# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-Q

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x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2013**

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: 1-13199**

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# SL GREEN REALTY CORP.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Maryland** | **13-3956775** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**420 Lexington Avenue, New York, New York 10170**

(Address of principal executive offices) (Zip Code)

**(212) 594-2700**

(Registrant s telephone number, including area code)

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 Web site, 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 definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer x | Accelerated filer o | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller Reporting Company o |

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

The number of shares outstanding of the registrant s common stock, $0.01 par value, was 91,976,638 as of July 31, 2013.

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**SL GREEN REALTY CORP.**

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**PART I.** **FINANCIAL INFORMATION**

**ITEM 1.** **Financial Statements**

**SL Green Realty Corp.**

**Consolidated Balance Sheets**

**(in thousands, except per share data)**

| | June 30, 2013 (Unaudited) | December 31, 2012 |
|---|---|---|
| **Assets** | | |
| Commercial real estate properties, at cost: | | |
| Land and land interests | **$ 2,866,048** | $ 2,886,099 |
| Building and improvements | **7,393,930** | 7,389,766 |
| Building leasehold and improvements | **1,352,953** | 1,346,748 |
| Properties under capital lease | **50,332** | 40,340 |
| | **11,663,263** | 11,662,953 |
| Less: accumulated depreciation | **(1,502,694)** | (1,393,323) |
| | **10,160,569** | 10,269,630 |
| Assets held for sale | **207,665** | 4,901 |
| Cash and cash equivalents | **198,969** | 189,984 |
| Restricted cash | **130,483** | 136,071 |
| Investment in marketable securities | **26,266** | 21,429 |
| Tenant and other receivables, net of allowance of $20,466 and $21,652 in 2013 and 2012, respectively | **51,646** | 48,544 |
| Related party receivables | **6,845** | 7,531 |
| Deferred rents receivable, net of allowance of $29,821 and $29,580 in 2013 and 2012, respectively | **360,954** | 340,747 |
| Debt and preferred equity investments, net of discounts and deferred origination fees of $27,107 and $22,341 and allowance of $7,000 both in 2013 and 2012, respectively | **1,227,421** | 1,348,434 |
| Investments in unconsolidated joint ventures | **1,085,793** | 1,032,243 |
| Deferred costs, net | **246,058** | 261,145 |
| Other assets | **699,256** | 718,326 |
| Total assets | **$ 14,401,925** | $ 14,378,985 |
| **Liabilities** | | |
| Mortgages and other loans payable | **$ 4,835,231** | $ 4,615,464 |
| Revolving credit facility | **40,000** | 70,000 |
| Term loan and senior unsecured notes | **1,735,205** | 1,734,956 |
| Accrued interest payable and other liabilities | **72,415** | 73,769 |
| Accounts payable and accrued expenses | **138,029** | 159,598 |
| Deferred revenue | **296,930** | 312,995 |
| Capitalized lease obligations | **47,240** | 37,518 |
| Deferred land leases payable | **19,948** | 20,897 |
| Dividend and distributions payable | **34,740** | 37,839 |
| Security deposits | **53,604** | 46,253 |
| Liabilities related to assets held for sale | **11,894** | 136 |
| | **100,000** | 100,000 |

| | | | | |
|---|---|---|---|---|
| Junior subordinate deferrable interest debentures held by trusts that issued trust preferred securities | | | | |
| Total liabilities | | **7,385,236** | | 7,209,425 |
| | | | | |
| Commitments and contingencies | | | | |
| Noncontrolling interest in the Operating Partnership | | **243,925** | | 212,907 |
| Series G preferred units, $25.00 liquidation preference, 1,902 issued and outstanding at both June 30, 2013 and December 31, 2012 | | **47,550** | | 47,550 |
| Series H preferred units, $25.00 liquidation preference, 80 issued and outstanding at both June 30, 2013 and December 31, 2012 | | **2,000** | | 2,000 |
| | | | | |
| **Equity** | | | | |
| SL Green stockholders equity: | | | | |
| Series C Preferred stock, $0.01 par value, $25.00 liquidation preference, 7,700 issued and outstanding at December 31, 2012 | | | | 180,340 |
| Series I Preferred stock, $0.01 par value, $25.00 liquidation preference, 9,200 issued and outstanding at both June 30, 2013 and December 31, 2012 | | **221,932** | | 221,965 |
| Common stock, $0.01 par value, 160,000 shares authorized and 95,376 and 94,896 issued and outstanding at June 30, 2013 and December 31, 2012, respectively (including 3,563 and 3,646 shares held in Treasury at June 30, 2013 and December 31, 2012, respectively) | | **955** | | 950 |
| Additional paid-in-capital | | **4,716,012** | | 4,667,900 |
| Treasury stock at cost | | **(316,768)** | | (322,858) |
| Accumulated other comprehensive loss | | **(18,622)** | | (29,587) |
| Retained earnings | | **1,631,287** | | 1,701,092 |
| Total SL Green stockholders equity | | **6,234,796** | | 6,419,802 |
| Noncontrolling interests in other partnerships | | **488,418** | | 487,301 |
| Total equity | | **6,723,214** | | 6,907,103 |
| Total liabilities and equity | **$** | **14,401,925** | $ | 14,378,985 |

