VORNADO REALTY TRUST
Form DEF 14A
April 06, 2018

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

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ý

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Check the appropriate box:
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VORNADO REALTY TRUST

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888 Seventh Avenue
New York, New York 10019

Notice of Annual Meeting of Shareholders to Be Held on May 17, 2018

To our Shareholders:

The 2018 Annual Meeting of Shareholders of Vornado Realty Trust, a Maryland real estate investment trust ("Vornado" or the "Company"), will be held at the Saddle Brook Marriott, Interstate 80 and the Garden State Parkway, Saddle Brook, New Jersey 07663, on Thursday, May 17, 2018, beginning at 11:30 A.M., New York City time, for the following purposes:

(1) To consider and vote upon the election of seven persons to the Board of Trustees of the Company, each to serve for a one-year term expiring at the 2019 annual meeting of shareholders of the Company and until his or her successor is duly elected and qualified.

(2) To consider and vote upon the ratification of the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the current fiscal year.

(3) To consider and vote upon an amendment (the "Amendment") to our Company's Declaration of Trust (the "Declaration") to permit shareholders to vote on amendments to our Bylaws to the extent provided in the Bylaws and confirm the power of shareholders to vote on certain additional matters.

(4) To consider and vote upon the approval of a non-binding, advisory resolution on executive compensation.

(5) To transact any other business as may properly come before the meeting or any postponement or adjournment of the meeting.

The Board of Trustees of the Company has fixed the close of business on March 19, 2018 as the record date for the determination of shareholders entitled to notice of, and to vote at, the meeting.

Please review the accompanying proxy statement and proxy card or voting instruction form. Whether or not you plan to attend the meeting, it is important that your shares be represented and voted. You may authorize your proxy through the Internet or by touch-tone telephone as described on the proxy card or voting instruction form. Alternatively, you may sign the proxy card or voting instruction form and return it in accordance with the instructions included with the proxy card or voting instruction form. You may revoke your proxy by (1) timely executing and submitting a later-dated proxy card or voting instruction form, (2) subsequently authorizing a proxy through the Internet or by telephone, (3) timely sending a written revocation of proxy to our Secretary at our principal executive office located at 888 Seventh Avenue, New York, New York 10019, or (4) attending the meeting and voting in person. To be effective, later-dated proxy cards, voting instruction forms, proxies authorized via the Internet or telephone or written revocations of proxies must be received by us by 11:59 P.M., New York City time, on Wednesday, May 16, 2018.

By Order of the Board of Trustees,
Alan J. Rice
Secretary
April 6, 2018

2018 PROXY STATEMENT SUMMARY

Overview of Voting Items

This summary highlights certain information that is covered elsewhere in this Proxy Statement. You are encouraged to read our complete Proxy Statement before voting.

Proposal 1:	Election of seven Trustees	For
Proposal 2:	Ratification of appointment of Independent Accounting Firm	For
Proposal 3:	Approval of amendment to the Company's Declaration of Trust to permit shareholders to vote on amendments to the Company's Bylaws to the extent provided in the Bylaws and confirm the power of shareholders to vote on certain additional matters	For
Proposal 4:	Advisory approval of executive compensation	For

We made significant progress in furthering our simplification and focus strategy by completing the spin-off of our Washington, D.C. segment and combining it with the management business and certain Washington, D.C. assets of The JBG Companies, a Washington D.C. real estate company. The combined company, JBG SMITH Properties (NYSE: JBGS), is the largest, market-leading, best-in-class, pure-play Washington, D.C. real estate company. Over the past several years, including the spin-off of Urban Edge Properties and the JBG SMITH Properties transaction, we have distributed $9.7 billion of assets to shareholders and exited $6.2 billion of non-core assets.

Net Operating Income ("NOI") at share increased by $37.3 million in 2017 over 2016. NOI and NOI at share are non-GAAP measures defined on page 22 of this Proxy Statement. "GAAP" means Generally Accepted Accounting Principles applicable in the United States.

We achieved a 2.7% increase in same store NOI at share in 2017 over 2016 for our New York Office and Retail portfolio, theMART and our 555 California Street complex.

FFO, as adjusted, increased $30.4 million (or $0.14 per diluted share) in 2017 over 2016. FFO and FFO, as adjusted are non-GAAP measures defined on page 22 of this Proxy Statement.

In 2017, we completed $4.8 billion of financings in 10 transactions.

Strong leasing performance in 2017. In our New York portfolio, we leased approximately 1,900,000 square feet of office space with strong mark-to-markets of 12.8% GAAP and 9.9% cash and 126,000 square feet of retail space with positive mark-to-markets of 26.5% GAAP and

25.4% cash.

In 2017, we made a $230 million upfront contribution for the acquisition of a 99-year leasehold of the Farley Post Office (a 50.1% interest). Please also see our Chairman's Letter that can be found on our website at www.vno.com/chairmansletter.

Shareholder Engagement and Recent Governance Changes

During the last four years, our Board of Trustees has adopted, or is proposing, a number of significant governance changes. These changes follow extensive engagement with our shareholders to better understand their views on our corporate governance practices. The Chair of our Corporate Governance and Nominating Committee was an active participant in these meetings with investors and she and members of our

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management team reported and discussed the feedback received with the full Board. As part of this engagement, we held in-person or telephonic meetings with shareholders representing approximately 50% of our outstanding common shares of beneficial interest in each of the last four years. In addition to the changes outlined below, we have also significantly enhanced the corporate governance, sustainability and executive compensation disclosures in our proxy statement.

Changes made since the date of our last proxy statement

- Subject to shareholder approval at this meeting, taking action to permit our shareholders to amend our Bylaws.
- Appointing Ms. Mandakini Puri, an additional "audit committee financial expert" to our Audit Committee so that each of the three current members qualifies as an "audit committee financial expert."

Changes made between 2016 and 2017 proxy statements

- Adding Ms. Mandakini Puri as a new independent Trustee.
- Adopting proxy access.
- Further enhancing the role and responsibilities of the Lead Trustee.

Other changes made since 2015

- Amending our Corporate Governance Guidelines to provide that, in an uncontested election, if a nominee for Trustee does not receive majority support for election to the Board (more "for" votes than "withhold" votes) that Trustee must offer to resign from the Board. The Board would then determine whether to accept or reject the resignation and disclose its rationale for its decision.
- Amending our Declaration of Trust to provide for the phased-in annual election of our Board of Trustees, with the Board fully declassified in 2019.
- Appointing Ms. Candace K. Beinecke as our new Lead Trustee.
- Amending our Corporate Governance Guidelines to provide for increased clarity and emphasis on diversity as a criteria for the selection of new Trustees.
- Increasing the power and authority of our Lead Trustee to reflect best practices.
- Increasing Trustee equity ownership requirements to five times (from four times) their annual cash retainer.
- Designating a second member of the Audit Committee to be an "audit committee financial expert."

Adopting an anti-hedging policy.

Adopting a claw-back policy.

Corporate Governance Highlights

ü Highly independent Board actively engaged in strategic, risk and management oversight
ü Resignation policy for any Trustee who does not receive majority support in an uncontested election
ü A highly experienced Board of Trustees with diverse experiences and expertise applicable to our strategic and business needs
ü Robust role for Lead Independent Trustee who is elected annually by the independent Trustees
ü Continued and enhanced focus on Board composition, refreshment and rotation

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- ü Annual evaluations of our Board, our Trustees and our Board committees
- ü Open communication and strong working relationships among Trustees with regular access to management
- ü High Trustee share ownership
- ü Strong succession planning oversight
- ü Proactive shareholder engagement program and responsive to shareholder feedback
- ü Proxy access (3%/3 years/20 aggregation)
- ü Commencing in 2019, a single class of Trustees
- ü Assuming shareholder approval of the Amendment, permitting shareholders to amend the Bylaws

Executive Compensation Highlights

- ü Significant portion of compensation is variable and performance-based

Formula-driven annual bonus plan

Equity grants tied to share performance goals which require a return to shareholders prior to their having any value

- ü Significant share ownership and retention requirements (6x salary for CEO, 5x annual cash retainer for Trustees, 3x salary for other NEOs)
- ü Double trigger equity acceleration upon a change of control
- ü Policy against hedging or pledging
- ü Clawback policy
- ü No tax gross-ups
- ü No excess perks and limited retirement benefits
- ü No golden parachute or contractual severance arrangement for our CEO

***Executive Compensation Program Objectives*:**

Retain a highly-experienced, "best-in-class" team of executives who have worked together as a team for a long period of time and who make major contributions to our success.

Attract other highly-qualified executives to strengthen that team as needed.

Motivate our executives to contribute to the achievement of company-wide and business-unit goals as well as to pursue individual goals.

Emphasize equity-based incentives with long-term performance measurement periods and vesting conditions.

Align the interests of executives with shareholders by linking payouts under annual incentives to performance measures that promote the creation of long-term shareholder value.

Achieve an appropriate balance between risk and reward in our compensation programs that does not encourage excessive or inappropriate risk-taking.

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888 Seventh Avenue
New York, New York 10019

PROXY STATEMENT

Annual Meeting of Shareholders to Be Held on May 17, 2018

The accompanying proxy is being solicited by the Board of Trustees (the "Board of Trustees" or the "Board") of Vornado Realty Trust, a Maryland real estate investment trust ("we," "us," "our" or the "Company"), for exercise at our 2018 Annual Meeting of Shareholders (the "Annual Meeting") to be held on Thursday, May 17, 2018, beginning at 11:30 A.M., New York City time, at the Saddle Brook Marriott, Interstate 80 and the Garden State Parkway, Saddle Brook, New Jersey 07663. Our principal executive office is located at 888 Seventh Avenue, New York, New York 10019. Our proxy materials, including this proxy statement, the Notice of Annual Meeting of Shareholders, the proxy card or voting instruction form and our 2017 Annual Report are being distributed and made available on or about April 6, 2018.

In accordance with rules and regulations adopted by the U.S. Securities and Exchange Commission (the "SEC"), we have elected to provide our shareholders access to our proxy materials on the Internet. Accordingly, a notice of Internet availability of proxy materials will be mailed on or about April 6, 2018 to our shareholders of record as of the close of business on March 19, 2018. Shareholders may (1) access the proxy materials on the website referred to in the notice or (2) request that a printed set of the proxy materials be sent, at no cost to them, by following the instructions in the notice. **You will need your 12-digit control number that is included with the notice mailed on or about April 6, 2018, to authorize your proxy for your Shares (as defined below) through the Internet. If you have not received a copy of this notice of internet availability, please contact our investor relations department at 201-587-1000 or send an e-mail to ircontact@vno.com. If you wish to receive a printed version of these materials, you may request them at www.proxyvote.com or by dialing 1-800-579-1639 and following the instructions at that website or phone number.**

How do you vote?

If you hold your Shares of record in your own name, you may vote in person at the Annual Meeting or you may authorize your proxy over the Internet (at www.proxyvote.com), by telephone (at 1-800-690-6903) or by executing and returning a proxy card or voting instruction form. Once you authorize a proxy, you may revoke that proxy by (1) timely executing and submitting a later-dated proxy card or voting instruction form, (2) subsequently authorizing a proxy through the Internet or by telephone, (3) timely sending a written revocation of your proxy to our Secretary at our principal executive office or (4) attending the Annual Meeting and voting in person. Attending the Annual Meeting without submitting a new proxy or voting in person will not automatically revoke your prior authorization of your proxy.

If you hold your Shares in "street name" (that is, as beneficial owner through a bank, broker or other nominee), your nominee will not vote your shares (other than with respect to the ratification of the appointment of our independent registered public accounting firm) unless you provide instructions to your nominee on how to vote your Shares. If you hold Shares in "street name," you will receive instructions from your nominee

that you must follow in order to have your proxy authorized, or you may contact your nominee directly to request these voting instructions. You should instruct your nominee how to vote your Shares by following the directions provided by your nominee.

To be effective, later-dated proxy cards, voting instruction forms, proxies authorized via the Internet or telephone or written revocations of proxies must be received by us by 11:59 P.M., New York City time, on Wednesday, May 16, 2018.

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We will pay the cost of soliciting proxies. We have hired MacKenzie Partners, Inc. to solicit proxies for a fee not to exceed $5,500. In addition to solicitation by mail, by telephone and by e-mail or the Internet, arrangements may be made with brokerage houses and other custodians, nominees and fiduciaries to send proxies and proxy materials to their principals and we may reimburse them for their expenses in so doing. Trustees or members of management of the Company may also solicit votes.

Who is entitled to vote?

Only holders of record of our common shares of beneficial interest, par value $0.04 per share (the "Shares"), as of the close of business on March 19, 2018 are entitled to notice of and to vote at the Annual Meeting. We refer to this date as the "record date." On that date, 190,167,582 of our Shares were outstanding. Holders of Shares as of the record date are entitled to one vote per Share on each matter properly presented at the Annual Meeting.

How do you attend the meeting in person?

If you hold your Shares in your own name, you will need only to present satisfactory evidence of your identity. If you hold your Shares in "street name" and would like to attend the Annual Meeting in person, you will need to bring an account statement or other evidence acceptable to us of ownership of your Shares as of the close of business on the record date. If you hold Shares in "street name" and wish to vote in person at the Annual Meeting, you will need to contact your bank, broker or other nominee and obtain a "legal proxy" from your nominee and bring it to the Annual Meeting. Obtaining a legal proxy may take several days. Directions to attend the Annual Meeting and vote in person are available upon request to the Secretary of the Company at its offices.

What is the quorum necessary for the meeting?

The holders of a majority of the outstanding Shares as of the close of business on the record date, present in person or by proxy, will constitute a quorum for the transaction of business at the Annual Meeting.

How will your votes be counted?

Any proxy, properly executed and returned, will be voted as directed and, if no direction is given, will be voted as recommended by the Board of Trustees in this proxy statement and in the discretion of the proxy holder as to any other matter that may properly come before the meeting. A broker non-vote and any proxy marked "withhold" or an abstention, as applicable, will count for the purposes of determining a quorum, but will have no effect on the result of the vote on the election of Trustees (Proposal 1), the ratification of the appointment of our registered independent public accounting firm (Proposal 2), or the non-binding, advisory vote on executive compensation (Proposal 4). However, because the vote required to amend our Amended and Restated Declaration of Trust (the "Declaration") to permit shareholders to vote on amendments to our Amended and Restated Bylaws (the "Bylaws") (Proposal 3) is based on votes entitled to be cast at the meeting (rather than votes actually cast at the meeting), abstentions and broker non-votes, if any, will have the effect of votes against the Amendment. A broker non-vote is a vote that is not cast on a non-routine matter because the Shares entitled to cast the vote are held in street name, the broker lacks discretionary authority to vote the Shares on that matter and the broker has not received voting instructions from the beneficial owner.

The election of each of our nominees for Trustee (Proposal 1) requires a plurality of the votes cast at the Annual Meeting, however, any nominee for Trustee who does not receive the approval of a majority of the votes cast (more "for" votes than "withhold" votes) will be required, pursuant to our Corporate Governance Guidelines (the "Guidelines"), to tender his or her offer of resignation to the Board of Trustees for its consideration. The ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm (Proposal 2), and the approval of the non-binding, advisory vote on executive compensation (Proposal 4) each requires a majority of the votes cast on such matter at the Annual Meeting. The approval of the amendment to the Declaration to permit shareholders to vote on amendments to the Bylaws (the "Amendment") (Proposal 3) requires the affirmative vote by holders of not less than a majority of our Shares outstanding and entitled to vote thereon.

PROPOSAL 1: ELECTION OF TRUSTEES

Trustees Standing for Election

Our Board has 10 Trustees. On February 8, 2018, our Board, on the recommendation of our Corporate Governance and Nominating Committee, nominated each of Messrs. Steven Roth, Michael D. Fascitelli, Michael Lynne and David M. Mandelbaum, Ms. Mandakini Puri and Messrs. Daniel R. Tisch and Russell B. Wight, Jr. for election at our Annual Meeting. Such persons will be elected to serve until the Annual Meeting of Shareholders in 2019 and until their respective successors are duly elected and qualified. Each of these nominees currently serves as a member of our Board. Our organizational documents provide that the Trustees who were elected at the 2016 annual meeting of shareholders will serve until the 2019 annual meeting. Beginning with the 2019 annual meeting of shareholders, all Trustees will be elected as a single class annually, in each case to serve for a term expiring at the next succeeding annual meeting and until their respective successors have been duly elected and qualified.

Unless you direct otherwise in your signed and returned proxy, each of the persons named in the accompanying proxy will vote your Shares for the election of each of the seven nominees for Trustees listed below. If any nominee at the time of election is unavailable to serve, it is intended that each of the persons named in the proxy will vote for an alternate nominee who will be recommended by the Corporate Governance and Nominating Committee of our Board and nominated by the Board. Alternatively, the Board may reduce the size of the Board and the number of nominees. Proxies may be exercised only for the nominees named or such alternates. We do not currently anticipate that any nominee for Trustee will be unable to serve as a Trustee.

The Board of Trustees recommends that shareholders vote "FOR" the election of each of the nominees listed below to serve as a Trustee until the Annual Meeting of Shareholders in 2019 and until his or her respective successor has been duly elected and qualified.

Under our Bylaws, a plurality of all the votes cast at the Annual Meeting, if a quorum is present, is sufficient to elect a Trustee. However, any Trustee who does not receive the affirmative vote of a majority of the votes cast for his or her election to the Board (a greater number of "for" votes than "withhold" votes) in an uncontested election (such as this election) will be required, pursuant to our Corporate Governance Guidelines, to tender his or her offer of resignation to the Board for its consideration. A broker non-vote will have no effect on the result of this vote.

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The following table lists the nominees and the other present members of the Board who will continue to serve following the 2018 Annual Meeting. For each such person, the table lists the age, principal occupation, position presently held with the Company, if any, and the year in which the person first became a member of our Board or a director of our predecessor, Vornado, Inc.

Nominees for Election to Serve as Trustees Until the Annual Meeting in 2019				
Steven Roth[1]	76	Chairman of the Board of Trustees of the Company since May 1989; Chief Executive Officer of the Company from May 1989 to May 2009 and since April 15, 2013; Managing General Partner of Interstate Properties	2019	1979
Michael D. Fascitelli	61	Owner, MDF Capital LLC since June 2013. From May 2009 to April 15, 2013, President and Chief Executive Officer of the Company	2019	1996
Michael Lynne[2,3]	76	Principal of Unique Features	2019	2005
David M. Mandelbaum[2,4]	82	A member of the law firm of Mandelbaum & Mandelbaum, P.C.; a general partner of Interstate Properties	2019	1979
Mandakini Puri[2,5]	57	Independent consultant	2019	2016
Daniel R. Tisch[2,3,5]	66	Managing Member of TowerView LLC	2019	2012
Russell B. Wight, Jr.[1,2,4]	78	A general partner of Interstate Properties	2019	1979
Present Trustees Elected to Serve as Trustees Until the Annual Meeting in 2019				
Candace K. Beinecke[1,2,4,6]	71	Chair of Hughes Hubbard & Reed LLP	2019	2007
Robert P. Kogod[2]	86	President of Charles E. Smith Management LLC	2019	2002
Dr. Richard R. West[2,3,5]	80	Dean Emeritus, Leonard N. Stern School of Business, New York University	2019	1982

(1) *Member of the Executive Committee of the Board.*

(2) *Independent pursuant to the rules of the New York Stock Exchange ("NYSE") as determined by the Board.*

(3) *Member of the Compensation Committee of the Board.*

(4) *Member of the Corporate Governance and Nominating Committee of the Board.*

(5) *Member of the Audit Committee of the Board.*

(6) *Lead Trustee.*

Biographies of our Trustees

Ms. Beinecke has served as Chair of Hughes Hubbard & Reed LLP, a New York law firm, since 1999 and is a practicing partner in Hughes Hubbard's Corporate Department. Ms. Beinecke also serves as Chairperson of the Board of Arnhold & S. Bleichroeder Advisors LLC's First Eagle Funds, Inc. (a U.S. public mutual fund family), and as a board member of ALSTOM (a public French transport and power company).

Mr. Fascitelli has served as a member of our Board of Trustees since December 1996. Since June 2013, Mr. Fascitelli has been the owner and principal of MDF Capital LLC (a private investment firm). Since November 2017, Mr. Fascitelli has served as Co-Founder and Managing Partner of Imperial Companies (a private real estate company). Also since November 2017, Mr. Fascitelli has served as a Founder and Non-Executive Director of Landscape Acquisitions (a special purpose acquisitions company focusing on real estate operating companies and listed on the London Stock Exchange). Since December 2014, Mr. Fascitelli has served as Chair of the Investment Committee, Senior Advisor and Board Member of Quadro Partners Inc. (a private online real estate investment platform). Previously, Mr. Fascitelli served as our President from

December 1996, and as our Chief Executive Officer from May 2009, until his resignation from both positions effective April 15, 2013. Until May 23, 2013, he was also a director of our affiliate, Alexander's, Inc. ("Alexander's") (a real estate investment trust 32.4% of which is owned by the Company), and served as its President until April 15, 2013. From 2004 until 2013, he also served as a director of our affiliate, Toys "R" Us, Inc. (a retailer). Since January 16, 2014, Mr. Fascitelli has served on the Board of Trustees of Invitation Homes Inc. (a publicly-traded residential real estate company) or its predecessors Colony Starwood Homes and Starwood Waypoint Residential Trust. Since 2015, Mr. Fascitelli has also served as a member of the Board of Commissioners of the Port Authority of New York and New Jersey.

Mr. Kogod has served as a member of our Board of Trustees since 2002. Currently, Mr. Kogod is the President of Charles E. Smith Management LLC (a privately-owned investment firm that is not affiliated with the Company). Previously, Mr. Kogod was Co-Chief Executive Officer and Co-Chairman of the Board of Directors of Charles E. Smith Commercial Realty L.P., from October 1997 through December 2001, and was Co-Chief Executive Officer and Co-Chairman of the Board of Directors of Charles E. Smith Residential Realty from June 1994 to October 2001.

Mr. Lynne has been a principal of Unique Features (a media company) since its formation in 2008. Prior to that, he was Co-Chairman and Co-Chief Executive Officer of New Line Cinema Corporation (a subsidiary of Time Warner, Inc. and a motion picture company) since 2001. Prior to 2001, Mr. Lynne served as President and Chief Operating Officer of New Line Cinema, starting in 1990. From 2006 until 2008, Mr. Lynne served on the Board of Directors of Time Warner Cable Inc. (a telecommunications company). Since July 2013, Mr. Lynne has been a member of the Board of Directors of IMAX Corporation (an entertainment technology company).

Mr. Mandelbaum has been a member of the law firm of Mandelbaum & Mandelbaum, P.C. since 1960. Since 1968, he has been a general partner of Interstate Properties (an owner of shopping centers and investor in securities and partnerships, "Interstate"). Mr. Mandelbaum is also a director of Alexander's.

Ms. Puri has been an independent consultant since May 2013. From May 2011 until May 2013, she served as a Managing Director and Co-Head of BlackRock Private Equity, a private equity business affiliated with BlackRock, Inc. From April 2009 until April 2011, Ms. Puri served as a consultant to Bank of America/Merrill Lynch Global Private Equity and prior to that she co-founded and served as Chief Investment Officer of Merrill Lynch Global Private Equity. She is a member of the Board of Validus Holdings Ltd., a public insurance holding company, where she serves as Chair of the Executive and Compensation Committees. She is also a member of the Wharton School Graduate Executive Board. Ms. Puri has a Bachelor of Commerce degree from Delhi University and an MBA from the Wharton School at the University of Pennsylvania and is a member of the Indian Institute of Chartered Accountants.

Mr. Roth has been the Chairman of our Board of Trustees since May 1989 and Chairman of the Executive Committee of the Board since April 1980. From May 1989 until May 2009, Mr. Roth served as our Chief Executive Officer. Since April 15, 2013, Mr. Roth has again been serving in that position. Since 1968, he has been a general partner of Interstate and he currently serves as its Managing General Partner. He is the Chairman of the Board and Chief Executive Officer of Alexander's. Since January 2015, Mr. Roth has been a member of the Board of Trustees of Urban Edge Properties (a real estate investment trust and former subsidiary of the Company which operates our former shopping center business, "Urban Edge"). Since July 18, 2017, Mr. Roth has been the Chairman of the Board of Trustees of JBG SMITH Properties (a real estate investment trust and the successor to our former Washington D.C. business, "JBG SMITH"). Mr. Roth was a director of J. C. Penney Company, Inc. (a retailer) from 2011 until September 2013. Mr. Roth serves on three other affiliated public company boards: Alexander's; Urban Edge and JBG SMITH. The Company owns 32.4% of Alexander's. Urban Edge is the company that resulted from the spin-off of our

retail business outside of New York City. The Company owns 4.5% of Urban Edge. JBG SMITH is the resulting entity of the spin-off of our Washington D.C. segment and its combination with the management business and certain Washington, D.C. assets of The JBG Companies (the "Washington Spin"). Our board believes the presence of Mr. Roth on each of these Boards is beneficial to the Company and/or the broadly overlapping shareholder base of the Company, Urban Edge, and JBG SMITH.

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Mr. Tisch has been the Managing Member of TowerView LLC (a private investment partnership) since 2001. Mr. Tisch also serves as a member of the Board of Directors of Tejon Ranch Company (a real estate development and agribusiness company). Mr. Tisch is also a Board member and member of the Finance, Audit and Investment Committees of New York University.

Dr. West is Dean Emeritus of the Leonard N. Stern School of Business at New York University. He was a professor there from September 1984 until September 1995 and Dean from September 1984 until August 1993. Prior thereto, Dr. West was Dean of the Amos Tuck School of Business Administration at Dartmouth College. Dr. West is also a director of Alexander's.

Mr. Wight has been a general partner of Interstate since 1968. Mr. Wight is also a director of Alexander's.

Relationships Among our Trustees

We are not aware of any family relationships among any of our Trustees or executive officers or persons nominated or chosen by us to become Trustees or executive officers.

Messrs. Roth, Wight and Mandelbaum each are general partners of Interstate. Since 1992, Vornado has managed all the operations of Interstate for a fee as described in "Certain Relationships and Related Transactions Transactions Involving Interstate Properties."

Messrs. Roth, Wight and Mandelbaum and Dr. West are also directors of Alexander's. As of the record date, the Company, together with Interstate and its general partners, beneficially owns approximately 59% of the outstanding common stock of Alexander's.

For more information concerning Interstate, Alexander's and other relationships involving our Trustees, see "Certain Relationships and Related Transactions."

CORPORATE GOVERNANCE

The common shares of the Company or its predecessor have been continuously listed on the NYSE since January 1962 and the Company is subject to the NYSE's Corporate Governance Standards.

Our Corporate Governance Framework

Vornado is committed to effective corporate governance and high ethical standards. Our Board believes that these values are conducive to strong performance and creating long-term shareholder value. Our governance framework gives our highly experienced independent Trustees the structure necessary to provide oversight, advice and counsel to the Company. The Board of Trustees has adopted the following documents, which are available on our website (www.vno.com/governance/overview):

Audit Committee Charter

- Compensation Committee Charter
- Corporate Governance and Nominating Committee Charter
- Corporate Governance Guidelines (attached as Annex A)
- Code of Business Conduct and Ethics

We will post any future changes to these documents to our website and may not otherwise publicly file such changes. Our regular filings with the SEC and our Trustees' and executive officers' filings under Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Securities Exchange Act"), are also available on our website. In addition, copies of these documents are available free of charge from the Company upon your

written request. Requests should be sent to our investor relations department located at our principal executive office.

