC Properties

On July 26, 2012, we completed the sale of 409 Third Street S.W., a 409,000 square foot office building in Washington, DC, for $200,000,000 in cash, which resulted in a net gain of $126,621,000. This building is contiguous to the Washington Design Center and was sold to the same purchaser.

On October 26, 2012, we entered into an agreement to sell three office buildings ("Reston Executive") located in suburban Fairfax County, Virginia, containing 494,000 square feet for $126,000,000, which will result in a net gain of approximately $35,000,000. The sale, which is subject to customary closing conditions, is expected to be completed in the fourth quarter.

Retail Properties

In 2012, we sold 12 non-core strip shopping centers in separate transactions, for an aggregate of $157,000,000 in cash, which resulted in a net gain aggregating $22,266,000, of which $4,464,000 was recognized in the third quarter. In addition we have entered into an agreement to sell a building on Market Street, Philadelphia, which is part of the Gallery at Market East for $60,000,000, which will result in a net gain of approximately $35,000,000. The sale, which is subject to customary closing conditions, is expected to be completed in the fourth quarter.

On October 21, 2012, we entered into an agreement to sell the Green Acres Mall located in Valley Stream, New York, for $500,000,000. Net proceeds from the sale will be approximately $185,000,000. The financial statement gain will be approximately $195,000,000. The tax gain will be approximately $304,000,000, which is expected to be deferred as part of a like-kind exchange. The sale, which is expected to be completed in the first quarter of 2013, is subject to customary closing conditions and is conditioned on the closing of the sale of Kings Plaza (an Alexander's property), which is being sold to the same purchaser.

2011 Activity:

During 2011, we (i) completed the disposition of the High Point Complex in North Carolina, which resulted in an $83,907,000 net gain on extinguishment of debt and (ii) sold three non-core strip shopping centers and two office buildings in Washington, DC for an aggregate of $168,000,000 in cash, which resulted in a net gain aggregating $51,623,000.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

8. Discontinued Operations - continued

We have reclassified the revenues and expenses of all of the properties discussed above, as well as eight other retail properties that are currently held for sale to "income from discontinued operations" and the related assets and liabilities to "assets related to discontinued operations" and "liabilities related to discontinued operations" for all of the periods presented in the accompanying financial statements. The tables below set forth the assets and liabilities related to discontinued operations at September 30, 2012 and December 31, 2011 and their combined results of operations for the three and nine months ended September 30, 2012 and 2011.

(Amounts in thousands)	Assets Related to Discontinued Operations as of		Liabilities Related to Discontinued Operations as of	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
Retail Properties	$ 384,973	$ 520,014	$ 319,233	$ 351,083
Washington, DC Properties	86,933	152,568	93,000	93,000
Merchandise Mart Properties	66,032	376,571	66,747	74,236
Total	$ 537,938	$ 1,049,153	$ 478,980	$ 518,319

(Amounts in thousands)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Total revenues	$ 27,651	$ 49,656	$ 112,585	$ 160,747
Total expenses	21,082	41,212	81,508	130,571
	6,569	8,444	31,077	30,176
Net gains on sale of real estate	131,088	-	203,801	51,623
Gain on sale of Canadian Trade Shows, net of $11,448 of income taxes	19,657	-	19,657	-
Impairment losses	-	-	(13,511)	-
Net gain on extinguishment of High Point debt	-	-	-	83,907
Income from discontinued operations	$ 157,314	$ 8,444	$ 241,024	$ 165,706

9. Mezzanine Loans Receivable

As of September 30, 2012 and December 31, 2011, the carrying amount of mezzanine loans receivable was $131,585,000 and $133,948,000, respectively. These loans have a weighted average interest rate of 9.53% and maturities ranging from August 2014 to May 2016.

On October 19, 2012, we acquired a 25% participation in a $475,000,000 first mortgage and mezzanine loan for the acquisition and redevelopment of a 10-story retail building at 701 Seventh Avenue in Times Square. The loan has an interest rate of LIBOR plus 10.2%, with a LIBOR floor of 1.0%. Of the $475,000,000, we have funded $93,750,000, representing our 25% share of the $375,000,000 that has been funded. $25,000,000, our 25% share of the remaining $100,000,000, will be funded during the development of the property.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

10. Identified Intangible Assets and Liabilities

The following summarizes our identified intangible assets (primarily acquired above-market leases) and liabilities (primarily acquired below-market leases) as of September 30, 2012 and December 31, 2011.

	Balance as of	
(Amounts in thousands)	September 30, 2012	December 31, 2011
Identified intangible assets:		
Gross amount	$ 615,199	$ 642,471
Accumulated amortization	(362,516)	(347,039)
Net	$ 252,683	$ 295,432
Identified intangible liabilities (included in deferred revenue):		
Gross amount	$ 816,774	$ 830,411
Accumulated amortization	(398,262)	(367,525)
Net	$ 418,512	$ 462,886

Amortization of acquired below-market leases, net of acquired above-market leases, resulted in an increase to rental income of $13,242,000 and $15,847,000 for the three months ended September 30, 2012 and 2011, respectively, and $39,228,000 and $48,681,000 for the nine months ended September 30, 2012 and 2011, respectively. Estimated annual amortization of acquired below-market leases, net of acquired above-market leases, for each of the five succeeding years commencing January 1, 2013 is as follows:

(Amounts in thousands)	
2013	$ 42,023
2014	36,603
2015	33,816
2016	31,333
2017	25,841