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

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**SL Green Realty Corp.**

**Consolidated Statements of Income**

**(unaudited, in thousands, except per share data)**

| | Three Months Ended June 30, 2013 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2013 | Six Months Ended June 30, 2012 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Rental revenue, net | **$ 273,307** | $ 263,838 | **$ 539,755** | $ 520,595 |
| Escalation and reimbursement | **39,381** | 40,967 | **79,926** | 82,080 |
| Investment and preferred equity income | **46,731** | 33,448 | **99,439** | 59,786 |
| Other income | **5,726** | 6,282 | **11,493** | 16,659 |
| Total revenues | **365,145** | 344,535 | **730,613** | 679,120 |
| **Expenses** | | | | |
| Operating expenses, including approximately $4,319 and $8,469 (2013) and $4,773 and $8,244 (2012) paid to related parties | **69,432** | 67,434 | **141,630** | 139,319 |
| Real estate taxes | **52,710** | 52,256 | **106,114** | 103,453 |
| Ground rent | **8,649** | 8,890 | **19,640** | 17,696 |
| Interest expense, net of interest income | **83,276** | 82,159 | **164,447** | 162,130 |
| Amortization of deferred financing costs | **4,240** | 3,553 | **8,703** | 7,133 |
| Depreciation and amortization | **82,020** | 76,207 | **161,114** | 151,739 |
| Loan loss and other investment reserves, net of recoveries | | | | 564 |
| Transaction related costs | **1,711** | 1,970 | **3,068** | 3,026 |
| Marketing, general and administrative | **21,514** | 20,721 | **42,582** | 40,917 |
| Total expenses | **323,552** | 313,190 | **647,298** | 625,977 |
| Income from continuing operations before equity in net (loss) income from unconsolidated joint ventures, equity in net (loss) gain on sale of interest in unconsolidated joint venture/real estate, loss on sale of investment in marketable securities, purchase price fair value adjustment, depreciable real estate reserves, net of recoveries, and loss on early extinguishment of debt | **41,593** | 31,345 | **83,315** | 53,143 |
| Equity in net (loss) income from unconsolidated joint ventures | **(3,761)** | 70,890 | **1,313** | 69,330 |
| Equity in net (loss) gain on sale of interest in unconsolidated joint venture/real estate | **(3,583)** | 9,534 | **(3,583)** | 16,794 |
| Loss on sale of investment in marketable securities | **(8)** | | **(65)** | |
| Purchase price fair value adjustment | **(2,305)** | | **(2,305)** | |
| Depreciable real estate reserves, net of recoveries | | 5,789 | | 5,789 |
| Loss on early extinguishment of debt | **(10)** | | **(18,523)** | |
| Income from continuing operations | **31,926** | 117,558 | **60,152** | 145,056 |
| Net (loss) income from discontinued operations | **(678)** | 899 | **320** | 1,931 |
| Gain on sale of discontinued operations | | | **1,113** | 6,627 |
| Net income | **31,248** | 118,457 | **61,585** | 153,614 |
| Net income attributable to noncontrolling interests: | | | | |
| Noncontrolling interests in the Operating Partnership | **(244)** | (3,421) | **(799)** | (4,309) |
| Noncontrolling interests in other partnerships | **(3,004)** | (3,887) | **(5,905)** | (4,958) |
| Preferred unit distributions | **(565)** | (565) | **(1,130)** | (962) |
| Net income attributable to SL Green | **27,435** | 110,584 | **53,751** | 143,385 |
| Preferred stock redemption costs | **(12,160)** | | **(12,160)** | |
| Perpetual preferred stock dividends | **(6,999)** | (7,544) | **(14,406)** | (15,089) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net income attributable to SL Green common stockholders | **$** | **8,276** | $ | 103,040 | **$** | **27,185** | $ | 128,296 |
| | | | | | | | | |
| **Amounts attributable to SL Green common stockholders:** | | | | | | | | |
| Income from continuing operations | **$** | **14,722** | $ | 92,967 | **$** | **31,580** | $ | 103,778 |
| Purchase price fair value adjustment | | **(2,305)** | | | | **(2,305)** | | |
| Equity in net (loss) gain on sale of interest in unconsolidated joint venture/real estate | | **(3,482)** | | 9,207 | | **(3,482)** | | 16,244 |
| Net (loss) income from discontinued operations | | **(659)** | | 866 | | **311** | | 1,864 |
| Gain on sale of discontinued operations | | | | | | **1,081** | | 6,410 |
| Net income | **$** | **8,276** | $ | 103,040 | **$** | **27,185** | $ | 128,296 |
| | | | | | | | | |
| **Basic earnings per share:** | | | | | | | | |
| Net income from continuing operations before discontinued operations | **$** | **0.14** | $ | 1.04 | **$** | **0.32** | $ | 1.18 |
| Equity in net (loss) gain on sale of interest in unconsolidated joint venture/real estate | | **(0.04)** | | 0.10 | | **(0.03)** | | 0.18 |
| Net (loss) income from discontinued operations | | **(0.01)** | | 0.01 | | | | 0.02 |
| Gain on sale of discontinued operations | | | | | | **0.01** | | 0.07 |
| Net income attributable to SL Green common stockholders | **$** | **0.09** | $ | 1.15 | **$** | **0.30** | $ | 1.45 |
| | | | | | | | | |
| **Diluted earnings per share:** | | | | | | | | |
| Net income from continuing operations before discontinued operations | **$** | **0.14** | $ | 1.03 | **$** | **0.32** | $ | 1.18 |
| Equity in net (loss) gain on sale of interest in unconsolidated joint venture/real estate | | **(0.04)** | | 0.10 | | **(0.03)** | | 0.18 |
| Net (loss) income from discontinued operations | | **(0.01)** | | 0.01 | | | | 0.02 |
| Gain on sale of discontinued operations | | | | | | **0.01** | | 0.07 |
| Net income attributable to SL Green common stockholders | **$** | **0.09** | $ | 1.14 | **$** | **0.30** | $ | 1.45 |
| Dividends per share | **$** | **0.33** | $ | 0.25 | **$** | **0.66** | $ | 0.50 |
| Basic weighted average common shares outstanding | | **91,660** | | 89,789 | | **91,530** | | 88,265 |
| Diluted weighted average common shares and common share equivalents outstanding | | **94,536** | | 93,351 | | **94,452** | | 91,766 |

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

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**SL Green Realty Corp.**

**Consolidated Statements of Comprehensive Income**

**(unaudited, in thousands)**

| | Three Months Ended June 30, 2013 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2013 | Six Months Ended June 30, 2012 |
|---|---|---|---|---|
| Net income | **$ 31,248** | $ 118,457 | **$ 61,585** | $ 153,614 |
| Other comprehensive income (loss): | | | | |
| Net unrealized gain (loss) on derivative instruments | **181** | (477) | **140** | (623) |
| Reclassification of net realized loss on derivatives designated as cashflow hedges into interest expense | **470** | 466 | **938** | 926 |
| SL Green s share of joint venture net unrealized gain (loss) on derivative instruments | **7,888** | (6,388) | **8,109** | (6,330) |
| Reclassification of SL Green s share of joint venture net realized loss on derivatives designated as cashflow hedges into equity in net income from unconsolidated joint ventures | **1,260** | 2,751 | **2,500** | 5,494 |
| Unrealized (loss) gain on marketable securities | **(1,848)** | (542) | **(207)** | 228 |
| Other comprehensive income (loss) | **7,951** | (4,190) | **11,480** | (305) |
| Comprehensive income | **39,199** | 114,267 | **73,065** | 153,309 |
| Net income attributable to noncontrolling interests | **(3,813)** | (7,873) | **(7,834)** | (10,229) |
| Other comprehensive (income) loss attributable to noncontrolling interests in the Operating Partnership | **(456)** | 153 | **(515)** | 337 |
| Comprehensive income attributable to SL Green common stockholders | **$ 34,930** | $ 106,547 | **$ 64,716** | $ 143,417 |

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

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**SL Green Realty Corp.**

**Consolidated Statement of Equity**

**(unaudited, in thousands, except per share data)**

| | **SL Green Realty Corp. Stockholders** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Series C Preferred Stock** | **Series I Preferred Stock** | **Common Stock Shares** | **Common Stock Par Value** | **Additional Paid-In-Capital** | **Treasury Stock** | **Accumulated Other Comprehensive Income (Loss)** | **Retained Earnings** | **Noncontrolling Interests** | **Total** |
| Balance at December 31, 2012 | $ 180,340 | $ 221,965 | 91,250 | $ 950 | $ 4,667,900 | $ (322,858) | $ (29,587) | $ 1,701,092 | $ 487,301 | $ 6,907,103 |
| Net income | | | | | | | | 53,751 | 5,905 | 59,656 |
| Other comprehensive income | | | | | | | 10,965 | | | 10,965 |
| Preferred dividends | | | | | | | | (14,406) | | (14,406) |
| DRIP proceeds | | | | | 26 | | | | | 26 |
| Conversion of units of the Operating Partnership to common stock | | | 224 | 2 | 17,285 | | | | | 17,287 |
| Reallocation of noncontrolling interest in the Operating Partnership | | | | | | | | (36,091) | | (36,091) |
| Amortization of deferred compensation plan | | | 4 | | 13,324 | | | | | 13,324 |
| Redemption of preferred stock | (180,340) | | | | | | | (12,160) | | (192,500) |
| Preferred stock issuance costs | | (33) | | | | | | | | (33) |
| Issuance of common stock | | | 95 | 1 | 8,510 | | | | | 8,511 |
| Sale of treasury stock | | | 83 | | | 6,090 | | | | 6,090 |
| Proceeds from stock options exercised | | | 157 | 2 | 8,967 | | | | | 8,969 |
| Contributions to consolidated joint venture | | | | | | | | | 3,364 | 3,364 |
| Cash distributions to noncontrolling interests | | | | | | | | | (8,152) | (8,152) |
| Cash distribution declared ($0.66 per common share, none of which represented a return of capital for federal income tax purposes) | | | | | | | | (60,899) | | (60,899) |
| **Balance at June 30, 2013** | **$** | **$ 221,932** | **91,813** | **$ 955** | **$ 4,716,012** | **$ (316,768)** | **$ (18,622)** | **$ 1,631,287** | **$ 488,418** | **$ 6,723,214** |