The Code of Business Conduct and Ethics applies to all of our Trustees, executive officers and other employees.

Board Independence

The Board has determined that Mses. Beinecke and Puri and Messrs. Kogod, Lynne, Mandelbaum, Tisch and Wight and Dr. West are independent under the Corporate Governance Standards of the NYSE, with the result that eight of our 10 Trustees are independent. The Board reached this conclusion after considering all applicable relationships between or among such Trustees and the Company or management of the Company. These relationships are described in the sections of this proxy statement entitled "Relationships Among Our Trustees" and "Certain Relationships and Related Transactions." Among other factors considered by the Board in making its determinations regarding independence was the Board's determination that these Trustees met all of the "bright-line" requirements of the NYSE's Corporate Governance Standards as well as the categorical standards adopted by the Board as contained in our Corporate Governance Guidelines.

Board Participation

Our Board is actively involved in strategic, risk and management oversight. Our Board regularly has in-depth discussions concerning the Company's strategies and risks during which the Board actively questions and considers these topics. Furthermore, the Board regularly meets with the most senior executive officers as well as the officers who directly report to the most senior executives. The Board believes a good working knowledge of these multiple levels of management aid it considerably in its important role of management oversight as well as with succession planning.

Shareholder Engagement and Governance Changes

During the past four years we have adopted or are proposing a number of significant governance changes following outreach to our shareholders for their views. During each of the last four years, we met with or spoke to holders of more than 50% of our Shares. Based on that outreach, we believe the combination of actions we have taken present an overall governance structure responsive to their views. The changes implemented include:

Changes made since the date of our last proxy statement

- Subject to shareholder approval at this meeting, taking action to permit our shareholders to amend our Bylaws.

- Appointing Ms. Mandakini Puri, an additional "audit committee financial expert" to our Audit Committee so that each of the three current members qualify as an "audit committee financial expert."

Changes made between 2016 and 2017 proxy statements

Adding Ms. Mandakini Puri as a new independent Trustee.

Adopting proxy access.

Further enhancing the roles and responsibilities of the Lead Trustee.

Other changes made since 2015

Amending our Corporate Governance Guidelines to provide that, in an uncontested election, if a nominee for Trustee does not receive majority support for election to the Board (more "for" votes than "withhold"

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votes) that Trustee must offer to resign from the Board. The Board would then determine whether to accept or reject the resignation and disclose its rationale for its decision.

Amending our Declaration of Trust to provide for the phased-in annual election of our Board of Trustees, with the Board fully declassified in 2019.

Appointing Ms. Candace K. Beinecke as our new Lead Trustee.

Amending our Corporate Governance Guidelines to provide for increased clarity and emphasis on diversity as a criteria for the selection of new Trustees.

Increasing the power and authority of our Lead Trustee to reflect best practices.

Increasing Trustee equity ownership requirements to five times (from four times) their annual cash retainer.

Designating a second member of the Audit Committee to be an "audit committee financial expert."

Adopting an anti-hedging policy.

Adopting a claw-back policy.

We have also significantly enhanced the corporate governance, sustainability and executive compensation disclosures in our proxy statement in the last four years.

Sustainability

We believe that our Company has been a leader in promoting sustainability practices. We regularly report to the Board on our sustainability programs and our Board plays an active role in the oversight of Vornado's sustainability practices, recognizing that sustainability and energy efficiency are central to Vornado's business strategy. In connection with our sustainability programs, we focus on:

Sustainable and efficient practices in the way we design, build, retrofit and maintain our portfolio of buildings. We believe that energy efficiency and resource conservation achieve the twofold benefit of controlling our operating expenses and reducing our impact on the environment.

Maintaining healthy indoor environments for our tenants and employees, and incorporating health and wellness into our design principles and operating standards.

Recognizing climate change as a material issue to our business, due to the risks that it may present to our assets. We assess opportunities to fortify our assets against these risks while mitigating our own contribution to climate change through reduction of our carbon footprint. We further our impact on climate change mitigation through membership in business associations in our markets and support for climate change policy and regulation.

Smart infrastructure improvements, investing in sustainable technologies and employing best practices for building operations.

Establishing partnerships with our tenants and communities.

Setting goals around our sustainability policies, and reporting on our progress and achievements in our annual sustainability report available on our website at www.vno.com/sustainability/overview.

We are recognized as an industry leader in sustainability and energy efficiency.

We have received the Energy Star Partner of the Year Award four times, most recently in 2017.

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In every year since 2013, we have received the Global Real Estate Sustainability Benchmark (GRESB) Green Star Ranking. We were recognized as a sector leader in 2017.

We have received the NAREIT Leader in the Light Award for every year since 2010, recognizing us as a leader in energy efficiency.

We are one of the largest owners of LEED-certified property in the United States.

Social Engagement

Our greatest and most scarce asset is our people. We strongly believe in training and retaining talented employees and having management at many levels engage with our Board.

Furthermore, a good relationship with the communities in which we operate is essential. We foster and encourage community engagement and volunteerism for all employees.

Corporate Governance at a Glance

Board Independence

Eight out of 10 of our Trustees are independent.

Our only non-independent Trustees are our current and former CEOs, who have extensive and valuable experience with our Company.

Our Board members generally have significant personal investments in our Company and engage in robust and open debates concerning all significant matters affecting our Company.

Board Composition

Currently the Board has fixed the number of Trustees at 10.

The Board at least annually assesses its performance through Board and committee self-evaluation as well as an evaluation of each individual member.

Our Trustees are highly experienced in their fields of endeavor and apply valuable and diverse skill sets to address our business and strategic needs.

The Corporate Governance and Nominating Committee leads the full Board in considering Board competencies and refreshment and actively seeks new candidates to consider as Board members.

Board Committees

We have four committees Audit, Compensation, Corporate Governance and Nominating, and Executive.

With the exception of the Executive Committee (our Chairman serves on this Committee), all other Committees are composed entirely of independent Trustees.

Leadership Structure

Our Chairman is the CEO of our Company. He interacts closely with our independent Lead Trustee, who has powers and duties that reflect corporate governance best practices.

The independent Board members consider our Lead Trustee annually. Our Board re-appointed Ms. Candace K. Beinecke as Lead Trustee on February 8, 2018. Among other duties, our Lead Trustee

chairs executive sessions of the independent Trustees to discuss certain matters without management present and approves agenda items and materials sent to the Board.

The Board will consider whether an independent chairperson is appropriate at the time of the next CEO transition.

Risk Oversight

Our full Board is responsible for risk oversight, and has designated, and may in the future designate, committees to have particular oversight of certain key risks. Our Board oversees management as management fulfills its responsibilities for the assessment and mitigation of risks and for taking appropriate risks. Our Board regularly has in-depth discussions concerning the Company's strategies and risks where the Board actively questions and considers these topics.

Open Communication and Shareholder Engagement

We encourage open communication and strong working relationships among the Lead Trustee, the Chairs of our Board committees, our Chairman and our other Trustees.

Our Trustees have access to, and regularly meet with, senior management and other employees.

We actively seek input from our shareholders through our shareholder engagement programs; shareholders may also contact our Board, Lead Trustee or management through our website or by regular mail.

We host quarterly earnings conference calls to which all shareholders have access.

Trustee Stock Ownership

Our Trustees are required to own (or acquire within a specified time-frame) Company equity having a value equal to at least five times their annual cash retainer.

Management Succession Planning

Our Corporate Governance and Nominating Committee actively monitors our succession planning.

Our Board regularly reviews senior management succession and development plans. Our Board regularly reviews future candidates for the CEO position and other senior leadership roles and potential succession timing for those positions, including under emergency circumstances. Our Board has adopted a formal CEO-succession plan and reviews that plan regularly.

The Board also reviews and discusses career development plans for individuals identified as high-potential candidates for senior leadership positions and the Board members interact with these candidates in formal and informal settings during the year.

Sustainability and Corporate Responsibility

The Board actively monitors our programs and initiatives on sustainability, environmental matters and social responsibility.

Developing an Effective Board

Our Board believes that the Board should be comprised of members who encompass a broad range of skills, expertise, industry knowledge and diversity of opinion and contacts relevant to our business. Our Board is deeply involved in the business and strategy of our Company and the great depth of experience and insight

that our Board members bring to meetings has been invaluable. The Board considers the following characteristics, competencies, and attributes when considering candidates for inclusion on our Board.

Personal Characteristics

Integrity and Accountability: High ethical standards, integrity and strength of character in his or her personal and professional dealings and a willingness to act on and be accountable for his or her decisions.

Informed Judgment: Demonstrate intelligence, wisdom and thoughtfulness in decision-making. Demonstrate a willingness to thoroughly discuss issues, ask questions, express reservations, and voice dissent.

Financial Literacy: An ability to read and understand financial statements, financial ratios and various other indices for evaluating the Company's performance.

Mature Confidence: Assertive, responsible and supportive in dealing with others. Respect for others, openness to others' opinions and the willingness to listen.

High Standards: History of achievements that reflect high standards for himself or herself and others.

Core competencies

Accounting and Finance: Experience in financial accounting and corporate finance, especially with respect to the industry in which our Company operates.

Business Judgment: Record of making good business decisions and evidence that he or she will act in good faith and in a manner that is in the best interests of our Company.

Strategic Insight: Record of insight with respect to our industry and market and other trends and conditions and applying such insight to create value or limit risk.

Management: Experience in corporate management. Understand management trends in general and in the areas in which we conduct our business.

Crisis Response: Ability and time to perform during periods of both short-term and prolonged crisis.

Industry: Specialized experience and skills in areas in which the Company conducts its business, including real estate, investments, capital markets and technology relevant to the Company.

Local Markets: Experience in markets in which our Company operates.

Leadership: Understand and possess skills and have a history of motivating high-performing, talented managers.

Strategy and Vision: Skills and capacity to provide strategic insight and direction by encouraging innovations, conceptualizing key trends, evaluating strategic decisions, and challenging our management to sharpen its vision.

Commitment to our Company

Time and Effort: Able and willing to commit the time and energy necessary to satisfy the requirements of Board and Board committee membership. Expected to attend and participate in all Board meetings and Board committee meetings for which they are a member. Encouraged to attend all annual meetings of shareholders. A willingness to rigorously prepare prior to each meeting and actively participate in the

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meeting. Willingness to make himself or herself available to management upon request to provide advice and counsel.

Awareness and Ongoing Education: Possess, or be willing to develop, a broad knowledge of both critical issues affecting our Company (including industry-, technology- and market-specific information), and Trustee's roles and responsibilities (including the general legal principles that guide Board members).

Other Commitments: In light of other existing commitments, ability to perform adequately as a Trustee and a willingness to do so.

Stock Ownership: Complies with the Company's equity ownership requirements.

Team and Company considerations

Balancing the Board: Contributes talent, skills and experience to the Board as a team to supplement existing resources and provide talent for future needs preferably as evidenced by a pattern of dealings with one or more current Board members.

Diversity: Contributes to the Board in a way that can enhance perspective and judgment through diversity in gender, age, background, geographic origin and professional experience (public, private, and non-profit sectors). Nomination of a candidate should not be based solely on these listed factors.

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The following chart summarizes the competencies currently represented on our Board; the details of each Trustee's competencies are included in each Trustee's profile.

Operating	x	x	x	x	x	x		x		x
Public company experience	x	x	x	x	x	x	x	x	x	x
Industry expertise	x		x	x		x		x		x
Financial literacy	x	x	x	x	x	x	x	x	x	x
Experience over several business cycles	x	x	x	x	x	x	x	x	x	x
	x	x	x	x		x	x	x	x	x

Capital markets expertise										
Investment expertise	x	x	x	x	x	x	x	x	x	x
Risk/crisis management	x	x	x	x	x	x	x	x	x	x
Accounting expertise	x		x				x	x	x	
Government/business conduct/legal	x	x	x	x	x	x	x		x	x
Sustainability experience	x	x								

Board Leadership Structure

Our Board is deeply focused on our corporate governance practices. We value independent board oversight as an essential component of strong corporate performance to enhance shareholder value. All of our Trustees are independent, except our current and former Chief Executive Officers. In addition, all of the members of our Board's committees, except the Executive Committee, are independent.

Our Board of Trustees is responsible for selecting the Chairman of the Board and the CEO. The Board annually reviews its leadership structure. The Board has determined that the combined role of Chairman and CEO, alongside an active and independent Lead Trustee position, is currently the best structure for Vornado and its shareholders. In its review of our leadership structure, the Board considered the following:

Our current structure promotes clear lines of responsibility and accountability, while maintaining the Board's independence from management.

- Mr. Roth, our Chairman and CEO, is a well-seasoned leader with over 35 years of experience in building and leading our Company. He has effectively guided the Company through various real estate cycles and over a long period of increase in shareholder value. After considering the views expressed by our shareholders and other constituents, as well as the particular circumstances affecting the Company, the Board concluded he is the best person to serve as Chairman.

- Mr. Roth fulfills his responsibilities in chairing an independent board through close interaction with our Lead Trustee, Ms. Beinecke.

- The power and authority of our Lead Trustee role was increased in 2015 and 2017, see "Lead Trustee Role."

- The views expressed by shareholders through direct outreach and engagement.

- Our governance culture fosters open communication among the Lead Trustee, Chairman and other Trustees, which we believe is essential to developing an understanding of important issues, promoting appropriate oversight and encouraging frank discussion of key topics relevant to a complex and dynamic enterprise.

Lead Trustee Role

A Lead Trustee is elected annually by the independent Trustees. Ms. Beinecke was first elected by our independent Trustees to serve as Lead Trustee for a one-year term on March 16, 2016, and was most-recently reelected on February 8, 2018. When making the selection, the Board considered the attributes desired in a Lead Trustee, including being an effective communicator, having the ability to provide leadership and encourage open dialogue, having a relevant background and the ability to devote sufficient time and attention to the position.

Our Lead Trustee position has clearly defined duties and responsibilities, which are set forth in our Governance Guidelines. They include the following authorities and responsibilities:

- preside at all meetings of the Board at which the Chairman is not present;

- serve as liaison between the Chairman and the independent Trustees;

- approve, in consultation with the Chairman:

the schedule of Board meetings,

Board meeting agenda items,

materials sent in advance of Board meetings, including the quality, quantity, appropriateness and timeliness of such information;

ability to call meetings of the independent Trustees as necessary and appropriate;

participate in annual self-evaluations of the Board and its committees;

contribute to ongoing management succession and development planning;

participate in shareholder outreach, and be available for consultation and direct communication if requested by major shareholders; and

communicate shareholder feedback to the full Board.

As both Lead Trustee and Chair of the Corporate Governance and Nominating committee, Ms. Beinecke has been actively involved in governance-related discussions with our shareholders. As Lead Trustee, Ms. Beinecke has worked closely with our Chairman, Mr. Roth, to develop Board meeting agenda items and ensure sufficient time allocation to these items and has facilitated robust discussions regarding long-term strategy and shareholder value creation and talent retention and development.

The strong working relationships among the Lead Trustee, Chairman and other Trustees are supported by a board governance culture that fosters open communications among the members, both during meetings and in the intervals between meetings. Open communication is important to develop an understanding of issues, promote appropriate oversight, and encourage the frank discussion of matters essential to leading a complex and dynamic enterprise.

Board Refreshment

In December 2016, we welcomed a new member, Ms. Mandakini Puri, to our Board of Trustees. We are committed to ongoing Board refreshment and will continue to actively pursue qualified, diverse candidates for election to our Board.

Committees of the Board of Trustees

The Board has an Executive Committee, an Audit Committee, a Compensation Committee and a Corporate Governance and Nominating Committee. Other than the Executive Committee, each committee is comprised solely of independent Trustees.

The Board held 10 meetings during 2017. Each Trustee attended at least 75% of the combined total of the meetings of the Board and all committees on which he or she served during 2017.

In addition to full meetings of the Board, our non-management Trustees met seven times in sessions without members of management present. Ms. Beinecke, as Lead Trustee, acted as presiding member during these non-management sessions. We do not have a policy with regard to Trustees' attendance at Annual Meetings of Shareholders. All of our Trustees serving at the time of our 2017 Annual Meeting of Shareholders were present at the meeting.

Executive Committee

The Executive Committee possesses and may exercise certain powers of the Board in the direction of the management of the business and affairs of the Company. The Executive Committee consists of three members, Mr. Roth, Ms. Beinecke and Mr. Wight. Mr. Roth is the Chairman of the Executive Committee. The Executive Committee did not meet in 2017.

Audit Committee

The Audit Committee held five meetings during 2017. The members of the Audit Committee are Dr. West, as Chairman, Ms. Puri and Mr. Tisch. Until May 18, 2017, Mr. Kogod served on our Audit Committee. Ms. Puri joined our Audit Committee on that date.

The Board has adopted a written Audit Committee Charter, which sets forth the membership requirements and responsibilities of the Audit Committee, among other matters. The Audit Committee Charter is available on our website (www.vno.com/governance/committee-charters). The Board has determined that all existing Audit Committee members meet the NYSE and SEC standards for independence and the NYSE standards for financial literacy. Previously our Board had determined that Mr. Kogod had met those standards during his service on the Audit Committee.

The Board has determined that each of Dr. West, Ms. Puri and Mr. Tisch is an "audit committee financial expert," as defined by SEC Regulation S-K (and thus has three such experts serving on its Audit Committee)

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and that each of such persons also meets the NYSE standards for financial management expertise. The Board reached this conclusion based on the relevant experience of each of Dr. West, Ms. Puri and Mr. Tisch, including as described above under "Biographies of our Trustees."

The Audit Committee's purposes are to: (i) assist the Board in its oversight of (a) the integrity of our financial statements, (b) our compliance with legal and regulatory requirements, (c) the independent registered public accounting firm's qualifications and independence and (d) the performance of the independent registered public accounting firm and the Company's internal audit function; and (ii) prepare an Audit Committee report as required by the SEC for inclusion in our annual proxy statement. The function of the Audit Committee is oversight. The management of the Company is responsible for the preparation, presentation and integrity of our financial statements and for the effectiveness of internal control over financial reporting. Management is responsible for maintaining appropriate accounting and financial reporting principles and policies and internal controls and procedures that provide for compliance with accounting standards and applicable laws and regulations. The independent registered public accounting firm is responsible for planning and carrying out a proper audit of our annual financial statements prior to the filing of our Annual Report on Form 10-K, reviewing our quarterly financial statements prior to the filing of each of our Quarterly Reports on Form 10-Q and annually auditing the effectiveness of internal control over financial reporting and other procedures. Persons interested in contacting our Audit Committee members with regard to accounting, auditing or financial concerns will find information on how to do so on our website (www.vno.com/governance/confidential-board-contact).

Compensation Committee

The Compensation Committee is responsible for establishing the terms of the compensation of the executive officers and the granting and administration of awards under the Company's omnibus share plans. The committee, which held five meetings during 2017, consists of the following members: Mr. Lynne, as Chairman, Dr. West and Mr. Tisch. All members of the Compensation Committee have been determined by the Board to be independent. The Board has adopted a written Compensation Committee Charter which is available on our website (www.vno.com/governance/committee-charters).

Compensation decisions for our executive officers are made by the Compensation Committee. Decisions regarding compensation of other employees are made by our Chief Executive Officer and are subject to review and approval of the Compensation Committee. Compensation decisions for our Trustees are made by the Compensation Committee and/or the full Board.

The agenda for meetings of the Compensation Committee is determined by its Chairman with the assistance of the Company's Secretary and/or other members of management. Compensation Committee meetings are attended from time to time by members of management at the invitation of the Compensation Committee. The Compensation Committee's Chairman reports the committee's determination of executive compensation to the Board. The Compensation Committee has authority under its charter to elect, retain and approve fees for, and to terminate the engagement of, compensation consultants, special counsel or other experts or consultants as it deems appropriate to assist in the fulfillment of its responsibilities. The Compensation Committee reviews the total fees paid by us to outside consultants to ensure that such consultants maintain their objectivity and independence when rendering advice to the committee. The Compensation Committee may receive advice from compensation consultants, special counsel or other experts or consultants only after consideration of relevant factors related to their fees, services and potential conflicts of interests, as outlined in the Compensation Committee's Charter.

The Compensation Committee may, in its discretion, delegate all or a portion of its duties and responsibilities to a subcommittee of the committee. In particular, the Compensation Committee may delegate the approval of certain transactions to a subcommittee consisting solely of

members of the committee who are (i) "Non-Employee Directors" for the purposes of SEC Rule 16b-3; and (ii) "outside directors" for the purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended. Currently, all members of the Compensation Committee meet these criteria.

See "Compensation Discussion and Analysis" below for a discussion of the role of executive officers in determining or recommending compensation for our executive officers. We have also included under

"Compensation Discussion and Analysis" a discussion of the role of compensation consultants in determining or recommending the amount or form of executive or Trustee compensation.

Corporate Governance and Nominating Committee

The Corporate Governance and Nominating Committee, which met once during 2017, consists of Ms. Beinecke, as Chair, and Messrs. Mandelbaum and Wight. In addition, during 2017, members of the Corporate Governance and Nominating Committee led several discussions of governance matters with the full Board. Further, in the past year Ms. Beinecke (and members of management) met in person or telephonically with several significant shareholders to discuss our governance practices. Each of Ms. Beinecke and Messrs. Mandelbaum and Wight has been determined by the Board to be independent. The Board has adopted a written Corporate Governance and Nominating Committee Charter, which is available on our website (www.vno.com/governance/committee-charters). The committee's responsibilities include the selection of potential candidates for the Board and the development and review of our governance principles. It also reviews Trustee compensation and benefits, and oversees annual self-evaluations of the Board and its committees. The committee also makes recommendations to the Board concerning the structure and membership of the other Board committees as well as management succession plans. The committee selects and evaluates candidates for the Board in accordance with the criteria set out in the Company's Corporate Governance Guidelines and as are set forth below. The committee is then responsible for recommending to the Board a slate of candidates for Trustee positions for the Board's approval. Generally, candidates for a position as a member of the Board are suggested by existing Board members; however, the Corporate Governance and Nominating Committee will consider shareholder recommendations for candidates for the Board sent to the Corporate Governance and Nominating Committee, c/o Alan J. Rice, Secretary, Vornado Realty Trust, 888 Seventh Avenue, New York, New York 10019, and will evaluate any such recommendations using the criteria set forth in the Corporate Governance and Nominating Committee Charter and our Corporate Governance Guidelines.

The Board's Role in Risk Oversight

While day-to-day risk management is primarily the responsibility of the Company's senior management team, the Board of Trustees is responsible for the overall supervision of the Company's risk management activities. The Board's oversight of the material risks faced by our Company occurs at both the full Board level and at the committee level. The Board's role in the Company's risk oversight process includes receiving reports from members of senior management on areas of material risk to the Company, including operational, financial, legal and regulatory, strategic and reputational risks. The full Board (or the appropriate committee in the case of risks that are under the purview of a particular committee) receives these reports from the appropriate "risk owner" within our organization or in connection with other management-prepared presentations of risk to enable the Board (or committee, as applicable) to understand our risk identification, risk management and risk mitigation strategies. By "risk owner," we mean that person or group of persons who is or are primarily responsible for overseeing a particular risk. As part of its charter, the Audit Committee discusses our policies with respect to risk assessment and risk management and reports to the full Board its conclusions as a partial basis for further discussion by the full Board. This enables the Board and the applicable committees to coordinate the risk oversight role, particularly with respect to risk interrelationships. In addition to the Board's review of risks applicable to the Company generally, the Board conducts regular strategic and personnel reviews.

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Persons wishing to contact the independent members of the Board should call (866) 537-4644. A recording of each phone call to this number will be sent to one independent member of the Audit Committee as well as to a member of management who may respond to any such call if the caller provides a return number. This means of contact should not be used for solicitations or communications with us of a general nature. Information on how to contact us generally is available on our website (www.vno.com).

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PRINCIPAL SECURITY HOLDERS

The following table lists the number of Shares and Units beneficially owned, as of March 19, 2018, by (i) each person who holds more than a 5% interest in the Company or our operating partnership, Vornado Realty L.P., a Delaware limited partnership (the "Operating Partnership"), (ii) Trustees of the Company, (iii) the executive officers of the Company defined as "Named Executive Officers" in "Executive Compensation" below, and (iv) the Trustees and all current executive officers of the Company as a group. Unless otherwise specified, "Units" are Class A units of limited partnership interest of our Operating Partnership and other classes of units convertible into Class A units. The Company's ownership of Units is not reflected in the table but is described in footnotes (1) and (2).

Name of Beneficial Owner	Address of Beneficial Owner	Number of Shares and Units Beneficially Owned(1)(2)	Percent of All Shares(1)(2)(3)	Percent of All Shares and Units(1)(2)(4)
Named Executive Officers and Trustees				
Steven Roth(5)(6)(7)(8)	(9)	9,969,470	5.20%	4.89%
David Mandelbaum(5)(8)(10)	(9)	8,960,622	4.71%	4.42%
Russell B. Wight, Jr.(5)(8)(11)	(9)	5,959,379	3.13%	2.94%
Michael D. Fascitelli(7)(8)(12)	(9)	2,921,370	1.53%	1.43%
Robert P. Kogod(8)(13)	(9)	2,062,086	1.08%	1.02%
David R. Greenbaum(7)(8)(14)	(9)	825,123	*	*
Joseph Macnow(7)(8)(15)	(9)	316,526	*	*
Michael J. Franco(7)(8)	(9)	257,708	*	*
Mitchell N. Schear(8)	(9)	186,441	*	*
Daniel R. Tisch(8)(16)	(9)	62,950	*	*
Richard R. West(8)(17)	(9)	36,733	*	*
Candace K. Beinecke(8)	(9)	13,520	*	*
Stephen Theriot(8)	(9)	8,231	*	*
Michael Lynne(8)	(9)	13,312	*	*
Mandakini Puri(8)	(9)	0	*	*
All Trustees and executive officers as a group (15 persons)(7)(8)	(9)	20,586,375	10.56%	10.04%
Other Beneficial Owners				
		30,211,674	15.89%	14.90%

The Vanguard Group, Inc.[18]	100 Vanguard Blvd Malvern, PA 19355			
Vanguard Specialized Funds Vanguard REIT Index Fund[19]	100 Vanguard Blvd Malvern, PA 19355	11,481,507	6.04%	5.66%
BlackRock, Inc.[20]	55 East 52nd Street New York, NY 10022	17,002,601	8.94%	8.38%
Norges Bank (The Central Bank of Norway)[21]	Bankplassen 2 PO Box 1179 Sentrum NO 0107 Oslo Norway	12,382,373	6.51%	6.11%
State Street Corporation[22]	One Lincoln Street Boston, MA 02111	9,703,831	5.10%	4.78%

* *Less than 1%.*

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(1)

Unless otherwise indicated, each person is the direct owner of, and has sole voting power and sole investment power with respect to, such Shares and Units. Numbers and percentages in the table are based on 190,167,582 Shares and 12,655,407 Units (other than Units held by the Company) outstanding as of March 19, 2018.