Amortization of all other identified intangible assets (a component of depreciation and amortization expense) was $11,940,000 and $15,397,000 for the three months ended September 30, 2012 and 2011, respectively, and $38,361,000 and $42,090,000 for the nine months ended September 30, 2012 and 2011, respectively. Estimated annual amortization of all other identified intangible assets including acquired in-place leases, customer relationships, and third party contracts for each of the five succeeding years commencing January 1, 2013 is as follows:

(Amounts in thousands)		
2013	$	40,739
2014		22,450
2015		17,244
2016		14,714
2017		11,853

We are a tenant under ground leases for certain properties. Amortization of these acquired below-market leases, net of above-market leases resulted in an increase to rent expense of $408,000 and $344,000 for the three months ended September 30, 2012 and 2011, respectively, and $1,182,000 and $1,033,000 for the nine months ended September 30, 2012 and 2011, respectively. Estimated annual amortization of these below-market leases, net of above-market leases for each of the five succeeding years commencing January 1, 2013 is as follows:

(Amounts in thousands)		
2013	$	1,472
2014		1,457
2015		1,457
2016		1,457
2017		1,457

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

11. Debt

The following is a summary of our debt:

(Amounts in thousands)		Interest Rate at September 30,	Balance at	
Notes and mortgages payable:	**Maturity (1)**	**2012**	**September 30, 2012**	**December 31, 2011**
Fixed rate:				
New York:				
Two Penn Plaza	03/18	5.13 %	$ 425,000	$ 425,000
1290 Avenue of the Americas	01/13	5.97 %	410,021	413,111
770 Broadway	03/16	5.65 %	353,000	353,000
888 Seventh Avenue	01/16	5.71 %	318,554	318,554
350 Park Avenue(2)	01/17	3.75 %	300,000	430,000
909 Third Avenue	04/15	5.64 %	200,241	203,217
828-850 Madison Avenue Condominium - retail	06/18	5.29 %	80,000	80,000
510 5th Avenue - retail	01/16	5.60 %	31,377	31,732
Washington, DC:				
Skyline Properties(3)	02/17	5.74 %	694,711	678,000
River House Apartments	04/15	5.43 %	195,546	195,546
2101 L Street(4)	08/24	3.97 %	150,000	-
2121 Crystal Drive	03/23	5.51 %	150,000	150,000
Bowen Building	06/16	6.14 %	115,022	115,022
1215 Clark Street, 200 12th Street and 251 18th Street	01/25	7.09 %	106,628	108,423
West End 25	06/21	4.88 %	101,671	101,671
Universal Buildings	04/14	6.49 %	94,497	98,239
2011 Crystal Drive	08/17	7.30 %	79,865	80,486
1550 and 1750 Crystal Drive	11/14	7.08 %	74,765	76,624
220 20th Street	02/18	4.61 %	74,246	75,037
2231 Crystal Drive	08/13	7.08 %	42,160	43,819
1225 Clark Street	08/13	7.08 %	25,219	26,211
1235 Clark Street	n/a	n/a	-	51,309
1750 Pennsylvania Avenue	n/a	n/a	-	44,330

Retail:					
	Cross-collateralized mortgages on 40 strip shopping centers	09/20	4.23 %	576,281	585,398
	Montehiedra Town Center	07/16	6.04 %	120,000	120,000
	Broadway Mall	07/13	5.30 %	85,840	87,750
	North Bergen (Tonnelle Avenue)	01/18	4.59 %	75,000	75,000
	Las Catalinas Mall	11/13	6.97 %	54,719	55,912
	Other	06/14-05/36	5.12%-7.30%	87,055	88,237
Merchandise Mart:					
	Merchandise Mart	12/16	5.57 %	550,000	550,000
Other:					
	555 California Street	09/21	5.10 %	600,000	600,000
	Borgata Land	02/21	5.14 %	60,000	60,000
Total fixed rate notes and mortgages payable			5.40 %	$ 6,231,418	$ 6,321,628

See notes on page 24.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

11. Debt - continued

(Amounts in thousands)	Maturity (1)	Spread over LIBOR	Interest Rate at September 30, 2012	Balance at September 30, 2012	Balance at December 31, 2011
Notes and mortgages payable:					
Variable rate:					
New York:					
Eleven Penn Plaza	01/19	L+235	2.58 %	$ 330,000	$ 330,000
100 West 33rd Street - office & retail(5)	03/17	L+250	2.73 %	325,000	232,000
4 Union Square South - retail	04/14	L+325	3.48 %	75,000	75,000
435 Seventh Avenue - retail(6)	08/19	L+225	2.47 %	98,000	51,353
866 UN Plaza	05/16	L+125	1.48 %	44,978	44,978
Washington, DC:					
River House Apartments	04/18	n/a (7)	1.63 %	64,000	64,000
2200/2300 Clarendon Boulevard	01/15	L+75	0.98 %	48,859	53,344
1730 M and 1150 17th Street	06/14	L+140	1.62 %	43,581	43,581
2101 L Street (4)	n/a	n/a	n/a	-	150,000
Retail:					
Bergen Town Center	03/13	L+150	1.73 %	282,312	283,590
San Jose Strip Center	03/13	L+400	4.25 %	106,332	112,476
Cross-collateralized mortgages on 40 strip shopping centers (8)	09/20	L+136 (8)	2.36 %	60,000	60,000
Beverly Connection	n/a	n/a	n/a	-	100,000
Other	11/12	L+375	3.98 %	19,427	19,876
Other:					
220 Central Park South	10/13	L+275	2.97 %	123,750	123,750
Total variable rate notes and mortgages payable			2.50 %	1,621,239	1,743,948
Total notes and mortgages payable			4.80 %	$7,852,657	$8,065,576
Senior unsecured notes:					