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

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**SL Green Realty Corp.**

**Consolidated Statements of Cash Flows**

**(unaudited, in thousands)**

| | Six Months Ended June 30, 2013 | 2012 |
|---|---|---|
| **Operating Activities** | | |
| Net income | **$ 61,585** | $ 153,614 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | **173,028** | 162,028 |
| Depreciable real estate reserves, net of recoveries | **2,150** | (5,789) |
| Equity in net income from unconsolidated joint ventures | **(1,313)** | (69,330) |
| Distributions of cumulative earnings from unconsolidated joint ventures | **13,467** | 77,981 |
| Purchase price fair value adjustment | **2,305** | |
| Equity in net loss (gain) on sale of interest in unconsolidated joint venture/real estate | **3,583** | (16,794) |
| Gain on sale of discontinued operations | **(1,113)** | (6,627) |
| Loan loss and other investment reserves, net of recoveries | | 564 |
| Loss on early extinguishment of debt | **10,968** | |
| Deferred rents receivable | **(29,452)** | (37,318) |
| Other non-cash adjustments | **(28,375)** | 3,759 |
| Changes in operating assets and liabilities: | | |
| Restricted cash operations | **6,127** | (7,104) |
| Tenant and other receivables | **4,896** | (5,006) |
| Related party receivables | **768** | (3,792) |
| Deferred lease costs | **(19,106)** | (28,549) |
| Other assets | **4,075** | (27,176) |
| Accounts payable, accrued expenses and other liabilities | **1,793** | 9,609 |
| Deferred revenue and land leases payable | **8,102** | (2,135) |
| Net cash provided by operating activities | **213,488** | 197,935 |
| **Investing Activities** | | |
| Acquisitions of real estate property | **(52,534)** | (248,468) |
| Additions to land, buildings and improvements | **(61,531)** | (76,585) |
| Escrowed cash capital improvements/acquisition deposits | **(394)** | (65,030) |
| Investments in unconsolidated joint ventures | **(81,913)** | (131,820) |
| Distributions in excess of cumulative earnings from unconsolidated joint ventures | **11,117** | 44,172 |
| Net proceeds from disposition of real estate/joint venture interest | **5,852** | 26,099 |
| Other investments | **(18,038)** | (31,206) |
| Debt and preferred equity and other investments, net of repayments/participations | **150,919** | (75,209) |
| Net cash used in investing activities | **(46,522)** | (558,047) |
| **Financing Activities** | | |
| Proceeds from mortgages and other loans payable | **980,333** | 1,113,500 |
| Repayments of mortgages and other loans payable | **(833,728)** | (472,288) |
| Proceeds from credit facility and senior unsecured notes | **370,000** | 468,339 |
| Repayments of credit facility and senior unsecured notes | **(404,970)** | (840,793) |
| Proceeds from stock options exercised and DRIP issuance | **8,995** | 105,195 |
| Net proceeds from sale of common stock/preferred stock | **8,478** | 201,307 |
| Redemption of preferred stock | **(192,500)** | |
| Purchases of treasury stock | | (11,158) |
| Distributions to noncontrolling interests in other partnerships | **(8,152)** | (11,999) |
| Contributions from noncontrolling interests in other partnerships | **3,364** | 18,799 |
| Distributions to noncontrolling interests in the Operating Partnership | **(1,775)** | (1,561) |

| | | |
|---|---|---|
| Dividends paid on common and preferred stock | **(79,534)** | (59,155) |
| Deferred loan costs and capitalized lease obligations | **(8,492)** | (31,467) |
| Net cash (used in) provided by financing activities | **(157,981)** | 478,719 |
| Net increase in cash and cash equivalents | **8,985** | 118,607 |
| Cash and cash equivalents at beginning of period | **189,984** | 138,192 |
| Cash and cash equivalents at end of period | **$ 198,969** | $ 256,799 |

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

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**SL Green Realty Corp.**

**Notes to Consolidated Financial Statements**

**June 30, 2013**

**(unaudited)**

## 1. Organization and Basis of Presentation

SL Green Realty Corp., which is referred to as the Company or SL Green, a Maryland corporation, and SL Green Operating Partnership, L.P., which is referred to as SLGOP or the Operating Partnership, a Delaware limited partnership, were formed in June 1997 for the purpose of combining the commercial real estate business of S.L. Green Properties, Inc. and its affiliated partnerships and entities. The Operating Partnership received a contribution of interest in the real estate properties, as well as 95% of the economic interest in the management, leasing and construction companies, which are referred to as the Service Corporation, a consolidated variable interest entity. All of the management, leasing and construction services with respect to the properties that are wholly-owned by us are conducted through SL Green Management LLC which is 100% owned by the Operating Partnership. The Company has qualified, and expects to qualify in the current fiscal year, as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code, and operates as a self-administered, self-managed REIT. A REIT is a legal entity that holds real estate interests and, through payments of dividends to stockholders, is permitted to minimize the payment of Federal income taxes at the corporate level. Unless the context requires otherwise, all references to we, our and us means the Company and all entities owned or controlled by the Company, including the Operating Partnership.

Substantially all of our assets are held by, and our operations are conducted through, the Operating Partnership. The Company is the sole managing general partner of the Operating Partnership. As of June 30, 2013, noncontrolling investors held, in the aggregate, a 2.95% limited partnership interest in the Operating Partnership. We refer to these interests as the noncontrolling interests in the Operating Partnership. See Note 13, Noncontrolling Interests in Operating Partnership.

Reckson Associates Realty Corp., or Reckson, and Reckson Operating Partnership, L.P., or ROP, are wholly-owned subsidiaries of the Operating Partnership.

As of June 30, 2013, we owned the following interests in commercial office properties in the New York Metropolitan area, primarily in midtown Manhattan, a borough of New York City. Our investments in the New York Metropolitan area also include investments in Brooklyn, Long Island, Westchester County, Connecticut and Northern New Jersey, which are collectively known as the Suburban assets:

| Location | Ownership | Number of Properties | Square Feet | Weighted Average Occupancy(1) |
|---|---|---|---|---|
| Manhattan | Consolidated properties | 27 | 18,347,945 | 93.9% |
| | Unconsolidated properties | 9 | 5,934,434 | 95.1% |
| | | | | |
| Suburban | Consolidated properties | 27 | 4,217,400 | 79.4% |
| | Unconsolidated properties | 4 | 1,222,100 | 84.3% |

| | | | |
|---|---|---|---|
| | 67 | 29,721,879 | 91.7% |

(1) The weighted average occupancy represents the total leased square feet divided by total available rentable square feet.

As of June 30, 2013, we also owned investments in 14 stand-alone retail properties encompassing approximately 465,200 square feet, 15 development properties encompassing approximately 2,580,700 square feet, three residential properties encompassing 468 units (approximately 497,100 square feet), two land interests encompassing approximately 961,400 square feet and 30 west coast office properties encompassing approximately 4,066,900 square feet. In addition, we manage two office properties owned by third parties and affiliated companies encompassing approximately 626,400 rentable square feet. As of June 30, 2013, we also held debt and preferred equity investments with a book value of $1.2 billion.

**Partnership Agreement**

In accordance with the partnership agreement of the Operating Partnership, or the Operating Partnership agreement, we allocate all distributions and profits and losses in proportion to the percentage ownership interests of the respective partners. As the managing general partner of the Operating Partnership, we are required to take such reasonable efforts, as determined by us in our sole discretion, to cause the Operating Partnership to distribute sufficient amounts to enable the payment of sufficient dividends by us to minimize any Federal income or excise tax at the Company level. Under the Operating Partnership agreement, each limited partner has the right to redeem units of limited partnership interests for cash, or if we so elect, for shares of our common stock on a one-for-one basis.

**Basis of Quarterly Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally

**SL Green Realty Corp.**

**Notes to Consolidated Financial Statements**

**June 30, 2013**

**(unaudited)**

accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for the fair presentation of the financial position of the Company at June 30, 2013 and the results of operations for the periods presented have been included. The 2013 operating results for the period presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These financial statements should be read in conjunction with the financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2012.

The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

**2. Significant Accounting Policies**

**Principles of Consolidation**

The consolidated financial statements include our accounts and those of our subsidiaries, which are wholly-owned or controlled by us. Entities which we do not control through our voting interest and entities which are variable interest entities, but where we are not the primary beneficiary, are accounted for under the equity method or as debt and preferred equity investments. See Note 5, Debt and Preferred Equity Investments and Note 6, Investments in Unconsolidated Joint Ventures. All significant intercompany balances and transactions have been eliminated.

We consolidate variable interest entities, or VIEs, in which we are considered the primary beneficiary. The primary beneficiary of a VIE is the entity that has (i) the power to direct the activities that most significantly impact the entity s economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could be significant to the VIE. Included in commercial real estate properties on our consolidated balance sheets as of June 30, 2013 and December 31, 2012 are approximately $599.3 million and $607.4 million, respectively, related to our consolidated VIEs. Included in mortgages and other loans payable on our consolidated balance sheets as of June 30, 2013 and December 31, 2012 are approximately $375.3 million and $379.6 million, respectively, related to our consolidated VIEs.