(2)

In April 1997, the Company transferred substantially all of its assets to the Operating Partnership. As a result, the Company conducts its business through, and substantially all of its interests in properties are held by, the Operating Partnership. The Company is the sole general partner of, and owned approximately 94% of the Units of, the Operating Partnership as of March 19, 2018 (one Unit for each Share outstanding). Generally, any time after one year from the date of issuance (or two years in the case of certain holders), holders of Units (other than the Company) have the right to have their Units redeemed in whole or in part by the Operating Partnership for cash equal to the fair market value, at the time of redemption, of one Share for each Unit redeemed or, at the option of the Company, cash or one Share for each Unit tendered, subject to customary anti-dilution provisions (the "Unit Redemption Right"). Holders of Units may be able to sell publicly Shares received upon the exercise of their Unit Redemption Right pursuant to registration rights agreements with the Company or otherwise pursuant to applicable securities laws and rules. The Company has filed registration statements with the SEC to register the issuance or resale of certain of the Shares issuable upon the exercise of the Unit Redemption Right.

(3)

The total number of Shares outstanding used in calculating this percentage assumes that all Shares that each person has the right to acquire within 60 days of the record date (pursuant to the exercise of options or upon the redemption or conversion of other Company or Operating Partnership securities for or into Shares) are deemed to be outstanding, but are not deemed to be outstanding for the purpose of computing the ownership percentage of any other person.

(4)

The total number of Shares and Units outstanding used in calculating this percentage assumes that all Shares and Units that each person has the right to acquire within 60 days of the record date (pursuant to the exercise of options or upon the redemption or conversion of Company or Operating Partnership securities for or into Shares or Units) are deemed to be outstanding, but are not deemed to be outstanding for the purpose of computing the ownership percentage of any other person.

(5)

Interstate, a partnership of which Messrs. Roth, Wight and Mandelbaum are, directly or indirectly, the three general partners, owns 5,503,548 Shares. These Shares are included in the total Shares and the percentage of class for each of them. Messrs. Roth, Wight and Mandelbaum share voting power and investment power with respect to these Shares.

(6)

Includes 3,873 Shares owned by the Daryl and Steven Roth Foundation over which Mr. Roth holds sole voting power and sole investment power. Does not include 37,299 Shares owned by Mr. Roth's spouse, as to which Mr. Roth disclaims any beneficial interest.

(7)

The number of Shares beneficially owned by the following persons includes the number of Shares indicated due to the vesting of options: Steven Roth 887,022; Michael D. Fascitelli 887,022; David R. Greenbaum 249,600; Joseph Macnow 199,144; Michael J. Franco 80,906; and all Trustees and executive officers as a group 2,303,694.

(8)

The number of Shares and Units (but not the number of Shares alone) beneficially owned by the following persons also includes the number of vested and redeemable restricted units (as described below) as indicated: Steven Roth 37,964; David Mandelbaum 8,236; Russell B. Wight, Jr. 8,236; Michael D. Fascitelli 3,898; Robert P. Kogod 8,236; David R. Greenbaum 20,991; Joseph Macnow 14,871; Michael J. Franco 18,054; Mitchell N. Schear 27,727; Daniel R. Tisch 7,950; Richard R. West 7,628; Candace K. Beinecke 10,777; Michael Lynne 11,040; Stephen W. Theriot 6,940; Mandakini Puri 0; and all Trustees and executive officers as a group 192,548. The number of Shares or Units beneficially owned by the following persons does not include the number of unvested or unredeemable restricted units as indicated: Steven Roth 186,512; David Mandelbaum 3,928; Russell B. Wight, Jr. 3,928; Michael D. Fascitelli 3,928; Robert P. Kogod 3,928; David R, Greenbaum 112,686; Joseph Macnow 77,144; Michael J. Franco 144,619; Mitchell N. Schear 17,163; Daniel R. Tisch 3,928; Richard R. West 3,928; Candace K. Beinecke 3,928; Michael Lynne 3,928; Stephen W. Theriot 11,952; Mandakini Puri 4,034; and all Trustees and executive officers as a group 585,534. The number of Shares or Units beneficially owned by

the following persons also includes the number of earned and vested Outperformance Plan Units ("OPP Units") as indicated: Steven Roth 72,258; David R. Greenbaum 19,298; Joseph Macnow 14,905; Michael J. Franco 18,437; Mitchell N. Schear 23,030; and all Trustees and executive officers as a group 147,928. The number of Shares or Units beneficially owned by the following persons does not include the number of unearned and unvested OPP Units as indicated: Steven Roth 667,576; David R. Greenbaum 224,204; Joseph Macnow 146,364; Michael J. Franco 208,838; Mitchell N. Schear 36,941; Stephen W. Theriot 29,285; and all Trustees and executive officers as a group 1,313,208.

(9)

The address of such person(s) is c/o Vornado Realty Trust, 888 Seventh Avenue, New York, New York 10019.

(10)

Of these Shares, 2,909,252 are held in a partnership of which the general partner is Mr. Mandelbaum and the limited partners are Mr. Mandelbaum and trusts for the benefit of Mr. Mandelbaum and his issue. In addition, 122,002 of these Shares are held in trusts for the benefit of Mr. Mandelbaum's grandchildren.

(11)

Includes 31,907 Shares owned by the Wight Foundation, over which Mr. Wight holds sole voting power and sole investment power. Does not include 20,575 Shares owned by the spouse and children of Mr. Wight as to which Mr. Wight disclaims any beneficial interest.

(12)

The number of Shares beneficially owned by Mr. Fascitelli includes 67,537 Shares held by a limited partnership and 105,191 Shares held in a limited liability company and does not include 3,150 Shares owned by his children as to which Mr. Fascitelli disclaims any beneficial interest.

(13)

Includes 1,099,796 Units held through corporations (individually or jointly with his spouse). Excludes 188,972 Shares/Units held by his spouse as to which Mr. Kogod disclaims any beneficial interest.

(14)

Includes 49,817 Units held by a limited liability company and 71,137 Shares held in grantor trusts and 30,700 Shares held in a family trust. Excludes 53,960 Shares and 3,040 Units held in trusts for the benefit of his children and 12,948 Units held by his spouse as to which Mr. Greenbaum disclaims any beneficial interest.

(15)

Excludes 4,884 Shares held by Mr. Macnow's spouse.

(16)

50,000 of these Shares are held through a foundation. Mr. Tisch maintains the right to control the vote and disposition of these Shares, but disclaims any pecuniary interest therein.

(17)

Dr. West and his wife own 3,231 of these Shares jointly. Also included are 1,953 Shares that may be acquired upon conversion of 1,000 Series A preferred shares of beneficial interest owned by Dr. West.

(18)
According to an amendment to Schedule 13G filed on February 9, 2018.

(19)
According to an amendment to Schedule 13G filed on February 2, 2018.

(20)
According to an amendment to Schedule 13G filed on January 23, 2018.

(21)
According to an amendment to Schedule 13 G filed on January 5, 2018.

(22)
According to a Schedule 13G filed on February 13, 2018.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act requires our Trustees and executive officers, and persons who own more than 10% of a registered class of our equity securities, to file reports of ownership of, and transactions in, certain classes of our equity securities with the SEC. Such Trustees, executive officers and 10% shareholders are also required to furnish us with copies of all Section 16(a) reports they file.

Based solely on a review of the Forms 3, 4 and 5, and any amendments thereto, furnished to us, and on written representations from certain reporting persons, we believe that the only filing deficiency under Section 16(a) by our trustees, executive officers and 10% shareholders in the year ended December 31, 2017 (or in 2018, prior to the mailing of this proxy statement) was one late filing by Ms. Candace K. Beinecke, a trustee, with regard to one transaction reported on a Form 4.

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COMPENSATION DISCUSSION AND ANALYSIS

Executive Summary

One of the fundamental objectives of our Compensation Committee is to ensure we provide a comprehensive compensation program that aids us in our efforts to attract, retain and appropriately reward a "best-in-class" executive management team. Such a program is critical to our achieving continued success in the highly-competitive commercial real estate industry. To better align the interests of our executive officers with those of our shareholders in a pay-for-performance setting, a significant portion of each executive's total compensation is variable through a combination of performance-based, short- and long-term incentives, which are described in more detail below.

The objectives of our executive compensation program are to:

- **Retain** a highly-experienced, "best-in-class" team of executives who have worked together as a team for a long period of time and who make major contributions to our success.
- **Attract** other highly-qualified executives to strengthen that team as needed.
- **Motivate** our executives to contribute to the achievement of company-wide and business-unit goals as well as to pursue individual goals.
- **Emphasize** equity-based incentives with long-term performance measurement periods and vesting conditions.
- **Align** the interests of executives with shareholders by linking payouts under annual incentives to performance measures that promote the creation of long-term shareholder value.
- **Achieve** an appropriate balance between risk and reward in our compensation programs that does not encourage excessive or inappropriate risk-taking.

Our executive compensation program is intended to reward the achievement of annual, long-term and strategic goals of both the Company and the individual executive. In order to achieve these intentions, our executive compensation program includes both fixed and variable components, as well as annual and long-term components, as described below. In particular, for our Chairman and Chief Executive Officer (or "CEO"), a majority of his compensation has been provided in the form of equity compensation. This equity compensation is awarded in a combination of "future performance" awards and/or time-based vesting provisions. The "future performance" awards made in 2018 (for 2017 performance) to

our CEO and other named executive officers (who are identified in the Summary Compensation Table below, the "Named Executive Officers" or "NEOs") are subject to multi-year TSR performance (OPP Units). In addition to our NEOs, our Executive Vice Presidents also received OPP Units in 2018 (for 2017 performance). "TSR" means our total shareholder return including dividends. The "future performance" requirements and/or time-based vesting provisions are designed to ensure that the value of our CEO's ultimately realized compensation is based on our share price performance, further aligning his interests with those of the Company and our shareholders. "OPP" means our outperformance plans and "OPP Units" are the awards granted under those plans. Awards made to executives other than our CEO and other Named Executive Officers in 2018 (for 2017 performance) were in the form of Appreciation-Only Long-Term Incentive Plan ("AO LTIP") grants. Executive Vice Presidents other than our NEO's received awards of both AO LTIP Units as well as OPP Units. AO LTIPs are awards of units in our Operating Partnership ("AO LTIP Units") that only have value if our share price at the time of conversion has increased from the share price on the date of grant.

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In addition to the goals and objectives of our compensation program, we are also committed to promoting appropriate governance that serves the interests of both our executive management team and shareholders. The table below highlights key features of our senior executive compensation and governance programs:

ü Directly align pay with performance as evidenced by our annual bonus program, which is formula-driven and our annual equity awards, which are tied to a material increase in our share price or absolute and relative TSR	× No excise tax gross-up provisions
ü Create significant alignment with shareholders and pay the majority of our executive compensation in the form of equity	× No guaranteed cash incentives, equity compensation or salary increases for Named Executive Officers
ü Maintain a cap on incentive compensation payments	× No excessive perquisites or benefits
ü Include robust hurdles in our Outperformance Plans based on absolute and relative TSR performance over a 3-year period to encourage long-term strategic planning	× No dividends or distributions on unearned equity awards subject to performance-based vesting (except limited distributions for tax purposes)
ü Mandatory hold periods. Members of senior management receive OPP Units with a 1-year holding period on earned awards after vesting	× No excessive retirement benefits
ü Robust equity ownership requirements CEO: 6x salary Other executives: 3x salary Trustees: 5x cash retainer	× No hedging or pledging of our equity securities
ü "Double trigger" acceleration of the vesting of any unvested equity awards in connection with a change of control	× No golden parachute for our CEO
ü Clawback policy	× No repricing of options
ü Annual compensation risk assessment	

ü Annual say-on-pay vote

ü Independent compensation consultant

As an indication of the positive response of our shareholders to our approach, at our 2017 Annual Meeting approximately 97% of the votes cast on our advisory vote on executive compensation were cast FOR our compensation program. Our Compensation Committee considered the results of the 2017 votes and has continued our compensation program design which it believes embodies shareholder-friendly practices.

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Business Highlights

During 2017, we continued our simplification and focusing strategy while recording strong financial results. For 2017, the following highlights were among the factors considered in the compensation decision process:

We made significant progress in furthering our simplification and focus strategy by completing the spin-off our Washington, D.C. segment and combining it with the management business and certain Washington, D.C. assets of The JBG Companies, a Washington D.C. real estate company. The combined company, JBG SMITH Properties (NYSE: JBGS), is the largest, market-leading, best-in-class, pure-play Washington, D.C. real estate company. Over the past several years, including the spin-off of Urban Edge Properties and the JBG SMITH Properties transaction, we have distributed $9.7 billion of assets to shareholders and exited $6.2 billion of non-core assets.

Net Operating Income ("NOI") at share increased by $37.3 million in 2017 over 2016. ("NOI" is our total revenues less our operating expenses. "NOI at share" means our NOI less NOI attributable to non-controlling interests in consolidated subsidiaries plus our share of NOI from partially owned entities.) Please refer to page 53 of the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for a reconciliation of NOI at share to the most comparable measure presented in accordance with Generally Accepted Accounting Principles applicable in the United States ("GAAP").

We achieved a 2.7% increase in same store NOI at share in 2017 over 2016 for our New York Office and Retail portfolio, theMART and our 555 California Street complex.

FFO, as adjusted, increased $30.4 million (or $0.14 per diluted share) in 2017 over 2016. "FFO" means our funds from operations as defined by the National Association of Real Estate Investment Trusts (NAREIT). "FFO, as adjusted," means our FFO as adjusted to exclude non-comparable gains and losses, impairments and non-real estate-related items. Please refer to Annex D to this Proxy Statement for a reconciliation of FFO, as adjusted, to the most comparable measure presented in accordance with GAAP. Please refer to page 33 of the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for a reconciliation of FFO to the most comparable measure presented in accordance with GAAP.

In 2017, we completed $4.8 billion of financings in 10 transactions.

Strong leasing performance in 2017. In our New York portfolio, we leased approximately 1,900,000 square feet of office space with strong mark-to-markets of 12.8% GAAP (as defined below) and 9.9% cash and 126,000 square feet of retail space with positive mark-to-markets of 26.5% GAAP and 25.4% cash.

In 2017, we made a $230 million upfront contribution for the acquisition of a 99-year leasehold of the Farley Post Office (a 50.1% interest).

Compensation Components

Our Named Executive Officers' compensation currently has three primary components:

- annual base salary;
- annual incentive awards, which include cash payments and/or awards of equity; and
- long-term equity incentives, which include restricted units and long-term incentive performance awards such as those awarded under our OPP.

The overall levels of compensation and the allocation among these components are determined annually by our Compensation Committee based upon an analysis of the Company's performance during the year and a review of the prevailing competitive market for executive talent in which we operate. Historically, a substantial majority of the total compensation for our CEO has been in the form of long-term equity awards, including performance-based awards subject to material performance thresholds such as those awarded under our OPP. These longer-term awards further the Compensation Committee's desire to directly align management and

shareholder interests and to provide incentives for each executive to successfully implement our long-term strategic goals.

The components of our compensation program for our senior management can be described as shown in the chart below. As noted below, each component of compensation is subject to a cap.

Base Salary	Cash	**Objective:** To provide an appropriate level of fixed compensation that will promote executive retention and recruitment **Key Features/Actions:** Fixed Compensation No executive receives in excess of $1,000,000 in salary (not including the effect of an "extra" pay period in 2016) NEO base salaries were unchanged for 2017 from 2016, nor have there been any increases in NEO base salary levels for the past several years
Annual Incentive Awards	Short-Term Variable Incentive Cash and Restricted Equity	**Objective:** To reward the achievement of financial and operating objectives based on the Compensation Committee's quantitative and qualitative assessment of the executive's contributions to that performance.

All or a portion of such award is typically given in restricted equity to further align executive's interests with those of shareholders.

Key Features/Actions:

Variable, short-term cash compensation and time-based equity awards

Funded upon the achievement of a threshold level of FFO, as adjusted

Aggregate pool capped at 1.25% of FFO, as adjusted

Allocated based on objective and subjective Company, business unit and individual performance

Committee can decide to pay out less than the full amount of the funded pool

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Annual Restricted Equity Grants	Long-Term Variable Incentive Equity	**Objective:** To align executive and shareholder interests, promote executive retention with multi-year vesting and provide stable long-term compensation. **Key Features/Actions:** Vest ratably over a four-year period Subject to a two-year holding period (regardless of vesting) and a "book-up" event (typically an increase in Share price) to have value
Outperformance Plan	Long-Term Variable Incentive At-Risk Equity	**Objective:** Designed to enhance the pay-for-performance structure and shareholder alignment, while motivating and rewarding senior management for superior TSR performance based on rigorous absolute and relative hurdles. **Key Features/Actions:** Only provides value to our executives upon the creation of meaningful shareholder value above specified hurdles over a three-year performance period

Subject to a maximum plan value of $35 million (for grants in 2018)

Under the Absolute TSR component, the Company must achieve a return in excess of 21% (or 7% per annum) for OPP Units to earn any value

Under the Relative TSR Component, the Company must achieve a return above an applicable industry index or indices (the "Index") for OPP Units to earn any value. The 2018 Plan used the SNL Office Index (70%) and the SNL Retail Index (30%).

Under the Relative TSR Component, to the extent the Company underperforms the Index by more than 600 basis points (or 200 basis points per annum), the Absolute TSR Component payout, if any, is reduced

The Relative TSR Component value is reduced if the Absolute TSR is below 3% per annum with a maximum payout of 50% of the awards if the Absolute TSR is less than 0%

Earned payouts are subject to two years of additional time-based vesting and an additional one year holding period following vesting

AO LTIP	Long-Term Variable Incentive At-Risk Equity	Appreciation-Only Long-Term Incentive Plan Units ("AO LTIP Units") are grants of interests in Vornado Realty L.P. which are intended to replicate the non-tax economic characteristics of option grants. AO LTIP Units are awarded with a strike price never lower than the price of one Share on the date of grant and are convertible into class A common units of Vornado Realty L.P. having a value equal to the excess of the Company's common share price on the date of conversion over the strike price. Awards of AO LTIP Units were made in 2018 (for 2017 performance) to executives other than NEOs. No NEOs have received awards of AO LTIPs. **Objective:** Designed to enhance our pay-for-performance structure and shareholder alignment, while motivating and rewarding senior management for superior share price performance **Key Features/Actions:**

Awards only have value upon conversion to the extent of an increase in the Company's share price

Vest over four years

Convertible for 10 years.

Subject to a two-year holding period (regardless of vesting) and a "book-up" event (typically an increase in Share price) to have value

Pay Mix

We believe that the executive management team's compensation should be appropriately at-risk and meaningfully dependent upon the achievement of robust and objective performance requirements. As illustrated below, approximately 91% of the Chief Executive Officer's total direct 2017 compensation and 77% of the other NEOs' total direct 2017 compensation is variable and subject to Company and individual performance results; as a subset of variable compensation, approximately 49% of our Chief Executive Officer's total direct 2017 compensation and 28% of the other NEOs' total direct 2017 compensation reflects pay at-risk based on prospective TSR performance.

Approach of this Compensation Discussion and Analysis Section

This Compensation Discussion and Analysis, or "CD&A," describes our executive compensation program for fiscal year 2017, certain elements of our 2018 program and the executive pay philosophy adhered to by our Compensation Committee in making executive compensation decisions. We use our executive compensation program to attract, retain and appropriately reward the members of our senior executive management team who lead our Company. In particular, this CD&A explains how the Compensation Committee made 2017 compensation decisions for our senior executive management team, including the following named executive officers (the "Named Executive Officers" or "NEOs"):

Steven Roth, Chairman and Chief Executive Officer (our "CEO")

Joseph Macnow, Chief Financial Officer and Chief Administrative Officer since February 15, 2017 and, prior to that, our Executive Vice President Finance and Chief Administrative Officer

Stephen W. Theriot, Chief Financial Officer until February 15, 2017 (when he became Chief Financial Officer of JBG SMITH which was a wholly owned subsidiary of the Company in Washington, D.C. until the consummation of the Washington Spin on July 18, 2017)

David R. Greenbaum, President, New York Division

Michael J. Franco, Executive Vice President and Chief Investment Officer

Mitchell N. Schear, President Vornado/Charles E. Smith Washington, D.C. Division until July 18, 2017 upon the consummation of the Washington Spin

Biographical information for our current Named Executive Officers is available in Part III to our Form 10-K for the year ended 2017, as filed with the SEC.

Under the rules and regulations of the SEC, each year the "Summary Compensation Table" must disclose the salary paid and cash bonus earned during that year. This table also requires disclosure of all equity-based awards in the year granted, even if that year is different than the year such compensation was earned. Because the equity we grant in any one year is awarded in recognition of performance in the prior year, the SEC's approach requires that we disclose our equity awards granted in respect of 2016 performance on the 2017 line in the Summary Compensation Table. Although we believe the most appropriate disclosure of our executive compensation would combine the annual cash compensation paid in 2017 (for instance) with the equity-based compensation granted in 2018 for 2017 performance, the rules and regulations do not permit that. In other words, we grant our annual incentives and equity-based compensation and make our compensation decisions retrospectively in the first quarter of a fiscal year for the actual performance of an executive in the just-then-completed prior year. To more accurately present our compensation information in line with how our decisions are actually made (as described in more detail below under " Comparison of 2015-2017 Total Direct Compensation"), the following discussion of compensation is with respect to both the annual incentive paid with respect to a stated year combined with the equity being granted following the close of that applicable year after performance has been assessed.

In addition, Mr. Franco's four-year employment agreement, entered into in 2014, provided that Mr. Franco would be entitled to a grant of $2,000,000 in face amount of restricted units (vesting in one year) on his three-year anniversary in 2017 (the "Employment Agreement Grant"). In January 2017, the Company granted Mr. Franco that equity and an additional grant of $3,000,000 in face amount of restricted units (vesting on the fourth anniversary of the date of grant) as consideration for superior service rendered in connection with the formation of JBG SMITH and the Washington Spin (the "Special Service Grant" and, together with the Employment Agreement Grant, the "Contract and Service Grants"). The aggregate Fair Value (as defined below) of these grants was $4,900,187. We view these grants to not be reflective of historic and on-going compensation levels and, consequently, in certain specified circumstances in this discussion, we have provided information in two formats: one including the impact of the Contract and Service Grants and one excluding that impact.

How Pay Aligns with Performance

2017 Performance Metrics Considered

For 2017 compensation, among the factors considered, both objectively and subjectively, were the changes in the Company's and the applicable division's operating and performance results during the year (NOI at share, FFO, as adjusted, and FFO), our TSR for the year, and the factors mentioned below. Increases or decreases in pay and allocations for 2017, 2016 and 2015 of various compensation elements to our Named Executive Officers were based, in part, upon the results of our review of these factors. "NOI" (or Net Operating Income) means total revenues less operating expenses. "FFO" means funds from operations as defined by the National Association of Real Estate Investment Trusts (NAREIT). "FFO, as adjusted," means FFO as adjusted to exclude non-comparable gains and losses, impairments and non-real estate-related items. Each of these metrics is provided in our regular annual and quarterly reports as well as reconciliations to the most comparable metric presented in accordance with Generally Accepted Accounting Principles applicable in the United States ("GAAP"). Although they are non-GAAP metrics, we use these metrics in making our compensation decisions because they facilitate meaningful comparisons in operating performance between periods and among our peers. TSR means our total shareholder return (including dividends) for a given period. Our NOI at share, FFO, as adjusted, FFO and TSR for 2017, 2016 and 2015 are presented below.

Metrics Considered

	2017	2016	2015
NOI at share	$1,401 million	$1,364 million	$1,342 million
FFO, as adjusted	$714 million	$683 million	$648 million
FFO	$718 million	$1,458 million	$1,039 million
1-year TSR	(4.3%)	7.3%	(3.9%)

Key Year-Over-Year Comparisons

Our TSR for 2017 was a negative 4.3% while that of the Office REIT was 5.3%. For 2017, we have kept flat our CEO's base compensation and annual incentive award (paid for 2017 in restricted units and for 2016 in cash) and the grant date value of restricted equity awards (as reflected in the "Total Direct Compensation Table" in this proxy statement). In addition, the total dollar value (after excluding the Contract and Service Grants made for 2016) of the long-term incentive awards for our CEO (and our other NEOs) was also kept flat for 2017. When making compensation decisions, we use the potentially earnable dollar amount of OPP awards ("Notional Amount") as one of the guideposts for year-over-year changes. We made changes to the terms of the 2018 OPP for 2017 performance and the 2017 OPP for 2016 performance to conform more closely to the standards for such plans adopted by other companies, including our peers. As a result of these changes and an increased volatility in our Share price, the accounting cost for a grant of the same Notional Amount of outperformance award increased for 2017 from 2016 and for 2016 from 2015. Consequently, while the aggregate actual salaries, bonuses, value of restricted equity awards and the Notional Amounts of outperformance awards were unchanged between 2017 and 2016 and between 2016 and 2015, the accounting cost for the aggregate compensation for our CEO and other NEOs increased by 0.8% for 2017 from 2016 and 2.5% for 2016 from 2015 (in each case not including the impact of the Contract and Service Grants). We also exclude from these comparisons the compensation of Messrs. Theriot and Schear as they only worked for the Company a partial year in 2017. Including the impact of the Contract and Service Grants, the accounting cost for the aggregate compensation for our CEO and other NEOs increased by 21.3% for 2016 from 2015.

Key Considerations

We operate in a highly competitive commercial real estate industry where we actively compete for business opportunities and executive talent. In determining annual incentive and long-term equity compensation levels earned for 2017, our Compensation Committee sought to find a balance among (i) appropriately rewarding the significant operational achievements by the Company during the year, as highlighted above, (ii) ensuring annual incentive, long-term equity and total compensation levels were in line with the prevailing competitive market and adequate to address our recruitment and retention needs and (iii) maintaining a balanced compensation program designed to foster alignment of management and shareholder interests in a manner that reflects evolving market "best practices" as well as views of our shareholders. No numerical weight is attributed to any one factor.

Alignment of Pay with Performance

Our Compensation Committee made compensation decisions for 2017 in line with our pay-for-performance philosophy.

- For each of our NEOs, base salaries were maintained at 2016 levels (with no change since 2008) to focus on the performance-oriented components of compensation.

- For our CEO, approximately 60% of his equity grants (other than grants in lieu of cash bonus which are described in footnote (2) of the Summary Compensation Table) were in the form of performance-based equity.

For our other NEOs, in the aggregate, approximately 60% of their equity grants (other than grants in lieu of cash bonus which are described in footnote (2) of the Summary Compensation Table) were in the form of performance-based equity.

To demonstrate the alignment of our pay with performance, the following chart illustrates how our CEO's Total Direct Compensation (as defined below under " Comparison of 2015-2017 Total Direct Compensation") compares to our FFO, as adjusted, for the applicable year.

How We Determine Executive Compensation

Our Compensation Committee determines compensation for our Named Executive Officers and is comprised of three independent trustees, Michael Lynne (Chairman), Daniel R. Tisch and Dr. Richard R. West. Our Compensation Committee exercises independent judgment with respect to executive compensation matters and administers our equity incentive programs, including reviewing and approving equity grants to our executives pursuant to our 2010 Omnibus Share Plan (as may be amended, the "2010 Plan"). Our Compensation Committee operates under a written charter adopted by the Board, a copy of which is available on our website (www.vno.com/governance/committee-charters).