Senior unsecured notes due 2015	04/15		4.25 %	$ 499,586	$ 499,462
Senior unsecured notes due 2039 (9)	10/39		7.88 %	460,000	460,000
Senior unsecured notes due 2022	01/22		5.00 %	398,335	398,199
Total senior unsecured notes			5.70 %	$1,357,921	$1,357,661
Unsecured revolving credit facilities:					
$1.25 billion unsecured revolving credit facility	11/16	L+125	1.43 %	$ 600,000	$ 138,000
$1.25 billion unsecured revolving credit facility ($22,576 reserved for outstanding letters of credit)	06/16	L+135	-	-	-
Total unsecured revolving credit facilities			1.43 %	$ 600,000	$ 138,000
3.88% exchangeable senior debentures(10)	n/a		n/a	$ -	$ 497,898
2.85% convertible senior debentures(10)	n/a		n/a	$ -	$ 10,168

See notes on the following page.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

11. Debt - continued

Notes to preceding tabular information (amounts in thousands):

(1) Represents the extended maturity for certain loans in which we have the unilateral right, ability and intent to extend.

(2) On January 9, 2012, we completed a $300,000 refinancing of this property. The five-year fixed rate loan bears interest at 3.75% and amortizes based on a 30-year schedule beginning in the third year. The proceeds of the new loan and $132,000 of existing cash were used to repay the existing loan and closing costs.

(3) In the first quarter of 2012, we notified the lender that due to scheduled lease expirations resulting primarily from the effects of the Base Realignment and Closure statute, the Skyline properties had a 26% vacancy rate, which is expected to increase and, accordingly, cash flows are expected to decrease. As a result, our subsidiary that owns these properties does not have and is not expected to have for some time sufficient funds to pay all of its current obligations, including interest payments to the lender. Based on the projected vacancy and the significant amount of capital required to re-tenant these properties, at our request, the mortgage loan was transferred to the special servicer. In the second quarter of 2012, we entered into a forbearance agreement with the special servicer to apply cash flows of the property, before interest on the loan, towards the repayment of $4,000 of tenant improvements and leasing commissions we recently funded in connection with a new lease at these properties. In the third quarter, we were repaid our capital in full. The forbearance agreement (amended September 1, 2012, to extend its maturity) provides that through the December 1, 2012 payment date, any interest shortfall would be deferred and added to the principal balance of the loan and not give rise to a loan default. As of September 30, 2012, the deferred interest amounted to $16,711. We continue to negotiate with the special servicer to restructure the terms of the loan.

(4) On July 26, 2012, we completed a $150,000 refinancing of this property. The twelve-year fixed rate loan bears interest at 3.97% and amortizes based on a 30-year schedule beginning in the third year.

(5) On March 5, 2012, we completed a $325,000 refinancing of this property. The three-year loan bears interest at LIBOR plus 2.50% and has two one-year extension options. We retained net proceeds of approximately $87,000, after repaying the existing loan and closing costs.

(6)

On August 17, 2012, we completed a $98,000 refinancing of this property. The seven-year loan bears interest at LIBOR plus 2.25%. We retained net proceeds of approximately $44,000 after repaying the existing loan and closing costs.

(7) Interest at the Freddie Mac Reference Note Rate plus 1.53%.

(8) LIBOR floor of 1.00%.

(9) May be redeemed at our option in whole or in part beginning on October 1, 2014, at a price equal to the principal amount plus accrued interest.

(10) In April 2012, we redeemed all of the outstanding exchangeable and convertible senior debentures at par, for an aggregate of $510,215 in cash.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

12. Redeemable Noncontrolling Interests

Redeemable noncontrolling interests on our consolidated balance sheets represent Operating Partnership units held by third parties and are comprised of Class A units and Series D-15 and D-16 cumulative redeemable preferred units. Redeemable noncontrolling interests on our consolidated balance sheets are recorded at the greater of their carrying amount or redemption value at the end of each reporting period. Changes in the value from period to period are charged to "additional capital" in our consolidated statements of changes in equity. Below is a table summarizing the activity of redeemable noncontrolling interests.

(Amounts in thousands)	
Balance at December 31, 2010	$ 1,327,974
Net income	47,364
Distributions	(38,393)
Conversion of Class A units into common shares, at redemption value	(38,220)
Adjustments to carry redeemable Class A units at redemption value	(114,628)
Redemption of Series D-11 redeemable units	(28,000)
Other, net	4,623
Balance at September 30, 2011	$ 1,160,720
Balance at December 31, 2011	$ 1,160,677
Net income	40,595
Distributions	(34,138)
Conversion of Class A units into common shares, at redemption value	(51,216)
Adjustments to carry redeemable Class A units at redemption value	63,657
Redemption of Series D-10 and D-14 redeemable units	(168,300)
Other, net	(15,776)
Balance at September 30, 2012	$ 995,499

On July 19, 2012, we redeemed all of the outstanding 7.0% Series D-10 and 6.75% Series D-14 cumulative redeemable preferred units with an aggregate face amount of $180,000,000 for $168,300,000 in cash, plus accrued and unpaid distributions through the date of redemption.

As of September 30, 2012 and December 31, 2011, the aggregate redemption value of redeemable Class A units was $949,499,000 and $934,677,000, respectively.