A noncontrolling interest in a consolidated subsidiary is defined as the portion of the equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. Noncontrolling interests are required to be presented as a separate component of equity in the consolidated balance sheet and the presentation of net income was modified to present earnings and other comprehensive income attributed to controlling and noncontrolling interests.

We assess the accounting treatment for each joint venture and debt and preferred equity investment. This assessment includes a review of each joint venture or limited liability company agreement to determine which party has what rights and whether those rights are protective or participating. For all VIE s, we review such agreements in order to determine which party has the power to direct the activities that most significantly impact the entity s economic performance. In situations where we and our partner approves, among other things, the annual budget, receives a detailed monthly reporting package from us, meets on a quarterly basis to review the results of the joint venture, reviews and approves the joint venture s tax return before filing, and approves all leases that cover more than a nominal amount of space relative to the total rentable space at each property, we do not consolidate the joint venture as we consider these to be substantive participation rights that result in shared power of the activities that most significantly impact the performance of our joint venture. Our joint venture agreements typically contain certain protective rights such as the requirement of partner approval to sell, finance or refinance the property and the payment of capital expenditures and operating expenditures outside of the approved budget or operating plan.

**Investment in Commercial Real Estate Properties**

On a periodic basis, we assess whether there are any indications that the value of our real estate properties may be impaired or that their carrying value may not be recoverable. A property s value is considered impaired if management s estimate of the aggregate future cash flows (undiscounted and without interest charges for consolidated properties) to be generated by the property is less than the carrying value of the property. To the extent impairment has occurred, the loss will be measured as the excess of the carrying amount of the property over the calculated fair value of the property. In June 2013, we recorded a $2.2 million impairment charge in connection with the expected sale of 300 Main Street in Stamford, Connecticut, which is accounted for as held for sale as of June 30, 2013.

We assess our investments in unconsolidated joint ventures for recoverability, and if it is determined that a loss in value of the investment is other than temporary, we write down the investment to its fair value. We evaluate our equity investments for

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impairment based on the joint venture s projected discounted cash flows. We do not believe that the values of any of our consolidated properties or equity investments were impaired at either June 30, 2013 or December 31, 2012.

When we acquire equity interests in an existing unconsolidated joint venture and gain control over the investment, we record the consolidated investment at fair value. The difference between the book value of our equity investment on the purchase date and our share of the fair value of the investment s purchase price is recorded as a purchase price fair value adjustment in our consolidated statements of income. In April 2013, we recognized a purchase price fair value adjustment of $(2.3) million in connection with the consolidation of 16 Court Street, which was previously accounted for as an investment in unconsolidated joint venture.

We allocate the purchase price of real estate to land and building (inclusive of tenant improvements) and, if determined to be material, intangibles, such as the value of above- and below-market leases and origination costs associated with the in-place leases. We depreciate the amount allocated to building (inclusive of tenant improvements) and other intangible assets over their estimated useful lives, which generally range from three to 40 years and from one to 14 years, respectively. The values of the above- and below-market leases are amortized and recorded as either an increase (in the case of below-market leases) or a decrease (in the case of above-market leases) to rental income over the remaining term of the associated lease, which generally range from one to 14 years. The value associated with in-place leases is amortized over the expected term of the associated lease, which generally ranges from one to 14 years. If a tenant vacates its space prior to the contractual termination of the lease and no rental payments are being made on the lease, any unamortized balance of the related intangible will be written off. The tenant improvements and origination costs are amortized as an expense over the remaining life of the lease (or charged against earnings if the lease is terminated prior to its contractual expiration date). We assess fair value of the leases based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends, and market/economic conditions that may affect the property. To the extent acquired leases contain fixed rate renewal options that are below market and determined to be material, we amortize such below market lease value into rental income over the renewal period.

We recognized an increase of approximately $6.2 million, $10.1 million, $2.8 million and $4.8 million in rental revenue for the three and six months ended June 30, 2013 and 2012, respectively, for the amortization of aggregate below-market leases in excess of above-market leases and a reduction in lease origination costs, resulting from the allocation of the purchase price of the applicable properties. We recognized an increase/(reduction) in interest expense for the amortization of the above-market rate mortgages assumed of approximately $(1.3) million, $(2.6) million, $1.6 million and $0.6 million for the three and six months ended June 30, 2013 and 2012, respectively.

The following summarizes our identified intangible assets (acquired above-market leases and in-place leases) and intangible liabilities (acquired below-market leases) as of June 30, 2013 and December 31, 2012 (in thousands):

| | | June 30, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Identified intangible assets (included in other assets): | | | | |
| Gross amount | **$** | **732,160** | $ | 725,861 |
| Accumulated amortization | | **(296,573)** | | (263,107) |
| Net | **$** | **435,587** | $ | 462,754 |
| | | | | |
| Identified intangible liabilities (included in deferred revenue): | | | | |
| Gross amount | **$** | **667,495** | $ | 651,921 |
| Accumulated amortization | | **(391,631)** | | (357,225) |
| Net | **$** | **275,864** | $ | 294,696 |

**Fair Value Measurements**

Fair value is a market-based measurement, not an entity-specific measurement, and should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, FASB guidance establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

We determined the fair value of our current investments in marketable securities using Level 1, Level 2 and Level 3 inputs.

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The estimated fair values of tangible and intangible assets and liabilities recorded in connection with business combinations are based on Level 3 inputs. We estimate fair values based on cash flow projections utilizing appropriate discount and/or capitalization rates and available market information.

We determine impairment in real estate investments and debt and preferred equity investments, including intangibles, utilizing cash flow projections that apply estimated revenue and expense growth rates, discount rates and capitalization rates, which are classified as Level 3 inputs.

We use the following methods and assumptions in estimating fair value disclosures for financial instruments.

- *Cash and cash equivalents, restricted cash, accounts receivable, and accounts payable and accrued expenses:* The carrying amount of cash and cash equivalents, restricted cash, accounts receivable, and accounts payable and accrued expenses reported in our consolidated balance sheets approximates fair value due to the short term nature of these instruments.

- *Debt and preferred equity investments:* The fair value of debt and preferred equity investments is estimated by discounting the future cash flows using current interest rates at which similar loans with the same maturities would be made to borrowers with similar credit ratings. See Reserve for Possible Credit Losses below regarding valuation allowances for loan losses.

- *Derivative instruments:* The fair value of derivative instruments is based on current market data received from financial sources that trade such instruments and are based on prevailing market data and derived from third party proprietary models based on well-recognized financial principles and reasonable estimates about relevant future market conditions.

- *Mortgage and other loans payable and other debt:* The fair value of borrowings is estimated by discounting the future cash flows using current interest rates at which similar borrowings could be made by us.

The methodologies used for measuring fair value have been categorized into three broad levels as follows:

Level 1 Quoted prices in active markets for identical instruments.

Level 2 Valuations based principally on other observable market parameters, including

- Quoted prices in active markets for similar instruments,
- Quoted prices in less active or inactive markets for identical or similar instruments,
- Other observable inputs (such as interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates), and
- Market corroborated inputs (derived principally from or corroborated by observable market data).

Level 3 Valuations based significantly on unobservable inputs.

- Valuations based on third-party indications (broker quotes or counterparty quotes) which were, in turn, based significantly on unobservable inputs or were otherwise not supportable as Level 2 valuations.
- Valuations based on internal models with significant unobservable inputs.

These levels form a hierarchy. We follow this hierarchy for our assets and liabilities measured at fair value on a recurring and nonrecurring basis. The classifications are based on the lowest level of input that is significant to the fair value measurement.

**Investment in Marketable Securities**

We invest in marketable securities. At the time of purchase, we are required to designate a security as held-to-maturity, available-for-sale, or trading depending on ability and intent. We do not have any securities designated as held-to-maturity or trading at this time. Securities available-for-sale are reported at fair value pursuant to ASC 820-10, with the net unrealized gains or losses reported as a component of accumulated other comprehensive loss. Unrealized losses that are determined to be other-than-temporary are recognized in earnings up to their credit component. Included in accumulated other comprehensive loss at June 30, 2013 and December 31, 2012 is approximately $3.1 million and $3.3 million, respectively, in net unrealized gains related to marketable securities.