We make our compensation decisions generally in the first quarter of a fiscal year. These decisions cover the prior year and are based on the prior year's performance by the Company and/or division or functional area and that of the applicable executive. In addition, in the first quarter of a fiscal year, we establish that year's performance threshold for our formula-based, short-term annual incentive program.

Our decisions on compensation for our Named Executive Officers are based primarily upon our assessment of each executive's leadership, operational performance and potential to enhance long-term shareholder value. For our CEO, this assessment is made by the Compensation Committee. For our other Named Executive Officers, this assessment is initially made by our CEO subject to the review and approval of the Compensation Committee. Our annual, short-term incentive program provides for a minimum performance threshold for, and a cap on, a bonus

pool comprising the aggregate dollar value of annual incentive awards we can make to our senior executive management team. We believe that this method, as opposed to an entirely formulaic method of determining compensation, provides us with the ability to adjust compensation based on a number of performance factors affecting an individual executive within a formulaic cap. It also has the added benefit of reducing the risk to the Company that could potentially be associated with entirely formulaic compensation decisions. Key factors we consider when making annual compensation decisions include: actual performance compared to the financial, operational and strategic goals established for the Company or the executive's operating division at the beginning of the year; the nature, scope and level of responsibilities; the contribution to the Company's financial results, particularly with respect to key metrics such as NOI at share, FFO, FFO, as adjusted, and TSR for the year; and the executive's contribution to the Company's commitment to corporate

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responsibility, including success in creating a culture of unyielding integrity and compliance with applicable laws and our ethics policies. These factors may be considered on an absolute and/or relative basis with respect to other companies or indices.

In determining individual pay levels and opportunities, we also consider each executive's current salary and prior-year bonus (or annual incentive award), the value of an executive's equity stake in the Company, and the appropriate balance between incentives for long-term and short-term performance and the compensation paid to the executive's peers within the Company. We also consider competitive market compensation paid by other companies that operate in our business or that compete for the same talent pool, such as other S&P 500 REITs, other real estate companies operating in our core markets and, in some cases, investment banking, hedge fund and private equity firms. However, we do not formulaically tie our compensation decisions to any particular range or level of total compensation paid to executives at these companies.

In addition, we encourage alignment with shareholders' interests through long-term, equity-based compensation. We apportion cash payments and equity incentive awards as we think best in order to provide the appropriate incentives to meet our compensation objectives both individually and in the aggregate for executives and other employees. The factors we consider in evaluating compensation for any particular year may not be applicable to determinations in other years. Typically, our Chairman and CEO receives a higher proportion of his compensation in the form of equity than other Named Executive Officers who, in turn, receive a higher proportion of their compensation in the form of equity than our other employees. This allocation is based on (1) the relative seniority of the applicable executives and (2) a determination that the applicable executives should have a greater proportion of their compensation in a form that further aligns their interests with those of shareholders. We regularly review our compensation program to determine whether we have given the proper incentives to our Named Executive Officers to deliver superior performance on a cost-effective basis and for them to continue their careers with us.

Role of the Corporate Governance and Nominating Committee, the Compensation Committee, and the CEO

The Corporate Governance and Nominating Committee of our Board is responsible for evaluating potential candidates for Chairman and CEO, and for overseeing the development of executive succession plans. The Compensation Committee of our Board (1) reviews and approves the compensation of our executive officers and other employees whose total cash compensation exceeds $200,000 per year, (2) oversees the administration and implementation of our incentive compensation and other equity-based awards, and (3) regularly evaluates the effectiveness of our overall executive compensation program.

As part of this responsibility, the Compensation Committee oversees the design, development and implementation of the compensation program for our CEO and our other Named Executive Officers. The Compensation Committee evaluates the performance of our CEO and sets his compensation. Our CEO and the Compensation Committee together assess the performance of our other senior executives and determine their compensation, based on the initial recommendations of our CEO. The other Named Executive Officers do not play a role in determining their own compensation, other than discussing individual performance objectives with our CEO.

In support of these responsibilities, members of our senior executive management team, in conjunction with other senior executives, have the initial responsibility of reviewing the performance of the employees reporting to him or her and recommending compensation actions for such employees.

This process involves multiple meetings among our CEO, our Compensation Committee and our Compensation Committee's compensation consultant. Typically, in the third and fourth quarters of each year, these parties meet to discuss and establish an overall level of compensation

for the year and the base compensation for the following year. For 2017, as has been our historical practice, our CEO obtained individual recommendations from division heads as to compensation levels for those persons reporting to the division heads. These recommendations are discussed among our CEO and the division heads prior to a recommendation being presented to the Compensation Committee. For our senior executive management team, other than our CEO, recommendations are prepared based upon discussions among the Compensation Committee and our CEO. These recommendations are based upon our objectives described above and may

include factors such as information obtained from compensation consultants. Our CEO discusses these recommendations with our other senior executives in one-on-one meetings. After these discussions, certain allocations or other aspects of compensation may be revised to some degree and the revised recommendations are presented to the Compensation Committee for discussion and review and, ultimately, through a continued process, approval. The compensation of our CEO is determined in accordance with a similar process involving direct discussions among the Compensation Committee, our CEO and the Compensation Committee's compensation consultants.

Role of Compensation Consultants

Our Compensation Committee has retained Willis Towers Watson Public Limited Company ("Willis Towers Watson") as its independent compensation consulting firm to provide the Compensation Committee with relevant data concerning the marketplace and our peer group as well as its own independent analysis and recommendations concerning executive compensation. Willis Towers Watson regularly participates in Compensation Committee meetings. Our Compensation Committee has the authority to set Willis Towers Watson's compensation and to replace Willis Towers Watson as its independent outside compensation consultant or hire additional consultants at any time. In addition, prior to the 2016 merger of Towers Watson & Co. with Willis Group, Willis Group had provided us with insurance-related services including services to our captive insurance company. Willis Towers Watson has continued to provide us with such insurance-related services and, in 2017, we paid Willis Towers Watson approximately $740,500 in fees for such services. In 2015, in light of the then anticipated merger of Towers Watson & Co. and Willis Group, the Compensation Committee assessed the independence of Willis Towers Watson pursuant to SEC rules (including Item 407(e)(3)(iv) of Regulation S-K) and the NYSE listing standards and concluded that no conflict of interest existed that would prevent Willis Towers Watson from independently advising the Compensation Committee. In particular, the Compensation Committee considered a presentation it received from Willis Towers Watson that described Willis Towers Watson's policies and procedures to prevent or mitigate conflicts of interest. The Compensation Committee also reviewed and was satisfied that there were no business or personal relationships between members of the Compensation Committee and the individuals at Willis Towers Watson supporting the Compensation Committee. The Compensation Committee considered that Willis Towers Watson reports directly to the Chair of the Compensation Committee and that the Compensation Committee has the authority to set Willis Towers Watson's compensation and to replace Willis Towers Watson as its independent outside compensation consultant or hire additional consultants at any time. Finally, the Compensation Committee considered other factors relevant to Willis Towers Watson's independence from management, including all of the factors set forth in the NYSE listing standards. The Compensation Committee regularly assesses the independence of its compensation consultants.

For 2017 compensation decisions, Willis Towers Watson prepared, among other reports, an analysis of compensation levels and performance at the following companies that it identified as peer companies within the context of the executive pay philosophy of the Compensation Committee: American Tower Corporation; Boston Properties, Inc.; CBRE Group, Inc.; Equity Residential; General Growth Properties, Inc.; HCP, Inc.; Host Hotels & Resorts, Inc.; Kimco Realty Corporation; ProLogis; Public Storage; Simon Property Group, Inc.; SL Green Realty Corp.; Welltower, Inc.; and Ventas, Inc. Our Compensation Committee has elected to use the foregoing executive compensation peer group, as the competitive landscape in which we compete for investment capital and executive talent is comprised of other publicly-traded REITs as well as real estate operating companies. Additionally, as many of our competitors in the markets in which we operate, particularly with respect to our New York division, are asset managers not structured as REITs and private entities such as real estate opportunity funds, sovereign wealth funds and pension funds, among others, our Compensation Committee, from time to time has also considered compensation levels and trends among our non-public competitors as obtained from surveys and other proprietary data sources.

Consistent with prior years, the Compensation Committee reviewed and discussed the analyses prepared by Willis Towers Watson, and determined that the analyses were useful in indicating that the compensation opportunities awarded to executive officers are in line with the

prevailing competitive market. Furthermore, realized awards duly reflect the performance of the Company and the shareholder value created.

From time to time, the Company also engages the services of FTI Consulting, Inc., as a compensation consultant, to provide assistance with gathering and presenting third-party data used in determining industry-or market-specific results.

Analysis of Risk Associated with Our Executive Compensation Program

Our Compensation Committee has discussed the concept of risk as it relates to our executive compensation program and the Compensation Committee does not believe our executive compensation program encourages excessive or inappropriate risk-taking for the reasons stated below.

We structure our pay to consist of both fixed and variable compensation. The fixed portion (base salary) of compensation is designed to provide a base level of income regardless of our financial or share price performance.

The variable portions of compensation (annual incentive and equity) are designed to encourage and reward both short- and long-term corporate performance. For short-term performance, annual incentives are awarded based on the formulaic funding of our annual incentive pool and assessments of performance during the prior year. For long-term performance, our options, restricted shares, restricted units, AO LTIPs and awards under our OPP generally vest over three, four or five years. Awards of options, AO LTIPs Units or OPP Units only have value if our Share price increases over time. Awards of restricted units only have an ability to be redeemed for Shares if our Share price increases over time. Awards of restricted shares only increase in value if our Share price increases over time. Awards of AO LTIPs and of restricted units require a two-year holding period (regardless of vesting). Furthermore, with regard to grants of OPP awards made since 2013, we require our Named Executive Officers to hold the equity received with respect to earned and vested awards for one additional year after they have vested. We believe that these variable elements of compensation are a sufficient percentage of total compensation to provide incentives to executives to produce superior short- and long-term corporate results, while the fixed element is also sufficiently high that the executives are not encouraged to take unnecessary or excessive risks in doing so. We and our Compensation Committee also believe that the mix of formulaic criteria and a non-formulaic evaluation of historic performance provides an incentive for our executives to produce superior performance without the distorting effects of providing a pre-determinable compensation award based on the performance of only one division or business unit or upon other results that may not reflect the long- or short-term results of the Company as a whole.

As demonstrated above, our executive compensation program is structured to achieve its objectives by (i) providing incentives to our Named Executive Officers to manage the Company for the creation of long-term shareholder value, (ii) avoiding the type of disproportionately large, short-term incentives that could encourage our Named Executive Officers to take risks that may not be in the Company's long-term interests, (iii) requiring our Named Executive Officers to maintain a significant investment in the Company and (iv) evaluating annually an array of performance criteria in determining executive compensation rather than focusing on a singular metric that may encourage unnecessary risk-taking. We believe this combination of factors encourages our Named Executive Officers to manage the Company prudently.

Elements of Our Compensation Program

Our Named Executive Officers' compensation currently has three primary components:

annual base salary;

annual incentive awards, which include cash payments and/or awards of equity; and

long-term equity incentives, which may include restricted units, stock options and long-term incentive performance unit awards such as those awarded under our OPP.

The overall levels of compensation and the allocation among these components are determined annually by our Compensation Committee based upon an analysis of the Company's performance during the year and a review of the prevailing competitive market for executive talent in which we operate. Historically, a substantial majority of the total compensation for our CEO has been in the form of long-term equity awards, including performance-based awards subject to performance thresholds such as those awarded under our OPP. These longer-term awards further the Compensation Committee's desire to directly align management and shareholder interests and to provide incentives for each executive to successfully implement our long-term strategic goals.

Annual Base Salary

Base salaries for our Named Executive Officers are established based on the scope of their responsibilities, taking into account the compensation paid by other companies for similar positions as well as salaries paid to the executives' peers within the Company and any applicable employment agreement. In accordance with our pay-for-performance philosophy, we structure an executive's annual base salary to be a relatively low percentage of total compensation. There were no increases in our Named Executive Officers' base salary levels for 2017 over that of 2016 (not including the impact of an extra pay period in 2016), nor have there been any increases in our Named Executive Officers' base salary levels for the past several years.

Annual Incentive Awards

Our Compensation Committee has established an annual short-term incentive program for the senior executive management team that formulaically ties a maximum award pool to achieving an FFO, as adjusted, performance threshold. The Company views and, we believe our shareholders view, FFO, as adjusted, as one of the key operating metrics within the REIT industry and, we believe, a primary driver of long-term TSR performance. Under our annual compensation program, members of our senior executive management team, including all of our Named Executive Officers, will have the ability to earn annual cash incentive payments and/or equity awards if and only if the Company achieves FFO, as adjusted, of at least 80% or more of the prior year's FFO, as adjusted. In the event that the Company fails to achieve FFO, as adjusted, of 80% or more of the prior year's FFO, as adjusted, no incentive payments would be earned or paid under the program. Moreover, even if the Company does achieve the stipulated FFO, as adjusted, performance requirement under the annual incentive program, the Compensation Committee always retains the right, consistent with best practices, to elect to reduce or make no payments under the program. Our Compensation Committee has elected to use FFO, as adjusted, as the primary metric for our annual incentive award rather than total FFO. FFO, as adjusted, 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 Compensation Committee believes it provides a better metric than total FFO for assessing management's performance for the year.

Aggregate incentive awards earned under the annual short-term incentive program by our senior executive management team are subject to a cap of 1.25% of FFO, as adjusted, earned by the Company for the year, with individual award allocations under the program determined by the Compensation Committee based on an assessment of individual and overall performance. Performance criteria evaluated by the Compensation Committee when determining individual incentive awards under the annual incentive program, assuming the Company has achieved the required FFO, as adjusted, performance threshold necessary for our senior executive management team to be eligible to earn incentive awards under the program, will include, among others, the following:

TSR, both on an absolute basis and relative to the performance of the peer group and the REIT industry;

Leasing performance and occupancy levels;

Capital markets performance and maintenance of a strong balance sheet;

- Same store NOI at share;
- Implementation and achievement of goals, including expense control and adherence to budget; and
- Achievement of business unit and/or departmental objectives.

Any awards earned under the annual incentive program are payable in cash and/or equity awards, generally in the first quarter of each year for the prior year's performance.

Long-Term Equity Incentives

Compensation is typically awarded to our Named Executive Officers in the form of long-term equity incentives issued under our 2010 Plan through performance-based equity awards such as those that may be earned under our OPP and future out-performance plans, grants of stock options and restricted units. The granting of equity awards links a Named Executive Officer's compensation directly to the performance of our Share price. We believe this encourages our NEOs to make business decisions with an ownership mentality.

OPP Awards. Our OPP was developed with the guidance and input of FTI Consulting, Inc. (a compensation consultant retained by the Company) and Willis Towers Watson. These performance-based awards are earned over a three-year period, which is then followed by back-end vesting requirements (during years three, four and five) to act as a retention device and provide a strong incentive to the executives to increase shareholder value long after they performed the services for which the equity awards were initially granted. In particular, the awards provide for immediate cancellation if the executive voluntarily leaves or is terminated for cause (and, in either case, such person is no longer providing services to the Company or any of its affiliates as an employee, trustee or otherwise), excluding certain outstanding awards held by retirement eligible executives and employees above the age of 65 (or above the age of 60 with at least 20 years of service to the Company). Furthermore, we require our executive officers (as defined in accordance with SEC rules, "Executives") to hold the equity received with respect to earned and vested awards for one additional year after they have vested.

Our OPP is designed to provide compensation in a "pay-for-performance" structure. Awards under the OPP are a class of units (collectively referred to as "OPP Units") of the Company's Operating Partnership, Vornado Realty L.P., issued under our 2010 Plan. If the specific performance objectives of the OPP are achieved, the earned OPP Units become convertible into Class A common units of the Operating Partnership (and ultimately into Shares) following vesting, and their value fluctuates with changes in the value of our Shares. If the performance objectives are not met, the OPP Units are cancelled. Generally, unvested OPP Units are forfeited if the executive leaves the Company, except that OPP Units vest automatically on death. OPP Units are intended to also provide recipients with better income tax attributes than grants of options. With regard to awards under our OPP, participants have the opportunity to earn compensation payable in the form of equity if and only if we outperform a predetermined TSR and/or outperform the market with respect to relative TSR over a three-year performance period as determined at the end of the third year. Specifically, awards under our OPP may potentially be earned if the Company (i) achieves a TSR above that of an applicable industry index or indices over a three-year performance period (the "Relative Component"), and/or (ii) achieves a TSR level greater than 21% (over the three-year performance period) (the "Absolute Component"). For the 2018 Plan, we used a combination of the SNL Office Index (70%) and the SNL Retail Index (30%). For the 2017 OPP Plan, we used the SNL REIT Index. To the extent awards would be

earned under the Absolute Component but the Company underperforms the Index by more than a specified margin, such awards earned under the Absolute Component would be reduced based on the degree to which the Company underperforms the Index. In certain circumstances, if the Company outperforms the Index, but awards would not otherwise be earned under the Absolute Component, awards may still be earned under the Relative Component. Moreover, to the extent awards would otherwise be earned under the Relative Component but the Company fails to achieve at least a 3% per annum absolute TSR level, such awards earned under the Relative Component would be reduced based on the Company's absolute TSR performance. For the 2018 OPP, if the TSR is less than 0% the maximum payout is 50% of the total award regardless of relative performance. If the designated performance objectives are achieved, OPP Units are also subject to time-based vesting requirements. This creates, in the aggregate, up to a five-year retention period (plus the additional one-year holding period for Executives) with respect to participants in the OPP. Even after achieving the performance thresholds, during the remaining two

years until full vesting (plus the additional one-year holding period for Executives), holders will continue to bear the same Share price and total return risk as our shareholders and be subject to the same "book-up" requirements as apply to Restricted Units and which are described below. Dividend payments 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. Furthermore, if the maximum award is earned (through any combination of the Relative and Absolute Components), the number of units actually awarded will be based on the Share price during a 120-day measurement period preceding the end of the three-year performance period which causes the award to be fully earned. On January 10, 2018, our 2015 OPP Plan expired unearned.

The following charts show some of the key components of our awards of OPP Units and, for illustration purposes only (and not as a projection of actual performance), present our most recent awards (made in 2018) as if they had been fully earned at March 15, 2021.

Earning and Vesting of OPP Awards

In addition, senior executive officers, including all our NEOs, are required to hold their earned and vested OPP Units for one year following vesting.

Allocation of Wealth Created

On an absolute total shareholder return basis, our 2018 OPP is designed to award management with equity at the rate of 2% for every dollar of shareholder value created after returning the first 21% of value created to shareholders over a three-year performance period, subject to a $35 million cap (if the full amount of the authorized OPP pool is actually awarded). While the earning of OPP awards not only requires performance under the Absolute Component, but also the Relative Component, for presentation purposes the table below is simplified to present only the results derived under the Absolute Component. Using this simplified format, the table below illustrates the rate at which OPP unitholders will share in the increases in shareholder value above the OPP initial share price along with shareholders and other unitholders.

Growth in TSR

Participation Percentage in Shareholder Value Creation under Terms of the 2018 OPP for:	**0% to 21%**	**21% to 35%**	**Above 35%**
Shareholders and unit holders	100%	98%	100%
OPP Unitholders	0%	2%	0%

AO LTIPs. "AO LTIP Units" are limited partnership units in Vornado Realty L.P. that are intended to produce for holders a substantially similar non-tax economic effect as that of options. AO LTIP Units are issued under the Company's Appreciation-Only Long-Term Incentive Plan. This plan was adopted in January 2018. None of our Named Executive Officers has been awarded AO LTIPs. AO LTIP Units are potentially convertible into

Class A Units of Vornado Realty L.P. if certain tax book-up events occur, and then are ultimately redeemable for Company Common Shares or cash at the option of the Company. AO LTIP Units are issued under our 2010 Plan and may be convertible for up to a period of 10 years from the date of grant. Awards of AO LTIP Units granted to date vest ratably over four years from the date of grant. On the date of grant, each AO LTIP Unit is awarded with a specified strike price. That strike price will be equal to or greater than the price for one Share on the date of grant. Each AO LTIP Unit, on exercise, will be converted into such number of Class A Units that have a value equal to the excess of the closing price per Share on the date of conversion on the New York Stock Exchange over the strike price. After a required two-year holding period, those Class A Units, in turn, may be redeemable for Shares. On January 12, 2018, we first granted AO LTIP Units to members of management other than our NEOs in lieu of OPP Units (except in certain instances) which they had received in prior years.

Stock Options. None of our Named Executive Officers was awarded stock options for 2017, 2016, or 2015 performance. The most recent stock option award to such executives was in 2011 for 2010 performance. Executives who do not receive AO LTIP or OPP awards may receive awards of stock options. Stock option awards issued under our 2010 Plan provide our executives the opportunity to purchase Shares at an exercise price determined on the date of grant. Historically, our stock option awards have either been in the form of at-the-money stock options, whereby the option exercise price is equal to the market price of Shares on the date of grant, or in the form of premium stock options, whereby the option exercise price is established at a level above the market price of Shares on the date of grant. In both instances, the market price of Shares must increase to a level above the option exercise price in order for the executives to achieve any value from their stock option awards. Generally, the stock options vest and become exercisable in equal annual installments over a four- or five-year period beginning one year after the date of grant, and remain exercisable for a period of ten years from the date of grant. Our 2010 Plan (i) prohibits the granting of in-the-money stock options and (ii) prohibits, without shareholder approval, the repricing of outstanding stock options that have fallen out of the money. Recipients of stock options do not receive any dividends paid on Shares on their outstanding option awards.

Restricted Shares and Units. "Restricted shares" are grants of Shares issued under our 2010 Plan that generally vest in three or four equal annual installments beginning approximately one year after the grant date. "Restricted units" are grants of limited partnership interests in Vornado Realty L.P., our operating partnership, through which we conduct substantially all of our business. These units also generally vest in three or four equal annual installments beginning approximately one year after the grant date and are exchangeable on a one-for-one basis into Vornado Realty L.P.'s Class A common units in certain circumstances. These circumstances principally include the requirement that Vornado Realty L.P. must have gone through certain tax "book-up" events whereby sufficient profits have been allocated to the restricted units so that they have the same capital account (and value) as Class A common units. In addition, there is a two-year holding requirement. Vornado Realty L.P.'s Class A common units can be redeemed for Shares on a one-for-one basis (or for the equivalent value in cash at the Company's option) with only limited restrictions, such as a 60-day waiting period between the time that a redemption notice is given and the date that Shares may be delivered. Restricted units are intended to also provide recipients with better income tax attributes than restricted shares and unlike option grants, grants of restricted units do not have a term at which they expire. During the restricted period, each restricted share or restricted unit entitles the recipient to receive payments from the Company equal to the dividends on one Share. Restricted equity awards further contribute in aligning management and shareholder interests, and the multi-year vesting requirements ranging from three to five years aid in our efforts to retain our executives and key employees over the long term. Further, our Compensation Committee believes restricted equity awards are a key component of a balanced equity compensation program, because incorporating time-based restricted equity awards into the equity compensation mix, as opposed to an equity compensation program comprised solely of awards subject to performance-based vesting requirements, ensures that a portion of each executive's equity compensation retains value even in a depressed market and provides executives with a baseline of value that lessens the likelihood that executives will take unreasonable risks to keep their market-based performance equity award vehicles "in the money."

Nonqualified Deferred Compensation Plans

We maintain two nonqualified deferred compensation plans, the Vornado Realty Trust Nonqualified Deferred Compensation Plan ("Plan I") and the Vornado Realty Trust Nonqualified Deferred Compensation Plan II ("Plan II"). Plan I and Plan II are substantially similar, except that Plan II, which applies to deferrals on and after January 1, 2005, is designed to comply with the deferred compensation restrictions of Section 409A of the Internal Revenue Code of 1986, as amended.

Employees having annual compensation of at least $200,000 are eligible to participate in Plan II, *provided that* they qualify as "accredited investors" under securities laws. Members of our Board of Trustees are also eligible to participate. To participate, an eligible individual must make an irrevocable election to defer at least $20,000 of his or her compensation (whether cash or equity) per year. Participant deferrals are always fully vested. The Company is permitted to make discretionary credits to the Plans on behalf of participants, but as of yet has not done so. Deferrals are credited with earnings based on the rate of return of specific security investments or various "benchmark funds" selected by the individual, some of which are based on the performance of the Company's securities.

Participants may elect to have their deferrals credited to a "Retirement Account" or a "Fixed Date Account." Retirement Accounts are generally payable following retirement or termination of employment. Fixed Date Accounts are generally payable at a time selected by the participant, which is at least two full calendar years after the year for which deferrals are made. Participants may elect to receive distributions as a lump sum or in the form of annual installments over no more than 10 years. In the event of a change of control of the Company, all accounts become immediately payable in a lump sum. Plan I also permits a participant to withdraw all or a portion of his or her account at any time, subject to a 10% withdrawal penalty.

Retirement and 401(k) Plans

We offer a 401(k) Retirement Plan to all of our employees in which we provide matching contributions (up to 75% of the statutory maximum but not more than 7.5% of cash compensation) that fully vest after five years of employment. We do not have any other retirement plan. Retirement plans are not a factor in our current compensation determinations.

Perquisites and Other Compensation

We provide our Named Executive Officers with certain perquisites that we believe are reasonable and in line with the prevailing competitive market. These perquisites include supplemental life insurance and an allowance for financial counseling and tax preparation services for certain Named Executive Officers. Additionally, due to the location of our corporate offices in New York City and the extensive business-related travel requirements of our Named Executive Officers, we provide certain of our Named Executive Officers with the use of a car and/or driver. Providing a car and driver allows these executive officers to use their travel time efficiently and productively for business purposes, including (i) telephonic meetings and (ii) visiting our properties and meeting with our tenants. Accordingly, we believe providing these benefits serves the best interests of our shareholders as it allows our executives to continue to focus on Company matters while traveling. While providing a car and driver does provide an incidental personal benefit to the executive, the cost of this personal benefit constitutes only a small percentage of the executive's total compensation. Nevertheless, the amounts disclosed in this proxy statement for car and driver costs include the entire value of the benefit, both business purpose and personal.

Equity Ownership Guidelines

In order to further foster the strong ownership culture among our senior executive management team and ensure the continued direct alignment of management and shareholder interests, and consistent with emerging corporate governance trends, we have adopted executive equity ownership guidelines requiring that our NEOs and other members of our senior executive management team maintain a minimum ownership level of Shares

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or related Company equity. The equity ownership requirements (comprised of Shares and certain securities convertible or redeemable for Shares) for our executives are as follows:

Chairman and CEO	6 times his annual base salary
All Other Executive Officers	3 times their annual base salaries

Executive officers have five years from the date of becoming an executive officer to satisfy the ownership requirement. All of our Named Executive Officers satisfy these guidelines.

We have also adopted equity ownership guidelines for our Board of Trustees. Under the equity ownership guidelines adopted for our Board of Trustees, all non-employee Trustees are required to maintain a minimum ownership level of Shares equal to at least five times their annual cash retainer. Non-employee Trustees have five years to satisfy the guidelines. All non-employee Trustees currently satisfy these guidelines or are expected to satisfy these guidelines within the prescribed period.