Redeemable noncontrolling interests exclude our Series G-1 through G-4 convertible preferred units and Series D-13 cumulative redeemable preferred units, as they are accounted for as liabilities in accordance with ASC 480, *Distinguishing Liabilities and Equity*, because of their possible settlement by issuing a variable number of Vornado common shares. Accordingly, the fair value of these units is included as a component of "other liabilities" on our consolidated balance sheets and aggregated $55,097,000 and $54,865,000 as of September 30, 2012 and December 31, 2011, respectively.

13. Shareholders' Equity

On July 11, 2012, we sold 12,000,000 5.70% Series K Cumulative Redeemable Preferred Shares at a price of $25.00 per share in an underwritten public offering pursuant to an effective registration statement. We retained aggregate net proceeds of $291,144,000, after underwriters' discounts and issuance costs. Dividends on the Series K Preferred Shares are cumulative and payable quarterly in arrears. The Series K Preferred Shares are not convertible into, or exchangeable for, any of our properties or securities. On or after five years from the date of issuance (or sooner under limited circumstances), we may redeem the Series K Preferred Shares at a redemption price of $25.00 per share, plus accrued and unpaid dividends through the date of redemption. The Series K Preferred Shares have no maturity date and will remain outstanding indefinitely unless redeemed by us.

On August 16, 2012, we redeemed all of the outstanding 7.0% Series E Cumulative Redeemable Preferred Shares at par, for an aggregate of $75,000,000 in cash, plus accrued and unpaid dividends through the date of redemption.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

14. Fair Value Measurements

ASC 820, *Fair Value Measurement and Disclosures* defines fair value and establishes a framework for measuring fair value. The objective of fair value is to determine the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). ASC 820 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels: Level 1 – quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities; Level 2 – observable prices that are based on inputs not quoted in active markets, but corroborated by market data; and Level 3 – unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In determining fair value, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, as well as consider counterparty credit risk in our assessment of fair value. Considerable judgment is necessary to interpret Level 2 and 3 inputs in determining the fair value of our financial and non-financial assets and liabilities. Accordingly, our fair value estimates, which are made at the end of each reporting period, may be different than the amounts that may ultimately be realized upon sale or disposition of these assets.

Financial Assets and Liabilities Measured at Fair Value

Financial assets and liabilities that are measured at fair value in our consolidated financial statements consist of (i) marketable securities, (ii) Real Estate Fund investments, (iii) the assets in our deferred compensation plan (for which there is a corresponding liability on our consolidated balance sheet), (iv) derivative positions in marketable equity securities, (v) interest rate swaps and (vi) mandatorily redeemable instruments (Series G-1 through G-4 convertible preferred units and Series D-13 cumulative redeemable preferred units). The tables below aggregate the fair values of these financial assets and liabilities by their levels in the fair value hierarchy at September 30, 2012 and December 31, 2011, respectively.

		As of September 30, 2012		
(Amounts in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Marketable securities	$ 485,001	$ 485,001	$ -	$ -
Real Estate Fund investments (75% of which is attributable to noncontrolling interests)	482,442	-	-	482,442

Deferred compensation plan assets (included in other assets)	103,003	42,236	-	60,767
J.C. Penney derivative position (included in other assets)(1)	8,524	-	8,524	-
Total assets	$ 1,078,970	$ 527,237	$ 8,524	$ 543,209
Mandatorily redeemable instruments (included in other liabilities)	$ 55,097	$ 55,097	$ -	$ -
Interest rate swap (included in other liabilities)	52,935	-	52,935	-
Total liabilities	$ 108,032	$ 55,097	$ 52,935	$ -

(1) Represents the cash deposited with the counterparty in excess of the mark-to-market loss on the derivative position.

	As of December 31, 2011			
(Amounts in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Marketable securities	$ 741,321	$ 741,321	$ -	$ -
Real Estate Fund investments (75% of which is attributable to noncontrolling interests)	346,650	-	-	346,650
Deferred compensation plan assets (included in other assets)	95,457	39,236	-	56,221
J.C. Penney derivative position (included in other assets)(1)	30,600	-	30,600	-
Total assets	$ 1,214,028	$ 780,557	$ 30,600	$ 402,871
Mandatorily redeemable instruments (included in other liabilities)	$ 54,865	$ 54,865	$ -	$ -
Interest rate swap (included in other liabilities)	44,114	-	44,114	-
Total liabilities	$ 98,979	$ 54,865	$ 44,114	$ -

(1) Represents the mark-to-market gain on the derivative position.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

14. Fair Value Measurements – continued

Financial Assets and Liabilities Measured at Fair Value - continued

Real Estate Fund Investments

At September 30, 2012, our Real Estate Fund had eight investments with an aggregate fair value of approximately $482,442,000, or $45,818,000 in excess of cost. These investments are classified as Level 3. We use a discounted cash flow valuation technique to estimate the fair value of each of these investments, which is updated quarterly by personnel responsible for the management of each investment and reviewed by senior management at each reporting period. The discounted cash flow valuation technique requires us to estimate cash flows for each investment over the anticipated holding period, which currently ranges from 1.8 to 6.4 years. Cash flows are derived from property rental revenue (base rents plus reimbursements) less operating expenses, real estate taxes and capital and other costs, plus projected sales proceeds in the year of exit. Property rental revenue is based on leases currently in place and our estimates for future leasing activity, which are based on current market rents for similar space plus a projected growth factor. Similarly, estimated operating expenses and real estate taxes are based on amounts incurred in the current period plus a projected growth factor for future periods. Anticipated sales proceeds at the end of an investment's expected holding period are determined based on the net cash flow of the investment in the year of exit, divided by a terminal capitalization rate, less estimated selling costs.