The cost of bonds and marketable securities sold was determined using the specific identification method.

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At June 30, 2013 and December 31, 2012, we held the following marketable securities (in thousands):

| | | June 30, 2013 | December 31, 2012 |
|---|---|---|---|
| Level 1 | Equity marketable securities | **$ 3,371** | $ 2,202 |
| Level 2 | Commercial mortgage-backed securities | **19,406** | 15,575 |
| Level 3 | Rake bonds | **3,489** | 3,652 |
| Total marketable securities available-for-sale | | **$ 26,266** | $ 21,429 |

The cost basis of the Level 3 securities was $3.7 million at both June 30, 2013 and December 31, 2012, respectively. There were no sales of Level 3 securities during the three and six months ended June 30, 2013. The Level 3 securities mature at various times through 2030.

**Revenue Recognition**

Rental revenue is recognized on a straight-line basis over the term of the lease. Rental revenue recognition commences when the tenant takes possession or controls the physical use of the leased space. In order for the tenant to take possession, the leased space must be substantially ready for its intended use. To determine whether the leased space is substantially ready for its intended use, management evaluates whether we are or the tenant is the owner of tenant improvements for accounting purposes. When management concludes that we are the owner of tenant improvements, rental revenue recognition begins when the tenant takes possession of the finished space, which is when such tenant improvements are substantially complete. In certain instances, when management concludes that we are not the owner (the tenant is the owner) of tenant improvements, rental revenue recognition begins when the tenant takes possession of or controls the space. When management concludes that we are the owner of tenant improvements for accounting purposes, management records amounts funded to construct the tenant improvements as a capital asset. For these tenant improvements, management records amounts reimbursed by tenants as a reduction of the capital asset. When management concludes that the tenant is the owner of tenant improvements for accounting purposes, management records our contribution towards those improvements as a lease incentive, which is included in deferred leasing costs on our consolidated balance sheets and amortized as a reduction to rental revenue on a straight-line basis over the term of the lease. The excess of rents recognized over amounts contractually due pursuant to the underlying leases are included in deferred rents receivable on the accompanying consolidated balance sheets. We establish, on a current basis, an allowance for future potential tenant credit losses, which may occur against this account. The balance reflected on the consolidated balance sheet is net of such allowance.

In addition to base rent, our tenants also generally will pay their pro rata share of increases in real estate taxes and operating expenses for the building over a base year. In some leases, in lieu of paying additional rent based upon increases in building operating expenses, the tenant will pay additional rent based upon increases in the wage rate paid to porters over the porters wage rate in effect during a base year or increases in the consumer price index over the index value in effect during a base year. In addition, many of our leases contain fixed percentage increases over the base rent to cover escalations. Electricity is most often supplied by the landlord either on a sub-metered basis, or rent inclusion basis (i.e., a fixed fee is included in the rent for electricity, which amount may increase based upon increases in electricity rates or increases in electrical usage by the tenant). Base building services other than electricity (such as heat, air conditioning and freight elevator service during business hours, and base building cleaning) are typically provided at no additional cost, with the tenant paying additional rent only for services which exceed base building services or for services which are provided outside normal business hours. These escalations are based on actual expenses incurred in the prior calendar year. If the expenses in the current year are different from those in the prior year, then during the current year, the escalations will be adjusted to reflect the actual expenses for the current year.

We record a gain on sale of real estate when title is conveyed to the buyer, subject to the buyer s financial commitment being sufficient to provide economic substance to the sale and we have no substantial economic involvement with the buyer.

Interest income on debt and preferred equity investments is recognized over the life of the investment using the effective interest method and recognized on the accrual basis. Fees received in connection with loan commitments are deferred until the loan is funded and are then recognized over the term of the loan as an adjustment to yield. Anticipated exit fees, whose collection is expected, are also recognized over the term of the loan as an adjustment to yield. Fees on commitments that expire unused are recognized at expiration.

Income recognition is generally suspended for debt and preferred equity investments at the earlier of the date at which payments become 90 days past due or when, in the opinion of management, a full recovery of interest income and principal becomes doubtful. Interest income recognition is resumed when the loan becomes contractually current and performance is demonstrated to be resumed. Interest is recorded as income on impaired loans only to the extent cash is received. Several of the debt and preferred equity investments provide for accrual of interest at specified rates, which differ from current payment terms. Interest is recognized on such loans at the accrual rate subject to management s determination that accrued interest and outstanding principal are ultimately

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collectible, based on the underlying collateral and operations of the borrower. If management cannot make this determination, interest income above the current pay rate is recognized only upon actual receipt.

If we purchase a debt or preferred equity investment at a discount, intend to hold it until maturity and expect to recover the full value of the investment, we accrete the discount into income as an adjustment to yield over the term of the investment. If we purchase a debt or preferred equity investment at a discount with the intention of foreclosing on the collateral, we do not accrete the discount.

**Reserve for Possible Credit Losses**

The expense for possible credit losses in connection with debt and preferred equity investments is the charge to earnings to increase the allowance for possible credit losses to the level that we estimate to be adequate, based on Level 3 data, considering delinquencies, loss experience and collateral quality. Other factors considered relate to geographic trends and product diversification, the size of the portfolio and current economic conditions. Based upon these factors, we establish the provision for possible credit losses on each individual investment. When it is probable that we will be unable to collect all amounts contractually due, the investment is considered impaired.

Where impairment is indicated on an investment that is held to maturity, a valuation allowance is measured based upon the excess of the recorded investment amount over the net fair value of the collateral. Any deficiency between the carrying amount of an asset and the calculated value of the collateral is charged to expense. The write-off of the reserve balance is called a charge off. We recorded no loan loss reserves during the three and six months ended June 30, 2013. During the three and six months ended June 30, 2012, we recorded loan loss reserves of zero and $3.0 million, respectively, on investments being held to maturity and approximately zero and $2.4 million, respectively, in recoveries in connection with the sale of our investments. This is included in loan loss and other investment reserves, net of recoveries in the accompanying consolidated statements of income.

Debt and preferred equity investments held for sale are carried at the lower of cost or fair market value using available market information obtained through consultation with dealers or other originators of such investments as well as discounted cash flow models based on Level 3 data pursuant to ASC 820-10. As circumstances change, management may conclude not to sell an investment designated as held for sale. In such situations, the investment will be reclassified at its net carrying value to debt and preferred equity investments held to maturity. For these reclassified investments, the difference between the current carrying value and the expected cash to be collected at maturity will be accreted into income over the remaining term of the investment.

**Income Taxes**

We are taxed as a REIT under Section 856(c) of the Code. As a REIT, we generally are not subject to Federal income tax. To maintain our qualification as a REIT, we must distribute at least 90% of our REIT taxable income to our stockholders and meet certain other requirements. If we fail to qualify as a REIT in any taxable year, we will be subject to Federal income tax on our taxable income at regular corporate rates. We may also be subject to certain state, local and franchise taxes. Under certain circumstances, Federal income and excise taxes may be due on our undistributed taxable income.

Pursuant to amendments to the Code that became effective January 1, 2001, we have elected, and may in the future, elect to treat certain of our existing or newly created corporate subsidiaries as taxable REIT subsidiaries, or a TRS. In general, our TRSs may perform non-customary services for our tenants, hold assets that we cannot hold directly and generally may engage in any real estate or non-real estate related business. Our TRSs generate income, resulting in Federal and state income tax liability for these entities.

During the three and six months ended June 30, 2013, we recorded Federal, state and local tax provisions of $2.3 million and $3.9 million, respectively, and made estimated tax payments of zero and $0.1 million, respectively. During the three and six months ended June 30, 2012, we recorded Federal, state and local tax provisions of $0.1 million and less than $0.1 million, respectively. We made no estimated payments during the three and six months ended June 30, 2012.

We follow a two-step approach for evaluating uncertain tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that is more-likely-than-not to be realized upon settlement. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. The use of a valuation allowance as a substitute for derecognition of tax positions is prohibited.