Comparison of 2015-2017 Total Direct Compensation

Under the rules and regulations of the SEC, each year the "Summary Compensation Table" must disclose the salary paid during that year, the annual incentive earned for that year and the equity-based, long-term incentive granted during that year, which for us represents the equity-based, long-term incentive award earned for the *prior* year. As discussed above, because the equity-based pay we award in the first quarter of each year (similar to the cash bonus paid in the first quarter of each year) was earned based on performance in the prior year, the SEC's approach prevents us from showing together all the pay salary, annual cash incentive and equity-based pay earned for any one year. In order to provide our shareholders with the aggregate amount of compensation *earned* by each Named Executive Officer for a given calendar year, we are including below a supplemental Total Direct Compensation Table. We believe the Total Direct Compensation Table enables a more meaningful year-over-year compensation comparison than the Summary Compensation Table presented later in this proxy statement. The Total Direct Compensation Table consists of (i) the actual salary paid for the year, (ii) the annual incentives awarded for the year and (iii) the annual grant date fair value of equity grants awarded for service and performance for the year, irrespective of when such amounts ultimately were granted, paid and/or vested. This table illustrates one of the analyses undertaken by our Compensation Committee in determining each element of our Named Executive Officers' compensation for the particular year in light of such executive's performance during the year. We also believe it demonstrates further the ongoing correlation between the executive's pay and overall Company performance.

The principal difference between the Total Direct Compensation Table and the Summary Compensation Table is that the Total Direct Compensation Table achieves "apples to apples" presentation of both cash and equity-based incentives by showing the value of equity awards in the year to which such grants relate, rather than the year in which such grants were made, as reflected in the Summary Compensation Table. Other companies may calculate Total Direct Compensation differently than we do.

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Direct Compensation Table

The Total Direct Compensation earned by our Named Executive Officers for the 2015-2017 period was as follows:

Name	Year	Salary(1)	Cash Incentive	Grant Date Fair Value of Restricted Unit Awards in Lieu of Cash Bonus	Grant Date Fair Value of Restricted Unit Awards as Long-Term Equity Compensation	Grant Date Fair Value of At-Risk, Multi-Year Performance-Based OPP Awards(2)	Total Direct Compensation(3)
Steven Roth	2017	$ 1,000,000		$ 950,055	$ 3,800,024	$ 5,613,559	**$ 11,363,638**
	2016	$ 1,038,462	$ 1,005,700		$ 3,800,082	$ 5,307,506	**$ 11,151,750**
	2015	$ 1,000,000	$ 1,000,000		$ 3,800,033	$ 5,050,847	**$ 10,850,880**
Joseph Macnow	2017	$ 1,000,000		$ 1,187,552	$ 831,306	$ 1,227,966	$ **4,246,824**
	2016	$ 1,038,462	$ 505,700	$ 712,522	$ 831,308	$ 1,161,017	**$ 4,249,009**
	2015	$ 1,000,000	$ 500,000	$ 712,578	$ 831,282	$ 1,104,873	**$ 4,148,733**
Stephen W. Theriot	2017	$ 557,692					$ **557,692**
	2016	$ 1,038,462	$ 255,700	$ 237,573	$ 285,009	$ 398,063	**$ 2,214,807**
	2015	$ 1,000,000	$ 250,000	$ 237,585	$ 285,013	$ 378,814	**$ 2,151,412**
David R. Greenbaum	2017	$ 1,000,000		$ 1,710,033	$ 1,282,525	$ 1,894,576	$ **5,887,134**
	2016	$ 1,038,462	$ 805,700	$ 950,095	$ 1,282,539	$ 1,791,283	**$ 5,868,079**
	2015	$ 1,000,000	$ 800,000	$ 950,074	$ 1,282,517	$ 1,704,661	**$ 5,737,252**
Michael J. Franco(4)	2017	$ 1,000,000	$ 750,000	$ 712,557	$ 1,187,552	$ 1,754,237	$ **5,404,346**
	2016	$ 1,038,462	$ 816,743	$ 712,522	$ 6,087,756	$ 1,658,596	**$ 10,314,079**
	2015	$ 1,000,000	$ 811,043	$ 712,578	$ 1,187,571	$ 1,578,390	**$ 5,289,582**
Mitchell N. Schear	2017	$ 561,538	$ 976,438				$ **1,537,976**

2016	$ 1,038,462	$ 1,805,700				**$ 2,844,162**
2015	$ 1,000,000	$ 800,000	$ 950,074	$ 688,819	$ 915,466	**$ 4,354,359**

(1)
Total base salary in 2016 is 1/26th more than 2017 and 2015 because 2016 had 27 bi-weekly pay periods as opposed to 26 bi-weekly pay periods in 2017 and 2015.

(2)
Represents the grant date fair value of each Named Executive Officer's allocation in 2017 under the OPP, which is a performance-based program under which participants may earn equity compensation awards if and only if certain absolute and/or relative TSR objectives are achieved over a three-year performance period.

(3)
Does not include the value of certain perquisites such as financial counseling and tax services, supplemental life insurance or automobile benefits provided to certain of our Named Executive Officers. The total value of these perquisites represents a de minimis component of total compensation.

(4)
In 2017 (for 2016 performance), Mr. Franco received two grants of restricted units (referred to elsewhere herein as the Contract and Service Grants) with an aggregate grant date Fair Value of $4,900,187.

Current Year Compensation Decisions

As explained above, we make our incentive compensation decisions generally in the first quarter of a fiscal year with respect to the prior year. In addition, in the first quarter of 2018, we established the 2018 performance thresholds for our formula-based short-term annual incentive program.

The compensation levels discussed in this Compensation Discussion and Analysis section are not directly comparable to the amounts presented in the Summary Compensation Table later in this proxy statement for the reasons discussed above under "How We Determine Executive Compensation" and "Comparison of 2015-2017 Total Direct Compensation."

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In addition, in the discussion below, when we discuss the "Fair Value" of equity awards, we refer to the "fair value" for such awards determined in accordance with applicable securities and accounting rules (excluding the impact of estimated forfeitures related to service-based vesting conditions). Fair Value is the method used for presenting values for equity awards in our "Summary Compensation Table" and elsewhere under "Executive Compensation." When we discuss the "Market Value" of equity awards we refer to values based on the market price of our Shares at the date of grant (the values considered by our Compensation Committee in making compensation decisions).

Total Compensation of Our CEO

For 2017, Mr. Roth's total compensation (with equity determined at Fair Value) was $11,363,638, compared to $11,151,750 in the prior year or a 1.9% increase. For 2016, Mr. Roth's total compensation (with equity determined at Fair Value) was $11,151,750, compared to $10,850,880 in the prior year or a 2.8% increase. However, as discussed earlier, the aggregate value for all of Mr. Roth's compensation other than OPP awards decreased by 1.6% in 2017 from 2016 and increased 0.1% in 2016 from 2015 and the total dollar value of the long-term incentive award potentially earnable (the "Notional Amount") of the OPP awards made to Mr. Roth for 2017 and 2016 was unchanged from 2015. Accordingly, the increase in compensation for Mr. Roth in 2017 from 2016 and in 2016 from 2015 was due primarily to an increase in the accounting cost for OPP awards with the same notional value. For 2015, Mr. Roth's total compensation (with equity determined at Fair Value) was $10,850,880, compared to $9,801,951 in the prior year or a 10.7% increase. Our one-year TSR for 2017 was -4.3%, 7.3% for 2016 and -3.9% for 2015.

Mr. Roth's salary, incentives and equity awards were based on an evaluation of those factors previously described and were approved by the Compensation Committee. Among the factors considered, both objective and subjective, were the strategic position of the Company, the changes in the Company's operating and performance metrics over the applicable period (NOI at share, FFO, as adjusted and FFO per Share), our TSR over the applicable period and the other factors previously described. These factors were considered as a whole and no numerical weight was attributed to any particular factor. The majority of Mr. Roth's compensation is in the form of equity to further align his interests with those of our shareholders.

Cash Compensation of Our CEO

Mr. Roth has served as our CEO since April 15, 2013. Mr. Roth's base salary of $1,000,000 was established in March 2001 and has remained unchanged since then. Mr. Roth's total cash compensation for 2017, 2016, and 2015 was $1,000,000, $2,044,162, and $2,000,000, respectively. The decrease in 2017 as compared to 2016 was due to Mr. Roth receiving for 2017 restricted units in lieu of a cash bonus. The increase in 2016 as compared to 2015 is due to 2016 having 27 bi-weekly pay periods as opposed to 26 bi-weekly pay periods in 2015.

Equity Compensation of Our CEO

Mr. Roth's long-term equity incentive compensation award for 2017 performance (granted in 2018) was 238,257 OPP Units and 73,122 restricted units (collectively having a Market Value of $10,613,641). The aggregate Fair Value at the date of grant of these OPP and restricted units was $10,363,638 and represents a 13.8% increase (a 3.4% increase if the restricted units awarded in lieu of cash bonus are not included) in the aggregate value of long-term equity grants compared to the prior year. Mr. Roth's long-term equity incentive compensation award for 2016 performance (granted in 2017) was 151,683 OPP Units and 38,293 restricted units (collectively having a Market Value of $9,307,593). The aggregate Fair Value at the date of grant of these OPP and restricted units was $9,107,588 and represents a 2.9% increase in the aggregate value of long-term equity grants of restricted and OPP Units compared to the prior year. The increase in the Fair Value of granted OPP Units for 2017 and 2016 primarily reflects increases in the accounting cost for such units. The Notional Amount of such grants has remained constant since

2014. For 2015 performance, Mr. Roth was granted (in 2016) 165,626 OPP Units and 43,025 restricted units (collectively having a Market Value of $9,050,881). The aggregate Fair Value at the date of grant of these OPP and restricted units was $8,850,880 and represents a

13.5% increase in the aggregate value of long-term equity grants of restricted and OPP Units compared to 2014.

Basis for Compensation of Other Named Executive Officers

For our other Named Executive Officers (Messrs. Macnow, Greenbaum, Franco, Schear and Theriot), such executive's salary, annual incentive and long-term equity awards were based on an evaluation of those factors previously described and were approved by the Compensation Committee. Among the factors considered, both objectively and subjectively, were the strategic position of the Company, the changes in the Company's operating and performance metrics over the applicable period (NOI at share, FFO, as adjusted, and FFO per Share), our TSR over the applicable period and the other factors previously mentioned. With regard to each of Messrs. Macnow and Theriot, we considered these factors as they apply to our Company as a whole as his responsibilities are company-wide. For Messrs. Greenbaum, Franco and Schear, we also considered these factors as they pertain to the division which such executive heads. Mr. Greenbaum is President New York Division, Mr. Franco is Executive Vice President Chief Investment Officer and Mr. Schear was President Vornado/Charles E. Smith Washington, D.C. Division. In all cases, these factors were considered as a whole and no numerical weight was attributed to any particular factor. In the aggregate, total compensation (with equity determined at Fair Value) awarded to these Named Executive Officers for 2017 decreased by 23.9% as compared to the prior year. In 2017, Mr. Franco received the Contract and Service Grants (two grants of restricted units with an aggregate Fair Value of $4,900,187). If the impact of the Contract and Service Grants is excluded, total compensation (with equity determined at Fair Value) awarded to these four Named Executive Officers for 2017 increased by 0.1% as compared to the prior year. We exclude from these comparisons the compensation of Messrs. Theriot and Schear as they only worked for the Company a partial year in 2017.

Other Compensation Policies and Practices

Equity Grant Practices

All of our equity-based compensation awards are made under our shareholder-approved 2010 Plan. The 2010 Plan provides that we are able to issue up to 6,000,000 Share equivalents with each award of a Share (or other securities that have the value equivalent to one Share when earned or vested) counting as one Share equivalent and each award of an option to acquire our Shares (or other securities that by their terms require the payment of an exercise price or deduction of a strike price) counting as one-half of a Share equivalent. Under the 2010 Plan, the exercise price of each stock option awarded must be (or must have been) no less than the average of the high and low price of our Shares on the New York Stock Exchange on the date granted by the Compensation Committee. The vast majority of our equity awards are determined and granted in the first quarter of each year at the same time as management and the Compensation Committee conclude their annual evaluation of the performance of our senior executive management team as a group and each executive individually. In addition and from time to time, additional equity awards may be granted in connection with new hires or promotions. We have never repriced options and our 2010 Plan does not permit repricing of options without shareholder approval.

Employment, Severance and Change of Control Agreements

We do, from time to time, enter into employment agreements with some members of our senior executive management team. Otherwise, our senior executive management team and other employees serve "at will." Except as may be provided in these employment agreements or pursuant to our compensation plans generally, we have not entered into any separate severance or change of control agreements. For those of our senior executive management team who have employment agreements, these agreements generally provide for a severance payment (for termination by

us without cause or by the executive with good reason (each as defined in the applicable employment agreement and further described below under "Employment Contracts")) and change of control payment (if employment is terminated following a change of control) in the range of one to three times the applicable executive's annual salary and incentive. Since 2012, the agreements evidencing awards under the 2010 Plan have provided for the satisfaction of a "double trigger" as a condition to the acceleration of the vesting of any unvested equity awards. These change of control arrangements are

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designed to compensate management in the event of a termination following a fundamental change in the Company, their employer, and to provide an incentive to these executives to continue with the Company at least through such time. Severance and change of control arrangements do not generally affect other compensation arrangements for a particular period. A more complete description of employment agreements, severance and change of control arrangements pertaining to the Named Executive Officers is set forth under "Employment Contracts" and "Severance and Change of Control Arrangements."

Tax Deductibility of Compensation

The tax efficiency of compensation is one of many factors that enter into the design of our compensation programs. We look at a combination of the rates at which our executives will be taxed and the value of any deduction that we may be entitled to when developing our approach to compensation. We believe that the limitations of Section 162(m) of the Internal Revenue Code (which limits the corporate tax deduction for certain executive officer compensation that exceeds $1 million a year) does not apply to most of the compensation we paid to our Named Executive Officers for 2017 and only a small portion of their compensation may not be deductible due to that limitation.

COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Board of Trustees of Vornado Realty Trust, a Maryland real estate investment trust (the "Company"), has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K of the Securities and Exchange Commission with management and, based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in the proxy statement and incorporated by reference in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The Compensation Committee of the Board of Trustees:

MICHAEL LYNNE
DANIEL R. TISCH
DR. RICHARD R. WEST

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EXECUTIVE COMPENSATION

The following table sets forth (in accordance with the reporting requirements of the SEC) the compensation of each of the Company's Chief Executive Officer, Chief Financial Officers and the three other most highly-compensated executive officers for 2017, 2016 and 2015 (the "Named Executive Officers" or "NEOs").

Summary Compensation Table

ame and Principal Position	Year	Salary ($)(1)	Cash Bonus ($)(2)	Restricted Share/Unit Awards ($)(3)	Option Awards ($)(3)	Non-Equity Incentive Plan Compensation ($)(4)	Changes in Pension Value and Non-qualified Deferred Compensation Earnings ($)	All Other Compensation ($)(5)	Total ($
teven Roth	2017	1,000,000		9,107,588				359,929	10,467,51
hairman and hief	2016	1,038,462	1,005,700	8,850,880				331,536	11,226,57
xecutive Officer Principal xecutive Officer)	2015	1,000,000	1,000,000	7,800,051		4,626		326,530	10,131,20
oseph Macnow	2017	1,000,000		2,704,847				359,240	4,064,08
hief Financial fficer	2016	1,038,462	505,700	2,648,733		4,857		372,711	4,570,46
Principal Financial fficer) from ebruary 15, 2017	2015	1,000,000	500,000	2,418,811				358,570	4,277,38
tephen W. Theriot	2017	557,692		920,645				22,525	1,500,86
hief Financial fficer	2016	1,038,462	255,700	901,412				23,873	2,219,44

Principal Financial)fficer) until ebruary 15, 2017	2015	1,000,000	250,000	822,573				23,873	2,096,44
David R. Greenbaum	2017	1,000,000		4,023,917			5,405	279,729	5,309,05
resident New York	2016	1,038,462	805,700	3,937,252				270,003	6,051,41
)ivision	2015	1,000,000	800,000	3,582,684				268,508	5,651,19
Michael J. Franco	2017	1,000,000	750,000	8,458,874				32,884	10,241,75
xecutive Vice	2016	1,038,462	816,743	3,478,539				33,346	5,367,09
resident Chief nvestment Officer ince May 21, 2015)	2015	1,000,000	811,043	3,150,084				32,884	4,994,01
Mitchell N. Schear	2017	561,538	976,438					5,155,772	6,693,74
resident Vornado/	2016	1,038,462	1,805,700	2,554,360				79,988	5,478,51
Charles E. Smith Vashington, D.C.)ivision until uly 18, 2017	2015	1,000,000	800,000	2,363,857				79,582	4,243,43

(1) *Total base salary in 2016 is 1/26th more than 2017 and 2015 because 2016 had 27 bi-weekly pay periods as opposed to 26 bi-weekly pay periods in 2017 and 2015.*

(2) *The information provided includes cash bonuses for services that are rendered in the year indicated and are awarded in the first quarter of the next succeeding year. None of Messrs. Roth, Macnow or Greenbaum received a cash bonus for 2017. In lieu of a 2017 cash bonus, Mr. Roth, Mr. Macnow and Mr. Greenbaum were awarded, on March 15, 2018, restricted units with a grant date fair value of $950,055, $1,187,552, and $1,710,033, respectively, which, pursuant to SEC rules and regulations, is not reflected in this table. In prior years, all or a portion of such NEO's cash bonus was paid in restricted units. On March 15, 2018, Mr. Franco also received restricted units with a grant date fair value of $712,557 in lieu of a portion of his 2017 cash bonus. Per his*

employment agreement, Mr. Franco received an additional bonus equal to the dividend equivalent with respect to an additional equity award of $2,000,000 that he received in January 2017. This amount was $0 in 2017, $61,043 in 2016, and $61,043 in 2015.

(3)
Information presented in this table includes the value of grants of Restricted Units in lieu of cash bonuses, Restricted Units and OPP Units made during the applicable period. Information presented in these columns reflects the aggregate grant date fair value of equity awards granted in the applicable fiscal year computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of these amounts are included in footnote 13 to our consolidated financial statements included in our Annual Report on Form 10-K (the "Form 10-K") for the applicable fiscal year as filed with the SEC. Pursuant to the rules and regulations of the SEC, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. Dividends or dividend equivalents are paid on both the vested and unvested portion of restricted share and restricted unit awards. In accordance with applicable SEC rules, amounts shown include the impact of bonuses paid in equity in the year actually granted. For the Named Executive Officers, the Restricted Share/Unit Awards set forth above reflect the grant of equity-based bonuses in lieu of cash in 2017, 2016, and 2015, respectively, in the following amounts: Mr. Roth $0, $0, and $0; Mr. Macnow $712,522, $712,578, and $712,546; Mr. Theriot $237,573, $237,585, and $237,555; Mr. Greenbaum $950,095, $950,074, and $950,101; Mr. Franco $712,522, $712,578, and $712,546; and Mr. Schear $0, $950,074, and $950,101.

(4)
Represents awards for long-term service with the Company.

(5)
See the All Other Compensation table for additional information.

All Other Compensation Table

The following table describes each component of the All Other Compensation column in the Summary Compensation Table.

Name	Year	Use of Car and Driver ($)(1)	Supplemental Life Insurance Premiums ($)	Reimbursement For Medical/ Dental Not Covered ($)	Severance ($)	Tax and Financial Planning Assistance Per Employment Contract ($)	Matching 401(k) Contribution ($)	Total ($)
Steven Roth	2017	297,319	44,610				18,000	359,929
	2016	272,290	41,246				18,000	331,536
	2015	261,724	46,806				18,000	326,530

Joseph Macnow	2017	181,302	144,938			15,000	18,000	359,240
	2016	200,147	139,564			15,000	18,000	372,711
	2015	187,805	137,765			15,000	18,000	358,570
Stephen W. Theriot	2017		4,525				18,000	22,525
	2016		5,873				18,000	23,873
	2015		5,873				18,000	23,873
David R. Greenbaum	2017	202,887	33,842	10,000		15,000	18,000	279,729
	2016	193,161	33,842	10,000		15,000	18,000	270,003
	2015	191,481	34,027	10,000		15,000	18,000	268,508
Michael J. Franco	2017	12,000	7,384				13,500	32,884
	2016	12,462	7,384				13,500	33,346
	2015	12,000	7,384				13,500	32,884
Mitchell N. Schear	2017	27,622	23,237	10,000	5,076,913(2)		18,000	5,155,772
	2016	28,751	23,237	10,000			18,000	79,988
	2015	28,345	23,237	10,000			18,000	79,582

(1) *For each applicable fiscal year, each of the Named Executive Officers (except Mr. Theriot) was provided with a car (or a car allowance) and (for Messrs. Roth, Macnow and Greenbaum) a driver. Each such Named Executive Officer has used the car and driver for both business and personal purposes and the amounts shown for such*

executive reflect the aggregate incremental cost to the Company for the car, driver and related expenses without allocating costs between business and personal uses. See also "Certain Other Transactions or Relationships" for additional information regarding certain of our Named Executive Officers.

(2) *Includes $438,462 for transition services provided to the Company.*

Grants of Plan-Based Awards in 2017

The following table lists all grants of plan-based awards to the Named Executive Officers made in 2017 and their grant date fair value.

		Estimated Future Payouts Under Equity Incentive Plan Awards[1]			All Other Stock Awards: Number of Units (#)[3]	Grant Date Fair Value of Awards ($)[4]
Name	**Grant Date**	**Threshold ($)**	**Target ($)[2]**	**Maximum ($)**		
Steven Roth	01/13/17		6,486,360	13,559,322		5,307,506
	01/13/17				38,293	3,800,082
Joseph Macnow	01/13/17		1,418,891	2,966,102		1,161,017
	01/13/17				15,557	1,543,830
Stephen W. Theriot	01/13/17		486,477	1,016,949		398,063
	01/13/17				5,266	522,582
David R. Greenbaum	01/13/17		2,189,146	4,576,271		1,791,283
	01/13/17				22,498	2,232,634
Michael J. Franco	01/13/17		2,026,987	4,237,288		1,658,596
	01/13/17				19,147	1,900,091
	01/10/17(5)				18,961	1,900,096
	01/13/17(6)				28,720	3,000,091
Mitchell N. Schear	01/13/17					
	01/13/17					

(1) *Amounts reflect awards granted under the 2017 OPP. The awards of OPP Units, if earned, vest ratably in the third, fourth and fifth year from the date of grant.*

(2)
Represents an estimated dollar value earned in achieving the target levels for the 2017 OPP.

(3)
The information presented in this column represents the number of restricted units that were granted to the Named Executive Officers. Restricted units are a separate class of units in Vornado Realty L.P. which will be convertible into Class A common units of Vornado Realty L.P. and will be ultimately redeemable for, at our option, cash or our Shares on a one-for-one basis. These restricted units vest ratably over four years. A portion of these grants (other than for Mr. Roth) represents the grant of restricted units in lieu of cash bonus. No options have been granted to the Named Executive Officers since 2011.

(4)
The amounts presented in this column represent the full grant date fair value of equity awards (calculated pursuant to FASB ASC Topic 718) granted to the Named Executive Officers in 2017. Pursuant to the rules and regulations of the SEC, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. The grant date fair value, including the impact of estimated forfeitures related to service-based vesting conditions, is the amount we would expense in our consolidated financial statements over the award's vesting schedule. For additional information on our value assumptions, refer to footnote 13 of our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC.

(5)
The amount represents consideration for superior service rendered in connection with the Washington Spin. This award is referred to in the Compensation Discussion and Analysis section as the "Special Service Grant."

(6)
The amount represents an award made in accordance with the terms of Mr. Franco's employment agreement and which vested on January 9, 2018. This award is referred to in the Compensation Discussion and Analysis section as the "Employment Agreement Grant."

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Outstanding Equity Awards at Year-End

The following tables summarize the number and value of equity awards held at December 31, 2017 and the aggregate option exercises in 2017 by, and restricted unit awards that vested in 2017 for, the Named Executive Officers. Pursuant to the terms of our omnibus share plans, the exercise price and number of Shares underlying options originally made at any date of grant may be adjusted to compensate the holder for special or extraordinary dividends that may be subsequently declared. The following table reflects such adjustments.

	Option Awards				Share and Unit Awards			
Name and Applicable Grant Date	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units That Have Not Vested (#)	Market Value of Shares or Units That Have Not Vested ($)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
Steven Roth								
1/13/17[1]					47,121	3,683,920	186,651	14,592,375
1/14/16[1]					39,708	3,104,371	203,808	15,933,709
1/14/15[1]					21,955	1,716,442	138,952	10,863,267
1/10/14[1]					91,693	7,168,559		
3/15/13[1]					33,398	2,611,056		
2/28/11[2]	187,868		66.49	2/27/21				
3/11/10[2]	285,453		52.64	3/11/20				
2/27/09[3]	413,701		24.52	2/27/19				
Joseph Macnow								
1/13/17[1]					19,143	1,496,600	40,830	3,192,089

1/14/16(1)				16,132	1,261,200	44,583	3,485,499	
1/14/15(1)				8,920	697,366	30,395	2,376,281	
1/10/14(1)				22,788	1,781,566			
3/15/13(1)				6,073	474,787			
2/28/11(2)	31,309	66.49	2/27/21					
						" style="width:01.72%;border-top:1pt none #D9D9D9 ;border-left:1pt none #D9D9D9 ;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9 ;height:17.25pt;padding:0pt;">		
3/11/10(2)	116,757	52.64	3/11/20				$ 7	$ 227

The following table shows the changes in other comprehensive income for the six months ended June 30, 2014 and 2013:

	For the six months ended June 30,					
	2014			2013		
(In thousands)	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax
Balance, beginning of period			$ (476)			$ 1,333
Unrealized holding gains (losses) on securities arising during the period	$ 1,171	$ 437	734	$ (1,499)	$ (615)	(884)
Less: Reclassification adjustment for gains on securities included in net income	378	127	251	334	112	222
Net unrealized gains (losses) on securities arising during the period	$ 793	$ 310	$ 483	$ (1,833)	$ (727)	$ (1,106)
Balance, end of period			$ 7			$ 227

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NOTE 6. Fair Value

Fair Value Measurement

The Company follows FASB ASC Topic 820, "Fair Value Measurement and Disclosures," which requires additional disclosures about the Company's assets and liabilities that are measured at fair value. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed as follows:

Level 1 Inputs

- Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain U.S. Treasury, U.S. Government and sponsored entity agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (i.e., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes U.S. Government and sponsored entity mortgage-backed securities, corporate debt securities and derivative contracts.

Level 3 Inputs

- Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
- These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair Value on a Recurring Basis

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis:

Securities Available for Sale

The fair value of available for sale ("AFS") securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers (Level 1). If listed prices or quotes are not available, fair value is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

As of June 30, 2014, the fair value of the Company's AFS securities portfolio was $68.7 million. Approximately 56 percent of the portfolio was made up of residential mortgage-backed securities, which had a fair value of $38.2 million at June 30, 2014. Approximately $37.0 million of the residential mortgage-backed securities are guaranteed by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC"). The underlying loans for these securities are residential mortgages that are geographically dispersed throughout the United States.