The fair value of each property is calculated by discounting the future cash flows (including the projected sales proceeds), using an appropriate discount rate and then reduced by the property's outstanding debt, if any, to determine the fair value of the equity in each investment. Significant unobservable quantitative inputs used in determining the fair value of each investment include capitalization rates and discount rates. These rates are based on the location, type and nature of each property, and current and anticipated market conditions, which are derived from original underwriting assumptions, industry publications and from the experience of our Acquisitions and Capital Markets departments. Significant unobservable quantitative inputs in the table below were utilized in determining the fair value of these Fund investments at September 30, 2012.

Unobservable Quantitative Input	Range	Weighted Average (based on fair value of investments)
Discount rates	12.5% to 23.3%	14.6 %
Terminal capitalization rates	5.3% to 6.8%	6.0 %

The above inputs are subject to change based on changes in economic and market conditions and/or changes in use or timing of exit. Changes in discount rates and terminal capitalization rates result in increases or decreases in the fair values of these investments. The discount rates encompass, among other things, uncertainties in the valuation models with respect to terminal capitalization rates and the amount and timing of cash flows. Therefore, a change in the fair value of these investments resulting from a change in the terminal capitalization rate, may be partially offset by a change in the discount rate. It is not possible for us to predict the effect of future economic or market conditions on our estimated fair values. The table below summarizes the changes in the fair value of Fund investments that are classified as Level 3, for the three and nine months ended September 30, 2012 and 2011.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(Amounts in thousands)	2012	2011	2012	2011
Beginning balance	$ 388,455	$ 255,795	$ 346,650	$ 144,423
Purchases	88,429	-	163,021	123,047
Sales/Returns	-	-	(61,052)	(12,831)
Realized gains	-	-	-	3,085
Unrealized gains	5,558	5,639	33,537	19,209
Other, net	-	(17)	286	(15,516)
Ending balance	$ 482,442	$ 261,417	$ 482,442	$ 261,417

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

14. Fair Value Measurements – continued

Financial Assets and Liabilities Measured at Fair Value - continued

Deferred Compensation Plan Assets

Deferred compensation plan assets that are classified as Level 3 consist of investments in limited partnerships and investment funds, which are managed by third parties. We receive quarterly financial reports from a third-party administrator, which are compiled from the quarterly reports provided to them from each limited partnership and investment fund. The quarterly reports provide net asset values on a fair value basis which are audited by independent public accounting firms on an annual basis. The third-party administrator does not adjust these values in determining our share of the net assets and we do not adjust these values when reported in our consolidated financial statements. The table below summarizes the changes in the fair value of Deferred Compensation Plan Assets for the three and nine months ended September 30, 2012 and 2011.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(Amounts in thousands)	2012	2011	2012	2011
Beginning balance	$ 58,313	$ 53,724	$ 56,221	$ 47,850
Purchases	1,650	3,155	5,416	22,259
Sales	(276)	(1,044)	(4,287)	(18,538)
Realized and unrealized gain (loss)	1,080	(2,051)	3,349	2,166
Other, net	-	103	68	150
Ending balance	$ 60,767	$ 53,887	$ 60,767	$ 53,887

Financial Assets and Liabilities not Measured at Fair Value

Financial assets and liabilities that are not measured at fair value in our consolidated financial statements include mezzanine loans receivable, a stock purchase warrant, and our secured and unsecured debt. Estimates of the fair value of these instruments are determined by the standard practice of modeling the contractual cash flows required under the instrument and discounting them back to their present value at the appropriate current risk adjusted interest rate, which is provided by a third-party specialist. For floating rate debt, we use forward rates derived from observable market yield curves to project the expected cash flows we would be required to make under the instrument. The fair value of our mezzanine loans receivable and the stock purchase warrant are classified as Level 3 and the fair value of our secured and unsecured debt are classified as Level 2. The table below summarizes the carrying amounts and fair value of these financial instruments as of September 30, 2012 and December 31, 2011.

	As of September 30, 2012		As of December 31, 2011	
(Amounts in thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Assets:				
Mezzanine loans receivable	$ 131,585	$ 127,000	$ 133,948	$ 129,000
Stock purchase warrant (residential property)	-	35,000	-	-
	$ 131,585	$ 162,000	$ 133,948	$ 129,000
Liabilities:				
Notes and mortgages payable	$ 7,852,657	$ 7,900,000	$ 8,065,576	$ 8,181,000
Senior unsecured notes	1,357,921	1,476,000	1,357,661	1,426,000
Revolving credit facility debt	600,000	600,000	138,000	138,000
Exchangeable senior debentures	-	-	497,898	510,000
Convertible senior debentures	-	-	10,168	10,000
	$ 9,810,578	$ 9,976,000	$ 10,069,303	$ 10,265,000

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

15. Incentive Compensation

Our Omnibus Share Plan (the "Plan") provides for grants of incentive and non-qualified stock options, restricted stock, restricted Operating Partnership units and out-performance plan rewards to certain of our employees and officers. We account for all stock-based compensation in accordance ASC 718, *Compensation – Stock Compensation*.

On March 30, 2012, our Compensation Committee (the "Committee") approved the 2012 formulaic annual incentive program for our senior executive management team. Under the program, our senior executive management team, including our Chairman and our President and Chief Executive Officer, will have the ability to earn annual incentive payments (cash or equity) if and only if we achieve comparable funds from operations ("Comparable FFO") of at least 80% or more of the prior year Comparable FFO. Moreover, even if we achieve the stipulated Comparable FFO performance requirement, the Committee retains the right, consistent with best practices, to elect to make no payments under the program. Comparable FFO excludes the impact of certain non-recurring items such as income or loss from discontinued operations, the sale or mark-to-market of marketable securities or derivatives and early extinguishment of debt, restructuring costs and non-cash impairment losses, among others, and thus the Committee believes provides a better metric than total FFO for assessing management's performance for the year. Aggregate incentive awards earned under the program are subject to a cap of 1.25% of Comparable FFO for the year, with individual award allocations determined by the Committee based on an assessment of individual and overall performance.