**Stock-Based Employee Compensation Plans**

We have a stock-based employee compensation plan, described more fully in Note 12, Stockholders Equity.

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Our stock options are recorded at fair value at the time of issuance. Fair value of the stock options is determined using the Black-Scholes option-pricing model. The Black-Scholes model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our plan has characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

Compensation cost for stock options, if any, is recognized ratably over the vesting period of the award. Our policy is to grant options with an exercise price equal to the quoted closing market price of our common stock on the grant date. Awards of stock or restricted stock are expensed as compensation over the benefit period based on the fair value of the stock on the grant date.

For share-based awards with a performance or market measure, we recognize compensation cost over the requisite service period, using the accelerated attribution expense method. The requisite service period begins on the date the compensation committee of our board of directors authorizes the award, adopts any relevant performance measures and communicates the award to the employees. For programs with performance measures, the total estimated compensation cost is based on the fair value of the award at the applicable reporting date estimated using a binomial model. For share-based awards for which there is no pre-established performance measure, we recognize compensation cost over the service vesting period, which represents the requisite service period, on a straight-line basis. In accordance with the provisions of our share-based incentive compensation plans, we accept the return of shares of our Company common stock, at the current quoted market price, from certain key employee to satisfy minimum statutory tax-withholding requirements related to shares that vested during the period.

Awards can also be made in the form of a separate series of units of limited partnership interest in the Operating Partnership called long-term incentive plan units, or LTIP Units. LTIP Units, which can be granted either as free-standing awards or in tandem with other awards under our stock incentive plan, are valued by reference to the value of our common stock at the time of grant, and are subject to such conditions and restrictions as the compensation committee of our board of directors may determine, including continued employment or service, computation of financial metrics and/or achievement of pre-established performance goals and objectives.

**Earnings per Share**

We present both basic and diluted earnings per share, or EPS. Basic EPS excludes dilution and is computed by dividing net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. Basic EPS includes participating securities, consisting of unvested restricted stock that receive nonforfeitable dividends similar to shares of common stock. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower EPS amount. This also includes units of limited partnership interest. The dilutive effect of stock options is reflected in the weighted average diluted outstanding shares calculation by application of the treasury stock method. There is no dilutive effect for the exchangeable senior debentures as the conversion premium will be paid in cash.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Concentrations of Credit Risk**

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash investments, debt and preferred equity investments and accounts receivable.  We place our cash investments in excess of insured amounts with high quality financial institutions.  The collateral securing our debt and preferred equity investments is located in the New York Metropolitan area. See Note 5,    Debt and Preferred Equity Investments.    We perform ongoing credit evaluations of our tenants and require most tenants to provide security deposits or letters of credit.  Though these security deposits and letters of credit are insufficient to meet the total value of a tenant   s lease obligation, they are a measure of good faith and a source of funds to offset the economic costs associated with lost rent and the costs associated with re-tenanting the space.  Although the properties in our real estate portfolio are primarily located in Manhattan, we also have Suburban properties located in Brooklyn, Long Island, Westchester County, Connecticut, Northern New Jersey and the west coast.  The tenants located in our buildings operate in various industries.  Other than three tenants who account for

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approximately 6.0%, 6.4% and 7.1% of our share of annualized cash rent, no other tenant in our portfolio accounted for more than 1.9% of our annualized cash rent, including our share of joint venture annualized cash rent for the three months ended June 30, 2013. Approximately 9%, 6% and 6% of our annualized cash rent for consolidated properties for the three months ended June 30, 2013 was attributable to 1515 Broadway, 1185 Avenue of the Americas and One Madison Avenue, respectively. In addition, two debt and preferred equity investments accounted for more than 10% of the income earned on debt and preferred equity investments during the three months ended June 30, 2013.

**Reclassification**

Certain prior year balances have been reclassified to conform to our current year presentation primarily in order to eliminate discontinued operations from income from continuing operations and to reclassify deferred origination fees from deferred income to debt and preferred equity investments.

**Accounting Standards Updates**

In February 2013, the FASB issued guidance on the presentation and disclosure of reclassification adjustments out of accumulated other comprehensive income, or AOCI. The standard requires an entity to present information about significant items reclassified out of AOCI by component either on the face of the statement where net income is presented or as a separate disclosure in the notes to financial statements. The guidance became effective for calendar year-end public companies beginning in the first quarter of 2013 and its adoption did not have a material impact on our consolidated financial statements.

**3. Property Acquisitions**

**2013 Acquisitions**

In April 2013, we acquired interests from our joint venture partner, City Investment Fund, or CIF, in 16 Court Street for $4.0 million. We have consolidated the ownership of the 318,000 square foot building. The transaction valued the consolidated interest at $96.2 million, inclusive of the $84.7 mortgage encumbering the property. We recognized a purchase price fair value adjustment of $(2.3) million upon the closing of this transaction. This property, which we initially acquired in July 2007, was previously accounted for as an investment in unconsolidated joint ventures. We are currently in the process of analyzing the fair value of the investment. Therefore, the purchase price allocation is preliminary and subject to change.

In March 2013, we, along with Magnum Real Estate Group, acquired 84 residential apartment units, consisting of 72 apartment units and 12 townhouses, located at 248-252 Bedford Avenue, Williamsburg, Brooklyn for $54.9 million. Simultaneous with the closing, the joint venture closed on a five-year $22.0 million mortgage loan which carries a floating rate of interest of 225 basis points over LIBOR. The property sits on top of a commercial property already owned by us. We hold a 90% controlling interest in this joint venture.

**2012 Acquisitions**

In December 2012, we acquired a 68,000 square foot mixed use retail, office and residential building located at 131-137 Spring Street for $122.3 million.

In December 2012, we acquired the aggregate 42,000 square foot vacant retail buildings located at 985-987 Third Avenue for $18.0 million.

In October 2012, we, along with Stonehenge Partners, acquired a 99-year leasehold position covering an 82,250 square foot, 96 unit residential building located at 1080 Amsterdam Avenue which we plan to redevelop into luxury residential units.

In September 2012, we acquired the aggregate 267,000 square foot office buildings located at 635 and 641 Sixth Avenue for $173.0 million.

In June 2012, we acquired a 215,000 square foot office building located at 304 Park Avenue South for $135.0 million. The property was acquired with approximately $102.0 million in cash and $33.0 million in units of limited partnership interest of the Operating Partnership.

In October 2011, we formed a joint venture with Stonehenge Partners and, in January 2012, we acquired five retail and two multifamily properties in Manhattan for $193.1 million, inclusive of the issuance of $47.6 million aggregate liquidation preference of 4.5% Series G preferred units of limited partnership interest of the Operating Partnership. Simultaneous with the closing, we financed the multifamily component, which encompasses 385 units and 488,000 square feet, with an aggregate 12-year $100.0 million fixed

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rate mortgage which bears interest at 4.125% and one of the retail properties financed with a five-year $8.5 million fixed rate mortgage which bears interest at 3.75%. We hold an 80% interest in this joint venture, which we consolidate as a VIE since we have been designated as the primary beneficiary.

The following summarizes our allocation of the purchase price of the assets acquired and liabilities assumed upon the closing of these acquisitions (in thousands):

| | 248-252 Bedford Avenue | 131-137 Spring Street | 635-641 Sixth Avenue | 304 Park Avenue South | Stonehenge Properties |
|---|---|---|---|---|---|
| Land | $ $10,865 | $ 27,021 | $ 69,848 | $ 54,189 | $ 65,533 |
| Building and building leasehold | 44,035 | 105,342 | 104,474 | 75,619 | 128,457 |
| Above market lease value | | 179 | | 2,824 | 594 |
| Acquired in-place leases | | 7,046 | 7,727 | 8,265 | 9,573 |
| Other assets, net of other liabilities | | | | | 2,190 |
| Assets acquired | 54,900 | 139,588 | 182,049 | 140,897 | 206,347 |
| | | | | | |
| Fair value adjustment to mortgage note payable | | | | | |
| Below market lease value | | 17,288 | 9,049 | 5,897 | 13,239 |
| Liabilities assumed | | 17,288 | 9,049 | 5,897 | 13,239 |
| | | | | | |
| Purchase price allocation | $ 54,900 | $ 122,300 | $ 173,000 | $ 135,000 | $ 193,108 |
| | | | | | |
| Net consideration funded by us at closing, excluding consideration financed by debt | $ 21,782 | $ 122,300 | $ 173,000 | $ 135,000 | $ 78,121 |
| Equity and/or debt investment held | $ | $ | $ | $ | $ |
| Debt assumed | $ | $ | $ | $ | $ |

## 4. Property Dispositions and Assets Held for Sale

In June 2013, we entered into an agreement to sell the property located at 333 West 34th, New York, New York for $220.3 million. This transaction is expected to close during the third quarter of 2013.