All of the Company’s AFS securities were classified as Level 2 assets at June 30, 2014. The valuation of AFS securities using Level 2 inputs was primarily determined using the market approach, which uses quoted prices for similar assets or liabilities in active markets and all other relevant information. It includes model pricing, defined as valuing securities based upon their relationship with other benchmark securities.

At December 31, 2013, the Company’s AFS securities included commercial mortgage-backed securities which were classified as Level 3 assets. For commercial mortgage-backed securities, the inputs used by either dealer market participants or an independent pricing service, may be derived from unobservable market information (Level 3 inputs). In these instances, management evaluates the appropriateness and quality of the assumptions and the resulting prices. In addition, management reviews the volume and level of activity for all AFS securities and attempts to identify transactions which may not be orderly or reflective of a significant level of activity and volume. For securities meeting these criteria, the quoted prices received from either market participants or an independent pricing service may be adjusted, as necessary, to estimate fair value and this results in fair values based on Level 3 inputs. In determining fair value, the Company utilizes unobservable inputs which reflect its own assumptions about the inputs that market participants would use in pricing each security. In

developing its assertion of market participant assumptions, the Company utilizes the best information that is both reasonable and available without undue cost and effort.

In calculating the fair value for AFS securities under Level 3, management prepared present value cash flow models for certain private label commercial mortgage-backed securities. Private label commercial mortgage-backed securities owned by the Bank are A1 and A2 tranche sequential structures and are currently paying principal. The cash flows for the commercial mortgage-backed securities incorporated the expected cash flow of each security adjusted for default rates, loss severities and prepayments of the individual loans collateralizing the security. The following table presents quantitative information about Level 3 inputs used to measure the fair value of commercial mortgage-backed securities at December 31, 2013:

December 31, 2013					
Valuation Technique	Unobservable Input	Range		Weighted Average	
Discounted Cash Flow	Prepayment rate	8 through 15	%	10.0	%
	Default rate	10 through 15	%	12.5	%
	Loss severity	10 through 25	%	18.0	%

Significant increases or decreases in any of the unobservable inputs in the table above in isolation would result in a significantly lower or higher fair value measurement of the securities. Generally, a change in the assumption used for the default rate is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

For the Level 3 available for sale private label commercial mortgage-backed securities, cash flow assumptions incorporate independent third party market participant data based on vintage year for each security. The discount rate utilized in determining the present value of cash flows for the commercial mortgage-backed securities was arrived at by combining the yield on orderly transactions for similar maturity government sponsored mortgage-backed securities with (i) the historical average risk premium of similar structured private label securities, (ii) a risk premium reflecting current market conditions, including liquidity risk and (iii) if applicable, a forecasted loss premium derived from the expected cash flows of each security. The estimated cash flows for each private label commercial mortgage-backed security are then discounted at the aforementioned effective rate to determine the fair value. The quoted prices received from either market participants or independent pricing services are weighted with the internal price estimate to determine the fair value of each instrument.

There were no changes in the inputs or methodologies used to determine fair value during the period ended June 30, 2014, as compared to the periods ended December 31, 2013 and June 30, 2013.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013:

	June 30, 2014			
(In thousands)	Level 1	Level 2	Level 3	Total
Securities available for sale:				
U.S. Government sponsored entities	$ -	$ 5,160	$ -	$ 5,160
State and political subdivisions	-	13,290	-	13,290
Residential mortgage-backed securities	-	38,197	-	38,197
Corporate and other securities	-	12,087	-	12,087
Total securities available for sale	$ -	$ 68,734	$ -	$ 68,734

	December 31, 2013			
(In thousands)	Level 1	Level 2	Level 3	Total
Securities available for sale:				
U.S. Government sponsored entities	$ -	$ 6,418	$ -	$ 6,418
State and political subdivisions	-	16,598	-	16,598
Residential mortgage-backed securities	-	44,389	-	44,389
Commercial mortgage-backed securities	-	-	888	888
Corporate and other securities	-	12,840	-	12,840
Total securities available for sale	$ -	$ 80,245	$ 888	$ 81,133

The following table summarizes changes in Level 3 assets during the three and six months ended June 30, 2014 and 2013, consisting of commercial mortgage-backed available for sale securities, measured at fair value on a recurring basis:

	For the three months ended June 30,		For the six ended June 30,	
(In thousands)	2014	2013	2014	2013
Commercial mortgage-backed securities:				
Balance, beginning of period	$ 499	$ 3,681	$ 888	$ 4,463
Payoffs	(342)	(32)	(714)	(566)
Principal paydowns	(153)	(2,041)	(173)	(2,256)
Total net losses included in:				
Other comprehensive income	(4)	(14)	(1)	(47)
Balance, end of period	$ -	$ 1,594	$ -	$ 1,594

There were no gains or losses (realized or unrealized) on Level 3 securities included in earnings for assets and liabilities held at June 30, 2014 or 2013.

Fair Value on a Nonrecurring Basis

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis:

Appraisal Policy

All appraisals must be performed in accordance with the Uniform Standards of Professional Appraisal Practice ("USPAP"). Appraisals are certified to the Company and performed by appraisers on the Company’s approved list of appraisers. Evaluations are completed by a person independent of Company management. The content of the appraisal depends on the complexity of the property. Appraisals are completed on a “retail value” and an “as is value”.

The Company requires current real estate appraisals on all loans that become OREO or in-substance foreclosure, loans that are classified substandard, doubtful or loss, or loans that are over $100,000 and nonperforming. Prior to each balance sheet date, the Company values impaired collateral-dependent loans and OREO based upon a third party appraisal, broker's price opinion, drive by appraisal, automated valuation model, updated market evaluation, or a combination of these methods. The amount is discounted for the decline in market real estate values (for original

appraisals), for any known damage or repair costs, and for selling and closing costs. The amount of the discount ranges from 10 to 25 percent and is dependent upon the method used to determine the original value. The original appraisal is generally used when a loan is first determined to be impaired. When applying the discount, the Company takes into consideration when the appraisal was performed, the collateral's location, the type of collateral, any known damage to the property and the type of business. Subsequent to entering impaired status and the Company determining that there is a collateral shortfall, the Company will generally, depending on the type of collateral, order a third party appraisal, broker's price opinion, automated valuation model or updated market evaluation. Subsequent to receiving the third party results, the Company will discount the value 8 to 10 percent for selling and closing costs.

Other Real Estate Owned ("OREO")

The fair value of OREO is determined using appraisals, which may be discounted based on management's review and changes in market conditions (Level 3 Inputs).

Impaired Collateral-Dependent Loans

The fair value of impaired collateral-dependent loans is derived in accordance with FASB ASC Topic 310, "Receivables." Fair value is determined based on the loan's observable market price or the fair value of the collateral. Partially charged-off loans are measured for impairment based upon an appraisal for collateral-dependant loans. When an updated appraisal is received for a nonperforming loan, the value on the appraisal is discounted in the manner discussed above. If there is a deficiency in the value after the Company applies these discounts, management applies a specific reserve and the loan remains in nonaccrual status. The receipt of an updated appraisal would not qualify as a reason to put a loan back into accruing status. The Company removes loans from nonaccrual status generally when the borrower makes six months of contractual payments and demonstrates the ability to service the debt going forward. Charge-offs are determined based upon the loss that management believes the Company will incur after evaluating collateral for impairment based upon the valuation methods described above and the ability of the borrower to pay any deficiency.

The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. At June 30, 2014 and December 31, 2013, the valuation allowance for impaired loans was $1.1 million.

The following tables present the assets and liabilities carried on the balance sheet by caption and by level within the hierarchy (as described above) as of June 30, 2014 and the fair value gains (losses) recognized during the three and six months ended June 30, 2014 and 2013:

(In thousands)	Fair value at June 30, 2014 Level 1	Level 2	Level 3	Total	Gains (losses) from fair value changes for the three months ended June 30, 2014	Gains (losses) from fair value changes for the six months ended June 30, 2014
Financial assets:						
OREO	$ -	$ -	$ 634	$ 634	$ (280)	$ (680)
Impaired collateral-dependent loans	-	-	1,771	1,771	(1)	-

(In thousands)	Fair value at June 30, 2013 Level 1	Level 2	Level 3	Total	Gains (losses) from fair value changes for the three months ended June 30, 2013	Gains (losses) from fair value changes for the six months ended June 30, 2013
Financial assets:						
OREO	$ -	$ -	$ 300	$ 300	$ -	$ (70)
Impaired collateral-dependent loans	-	-	5,970	5,970	(54)	268

Fair Value of Financial Instruments

FASB ASC Topic 825, “Financial Instruments,” requires the disclosure of the estimated fair value of certain financial instruments, including those financial instruments for which the Company did not elect the fair value option. These estimated fair values as of June 30, 2014 and December 31, 2013 have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop estimates of fair value. The estimates presented are not necessarily indicative of amounts the Company could realize in a current market exchange. The use of alternative market assumptions and estimation methodologies could have had a material effect on these estimates of fair value. The methodology for estimating the fair value of financial

assets and liabilities that are measured on a recurring or nonrecurring basis are discussed above. The following methods and assumptions were used to estimate the fair value of other financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents

For these short-term instruments, the carrying value is a reasonable estimate of fair value.

Securities Held to Maturity

The fair value of held to maturity ("HTM") securities is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

SBA Loans Held for Sale

The fair value of SBA loans held for sale is estimated by using a market approach that includes significant other observable inputs.

Loans

The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the interest rate risk inherent in the loan, except for previously discussed impaired loans.

Federal Home Loan Bank Stock

Federal Home Loan Bank stock is carried at cost. Carrying value approximates fair value based on the redemption provisions of the issues.

SBA Servicing Assets

SBA servicing assets do not trade in an active, open market with readily observable prices. The Company estimates the fair value of SBA servicing assets using discounted cash flow models incorporating numerous assumptions from the perspective of a market participant including market discount rates and prepayment speeds.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposit Liabilities

The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date (i.e. carrying value). The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using current market rates.

Borrowed Funds and Subordinated Debentures

The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.

Standby Letters of Credit

At June 30, 2014, the Bank had standby letters of credit outstanding of $1.4 million, consistent with December 31, 2013. The fair value of these commitments is nominal.

The table below presents the carrying amount and estimated fair values of the Company's financial instruments not previously presented as of June 30, 2014 and December 31, 2013:

(In thousands)	Fair value level	June 30, 2014 Carrying amount	June 30, 2014 Estimated fair value	December 31, 2013 Carrying amount	December 31, 2013 Estimated fair value
Financial assets:					
Cash and cash equivalents	Level 1	$ 95,338	$ 95,338	$ 99,404	$ 99,404
Securities held to maturity (1)	Level 2	21,736	21,591	26,381	25,549
SBA loans held for sale	Level 2	6,444	7,029	6,673	7,267
Loans, net of allowance for loan losses (2)	Level 2	689,587	678,871	658,887	645,582
Federal Home Loan Bank stock	Level 2	6,378	6,378	5,392	5,392
Servicing assets	Level 3	618	618	437	437
Accrued interest receivable	Level 2	3,283	3,283	3,272	3,272
Financial liabilities:					
Deposits	Level 2	728,083	728,507	738,698	738,337
Borrowed funds and subordinated debentures	Level 2	140,465	146,707	122,465	129,732
Accrued interest payable	Level 2	466	466	454	454

(1) Includes held to maturity commercial mortgage-backed securities that are considered Level 3. These securities had book values of $4.1 million and $6.8 million at June 30, 2014 and December 31, 2013, respectively, and market values of $3.8 million and $6.4 million at June 30, 2014 and December 31, 2013, respectively.

(2) Includes collateral-dependent impaired loans that are considered Level 3 and reported separately in the tables under the "Fair Value on a Nonrecurring Basis" heading. Collateral-dependent impaired loans, net of specific reserves totaled $1.8 million and $4.5 million at June 30, 2014 and December 31, 2013, respectively.

NOTE 7. Securities

This table provides the major components of securities available for sale ("AFS") and held to maturity ("HTM") at amortized cost and estimated fair value at June 30, 2014 and December 31, 2013:

	June 30, 2014				December 31, 2013			
(In thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale:								
U.S. Government sponsored entities	$ 5,349	$ -	$ (189)	$ 5,160	$ 6,723	$ 27	$ (332)	$ 6,418
State and political subdivisions	13,301	184	(195)	13,290	16,960	192	(554)	16,598
Residential mortgage-backed securities	37,742	671	(216)	38,197	44,168	696	(475)	44,389
Commercial mortgage-backed securities	-	-	-	-	887	2	(1)	888
Corporate and other securities	12,327	44	(284)	12,087	13,173	67	(400)	12,840
Total securities available for sale	$ 68,719	$ 899	$ (884)	$ 68,734	$ 81,911	$ 984	$ (1,762)	$ 81,133
Held to maturity:								
U.S. Government sponsored entities	$ 4,626	$ -	$ (254)	$ 4,372	$ 5,814	$ -	$ (460)	$ 5,354
State and political subdivisions	2,437	244	-	2,681	2,441	121	(17)	2,545
Residential mortgage-backed securities	9,636	206	(84)	9,758	10,395	145	(198)	10,342
Commercial mortgage-backed securities	4,055	-	(230)	3,825	6,750	87	(437)	6,400
Corporate and other securities	982	-	(27)	955	981	-	(73)	908
Total securities held to maturity	$ 21,736	$ 450	$ (595)	$ 21,591	$ 26,381	$ 353	$ (1,185)	$ 25,549

This table provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at June 30, 2014 is distributed by contractual maturity. Mortgage-backed securities and other securities, which may have principal prepayment provisions, are distributed based on contractual maturity. Expected maturities will differ materially from contractual maturities as a result of early prepayments and calls.

(In thousands, except percentages)	Within one year		After one through five years		After five through ten years		After ten years		Total carrying value	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale at fair value:										
U.S. Government sponsored entities	$ -	- %	$ 1,013	1.00 %	$ 964	2.05 %	$ 3,183	2.03 %	$ 5,160	1.83 %
State and political subdivisions	-	-	1,132	2.69	8,255	2.66	3,903	2.70	13,290	2.68
Residential mortgage-backed securities	-	-	2,123	1.61	2,652	1.91	33,422	2.85	38,197	2.71
Corporate and other securities	-	-	2,413	0.99	3,580	2.08	6,094	1.44	12,087	1.54
Total securities available for sale	$ -	- %	$ 6,681	1.47 %	$ 15,451	2.36 %	$ 46,602	2.60 %	$ 68,734	2.44 %
Held to maturity at cost:										
U.S. Government sponsored entities	$ -	- %	$ -	- %	$ -	- %	$ 4,626	1.97 %	$ 4,626	1.97 %
State and political subdivisions	326	0.75	-	-	-	-	2,111	4.71	2,437	4.18
Residential mortgage-backed securities	-	-	612	4.90	210	5.22	8,814	4.61	9,636	4.64
Commercial mortgage-backed securities	-	-	-	-	-	-	4,055	2.76	4,055	2.76
Corporate and other securities	-	-	-	-	982	2.95	-	-	982	2.95
Total securities held to maturity	$ 326	0.75 %	$ 612	4.90 %	$ 1,192	3.35 %	$ 19,606	3.61 %	$ 21,736	3.59 %

The fair value of securities with unrealized losses by length of time that the individual securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013 are as follows:

	June 30, 2014						
		Less than 12 months		12 months and greater		Total	
(In thousands, except number in a loss position)	Total number in a loss position	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss
Available for sale:							
U.S. Government sponsored entities	5	$ -	$ -	$ 5,126	$ (189)	$ 5,126	$ (189)
State and political subdivisions	10	-	-	6,001	(195)	6,001	(195)
Residential mortgage-backed securities	13	9,644	(46)	7,569	(170)	17,213	(216)
Corporate and other securities	8	3,063	(60)	3,758	(224)	6,821	(284)
Total temporarily impaired securities	36	$ 12,707	$ (106)	$ 22,454	$ (778)	$ 35,161	$ (884)
Held to maturity:							
U.S. Government sponsored entities	2	$ -	$ -	$ 4,372	$ (254)	$ 4,372	$ (254)
Residential mortgage-backed securities	4	914	(16)	2,901	(68)	3,815	(84)
Commercial mortgage-backed securities	2	-	-	3,825	(230)	3,825	(230)
Corporate and other securities	1	-	-	955	(27)	955	(27)
Total temporarily impaired securities	9	$ 914	$ (16)	$ 12,053	$ (579)	$ 12,967	$ (595)

	December 31, 2013						
		Less than 12 months		12 months and greater		Total	
(In thousands, except number in a loss position)	Total number in a loss position	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss
Available for sale:							
U.S. Government sponsored entities	5	$ 5,591	$ (332)	$ -	$ -	$ 5,591	$ (332)
State and political subdivisions	19	8,575	(453)	934	(101)	9,509	(554)
Residential mortgage-backed securities	13	13,226	(398)	1,474	(77)	14,700	(475)
Commercial mortgage-backed securities	3	368	(1)	-	-	368	(1)
Corporate and other securities	9	3,994	(105)	3,088	(295)	7,082	(400)
Total temporarily impaired securities	49	$ 31,754	$ (1,289)	$ 5,496	$ (473)	$ 37,250	$ (1,762)
Held to maturity:							
U.S. Government sponsored entities	3	$ 5,355	$ (460)	$ -	$ -	$ 5,355	$ (460)
State and political subdivisions	2	986	(17)	-	-	986	(17)

Residential mortgage-backed securities	7	6,333	(193)	114	(5)	6,447	(198)
Commercial mortgage-backed securities	2	3,668	(437)	-	-	3,668	(437)
Corporate and other securities	1	907	(73)	-	-	907	(73)
Total temporarily impaired securities	15	$ 17,249	$ (1,180)	$ 114	$ (5)	$ 17,363	$ (1,185)

Unrealized Losses

The unrealized losses in each of the categories presented in the tables above are discussed in the paragraphs that follow:

U.S. government sponsored entities and state and political subdivision securities: The unrealized losses on investments in these types of securities were caused by the increase in interest rate spreads or the increase in interest rates at the long end of the Treasury curve. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not consider these investments to be other-than temporarily impaired as of June 30, 2014. There was no impairment on these securities at December 31, 2013.

Residential and commercial mortgage-backed securities: The unrealized losses on investments in mortgage-backed securities were caused by increases in interest rate spreads or the increase in interest rates at the long end of the Treasury curve. The majority of contractual cash flows of these securities are guaranteed by Fannie Mae, Ginnie Mae and the Federal Home Loan Mortgage Corporation. It is expected that the securities would not be settled at a price significantly less than the par value of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not consider these investments to be other-than-temporarily impaired as of June 30, 2014 or December 31, 2013.

Corporate and other securities: Included in this category are corporate debt securities, Community Reinvestment Act ("CRA") investments, asset-backed securities, and one trust preferred security. The unrealized losses on corporate debt securities were due to widening credit spreads or the increase in interest rates at the long end of the Treasury curve and the unrealized losses on CRA investments were caused by decreases in the market prices of the shares. The Company evaluated the prospects of the issuers and forecasted a recovery period; and as a result determined it did not consider these investments to be other-than-temporarily impaired as of June 30, 2014 or December 31, 2013. The unrealized loss on the trust preferred security was caused by an inactive trading market and changes in market credit spreads. At June 30, 2014 and December 31, 2013, this category consisted of one single-issuer trust preferred security. The contractual terms do not allow the security to be settled at a price less than the par value. Because the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, which may be at maturity, the Company did not consider this security to be other-than-temporarily impaired as of June 30, 2014 or December 31, 2013.

Realized Gains and Losses

Gross realized gains (losses) on securities for the three and six months ended June 30, 2014 and 2013 are detailed in the table below:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Available for sale:				
Realized gains	$ 271	$ 108	$ 385	$ 338
Realized losses	(3)	-	(7)	(4)
Total securities available for sale	268	108	378	334
Held to maturity:				
Realized gains	-	-	-	-
Realized losses	-	-	-	-
Total securities held to maturity	-	-	-	-
Net gains on sales of securities	$ 268	$ 108	$ 378	$ 334

The net realized gains are included in noninterest income in the Consolidated Statements of Income as net security gains. For the three and six months ended June 30, 2014, there were gross realized gains of $271 thousand and $385 thousand, respectively. For the three and six months ended June 30, 2014, there were gross realized losses of $3 thousand and $7 thousand, respectively The net realized gains during 2014 were a result of the following:

- For the six months ended June 30, 2014, the Company sold approximately $15.5 million in book value of available for sale municipal securities, mortgage-backed securities, asset-backed securities, and corporate bonds, resulting in pre-tax gains of approximately $385 thousand.

For the three and six months ended June 30, 2013, there were gross realized gains of $108 thousand and $338 thousand, respectively. There were no realized losses during the second quarter of 2013 and gross realized losses of $4 thousand in the first quarter. The net realized gains during 2013 were a result of the following:

- For the six months ended June 30, 2013, the Company sold approximately $9.1 million in book value of available for sale asset-backed securities and corporate bonds, resulting in pre-tax gains of approximately $338 thousand.

Pledged Securities

Securities with a carrying value of $61.9 million and $74.5 million at June 30, 2014 and December 31, 2013, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law. Included in these figures was $18.5 million and $19.9 million pledged against municipal deposits at June 30, 2014 and December 31, 2013, respectively.

Note 8. Loans

The following table sets forth the classification of loans by class, including unearned fees, deferred costs and excluding the allowance for loan losses as of June 30, 2014 and December 31, 2013:

(In thousands)	June 30, 2014	December 31, 2013
SBA loans held for investment	$ 46,890	$ 48,918
SBA 504 loans	34,452	31,564
Commercial loans		
Commercial other	37,536	37,611
Commercial real estate	326,231	317,471
Commercial real estate construction	12,209	8,258
Residential mortgage loans	196,184	182,067
Consumer loans		
Home equity	47,784	43,704
Consumer other	1,159	2,435
Total loans held for investment	$ 702,445	$ 672,028
SBA loans held for sale	6,444	6,673
Total loans	$ 708,889	$ 678,701

Loans are made to individuals as well as commercial entities. Specific loan terms vary as to interest rate, repayment, and collateral requirements based on the type of loan requested and the credit worthiness of the prospective borrower. Credit risk tends to be geographically concentrated in that a majority of the loan customers are located in the markets serviced by the Bank. As a preferred SBA lender, a portion of the SBA portfolio is to borrowers outside the Company’s lending area. However, during late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and/or property type. A description of the Company's different loan segments follows:

SBA Loans: SBA 7(a) loans, on which the SBA has historically provided guarantees of up to 90 percent of the principal balance, are considered a higher risk loan product for the Company than its other loan products. The guaranteed portion of the Company’s SBA loans is generally sold in the secondary market with the nonguaranteed portion held in the portfolio as a loan held for investment. SBA loans are for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. Loans are guaranteed by the businesses' major owners. SBA loans are made based primarily on the historical and projected cash

flow of the business and secondarily on the underlying collateral provided.

SBA 504 Loans: The SBA 504 program consists of real estate backed commercial mortgages where the Company has the first mortgage and the SBA has the second mortgage on the property. SBA 504 loans are made based primarily on the historical and projected cash flow of the business and secondarily on the underlying collateral provided. Generally, the Company has a 50 percent loan to value ratio on SBA 504 program loans at origination.

Commercial Loans: Commercial credit is extended primarily to middle market and small business customers. Commercial loans are generally made in the Company's market place for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. Loans will generally be guaranteed in full or for a meaningful amount by the businesses' major owners. Commercial loans are made based primarily on the historical and projected cash flow of the business and secondarily on the underlying collateral provided.

Residential Mortgage and Consumer Loans: The Company originates mortgage and consumer loans including principally residential real estate and home equity lines and loans. Each loan type is evaluated on debt to income, type of collateral and loan to collateral value, credit history and Company relationship with the borrower.

Inherent in the lending function is credit risk, which is the possibility a borrower may not perform in accordance with the contractual terms of their loan. A borrower's inability to pay their obligations according to the contractual terms can create the risk of past due loans and, ultimately, credit losses, especially on collateral deficient loans. The Company minimizes its credit risk by loan diversification and adhering to credit administration policies and procedures. Due diligence on loans begins when we initiate contact regarding a loan with a borrower. Documentation, including a borrower's credit history, materials establishing the value and liquidity of potential collateral, the purpose of the loan, the source of funds for repayment of the loan, and other factors, are analyzed before a loan is submitted for approval. The loan portfolio is then subject to on-going internal reviews for credit quality, as well as independent credit reviews by an outside firm.

The Company's extension of credit is governed by the Credit Risk Policy which was established to control the quality of the Company's loans. These policies and procedures are reviewed and approved by the Board of Directors on a regular basis.

Credit Ratings

For SBA 7(a), SBA 504 and commercial loans, management uses internally assigned risk ratings as the best indicator of credit quality. A loan's internal risk rating is updated at least annually and more frequently if circumstances warrant a change in risk rating. The Company uses a 1 through 10 loan grading system that follows regulatorily accepted definitions.

Pass: Risk ratings of 1 through 6 are used for loans that are performing, as they meet, and are expected to continue to meet, all of the terms and conditions set forth in the original loan documentation, and are generally current on principal and interest payments. These performing loans are termed "Pass".

Special Mention: Criticized loans are assigned a risk rating of 7 and termed "Special Mention", as the borrowers exhibit potential credit weaknesses or downward trends deserving management's close attention. If not checked or corrected, these trends will weaken the Bank's collateral and position. While potentially weak, these borrowers are currently marginally acceptable and no loss of interest or principal is anticipated. As a result, special mention assets do not expose an institution to sufficient risk to warrant adverse classification. Included in "Special Mention" could be turnaround situations, such as borrowers with deteriorating trends beyond one year, borrowers in startup or deteriorating industries, or borrowers with a poor market share in an average industry. "Special Mention" loans may include an element of asset quality, financial flexibility, or below average management. Management and ownership may have limited depth or experience. Regulatory agencies have agreed on a consistent definition of "Special Mention" as an asset with potential weaknesses which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. This definition is intended to ensure that the "Special Mention" category is not used to identify assets that have as their sole weakness credit data exceptions or collateral documentation exceptions that are not material to the repayment of the asset.

Substandard: Classified loans are assigned a risk rating of an 8 or 9, depending upon the prospect for collection, and deemed “Substandard”. A risk rating of 8 is used for borrowers with well-defined weaknesses that jeopardize the orderly liquidation of debt. The loan is inadequately protected by the current paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. There is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified “Substandard”.

A risk rating of 9 is used for borrowers that have all the weaknesses inherent in a loan with a risk rating of 8, with the added characteristic that the weaknesses make collection of debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely. The possibility of loss is extremely high, but because of certain important, reasonably specific pending factors that may work to strengthen the assets, the loans’ classification as estimated losses is deferred until a more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures; capital injection; perfecting liens on additional collateral; and refinancing plans. Partial charge-offs are likely.

Loss: Once a borrower is deemed incapable of repayment of unsecured debt, the risk rating becomes a 10, the loan is termed a “Loss”, and charged-off immediately. Loans to such borrowers are considered uncollectible and of such little value that continuance as active assets of the Bank is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may be affected in the future.