On March 30, 2012, the Committee also approved the 2012 Out-Performance Plan, a multi-year, performance-based equity compensation plan (the "2012 OPP"). The aggregate notional amount of the 2012 OPP is $40,000,000. Under the 2012 OPP, participants, including our Chairman and our President and Chief Executive Officer, have the opportunity to earn compensation payable in the form of equity awards if and only if we outperform a predetermined total shareholder return ("TSR") and/or outperform the market with respect to a relative TSR in any year during a three-year performance period. Specifically, awards under our 2012 OPP may be earned if we (i) achieve a TSR above that of the SNL US REIT Index (the "Index") over a one-year, two-year or three-year performance period (the "Relative Component"), and/or (ii) achieve a TSR level greater than 7% per annum, or 21% over the three-year performance period (the "Absolute Component"). To the extent awards would be earned under the Absolute Component of the 2012 OPP but we underperform the Index, such awards would be reduced (and potentially fully negated) based on the degree to which we underperform the Index. In certain circumstances, in the event we outperform the Index but awards would not otherwise be earned under the Absolute Component, awards may still be earned under the Relative Component. To the extent awards would otherwise be earned under the Relative Component but we fail to achieve at least a 6% per annum absolute TSR level, such awards would be reduced based on our absolute TSR performance, with no awards being earned in the event our TSR during the applicable measurement period is 0% or negative, irrespective of the degree to which we may outperform the Index. If the designated performance objectives are achieved, OPP Units are also subject to time-based vesting requirements. Dividends on awards issued accrue during the performance period and are paid to participants if and only if awards are ultimately earned based on the achievement of the designated performance objectives. Awards earned under the 2012 OPP vest 33% in year three, 33% in year four and 34% in year five. The fair value of the 2012 OPP on the date of grant, as adjusted for estimated forfeitures, was $12,250,000, and is being amortized into expense over a five-year period from the date of grant, using a graded vesting attribution model.

Stock-based compensation expense consists of stock option awards, restricted stock awards, Operating Partnership unit awards and out-performance plan awards. Stock-based compensation expense was $7,774,000 and $7,320,000 in the three months ended September 30, 2012 and 2011, respectively, and $22,821,000 and $21,384,000 in the nine months ended September 30, 2012 and 2011, respectively.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

16. Fee and Other Income

The following table sets forth the details of our fee and other income:

(Amounts in thousands)	For the Three Months Ended September 30, 2012	2011	For the Nine Months Ended September 30, 2012	2011
BMS cleaning fees	$ 16,945	$ 15,647	$ 49,437	$ 46,479
Signage revenue	4,783	5,085	14,252	14,746
Management and leasing fees	7,234	4,773	16,534	16,660
Lease termination fees	282	4,803	1,172	12,478
Other income	10,444	6,468	24,623	21,450
	$ 39,688	$ 36,776	$ 106,018	$ 111,813

Management and leasing fees include management fees from Interstate Properties, a related party, of $197,000 and $195,000 for the three months ended September 30, 2012 and 2011, respectively, and $588,000 and $586,000 for the nine months ended September 30, 2012 and 2011, respectively. The above table excludes fee income from partially owned entities, which is typically included in "income from partially owned entities" (see Note 7 – Investments in Partially Owned Entities).

17. Interest and Other Investment Income (Loss), Net

The following table sets forth the details of our interest and other investment income (loss):

(Amounts in thousands)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Income (loss) from the mark-to-market of J.C. Penney derivative position	$ 4,344	$ (37,537)	$ (53,343)	$ (27,136)
Interest on mezzanine loans receivable	2,852	3,442	8,867	9,169
Mark-to-market of investments in our deferred compensation plan [(1)]	1,116	(5,243)	5,267	1,502
Dividends and interest on marketable securities	-	7,605	11,093	22,941
Mezzanine loans loss reversal and net gain on disposition	-	-	-	82,744
Other, net	2,211	1,722	5,132	5,866
	$ 10,523	$ (30,011)	$ (22,984)	$ 95,086

(1) This income is entirely offset by the expense resulting from the mark-to-market of the deferred compensation plan liability, which is included in "general and administrative" expense.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

18. Income Per Share

The following table provides a reconciliation of both net income and the number of common shares used in the computation of (i) basic income per common share - which includes the weighted average number of common shares outstanding without regard to dilutive potential common shares, and (ii) diluted income per common share - which includes the weighted average common shares and dilutive share equivalents. Dilutive share equivalents may include our Series A convertible preferred shares, employee stock options and restricted stock.