In March 2013, we entered into an agreement to sell the property located at 300 Main Street, Stamford, Connecticut for $13.5 million. We recorded a $2.2 million impairment charge, in the second quarter of 2013, in connection with the expected sale of this property. This transaction is expected to close during the third quarter of 2013.

In February 2013, we, along with our joint venture partner, sold our property located at 44 West 55th Street for $6.3 million. We recognized a gain of $1.1 million on the sale.

In February 2012, we sold our leased fee interest at 292 Madison Avenue for $85.0 million. We recognized a gain of $6.6 million on the sale.

Discontinued operations included the results of operations of real estate assets under contract or sold prior to June 30, 2013. This included 300 Main Street and 333 West 34th Street, which were held for sale at June 30, 2013, 44 West 55th Street, which was sold in February 2013 and 292 Madison Avenue, which was sold in February 2012.

The following table summarizes income from discontinued operations for the three and six months ended June 30, 2013 and 2012, respectively (in thousands).

| | **Three Months Ended June 30,** | | **Six Months Ended June 30,** | |
|---|---|---|---|---|
| | **2013** | **2012** | **2013** | **2012** |
| Revenues | | | | |
| Rental revenue | **$ 4,930** | $ 3,853 | **$ 8,960** | $ 8,425 |

ine">awards and the corresponding use of estimated amounts may produce additional volatility in our consolidated financial statements as we record cumulative adjustments to the estimated number of common shares to be awarded under the LTIP grants as described above.

We have also granted share-based compensation awards that have share-price, or market-based, vesting conditions. As a result, we used “Monte Carlo” simulation models to determine the fair value and expected service period of these awards. The Monte Carlo pricing models required the input of subjective assumptions, including items such as the expected term of the options. If factors change, and we use different assumptions for estimating share-based compensation expense related to future awards, our share-based compensation expense may differ materially from that recorded in the current period.

Accounts Receivable Valuation

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Our allowance for doubtful accounts calculations contain uncertainties because the calculations require us to make assumptions and judgments regarding the collectability of customer accounts, which may be influenced by a number of factors that are not within our control, such as the financial health of each customer. We regularly review the collectability assumptions of our allowance for doubtful accounts calculation and compare them against historical collections. Adjustments to the assumptions may either increase or decrease our total allowance for doubtful accounts. For example, a 10 percent increase to our allowance for doubtful accounts at May 31, 2014 would reduce our reported income from operations by approximately $0.1 million.

Related Party Receivable

At May 31, 2014, we had receivables from FC Organizational Products, an entity in which we own 19.5 percent, for reimbursement of certain operating costs and for working capital and other advances, even though we are not obligated to provide advances to, or fund the losses of FCOP. We make use of estimates to account for these receivables, including estimates of the collectability of amounts receivable from FCOP in future periods and, based upon revisions to the timing of estimated collections in fiscal 2012, we were required to reclassify a portion of the receivable from current to long-term. In accordance with applicable accounting guidance, we were required to discount the long-term portion of the receivable to its net present value using an estimated effective borrowing rate for FCOP.

We estimated the effective risk-adjusted borrowing rate to discount the long-term portion of the receivable at 15 percent, which was recorded as a discount on a related party receivable in our consolidated income statements. Our estimate of the effective borrowing rate required us to estimate a variety of factors, including the availability of debt financing for FCOP, projected borrowing rates for comparable debt, and the timing and realizability of projected cash flows from FCOP. These estimates were based on information known at the time of the preparation of these financial statements. A change in the assumptions and factors used, including estimated interest rates, may change the amount of discount taken.

Our assessments regarding the collectability of the FCOP receivable requires us to make assumptions and judgments regarding the financial health of FCOP and are dependent on projected financial information for FCOP in future periods. Such financial information contains inherent uncertainties, and is subject to factors that are not within our control. Failure to receive projected cash flows from FCOP in future periods may result in adverse consequences to our liquidity, financial position, and results of operations.

For further information regarding our investment in FCOP, refer to the notes to our financial statements for the fiscal year ended August 31, 2013.

Inventory Valuation

Our inventories are primarily comprised of training materials and related accessories. Inventories are reduced to their fair market value through the use of inventory valuation reserves, which are recorded during the normal course of business. Our inventory valuation calculations contain uncertainties because the calculations require us to make assumptions and judgments regarding a number of factors, including future inventory demand requirements and pricing strategies. During the evaluation process we consider historical sales patterns and current sales trends, but these may not be indicative of future inventory losses. While we have not made material changes to our inventory valuation methodology during the past three years, our inventory requirements may change based on projected customer demand, technological and product life cycle changes, longer or shorter than expected usage periods, and other factors that could affect the valuation of our inventories. If our estimates regarding consumer demand and other factors are inaccurate, we may be exposed to losses that may have an adverse impact upon our financial position and results of operations. For example, a 10 percent increase to our inventory valuation reserves at May 31, 2014 would decrease our reported income from operations by $0.1 million.

Indefinite-Lived Intangible Assets and Goodwill

Intangible assets that are deemed to have an indefinite life and goodwill balances are not amortized, but rather are tested for impairment on an annual basis, or more often if events or circumstances indicate that a potential impairment exists. The Covey trade name intangible asset was generated by the merger with the Covey Leadership Center and has been deemed to have an indefinite life. This intangible asset is quantitatively tested for impairment using the present value of estimated royalties on trade name related revenues, which consist primarily of training seminars and international licensee royalties.

Our impairment evaluation calculations for goodwill and the Covey trade name contain uncertainties because they require us to make assumptions and apply judgment in order to qualitatively assess the fair value of these assets, and may require estimated future cash flows, an estimated appropriate royalty rate, and an estimated discount rate that reflects the inherent risk of future cash flows when these assets are evaluated on a quantitative basis. If forecasts and assumptions used to support the carrying value of our indefinite-lived intangible asset change in future periods, significant impairment charges could result that would have an adverse effect upon our results of operations and financial condition. The valuation methodologies for both indefinite-lived intangible assets and goodwill are also dependent upon the share price of our common stock and our corresponding market capitalization, which may differ from estimated royalties used in our impairment testing. Based upon the fiscal 2013 evaluation of the Covey trade name and goodwill, our trade-name related revenues, licensee royalties, consolidated sales, and market capitalization would have to suffer significant reductions before we would be required to impair these long-lived assets.

The acquisition of NinetyFive 5 in fiscal 2013 requires us to reassess the fair value of the contingent earn out payments each reporting period. Although subsequent changes to the contingent consideration liability do not affect the goodwill generated from the acquisition transaction, the valuation of expected contingent consideration requires us to estimate future sales and profitability. These estimates require the use of numerous assumptions, many of which may change frequently and lead to increased or decreased operating income in future periods. For instance, we recorded reductions totaling $0.9 million to the fair value of the expected contingent earn out payment during the three quarters ended May 31, 2014 which resulted in corresponding reductions of selling, general, administrative expenses during the first three quarters of fiscal 2014.

Impairment of Long-Lived Assets

Long-lived tangible assets and definite-lived intangible assets are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We use an estimate of undiscounted future net cash flows of the assets over their remaining useful lives in determining whether the carrying value of the assets is recoverable. If the carrying values of the assets exceed the anticipated future cash flows of the assets, we calculate an impairment loss. The impairment loss calculation compares the carrying value of the asset to the asset's estimated fair value, which may be based upon discounted cash flows over the estimated remaining useful life of the asset. If we recognize an impairment loss, the adjusted carrying amount of the asset becomes its new cost basis, which is then depreciated or amortized over the remaining useful life of the asset. Impairment of long-lived assets is assessed at the lowest levels for which there are identifiable cash flows that are independent from other groups of assets.