For residential mortgage and consumer loans, management uses performing versus nonperforming as the best indicator of credit quality. Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. These credit quality indicators are updated on an ongoing basis, as a loan is placed on nonaccrual status as soon as management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan.

The tables below detail the Company's loan portfolio by class according to their credit quality indicators discussed in the paragraphs above as of June 30, 2014:

	June 30, 2014 SBA, SBA 504 & Commercial loans - Internal risk ratings			
(In thousands)	Pass	Special mention	Substandard	Total
SBA loans held for investment	$ 41,732	$ 1,438	$ 3,720	$ 46,890
SBA 504 loans	24,394	9,418	640	34,452
Commercial loans				
Commercial other	35,032	1,371	1,133	37,536
Commercial real estate	300,827	20,969	4,435	326,231
Commercial real estate construction	11,891	318	-	12,209
Total commercial loans	347,750	22,658	5,568	375,976
Total SBA, SBA 504 and commercial loans	$ 413,876	$ 33,514	$ 9,928	$ 457,318

	Residential mortgage & Consumer loans - Performing/Nonperforming		
(In thousands)	Performing	Nonperforming	Total
Residential mortgage loans	$ 192,050	$ 4,134	$ 196,184
Consumer loans			
Home equity	46,860	924	47,784
Consumer other	1,159	-	1,159
Total consumer loans	48,019	924	48,943
Total residential mortgage and consumer loans	$ 240,069	$ 5,058	$ 245,127

The tables below detail the Company's loan portfolio by class according to their credit quality indicators discussed in the paragraphs above as of December 31, 2013:

	December 31, 2013 SBA, SBA 504 & Commercial loans - Internal risk ratings			
(In thousands)	Pass	Special mention	Substandard	Total
SBA loans held for investment	$ 43,778	$ 2,035	$ 3,105	$ 48,918
SBA 504 loans	20,641	9,595	1,328	31,564
Commercial loans				

Commercial other	34,946	1,499	1,166	37,611
Commercial real estate	289,220	21,137	7,114	317,471
Commercial real estate construction	8,081	-	177	8,258
Total commercial loans	332,247	22,636	8,457	363,340
Total SBA, SBA 504 and commercial loans	$ 396,666	$ 34,266	$ 12,890	$ 443,822

	Residential mortgage & Consumer loans - Performing/Nonperforming		
(In thousands)	Performing	Nonperforming	Total
Residential mortgage loans	$ 176,340	$ 5,727	$ 182,067
Consumer loans			
Home equity	42,029	1,675	43,704
Consumer other	2,430	5	2,435
Total consumer loans	44,459	1,680	46,139
Total residential mortgage and consumer loans	$ 220,799	$ 7,407	$ 228,206

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Nonperforming and Past Due Loans

Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. Loans past due 90 days or more and still accruing interest are not included in nonperforming loans and generally represent loans that are well collateralized and in a continuing process expected to result in repayment or restoration to current status. The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. The current state of the economy and the downturn in the real estate market has resulted in increased loan delinquencies and defaults. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market. In response to the credit risk in its portfolio, the Company has increased staffing in its credit monitoring department and increased efforts in the collection and analysis of borrowers' financial statements and tax returns.

The following tables set forth an aging analysis of past due and nonaccrual loans as of June 30, 2014 and December 31, 2013:

	June 30, 2014						
(In thousands)	30-59 days past due	60-89 days past due	90+ days and still accruing	Nonaccrual (1)	Total past due	Current	Total loans
SBA loans held for investment	$ 15	$ 185	$ -	$ 5,113	$ 5,313	$ 41,577	$ 46,890
SBA 504 loans	-	-	-	433	433	34,019	34,452
Commercial loans							
Commercial other	70	-	-	73	143	37,393	37,536
Commercial real estate	907	425	-	1,252	2,584	323,647	326,231
Commercial real estate construction	-	-	-	-	-	12,209	12,209
Residential mortgage loans	2,341	386	-	4,134	6,861	189,323	196,184
Consumer loans							
Home equity	201	16	-	924	1,141	46,643	47,784
Consumer other	7	-	-	-	7	1,152	1,159
Total loans held for investment	$ 3,541	$ 1,012	$ -	$ 11,929	$ 16,482	$ 685,963	$ 702,445
SBA loans held for sale	-	58	-	-	58	6,386	6,444
Total loans	$ 3,541	$ 1,070	$ -	$ 11,929	$ 16,540	$ 692,349	$ 708,889

(1)

At June 30, 2014, nonaccrual loans included $741 thousand of troubled debt restructurings ("TDRs") and $2.3 million of loans guaranteed by the SBA. The remaining $7.0 million of TDRs are in accrual status because they are performing in accordance with their restructured terms.

	December 31, 2013						
(In thousands)	30-59 days past due	60-89 days past due	90+ days and still accruing	Nonaccrual (1)	Total past due	Current	Total loans
SBA loans held for investment	$ 4,314	$ 264	$ -	$ 2,746	$ 7,324	$ 41,594	$ 48,918
SBA 504 loans	-	-	-	1,101	1,101	30,463	31,564
Commercial loans							
Commercial other	123	-	-	67	190	37,421	37,611
Commercial real estate	347	190	14	3,785	4,336	313,135	317,471
Commercial real estate construction	-	-	-	177	177	8,081	8,258
Residential mortgage loans	3,050	-	5	5,727	8,782	173,285	182,067
Consumer loans							
Home equity	142	69	-	1,675	1,886	41,818	43,704
Consumer other	9	1	-	5	15	2,420	2,435
Total loans held for investment	$ 7,985	$ 524	$ 19	$ 15,283	$ 23,811	$ 648,217	$ 672,028
SBA loans held for sale	65	-	-	-	65	6,608	6,673
Total loans	$ 8,050	$ 524	$ 19	$ 15,283	$ 23,876	$ 654,825	$ 678,701

(1) At December 31, 2013, nonaccrual loans included $467 thousand of TDRs and $540 thousand of loans guaranteed by the SBA. The remaining $7.5 million of TDRs are in accrual status because they are performing in accordance with their restructured terms.

Impaired Loans

The Company has defined impaired loans to be all nonperforming loans individually evaluated for impairment and troubled debt restructurings. Management considers a loan impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract. Impairment is evaluated on an individual basis for SBA, SBA 504, and commercial loans.

The following table provides detail on the Company's impaired loans that are individually evaluated for impairment with the associated allowance amount, if applicable, as of June 30, 2014:

	June 30, 2014		
(In thousands)	Unpaid principal balance	Recorded investment	Specific reserves
With no related allowance:			
SBA loans held for investment (1)	$ 1,158	$ 1,017	$ -
SBA 504 loans	2,232	2,232	-
Commercial loans			
Commercial other	55	56	-
Commercial real estate	5,406	5,317	-
Total commercial loans	5,461	5,373	-
Total impaired loans with no related allowance	8,851	8,622	-
With an allowance:			
SBA loans held for investment (1)	2,428	2,251	1,049
Commercial loans			
Commercial other	30	17	17
Commercial real estate	691	641	72
Total commercial loans	721	658	89
Total impaired loans with a related allowance	3,149	2,909	1,138
Total individually evaluated impaired loans:			
SBA loans held for investment (1)	3,586	3,268	1,049
SBA 504 loans	2,232	2,232	-
Commercial loans			
Commercial other	85	73	17
Commercial real estate	6,097	5,958	72
Total commercial loans	6,182	6,031	89
Total individually evaluated impaired loans	$ 12,000	$ 11,531	$ 1,138

(1) Balances are reduced by amount guaranteed by the SBA of $2.3 million at June 30, 2014.

The following table provides detail on the Company’s impaired loans that are individually evaluated for impairment with the associated allowance amount, if applicable, as of December 31, 2013:

(In thousands)	December 31, 2013 Unpaid principal balance	Recorded investment	Specific reserves
With no related allowance:			
SBA loans held for investment (1)	$ 1,123	$ 835	$ -
SBA 504 loans	2,251	2,251	-
Commercial loans			
Commercial other	56	55	-
Commercial real estate	6,116	5,969	-
Total commercial loans	6,172	6,024	-
Total impaired loans with no related allowance	9,546	9,110	-
With an allowance:			
SBA loans held for investment (1)	2,282	1,905	831
SBA 504 loans	1,277	677	29
Commercial loans			
Commercial other	24	12	12
Commercial real estate	3,557	2,907	230
Commercial real estate construction	202	177	36
Total commercial loans	3,783	3,096	278
Total impaired loans with a related allowance	7,342	5,678	1,138
Total individually evaluated impaired loans:			
SBA loans held for investment (1)	3,405	2,740	831
SBA 504 loans	3,528	2,928	29
Commercial loans			
Commercial other	80	67	12
Commercial real estate	9,673	8,876	230
Commercial real estate construction	202	177	36
Total commercial loans	9,955	9,120	278
Total individually evaluated impaired loans	$ 16,888	$ 14,788	$ 1,138

(1) Balances are reduced by amount guaranteed by the SBA of $540 thousand at December 31, 2013.

The following tables present the average recorded investments in impaired loans and the related amount of interest recognized during the time period in which the loans were impaired for the three and six months ended June 30, 2014 and 2013. The average balances are calculated based on the month-end balances of impaired loans. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal under the cost recovery method, therefore no interest income is recognized. The interest income recognized on impaired loans noted below represents primarily accruing troubled debt restructurings and nominal amounts of income recognized on a cash basis for well-collateralized impaired loans.

	For the three months ended June 30,			
	2014		2013	
(In thousands)	Average recorded investment	Interest income recognized on impaired loans	Average recorded investment	Interest income recognized on impaired loans
SBA loans held for investment (1)	$ 3,167	$ 21	$ 3,421	$ 85
SBA 504 loans	2,238	27	5,372	55
Commercial loans				
Commercial other	75	1	2,049	24
Commercial real estate	6,256	54	10,418	86
Commercial real estate construction	115	-	194	-
Total	$ 11,851	$ 103	$ 21,454	$ 250

(1) Balances are reduced by the average amount guaranteed by the Small Business Administration of $2.0 million and $921 thousand for the three months ended June 30, 2014 and 2013, respectively.

	For the six months ended June 30,			
	2014		2013	
(In thousands)	Average recorded investment	Interest income recognized on impaired loans	Average recorded investment	Interest income recognized on impaired loans
SBA loans held for investment (1)	$ 3,108	$ 56	$ 3,482	$ 141
SBA 504 loans	2,468	55	6,428	139
Commercial loans				
Commercial other	71	2	2,045	85
Commercial real estate	7,143	123	10,722	139
Commercial real estate construction	146	-	164	-

Total	$ 12,936	$ 236	$ 22,841	$ 504

(1) Balances are reduced by the average amount guaranteed by the Small Business Administration of $2.3 million and $1.3 million for the six months ended June 30, 2014 and 2013, respectively.

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Troubled Debt Restructurings

The Company's loan portfolio also includes certain loans that have been modified in a troubled debt restructuring ("TDR"). TDRs occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider, unless it results in a delay in payment that is insignificant. These concessions typically include reductions in interest rate, extending the maturity of a loan, or a combination of both. When the Company modifies a loan, management evaluates for any possible impairment using either the discounted cash flows method, where the value of the modified loan is based on the present value of expected cash flows, discounted at the contractual interest rate of the original loan agreement, or by using the fair value of the collateral less selling costs if the loan is collateral-dependent. If management determines that the value of the modified loan is less than the recorded investment in the loan, impairment is recognized by segment or class of loan, as applicable, through an allowance estimate or charge-off to the allowance. This process is used, regardless of loan type, and for loans modified as TDRs that subsequently default on their modified terms.

TDRs of $7.7 million and $7.9 million are included in the impaired loan numbers as of June 30, 2014 and December 31, 2013, respectively. Specific reserves for these TDRs were $291 thousand and $363 thousand as of June, 2014 and December 31, 2013, respectively. At June 30, 2014, $741 thousand of TDRs were in nonaccrual status, compared to $467 thousand at December 31, 2013. The remaining TDRs are in accrual status since they continue to perform in accordance with their restructured terms.

There were no loans modified during the three or six months ended June 30, 2014 that were deemed to be TDRs. There were no loans modified during the three months ended June 30, 2013 that were deemed to be TDRs. There was one such loan modified in the quarter ended March 31, 2013.

The following table details loans modified during the six months ended June 30, 2014 and 2013, including the number of modifications and the recorded investment at the time of the modification.

	For the six months ended June 30,					
	2014			2013		
(In thousands, except number of contracts)	Number of contracts	Recorded investment at time of modification	Impact of interest rate change on income	Number of contracts	Recorded investment at time of modification	Impact of interest rate change on income

Commercial real estate	$ -	$ -	-	$ 1	$ 2,684	17
Total	$ -	$ -	$ -	$ 1	$ 2,684	$ 17

There was one loan modified as a TDR within the previous 12 months where a concession was made and the loan subsequently defaulted at some point during the three months ended June 30, 2014. In this case, subsequent default is defined as being transferred to nonaccrual status. There were no additional defaults during the current year to date period. In addition, there were no qualifying subsequent defaults to TDRs for the three and six months ended June 30, 2013. These defaults are detailed in the following table:

	For the three months ended June 30,			
	2014		2013	
(In thousands, except number of contracts)	Number of contracts	Recorded investment	Number of contracts	Recorded investment
SBA loans held for investment	1	$ 131	-	$ -
Total	1	$ 131	-	$ -

To date, the Company's TDRs consisted of interest rate reductions and maturity extensions. There has been no principal forgiveness. There were no TDR modifications done during the six months ended June 30, 2014. The following table shows the types of modifications done during the six months ended June 30, 2013, with the respective loan balances as of the period ending:

(In thousands)	For the six months ended June 30, 2013 Commercial real estate	Total
Type of modification:		
Interest only with reduced interest rate	$ 2,684	$ 2,684
Total TDRs	$ 2,684	$ 2,684

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Note 9. Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

Allowance for Loan Losses

The Company has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. At a minimum, the adequacy of the allowance for loan losses is reviewed by management on a quarterly basis. For purposes of determining the allowance for loan losses, the Company has segmented the loans in its portfolio by loan type. Loans are segmented into the following pools: SBA 7(a), SBA 504, commercial, residential mortgages, and consumer loans. Certain portfolio segments are further broken down into classes based on the associated risks within those segments and the type of collateral underlying each loan. Commercial loans are divided into the following three classes: commercial real estate, commercial real estate construction and commercial other. Consumer loans are divided into two classes as follows: Home equity and other.

The standardized methodology used to assess the adequacy of the allowance includes the allocation of specific and general reserves. The same standard methodology is used, regardless of loan type. Specific reserves are made to individual impaired loans and troubled debt restructurings (see Note 1 for additional information on this term). The general reserve is set based upon a representative average historical net charge-off rate adjusted for the following environmental factors: delinquency and impairment trends, charge-off and recovery trends, changes in the volume of restructured loans, volume and loan term trends, changes in risk and underwriting policy trends, staffing and experience changes, national and local economic trends, industry conditions and credit concentration changes. Within the five-year historical net charge-off rate, the Company weights the past three years more heavily as it believes it is more indicative of future charge-offs. All of the environmental factors are ranked and assigned a basis points value based on the following scale: low, low moderate, moderate, high moderate and high risk. Each environmental factor is evaluated separately for each class of loans and risk weighted based on its individual characteristics.

- For SBA 7(a), SBA 504 and commercial loans, the estimate of loss based on pools of loans with similar characteristics is made through the use of a standardized loan grading system that is applied on an individual loan level and updated on a continuous basis. The loan grading system incorporates reviews of the financial performance of the borrower, including cash flow, debt-service coverage ratio, earnings power, debt level and equity position, in conjunction with an assessment of the borrower's industry and future prospects. It also incorporates analysis of the type of collateral and the relative loan to value ratio.
- For residential mortgage and consumer loans, the estimate of loss is based on pools of loans with similar characteristics. Factors such as credit score, delinquency status and type of collateral are evaluated. Factors are updated frequently to capture the recent behavioral characteristics of the subject portfolios, as well as any changes in loss mitigation or credit origination strategies, and adjustments to the reserve factors are made as needed.

According to the Company’s policy, a loss (“charge-off”) is to be recognized and charged to the allowance for loan losses as soon as a loan is recognized as uncollectable. All credits which are 90 days past due must be analyzed for the Company’s ability to collect on the credit. Once a loss is known to exist, the charge-off approval process is immediately expedited. This charge-off policy is followed for all loan types.

The allocated allowance is the total of identified specific and general reserves by loan category. The allocation is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of the portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in methodologies for estimating allocated and general reserves in the portfolio. The unallocated portion of the allowance increased for the six months ended June 30, 2014 due to changes in environmental factors such as charge-off and recovery trends and improvements in industry conditions partially offset by growth in the loan portfolio and credits transferred into nonaccrual status needing a specific reserve.

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The following tables detail the activity in the allowance for loan losses by porfolio segment for the three months ended June 30, 2014 and 2013:

	For the three months ended June 30, 2014						
(In thousands)	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	$ 2,346	$ 947	$ 6,402	$ 2,062	$ 705	$ 345	$ 12,807
Charge-offs	(199)	-	(134)	(5)	(203)	-	(541)
Recoveries	10	-	31	-	1	-	42
Net charge-offs	(189)	-	(103)	(5)	(202)	-	(499)
Provision for loan losses charged to expense	348	(18)	(17)	114	238	(115)	550
Balance, end of period	$ 2,505	$ 929	$ 6,282	$ 2,171	$ 741	$ 230	$ 12,858

	For the three months ended June 30, 2013						
(In thousands)	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	$ 3,408	$ 1,296	$ 6,879	$ 1,877	$ 556	$ 329	$ 14,345
Charge-offs	(167)	(200)	(200)	-	-	-	(567)
Recoveries	8	154	65	2	2	-	231
Net charge-offs	(159)	(46)	(135)	2	2	-	(336)
Provision for loan losses charged to expense	(114)	238	62	75	(69)	108	300
Balance, end of period	$ 3,135	$ 1,488	$ 6,806	$ 1,954	$ 489	$ 437	$ 14,309

The following tables detail the activity in the allowance for loan losses by porfolio segment for the six months ended June 30, 2014 and 2013:

	For the six months ended June 30, 2014						
(In thousands)	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	$ 2,587	$ 957	$ 6,840	$ 2,132	$ 573	$ 52	$ 13,141
Charge-offs	(253)	(92)	(588)	(177)	(382)	-	(1,492)
Recoveries	18	-	40	-	1	-	59
Net charge-offs	(235)	(92)	(548)	(177)	(381)	-	(1,433)
Provision for loan losses charged to expense	153	64	(10)	216	549	178	1,150

Balance, end of period	$ 2,505	$ 929	$ 6,282	$ 2,171	$ 741	$ 230	$ 12,858

	For the six months ended June 30, 2013						
(In thousands)	SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Balance, beginning of period	$ 3,378	$ 1,312	$ 7,091	$ 1,769	$ 524	$ 684	$ 14,758
Charge-offs	(737)	(400)	(575)	(125)	(59)	-	(1,896)
Recoveries	145	179	166	4	3	-	497
Net charge-offs	(592)	(221)	(409)	(121)	(56)	-	(1,399)
Provision for loan losses charged to expense	349	397	124	306	21	(247)	950
Balance, end of period	$ 3,135	$ 1,488	$ 6,806	$ 1,954	$ 489	$ 437	$ 14,309

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The following tables present loans and their related allowance for loan losses, by portfolio segment, as of June 30, 2014 and December 31, 2013:

(In thousands)	June 30, 2014 SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses ending balance:							
Individually evaluated for impairment	$ 1,049	$ -	$ 89	$ -	$ -	$ -	$ 1,138
Collectively evaluated for impairment	1,456	929	6,193	2,171	741	230	11,720
Total	$ 2,505	$ 929	$ 6,282	$ 2,171	$ 741	$ 230	$ 12,858
Loan ending balances:							
Individually evaluated for impairment	$ 3,268	$ 2,232	$ 6,031	$ -	$ -	$ -	$ 11,531
Collectively evaluated for impairment	43,622	32,220	369,945	196,184	48,943	-	690,914
Total	$ 46,890	$ 34,452	$ 375,976	$ 196,184	$ 48,943	$ -	$ 702,445

(In thousands)	December 31, 2013 SBA held for investment	SBA 504	Commercial	Residential	Consumer	Unallocated	Total
Allowance for loan losses ending balance:							
Individually evaluated for impairment	$ 831	$ 29	$ 278	$ -	$ -	$ -	$ 1,138
Collectively evaluated for impairment	1,756	928	6,562	2,132	573	52	12,003
Total	$ 2,587	$ 957	$ 6,840	$ 2,132	$ 573	$ 52	$ 13,141
Loan ending balances:							
Individually evaluated for impairment	$ 2,740	$ 2,928	$ 9,120	$ -	$ -	$ -	$ 14,788
Collectively evaluated for impairment	46,178	28,636	354,220	182,067	46,139	-	657,240
Total	$ 48,918	$ 31,564	$ 363,340	$ 182,067	$ 46,139	$ -	$ 672,028

Changes in Methodology:

The Company did not make any changes to its allowance for loan losses methodology in the current period.

Reserve for Unfunded Loan Commitments

In addition to the allowance for loan losses, the Company maintains a reserve for unfunded loan commitments at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the reserve are made through other expense and applied to the reserve which is classified as other liabilities. At June 30, 2014, a $132 thousand commitment reserve was reported on the balance sheet as an “other liability”, compared to a $103 thousand commitment reserve at December 31, 2013.

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Note 10. New Accounting Pronouncements

ASU No. 2014-04, "Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." ASU 2014-04 clarifies that a in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU 2014-04 requires interim and annual disclosure of both (a) the amount of foreclosed residential real estate property held by the creditor and (b) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in ASU 2014-04 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. An entity can elect to adopt the amendments using either a modified retrospective transition method or prospective transition method. Early adoption is permitted. The Company is currently evaluating the impact of these amendments.

ASU 2014-11, "Transfers and Servicing (Topic 860): Repurchase to Maturity Transactions, Repurchase Financings, and Disclosures." ASU 2014-11, require two accounting changes: 1) repurchase-to-maturity transactions to secured borrowing accounting and 2) repurchase financing arrangements, amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, will result in secured borrowing accounting for the repurchase agreement. ASU 2014-11 also requires additional disclosures for repurchase agreements, securities lending transactions and repurchase-to-maturity transactions that are accounted for as secured borrowings. The accounting changes in this update are effective for public business entities for the first interim or annual period beginning after December 15, 2014. Early application is prohibited. The Company is currently evaluating the impact of the standard.

ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." This ASU has three sections:

Section A – Summary and amendments that creates revenue from contracts with customers (Topic 606) and Other Assets and Deferred Costs – Contracts with Customers (Subtopic 340-40);

Section B – Conforming amendments to other topics and subtopics in the codification and status tables;

Section C – Background information and basis for conclusions.

The accounting changes in this update are effective for public business entities for the first interim or annual period beginning after December 15, 2016. Early application is prohibited. The Company is currently evaluating the impact of the standard.

ITEM 2Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the 2013 consolidated audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013. When necessary, reclassifications have been made to prior period data throughout the following discussion and analysis for purposes of comparability. This Quarterly Report on Form 10-Q contains certain “forward looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, which may be identified by the use of such words as “believe”, “expect”, “anticipate”, “should”, “planned”, “estimated” “potential”. Examples of forward looking statements include, but are not limited to, estimates with respect to the financial condition, results of operations and business of Unity Bancorp, Inc. that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, in addition to those items contained in the Company’s Annual Report on Form 10-K under Item IA-Risk Factors, as updated by our subsequent Quarterly Reports on Form 10-Q, the following: changes in general, economic, and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects Unity Bancorp, Inc.’s interest rate spread or other income anticipated from operations and investments.

Overview

Unity Bancorp, Inc. (the “Parent Company”) is incorporated in New Jersey and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Its wholly-owned subsidiary, Unity Bank (the “Bank” or, when consolidated with the Parent Company, the “Company”) was granted a charter by the New Jersey Department of Banking and Insurance and commenced operations on September 13, 1991. The Bank provides a full range of commercial and retail banking services through 15 branch offices located in Hunterdon, Somerset, Middlesex, Union and Warren counties in New Jersey, and Northampton County in Pennsylvania. These services include the acceptance of demand, savings, and time deposits and the extension of consumer, real estate, Small Business Administration and other commercial credits. The Bank has multiple subsidiaries used to hold part of its investment and loan portfolios and other real estate owned (“OREO”) properties.

Unity (NJ) Statutory Trust II is a statutory business trust and wholly owned subsidiary of Unity Bancorp, Inc. On July 24, 2006, the Trust issued $10.0 million of trust preferred securities to investors. Unity (NJ) Statutory Trust III is a statutory business trust and wholly owned subsidiary of Unity Bancorp, Inc. On December 19, 2006, the Trust issued $5.0 million of trust preferred securities to investors. These floating rate securities are treated as subordinated debentures on the Company’s financial statements. However, they qualify as Tier I Capital for regulatory capital compliance purposes, subject to certain limitations. The Company does not consolidate the accounts and related activity of any of its business trust subsidiaries.

Earnings Summary

Net income available to common shareholders totaled $1.5 million, or $0.20 per diluted share for the quarter ended June 30, 2014, a 73.2 percent increase compared to $882 thousand, or $0.11 per diluted share for the same period a year ago. Return on average assets and average common equity for the quarter were 0.68% and 10.31%, respectively, compared to 0.67% and 6.11% for the same period a year ago. The continued improvement in our operating results is the product of our strategic initiatives, which include expansion of our in-market loan and deposit relationships, improving credit quality and core earnings growth.

Second quarter highlights include:

× Loan growth of 4.4% since December 31, 2013 across all product lines except SBA 7(a) loans – 9.1% growth in SBA 504 loans, 7.8% in residential mortgage loans, 6.1% in consumer loans and 3.5% growth in commercial loans.
× Noninterest-bearing demand deposit growth of 6.5% since December 31, 2013.
× Core earnings growth - Net interest income increased 7.4% compared to the prior year's quarter due to strong commercial and residential loan portfolio growth.
× Controlled expenses at $6.1 million for each quarter.
× Announced common stock rights offering to provide capital for continued growth.

Net income available to common shareholders totaled $2.8 million, or $0.37 per diluted share for the six months ended June 30, 2014, a 68.2 percent increase compared to $1.7 million, or $0.21 per diluted share for the same period a year ago. Return on average assets and average common equity for the six month period were 0.64% and 9.70%, respectively, compared to 0.63% and 5.88% for the same period a year ago.

The Company's quarterly and year to date performance ratios may be found in the table below.

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Net income per common share - Basic (1)	$ 0.20	$ 0.12	$ 0.37	$ 0.22
Net income per common share - Diluted (1)	$ 0.20	$ 0.11	$ 0.37	$ 0.21
Return on average assets	0.68 %	0.67 %	0.64 %	0.63 %
Return on average equity (2)	10.31 %	6.11 %	9.70 %	5.88 %
Efficiency ratio	70.81 %	72.72 %	71.36 %	73.31 %

(1) Defined as net income adjusted for dividends accrued and accretion of discount on perpetual preferred stock divided by weighted average shares outstanding.
(2) Defined as net income adjusted for dividends accrued and accretion of discount on perpetual preferred stock divided by average shareholders' equity (excluding preferred stock).