(Amounts in thousands, except per share amounts)	For the Three Months Ended September 30, 2012	2011	For the Nine Months Ended September 30, 2012	2011
Numerator:				
Income from continuing operations, net of income attributable to noncontrolling interests	$ 93,433	$ 45,553	$ 303,755	$ 418,163
Income from discontinued operations, net of income attributable to noncontrolling interests	147,873	8,209	227,370	156,843
Net income attributable to Vornado	241,306	53,762	531,125	575,006
Preferred share dividends	(20,613)	(17,627)	(56,187)	(47,743)
Discount on preferred unit redemptions	11,700	5,000	11,700	5,000
Net income attributable to common shareholders	232,393	41,135	486,638	532,263
Earnings allocated to unvested participating securities	(71)	(48)	(149)	(199)
Numerator for basic income per share	232,322	41,087	486,489	532,064
Impact of assumed conversions:				
	28	-	85	94

Convertible preferred share dividends				
Numerator for diluted income per share	$ 232,350	$ 41,087	$ 486,574	$ 532,158
Denominator:				
Denominator for basic income per share –				
weighted average shares	185,924	184,398	185,656	184,220
Effect of dilutive securities[(1)]:				
Employee stock options and restricted share awards	681	1,667	693	1,764
Convertible preferred shares	50	-	50	55
Denominator for diluted income per share –				
weighted average shares and assumed conversions	186,655	186,065	186,399	186,039
INCOME PER COMMON SHARE – BASIC:				
Income from continuing operations, net	$ 0.45	$ 0.18	$ 1.40	$ 2.04
Income from discontinued operations, net	0.80	0.04	1.22	0.85
Net income per common share	$ 1.25	$ 0.22	$ 2.62	$ 2.89
INCOME PER COMMON SHARE – DILUTED:				
Income from continuing operations, net	$ 0.45	$ 0.18	$ 1.39	$ 2.02
Income from discontinued operations, net	0.79	0.04	1.22	0.84
Net income per common share	$ 1.24	$ 0.22	$ 2.61	$ 2.86

(1) The effect of dilutive securities above excludes anti-dilutive weighted average common share equivalent of 12,652 and 18,857 in the three months ended September 30, 2012 and 2011, respectively, and 15,048 and 18,687 in the nine months ended September 30, 2012 and 2011, respectively.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

19. Commitments and Contingencies

Insurance

We maintain general liability insurance with limits of $300,000,000 per occurrence and all risk property and rental value insurance with limits of $2.0 billion per occurrence, including coverage for terrorist acts, with sub-limits for certain perils such as floods. Our California properties have earthquake insurance with coverage of $180,000,000 per occurrence, subject to a deductible in the amount of 5% of the value of the affected property, up to a $180,000,000 annual aggregate.

Penn Plaza Insurance Company, LLC ("PPIC"), our wholly owned consolidated subsidiary, acts as a re-insurer with respect to a portion of all risk property and rental value insurance and a portion of our earthquake insurance coverage, and as a direct insurer for coverage for acts of terrorism, including nuclear, biological, chemical and radiological ("NBCR") acts, as defined by the Terrorism Risk Insurance Program Reauthorization Act. Coverage for acts of terrorism (excluding NBCR acts) is fully reinsured by third party insurance companies and the Federal government with no exposure to PPIC. Coverage for NBCR losses is up to $2.0 billion per occurrence, for which PPIC is responsible for a deductible of $3,200,000 and 15% of the balance of a covered loss and the Federal government is responsible for the remaining 85% of a covered loss. We are ultimately responsible for any losses incurred by PPIC.

We continue to monitor the state of the insurance market and the scope and costs of coverage for acts of terrorism. However, we cannot anticipate what coverage will be available on commercially reasonable terms in future policy years.

Our debt instruments, consisting of mortgage loans secured by our properties which are non-recourse to us, senior unsecured notes and revolving credit agreements contain customary covenants requiring us to maintain insurance. Although we believe that we have adequate insurance coverage for purposes of these agreements, we may not be able to obtain an equivalent amount of coverage at reasonable costs in the future. Further, if lenders insist on greater coverage than we are able to obtain it could adversely affect our ability to finance our properties and expand our portfolio.

Other Commitments and Contingencies

Our mortgage loans are non-recourse to us. However, in certain cases we have provided guarantees or master leased tenant space. These guarantees and master leases terminate either upon the satisfaction of specified circumstances or repayment of the underlying loans. As of September 30, 2012, the aggregate dollar amount of these guarantees and master leases is approximately $267,090,000.

At September 30, 2012, $22,576,000 of letters of credit were outstanding under one of our revolving credit facilities. Our credit facilities contain financial covenants that require us to maintain minimum interest coverage and maximum debt to market capitalization ratios, and provide for higher interest rates in the event of a decline in our ratings below Baa3/BBB. Our credit facilities also contain customary conditions precedent to borrowing, including representations and warranties, and also contain customary events of default that could give rise to accelerated repayment, including such items as failure to pay interest or principal.

Each of our properties has been subjected to varying degrees of environmental assessment at various times. The environmental assessments did not reveal any material environmental contamination. However, there can be no assurance that the identification of new areas of contamination, changes in the extent or known scope of contamination, the discovery of additional sites, or changes in cleanup requirements would not result in significant costs to us.

Two of our wholly owned subsidiaries that are contracted to develop and operate the Cleveland Medical Mart and Convention Center, in Cleveland, Ohio, are required to fund $11,500,000, primarily for tenant improvements, and they are responsible for operating expenses and are entitled to the net operating income, if any, upon the completion of development and the commencement of operations. As of September 30, 2012, our subsidiaries have funded $1,100,000 of the commitment.

As of September 30, 2012, we expect to fund additional capital to certain of our partially owned entities aggregating approximately $244,463,000.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

19. Commitments and Contingencies – continued

Litigation

We are from time to time involved in legal actions arising in the ordinary course of business. In our opinion, after consultation with legal counsel, the outcome of such matters, including the matter referred to below, is not expected to have a material adverse effect on our financial position, results of operations or cash flows.