Our impairment evaluation calculations contain uncertainties because they require us to make assumptions and apply judgment in order to estimate future cash flows, forecast the useful lives of the assets, and select a discount rate that reflects the risk inherent in future cash flows. Although we have not made any material recent changes to our long-lived assets impairment assessment methodology, if forecasts and assumptions used to support the carrying value of our long-lived tangible and definite-lived intangible assets change in the future, significant impairment charges could result that would adversely affect our results of operations and financial condition.

Income Taxes

We regularly evaluate our United States federal and various state and foreign jurisdiction income tax exposures. We account for certain aspects of our income tax provision using the provisions of FASC 740-10-05, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon final settlement. The provisions of FASC 740-10-05 also provide guidance on de-recognition, classification, interest, and penalties on income taxes, accounting for income taxes in interim periods, and require increased disclosure of various income tax items. Taxes and penalties are components of our overall income tax provision.

We record previously unrecognized tax benefits in the financial statements when it becomes more likely than not (greater than a 50 percent likelihood) that the tax position will be sustained. To assess the probability of sustaining a tax position, we consider all available evidence. In many instances, sufficient positive evidence may not be available until the expiration of the statute of limitations for audits by taxing jurisdictions, at which time the entire benefit will be recognized as a discrete item in the applicable period.

Our unrecognized tax benefits result from uncertain tax positions about which we are required to make assumptions and apply judgment to estimate the exposures associated with our various tax filing positions. The calculation of our income tax provision or benefit, as applicable, requires estimates of future taxable income or losses. During the course of the fiscal year, these estimates are compared to actual financial results and adjustments may be made to our tax provision or benefit to reflect these revised estimates. Our effective income tax rate is also affected by changes in tax law and the results of tax audits by various jurisdictions. Although we believe that our judgments and estimates discussed herein are reasonable, actual results could differ, and we could be exposed to losses or gains that could be material.

We establish valuation allowances for deferred tax assets when we estimate it is more likely than not that the tax assets will not be realized. The determination of whether valuation allowances are needed on our deferred income tax assets contains uncertainties because we must project future

income, including the use of tax-planning strategies, by individual tax jurisdictions. Changes in industry and economic conditions and the competitive environment may impact the accuracy of our projections. We regularly assess the likelihood that our deferred tax assets will be realized and determine if adjustments to our valuation allowance are necessary.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain written and oral statements made by the Company in this report are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934 as amended (the Exchange Act). Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate, or imply future results, performance, or achievements, and may contain words such as “believe,” “anticipate,” “expect,” “estimate,” “project,” or words or phrases of similar meaning. In our reports and filings we may make forward looking statements regarding our expectations about future sales levels and financial results, future training and consulting sales activity, anticipated expenses, future gross margins, the effects of the acquisition of NinetyFive 5, the release of new services or products, the adequacy of existing capital resources, our ability to extend our line of credit facility, the amount of cash expected to be paid for income taxes, our ability to maintain adequate capital for our operations, projected cost reduction and strategic initiatives, expected levels of depreciation and amortization expense, expectations regarding tangible and intangible asset valuations, the seasonality of future sales, the seasonal fluctuations in cash used for and provided by operating activities, expected improvements in cash flows from operating activities, expected improvements in our working capital, future compliance with the terms and conditions of our line of credit, the ability to borrow on our line of credit, expected collection of amounts receivable from FC Organizational Products LLC and others, estimated capital expenditures, and cash flow estimates used to determine the fair value of long-lived assets. These, and other forward-looking statements, are subject to certain risks and uncertainties that may cause actual results to differ materially from the forward-looking statements. These risks and uncertainties are disclosed from time to time in reports filed by us with the SEC, including reports on Forms 8-K, 10-Q, and 10-K. Such risks and uncertainties include, but are not limited to, the matters discussed in Item 1A of our annual report on Form 10-K for the fiscal year ended August 31, 2013, entitled “Risk Factors.” In addition, such risks and uncertainties may include unanticipated developments in any one or more of the following areas: unanticipated costs or capital expenditures; difficulties encountered by HP Enterprise Services in operating and maintaining our information systems and controls, including without limitation, the systems related to demand and supply planning, inventory control, and order fulfillment; delays or unanticipated outcomes relating to our strategic plans; dependence on existing products or services; the rate and consumer acceptance of new product introductions; competition; the number and nature of customers and their product orders, including changes in the timing or mix of product or training orders; pricing of our products and services and those of competitors; adverse publicity; and other factors which may adversely affect our business.

The risks included here are not exhaustive. Other sections of this report may include additional factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors may emerge and it is not possible for our management to predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any single factor, or combination of factors, may cause actual results to differ materially from those contained in forward-looking statements. Given these risks and uncertainties, investors should not rely on forward-looking statements as a prediction of actual results.

The market price of our common stock has been and may remain volatile. In addition, the stock markets in general have experienced increased volatility. Factors such as quarter-to-quarter variations in revenues and earnings or losses and our failure to meet expectations could have a significant impact on the market price of our common stock. In addition, the price of our common stock can change for reasons unrelated to our performance. Due to our low market capitalization, the price of our common stock may also be affected by conditions such as a lack of analyst coverage and fewer potential investors.

Forward-looking statements are based on management's expectations as of the date made, and the Company does not undertake any responsibility to update any of these statements in the future except as required by law. Actual future performance and results will differ and may differ materially from that contained in or suggested by forward-looking statements as a result of the factors set forth in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in our filings with the SEC.

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

There have been no material changes from the information previously reported under Item 7A of our Annual Report on Form 10-K for the fiscal year ended August 31, 2013. We did not utilize any foreign currency or interest rate derivative instruments during the quarter or three quarters ended May 31, 2014.

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f)) during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1A. RISK FACTORS

For further information regarding our Risk Factors, please refer to Item 1A in our Annual Report on Form 10-K for the fiscal year ended August 31, 2013.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes the purchases of our common stock during the fiscal quarter ended May 31, 2014:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (in thousands) | |
|---|---|---|---|---|---|
| March 2, 2014 to April 5, 2014 | - | $ - | - | $ 9,225 | |
| April 6, 2014 to May 3, 2014 | - | - | - | 9,225 | |
| May 4, 2014 to May 31, 2014 | - | - | - | 9,225 | (1) |
| Total Common Shares | - | $ - | - | | |

(1) On March 26, 2012, our Board of Directors approved a plan to repurchase up to $10.0 million of the Company's outstanding common stock. We intend to use available cash in excess of $10.0 million, provided we have no balance outstanding on our line of credit, to make the purchases. All previously existing common stock repurchase plans were canceled and the new common share repurchase plan does not have an expiration date. Following the approval of this common stock repurchase plan, we have purchased a total of 73,320 shares of our common stock for $0.8 million through May 31, 2014.

The actual timing, number, and value of common shares repurchased under this plan will be determined at our discretion and will depend on a number of factors, including, among others, general market and business conditions, the trading price of common shares, and applicable legal requirements. The Company has no obligation to repurchase any common shares under the authorization, and the repurchase plan may be suspended, discontinued, or modified at any time for any reason.

Item 6. EXHIBITS

(A) Exhibits:

| | |
|---|---|
| 31.1 | Rule 13a-14(a) Certifications of the Chief Executive Officer.** |
| 31.2 | Rule 13a-14(a) Certifications of the Chief Financial Officer.** |
| 32 | Section 1350 Certifications.** |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

**Filed herewith.

SIGNATURES

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

| | | | |
|---|---|---|---|
| | | FRANKLIN COVEY CO. | |
| Date: | July 9, 2014 | By: | /s/ Robert A. Whitman<br><br>Robert A. Whitman<br>Chief Executive Officer<br>(Duly Authorized Officer) |
| Date: | July 9, 2014 | By: | /s/ Stephen D. Young<br><br>Stephen D. Young<br>Chief Financial Officer<br>(Principal Financial and Accounting Officer) |