In 2003, Stop & Shop filed an action against us in the New York Supreme Court, claiming that we had no right to reallocate and therefore continue to collect $5,000,000 of annual rent from Stop & Shop pursuant to a Master Agreement and Guaranty, because of the expiration of the leases to which the annual rent was previously allocated. Stop & Shop asserted that an order of the Bankruptcy Court for the Southern District of New York, as modified on appeal by the District Court, froze our right to reallocate and effectively terminated our right to collect the annual rent from Stop & Shop. We asserted a counterclaim seeking a judgment for all the unpaid annual rent accruing through the date of the judgment and a declaration that Stop & Shop will continue to be liable for the annual rent as long as any of the leases subject to the Master Agreement and Guaranty remain in effect. After summary judgment motions by both sides were denied, the parties conducted discovery. A trial was held in November 2010. On November 7, 2011, the Court determined that we have a continuing right to allocate the annual rent to unexpired leases covered by the Master Agreement and Guaranty, and directed entry of a judgment in our favor ordering Stop & Shop to pay us the unpaid annual rent accrued through February 28, 2011 in the amount of $37,422,000, a portion of the annual rent due from March 1, 2011 through the date of judgment, interest, and attorneys' fees. On December 16, 2011, a money judgment based on the Court's decision was entered in our favor in the amount of $56,597,000 (including interest and costs). The amount for attorneys' fees is being addressed in a proceeding before a special referee. Stop & Shop appealed the Court's decision and the judgment, and has posted a bond to secure payment of the judgment. On January 12, 2012, we commenced a new action against Stop & Shop seeking recovery of $2,500,000 of annual rent not included in the money judgment, plus additional annual rent as it accrues. A motion by Stop & Shop to dismiss the new action was denied on July 19, 2012. Stop & Shop's appeal of that ruling was heard on October 18, 2012, and a decision has not yet been issued.

As of September 30, 2012, we have a $46,400,000 receivable from Stop & Shop, excluding amounts due to us for interest and costs resulting from the Court's judgment. As a result of Stop & Shop appealing the Court's decision, we believe, after consultation with counsel, that the maximum reasonably possible loss is up to the total amount of the receivable of $46,400,000.

20. Related Party Transactions

On March 8, 2012, Steven Roth, the Chairman of our Board of Trustees, repaid his $13,122,500 outstanding loan from the Company.

VORNADO REALTY TRUST

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

21. Segment Information

Effective January 1, 2012, as a result of certain organizational and operational changes, we redefined the New York business segment to encompass all of our Manhattan assets by including the 1.0 million square feet in 21 freestanding Manhattan street retail assets (formerly in our Retail segment), and the Hotel Pennsylvania and our interest in Alexander's, Inc. (formerly in our Other segment). Accordingly, we have reclassified the prior period segment financial results to conform to the current year presentation. See note (4) on page 38 for the elements of the New York segment's EBITDA. Below is a summary of net income and a reconciliation of net income to EBITDA[1] by segment for the three and nine months ended September 30, 2012 and 2011.

(Amounts in thousands)	For the Three Months Ended September 30, 2012						
	Total	New York	Washington, DC	Retail Properties	Merchandise Mart	Toys	Other
Property rentals	$ 492,989	$ 255,703	$ 115,641	$ 67,919	$ 31,625	$ -	$ 22,101
Straight-line rent adjustments	11,910	8,140	1,267	2,392	(171)	-	282
Amortization of acquired below-market leases, net	13,242	8,458	506	2,868	-	-	1,410
Total rentals	518,141	272,301	117,414	73,179	31,454	-	23,793
Tenant expense reimbursements	80,497	45,164	9,601	21,069	1,201	-	3,462
Cleveland Medical Mart development project	72,651	-	-	-	72,651	-	-
Fee and other income:							
BMS cleaning fees	16,945	23,918	-	-	-	-	(6,973)

Signage revenue	4,783	4,783	-	-	-	-	-
Management and leasing fees	7,234	1,816	4,615	736	142	-	(75)
Lease termination fees	282	78	128	73	3	-	-
Other income	10,444	1,116	8,288	632	481	-	(73)
Total revenues	710,977	349,176	140,046	95,689	105,932	-	20,134
Operating expenses	264,487	159,048	50,305	33,519	19,130	-	2,485
Depreciation and amortization	124,335	57,967	29,825	18,202	7,439	-	10,902
General and administrative	48,742	6,739	6,668	6,103	4,120	-	25,112
Cleveland Medical Mart development project	70,431	-	-	-	70,431	-	-
Acquisition related costs and tenant buy-outs	1,070	-	-	-	-	-	1,070
Total expenses	509,065	223,754	86,798	57,824	101,120	-	39,569
Operating income (loss)	201,912	125,422	53,248	37,865	4,812	-	(19,435)
(Loss) applicable to Toys	(8,585)	-	-	-	-	(8,585)	-
Income (loss) from partially owned entities	21,268	9,309	(2,182)	342	219	-	13,580
Income from Real Estate Fund	5,509	-	-	-	-	-	5,509
Interest and other investment income, net	10,523	1,057	24	4	-	-	9,438
Interest and debt expense	(120,770)	(36,817)	(28,311)	(14,732)	(7,906)	-	(33,004)
Income (loss) before income taxes	109,857	98,971	22,779	23,479	(2,875)	(8,585)	(23,912)

Income tax (expense) benefit	(3,015)	(815)	25	-	2,166	-	(4,391)
Income (loss) from continuing operations	106,842	98,156	22,804	23,479	(709)	(8,585)	(28,303)
Income from discontinued operations	157,314	-	126,437	11,085	19,792	-	-
Net income (loss)	264,156	98,156	149,241	34,564	19,083		