Net Interest Income

The primary source of the Company's operating income is net interest income, which is the difference between interest and dividends earned on earning assets and fees earned on loans, and interest paid on interest-bearing liabilities. Earning assets include loans to individuals and businesses, investment securities, interest-earning deposits and federal funds sold. Interest-bearing liabilities include interest-bearing demand, savings and time deposits, Federal Home Loan Bank advances and other borrowings. Net interest income is determined by the difference between the yields earned on earning assets and the rates paid on interest-bearing liabilities ("net interest spread") and the relative amounts of earning assets and interest-bearing liabilities. The Company's net interest spread is affected by regulatory,

economic and competitive factors that influence interest rates, loan demand, deposit flows and general levels of nonperforming assets.

During the quarter ended June 30, 2014, tax-equivalent net interest income amounted to $7.3 million, an increase of $485 thousand or 7.1 percent when compared to the same period in 2013. The net interest margin decreased 17 basis points to 3.49 percent for the quarter ended June 30, 2014, compared to 3.66 percent for the same period in 2013. The net interest spread was 3.31 percent for the second quarter of 2014, a 14 basis point decrease compared to the same period in 2013.

During the three months ended June 30, 2014, tax-equivalent interest income was $9.1 million, an increase of $683 thousand or 8.1 percent when compared to the same period in the prior year. This increase was driven by the increase in average loans, partially offset by a lower average yield on the loan portfolio:

- Of the $683 thousand net increase in interest income on a tax-equivalent basis, $921 thousand of the increase was due to increased average earning assets, primarily loans, partially offset by $238 thousand in reduced interest income due to reduced yields on our earning assets.
- The average volume of interest-earning assets increased $91.6 million to $843.7 million for the second quarter of 2014 compared to $752.1 million for the same period in 2013. This was due primarily to an $84.8 million increase in average loans, primarily commercial and residential mortgage loans, and a $22.5 million increase in federal funds sold and interest-bearing deposits, partially offset by a $15.9 million decrease in average investment securities.
- The yield on interest-earning assets decreased 17 basis points to 4.34 percent for the three months ended June 30, 2014 when compared to the same period in 2013. The yield on our loan portfolio declined 16 basis points to 4.87 percent.

Total interest expense was $1.8 million for the three months ended June 30, 2014, an increase of $198 thousand or 12.4 percent compared to the same period in 2013. This increase was driven by the increase in average time deposits, partially offset by lower rates on these deposits compared to a year ago:

- Of the $198 thousand increase in interest expense, $311 thousand of the increase was due to an increase in the volume of average interest-bearing liabilities, primarily time deposits, partially offset by a $113 thousand decrease due to the decrease in the rates paid on interest-bearing liabilities.
- Interest-bearing liabilities averaged $694.0 million for the second quarter of 2014, an increase of $91.5 million or 15.2 percent, compared to the prior year's quarter. The increase in interest-bearing liabilities was a result of an increase in average time deposits and interest-bearing demand deposits, partially offset by a decrease in average savings deposits.
- The average cost of interest-bearing liabilities decreased 3 basis points to 1.03 percent. The cost of interest-bearing deposits increased 4 basis points to 0.66 percent for the second quarter of 2014 and the cost of borrowed funds and subordinated debentures increased 2 basis points to 3.51 percent.

During the six months ended June 30, 2014, tax-equivalent net interest income amounted to $14.7 million, an increase of $1.1 million or 7.9 percent when compared to the same period in 2013. The net interest margin decreased 6 basis

points to 3.53 percent for the six months ended June 30, 2014, compared to 3.59 percent for the same period in 2013. The net interest spread was 3.35 percent for the six months ended June 30, 2014, a 2 basis point decrease compared to the same period in 2013.

During the six months ended June 30, 2014, tax-equivalent interest income was $18.2 million, an increase of $1.4 million or 8.2 percent when compared to the same period in the prior year. This increase was driven by the increase in average loans, partially offset by a lower average yield on the loan portfolio:

- Of the $1.4 million net increase in interest income on a tax-equivalent basis, $1.9 million of the increase was due to increased average earning assets, primarily loans, partially offset by $479 thousand in reduced interest income due to reduced yields on these assets.
- The average volume of interest-earning assets increased $73.5 million to $838.6 million for the six months ended June 30, 2014 compared to $765.2 million for the same period in 2013. This was due primarily to an $84.7 million increase in average loans, primarily commercial and residential mortgage loans, and a $1.1 million increase in federal funds sold and interest-bearing deposits, partially offset by a $12.4 million decrease in average investment securities.
- The yield on interest-earning assets decreased 5 basis points to 4.37 percent for the six months ended June 30, 2014 when compared to the same period in 2013. The yield on our loan portfolio declined 20 basis points to 4.86 percent.

Total interest expense was $3.5 million for the six months ended June 30, 2014, an increase of $310 thousand or 9.6 percent compared to the same period in 2013. This increase was driven by the increase in average time deposits, partially offset by lower rates on these deposits compared to a year ago:

- Of the $310 thousand increase in interest expense, $606 thousand of the increase was due to an increase in the volume of average interest-bearing liabilities, primarily time deposits, partially offset by a $296 thousand decrease due to the decrease in the rates paid on interest-bearing liabilities.
- Interest-bearing liabilities averaged $693.9 million for the six months ended June 30, 2014, an increase of $79.1 million or 12.9 percent, compared to the same period in the prior year. The increase in interest-bearing liabilities was a result of an increase in average time deposits and interest-bearing demand deposits, partially offset by a decrease in average savings deposits.
- The average cost of interest-bearing liabilities decreased 3 basis points to 1.02 percent. The cost of interest-bearing deposits increased 2 basis points to 0.64 percent for the six months ended June 30, 2014 and the cost of borrowed funds and subordinated debentures decreased 1 basis point to 3.50 percent.

Our net interest income continues to be impacted by the sustained low interest rate environment. The Federal Open Market Committee (“FOMC”) of the Federal Reserve Board forecasts the overnight federal funds rate will continue to remain at 25 basis points through late 2015. This rate environment has resulted in a tighter net interest margin as our earning assets continue to re-price at lower rates. Partially offsetting these declines are lower funding costs; however, the reduction in yield on earning assets is anticipated to exceed the benefits of further declines in the cost of funds from already low levels.

The following table reflects the components of net interest income, setting forth for the periods presented herein: (1) average assets, liabilities and shareholders’ equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid

on interest-bearing liabilities, (4) net interest spread, and (5) net interest income/margin on average earning assets. Rates/Yields are computed on a fully tax-equivalent basis, assuming a federal income tax rate of 34 percent.

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Consolidated Average Balance Sheets

(Dollar amounts in thousands, interest amounts and interest rates/yields on a fully tax-equivalent basis)

	For the three months ended June 30, 2014			June 30, 2013		
	Average Balance	Interest	Rate/Yield	Average Balance	Interest	Rate/Yield
ASSETS						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits	$ 47,859	$ 10	0.08 %	$ 25,312	$ 7	0.11 %
Federal Home Loan Bank stock	4,149	40	3.87	4,007	35	3.50
Securities:						
Taxable	85,598	552	2.58	95,675	620	2.59
Tax-exempt	14,608	133	3.64	20,440	186	3.64
Total securities (A)	100,206	685	2.73	116,115	806	2.77
Loans:						
SBA loans	53,965	643	4.77	63,007	778	4.94
SBA 504 loans	34,415	433	5.05	39,408	441	4.49
Commercial loans	370,345	4,738	5.13	315,128	4,250	5.41
Residential mortgage loans	185,016	2,052	4.44	143,835	1,649	4.59
Consumer loans	47,737	544	4.57	45,295	496	4.39
Total loans (B)	691,478	8,410	4.87	606,673	7,614	5.03
Total interest-earning assets	$ 843,692	$ 9,145	4.34 %	$ 752,107	$ 8,462	4.51 %
Noninterest-earning assets:						
Cash and due from banks	24,368			22,866		
Allowance for loan losses	(13,037)			(14,747)		
Other assets	45,410			41,435		
Total noninterest-earning assets	56,741			49,554		
Total assets	$ 900,433			$ 801,661		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 128,351	$ 109	0.34 %	$ 116,414	$ 90	0.31 %
Savings deposits	261,419	188	0.29	270,097	164	0.24
Time deposits	213,122	693	1.30	124,285	537	1.73
Total interest-bearing deposits	602,892	990	0.66	510,796	791	0.62
Borrowed funds and subordinated debentures	91,069	807	3.51	91,653	808	3.49
Total interest-bearing liabilities	$ 693,961	$ 1,797	1.03 %	$ 602,449	$ 1,599	1.06 %
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	143,720			122,635		
Other liabilities	3,332			3,554		
Total noninterest-bearing liabilities	147,052			126,189		

Total shareholders' equity	59,420			73,023		
Total liabilities and shareholders' equity	$ 900,433			$ 801,661		
Net interest spread		$ 7,348	3.31 %		$ 6,863	3.45 %
Tax-equivalent basis adjustment		(43)			(61)	
Net interest income		$ 7,305			$ 6,802	
Net interest margin			3.49 %			3.66 %

(A) Yields related to securities exempt from federal and state income taxes are stated on a fully tax-equivalent basis. They are reduced by the nondeductible portion of interest expense, assuming a federal tax rate of 34 percent and applicable state rates.

(B) The loan averages are stated net of unearned income, and the averages include loans on which the accrual of interest has been discontinued.

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Consolidated Average Balance Sheets

(Dollar amounts in thousands, interest amounts and interest rates/yields on a fully tax-equivalent basis)

	For the six months ended June 30, 2014			June 30, 2013		
	Average Balance	Interest	Rate/Yield	Average Balance	Interest	Rate/Yield
ASSETS						
Interest-earning assets:						
Federal funds sold and interest-bearing deposits	$ 44,960	$ 19	0.09 %	$ 43,818	$ 22	0.10 %
Federal Home Loan Bank stock	4,069	87	4.31	3,998	78	3.93
Securities:						
Taxable	89,183	1,278	2.87	97,856	1,267	2.59
Tax-exempt	15,718	289	3.68	19,463	363	3.73
Total securities (A)	104,901	1,567	2.99	117,319	1,630	2.78
Loans:						
SBA loans	54,375	1,226	4.51	64,190	1,555	4.84
SBA 504 loans	33,075	832	5.07	40,266	1,092	5.47
Commercial loans	367,360	9,340	5.13	309,990	8,251	5.37
Residential mortgage loans	183,048	4,110	4.49	139,882	3,199	4.57
Consumer loans	46,843	1,039	4.47	45,700	1,005	4.43
Total loans (B)	684,701	16,547	4.86	600,028	15,102	5.06
Total interest-earning assets	$ 838,631	$ 18,220	4.37 %	$ 765,163	$ 16,832	4.42 %
Noninterest-earning assets:						
Cash and due from banks	23,881			21,310		
Allowance for loan losses	(13,222)			(14,872)		
Other assets	44,510			39,680		
Total noninterest-earning assets	55,169			46,118		
Total assets	$ 893,800			$ 811,281		
LIABILITIES AND SHAREHOLDERS' EQUITY						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$ 129,761	$ 220	0.34 %	$ 117,535	$ 191	0.33 %
Savings deposits	263,856	370	0.28	282,738	340	0.24
Time deposits	209,148	1,337	1.29	123,495	1,083	1.77
Total interest-bearing deposits	602,765	1,927	0.64	523,768	1,614	0.62
Borrowed funds and subordinated debentures	91,167	1,606	3.50	91,063	1,609	3.51
Total interest-bearing liabilities	$ 693,932	$ 3,533	1.02 %	$ 614,831	$ 3,223	1.05 %
Noninterest-bearing liabilities:						
Noninterest-bearing demand deposits	137,976			117,844		

Other liabilities	3,251				3,398		
Total noninterest-bearing liabilities	141,227				121,242		
Total shareholders' equity	58,641				75,208		
Total liabilities and shareholders' equity	$ 893,800				$ 811,281		
Net interest spread		$ 14,687	3.35	%		$ 13,609	3.37 %
Tax-equivalent basis adjustment		(94)				(118)	
Net interest income		$ 14,593				$ 13,491	
Net interest margin			3.53	%			3.59 %

(A) Yields related to securities exempt from federal and state income taxes are stated on a fully tax-equivalent basis. They are reduced by the nondeductible portion of interest expense, assuming a federal tax rate of 34 percent and applicable state rates.

(B) The loan averages are stated net of unearned income, and the averages include loans on which the accrual of interest has been discontinued.

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The rate volume table below presents an analysis of the impact on interest income and expense resulting from changes in average volume and rates over the periods presented. Changes that are not due to volume or rate variances have been allocated proportionally to both, based on their relative absolute values. Amounts have been computed on a tax-equivalent basis, assuming a federal income tax rate of 34 percent.

	For the three months ended June 30, 2014 versus June 30, 2013 Increase (decrease) due to change in:			For the six months ended June 30, 2014 versus June 30, 2013 Increase (decrease) due to change in:		
(In thousands on a tax-equivalent basis)	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Federal funds sold and interest-bearing deposits	$ 5	$ (2)	$ 3	$ -	$ (3)	$ (3)
Federal Home Loan Bank stock	1	4	5	1	8	9
Securities	(119)	(2)	(121)	(187)	124	(63)
Loans	1,034	(238)	796	2,053	(608)	1,445
Total interest income	$ 921	$ (238)	$ 683	$ 1,867	$ (479)	$ 1,388
Interest expense:						
Demand deposits	$ 10	$ 9	$ 19	$ 22	$ 7	$ 29
Savings deposits	(6)	30	24	(23)	53	30
Time deposits	313	(157)	156	605	(351)	254
Total interest-bearing deposits	317	(118)	199	604	(291)	313
Borrowed funds and subordinated debentures	(6)	5	(1)	2	(5)	(3)
Total interest expense	311	(113)	198	606	(296)	310
Net interest income - fully tax-equivalent	$ 610	$ (125)	$ 485	$ 1,261	$ (183)	$ 1,078
Decrease in tax-equivalent adjustment			18			24
Net interest income			$ 503			$ 1,102

Provision for Loan Losses

The provision for loan losses totaled $550 thousand for the three months ended June 30, 2014, compared to $300 thousand for the three months ended June 30, 2013. For the six months ended June 30, 2014, the provision for loan losses totaled $1.2 million, compared to $950 thousand for the same period in 2013. Each period's loan loss provision is the result of management's analysis of the loan portfolio and reflects changes in the size and composition of the portfolio, the level of net charge-offs, delinquencies, current economic conditions and other internal and external factors impacting the risk within the loan portfolio. The provision reflects a higher level of net charge-offs for the quarter and year-to-date periods. Additional information may be found under the captions "Financial Condition - Asset Quality" and "Financial Condition - Allowance for Loan Losses and Reserve for Unfunded Loan Commitments." The current provision is considered appropriate under management's assessment of the adequacy of the allowance for loan losses.

Noninterest Income

The following table shows the components of noninterest income for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Branch fee income	$ 342	$ 348	$ 718	$ 695
Service and loan fee income	285	319	580	623
Gain on sale of SBA loans held for sale, net	255	86	337	327
Gain on sale of mortgage loans, net	188	547	553	1,025
BOLI income	96	75	192	146
Net security gains	268	108	378	334
Other income	206	175	408	332
Total noninterest income	$ 1,640	$ 1,658	$ 3,166	$ 3,482

Our noninterest income consists primarily of branch and loan fee income, gains on the sale of SBA and residential mortgage loans, gains on the sale of securities, and BOLI income. For the three months ended June 30, 2014, noninterest income amounted to $1.6 million, a decrease of $18 thousand from the prior year period. For the six months ended June 30, 2014, noninterest income decreased $316 thousand to $3.2 million when compared to the same period in 2013, primarily due to the lower volume of residential mortgage sales.

Changes in our noninterest income for the three and six months ended June 30, 2014 versus 2013 reflect:

- For the three months ended June 30 2014, branch fee income, which consists of deposit service charges and overdraft fees, decreased $6 thousand when compared to the same period in 2013, due to lower commercial service charges. For the six months ended June 30, 2014, branch fee income increased $23 thousand when compared to the same period in 2013, primarily due to increased overdraft fees.
- For the three and six months ended June 30, 2014, service and loan fee income decreased $34 thousand and $43 thousand, respectively, when compared to the same periods in the prior year. These decreases were due to lower late charges and SBA servicing income.
- Net gains on SBA loan sales amounted to $255 thousand on $2.3 million in sales and $337 thousand on $3.2 million in sales for the three and six months ended June 30, 2014, respectively, compared to net gains of $86 thousand on $900 thousand in sales and $327 thousand on $3.2 million in sales during the same periods in 2013. We anticipate an increase in the volume of originations and sales in 2014, due to the addition of SBA business developments officers.
- For the three and six months ended June 30, 2014, gains on sales of residential mortgage loans decreased $359 thousand and $472 thousand when compared to the same period in the prior year. Net gains on mortgage loan sales amounted to $188 thousand on $11.1 million in sales and $553 thousand on $28.6 million in sales for the three and six months ended June 30, 2014, respectively, compared to net gains of $547 thousand on $25.9 million in sales and $1.0 million on $48.5 million in sales during the same periods in 2013. Approximately, $10.1 million of the sold loans were previously originated loans from our portfolio, with the remainder consisting of new production.
- BOLI income increased $21 thousand and $46 thousand for the three and six months ended June 30, 2014, respectively, when compared to the same periods in the prior year.
- Net realized gains on the sale of securities amounted to $268 thousand for the three months ended June 30, 2014, compared to net gains of $108 thousand for the same period in the prior year. For the six months ended June 30, 2014 and 2013, net realized security gains amounted to $378 thousand and $334 thousand, respectively. For additional information, see Note 7 - Securities.
- For the three and six months ended June 30, 2014, other income, which includes check card related income and miscellaneous service charges, increased $31 thousand and $76 thousand, respectively, when compared to the same periods in the prior year, primarily due to increases in VISA check card interchange fees and OREO rental income.

Noninterest Expense

The following table presents a breakdown of noninterest expense for the three and six months ended June 30, 2014 and 2013:

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands)	2014	2013	2014	2013
Compensation and benefits	$ 3,122	$ 3,166	$ 6,340	$ 6,341
Occupancy	619	627	1,279	1,321
Processing and communications	597	562	1,179	1,123
Furniture and equipment	379	371	735	736
Professional services	247	234	458	424

Loan costs	174	228	344	406
OREO expenses	95	63	342	190
Deposit insurance	171	179	349	328
Advertising	287	181	438	301
Other expenses	453	463	939	1,029
Total noninterest expense	$ 6,144	$ 6,074	$ 12,403	$ 12,199

Noninterest expense increased $70 thousand to $6.1 million for the three months ended June 30, 2014, while year-to-date expenses increased $204 thousand to $12.4 million.

Changes in noninterest expense for the three and six months ended June 30, 2014 versus 2013 reflect:

- Compensation and benefits expense, the largest component of noninterest expense, decreased $44 thousand for the three months ending June 30, 2014. Expenses decreased over the three month period as lower mortgage commission expense, due to a lower volume of originations, offset an increase in bonus accruals and benefits expense. Year-to-date compensation and benefits expense remained relatively flat.
- Occupancy expense decreased $8 thousand and $42 thousand for the three and six months ended June 30, 2014, respectively. The year-to-date decrease was due to the reduction in lease and leasehold depreciation expense related to the three branch sites that were purchased a year ago. These savings were partially offset by the increase in seasonal weather related expenses.
- Processing and communications expenses increased $35 thousand and $56 thousand for the three and six months ended June 30, 2014, respectively, primarily due to volume driven expenses such as items processing, merchant services, and postage as well as increased electronic access expenses such as data processing lines and internet access.
- Furniture and equipment expense remained relatively flat for the three and six month periods.

- Professional service fees increased $13 thousand and $34 thousand for the three and six months ended June 30, 2014, respectively, primarily due to increased audit related and consulting expenses.
- Loan costs decreased $54 thousand and $62 thousand for the three and six months ending June 30, 2014, respectively, due to lower loan legal and appraisal costs associated with collection accounts as credit quality improves, while mortgage servicing related costs have increased due to a larger portfolio.
- OREO expenses increased $32 thousand and $152 thousand for the three and six months ended June 30, 2014, respectively. OREO expenses remain elevated as we work through the collection process and incur expenses such as property maintenance, insurance and legal costs, as well as delinquent taxes, and losses on sale.
- Deposit insurance expense remained relatively flat for the three months ended June 30, 2014 when compared to the same period in the prior year. For the six months ended June 30, 2014, expenses increased $21 thousand when compared to the same period in 2013 due to growth in the company's assets.
- Advertising expense increased $106 thousand and $137 thousand for the three and six months ended June 30, 2014, respectively. Expenses increased in both periods due to the expanded use of print, direct mail and bill board media, plus seasonal involvement in various community events.
- Other expenses decreased $10 thousand and $90 thousand for the three and six months ended June 30, 2014, respectively. The year-to-date decrease was due to lower director fees, printing and office supplies and provision for loan commitments.

Income Tax Expense

For the quarter ended June 30, 2014, the Company reported income tax expense of $723 thousand for an effective tax rate of 32.1 percent, compared to an income tax expense of $739 thousand and effective tax rate of 35.4 percent for the prior year's quarter. For the six months ended June 30, 2014, the Company reported income tax expense of $1.4 million for an effective tax rate of 32.9 percent, compared to an income tax expense of $1.3 million and effective tax rate of 33.4 percent for the six months ended June 30, 2013. The effective tax rates declined due to state tax planning.

Financial Condition at June 30, 2014

Total assets increased $11.3 million or 1.2 percent, to $932.4 million at June 30, 2014, compared to $921.1 million at December 31, 2013. This increase was primarily due to an increase of $30.2 million in loans, partially offset by a decrease of $17.0 million in securities. Total deposits decreased $10.6 million, due to decreases of $20.2 million and $9.5 million in interest-bearing demand deposits and savings deposits, respectively, partially offset by increases of $10.3 million and $8.8 million in time deposits and noninterest-bearing demand deposits. Borrowed funds increased $18.0 million over year-end 2013 due to a $50.0 million overnight advance at June 30, 2014 versus a $32.0 million overnight advance at December 31, 2013. There were no changes to subordinated debentures. Total shareholders' equity increased $3.3 million over year-end 2013, primarily due to retained earnings. These fluctuations are discussed in further detail in the paragraphs that follow.

Securities Portfolio

The Company's securities portfolio consists of available for sale ("AFS") and held to maturity ("HTM") investments. Management determines the appropriate security classification of available for sale or held to maturity at the time of purchase. The investment securities portfolio is maintained for asset-liability management purposes, as well as for liquidity and earnings purposes.

AFS securities are investments carried at fair value that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk, to take advantage of market conditions that create economically attractive returns and as an additional source of earnings. AFS securities consist primarily of obligations of U.S. Government sponsored entities, obligations of state and political subdivisions, mortgage-backed securities, and corporate and other securities.

AFS securities totaled $68.7 million at June 30, 2014, a decrease of $12.4 million or 15.3 percent, compared to $81.1 million at December 31, 2013. This net increase was the result of:

- $9.9 million in purchases, consisting primarily of mortgage-backed securities, one corporate bond and one agency security, and
- $793 thousand of appreciation in the market value of the portfolio. At June 30, 2014, the portfolio had net unrealized gains of $15 thousand compared to net unrealized losses of $778 thousand at December 31, 2013. These net unrealized gains (losses) are reflected net of tax in shareholders' equity as accumulated other comprehensive income (loss), partially offset by
- $17.5 million in sales net of realized gains, which consisted of municipal securities, mortgage-backed securities, one asset-backed security, and one corporate bond,
- $5.4 million in principal payments, maturities and called bonds, and
- $237 thousand in net amortization of premiums

The weighted average life of AFS securities, adjusted for prepayments, amounted to 4.2 years at June 30, 2014 and 5.4 years at December 31, 2013.

HTM securities, which are carried at amortized cost, are investments for which there is the positive intent and ability to hold to maturity. The portfolio is comprised primarily of U.S. Government sponsored entities, obligations of state and political subdivisions, mortgage-backed securities, and corporate and other securities.

HTM securities were $21.7 million at June 30, 2014, a decrease of $4.6 million or 17.6 percent, from year-end 2013. This decrease was the result of:

- $4.6 million in principal payments and maturities, and
- $34 thousand in net amortization of premiums.

The weighted average life of HTM securities, adjusted for prepayments, amounted to 6.5 years and 8.5 years at June 30, 2014 and December 31, 2013, respectively. As of June 30, 2014 and December 31, 2013, the fair value of HTM securities was $21.6 million and $25.5 million, respectively.

The average balance of taxable securities amounted to $89.2 million for the six months ended June 30, 2014, compared to $97.9 million for the same period in 2013. The average yield earned on taxable securities increased 28 basis points, to 2.87 percent for the six months ended June 30, 2014, from 2.59 percent for the same period in the prior year. The average balance of tax-exempt securities amounted to $15.7 million for the six months ended June 30, 2014, compared to $19.5 million for the same period in 2013. The average yield earned on tax-exempt securities decreased 5 basis points, to 3.68 percent for the six months ended June 30, 2014, from 3.73 percent for the same period in 2013.

Securities with a carrying value of $61.9 million and $74.5 million at June 30, 2014 and December 31, 2013, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law.

Approximately 87 percent of the total investment portfolio had a fixed rate of interest at June 30, 2014.

See Note 7 to the accompanying Consolidated Financial Statements for more information regarding Securities.

Loan Portfolio

The loan portfolio, which represents the Company's largest asset group, is a significant source of both interest and fee income. The portfolio consists of SBA, SBA 504, commercial, residential mortgage and consumer loans. Each of these segments is subject to differing levels of credit and interest rate risk.

Total loans increased $30.2 million or 4.4 percent to $708.9 million at June 30, 2014, compared to $678.7 million at year-end 2013. Residential mortgages, commercial loans, SBA 504 loans, and consumer loans increased $14.1 million, $12.6 million, $2.9 million, and $2.8 million respectively, partially offset by a decline of $2.3 million in SBA loans.

The following table sets forth the classification of loans by major category, including unearned fees and deferred costs and excluding the allowance for loan losses as of June 30, 2014 and December 31, 2013:

	June 30, 2014		December 31, 2013	
(In thousands, except percentages)	Amount	% of total	Amount	% of total
SBA loans held for investment	$ 46,890	6.6 %	$ 48,918	7.2 %
SBA 504 loans	34,452	4.9	31,564	4.7
Commercial loans	375,976	53.0	363,340	53.5
Residential mortgage loans	196,184	27.7	182,067	26.8
Consumer loans	48,943	6.9	46,139	6.8
Total loans held for investment	702,445	99.1	672,028	99.0
SBA loans held for sale	6,444	0.9	6,673	1.0
Total loans	$ 708,889	100.0 %	$ 678,701	100.0 %

Average loans increased $84.7 million or 14.1 percent from $600.0 million for the six months ended June 30, 2013, to $684.7 million for the same period in 2014. The increase in average loans was due to increases in residential mortgages, commercial loans, and consumer loans, partially offset by a decline in SBA 7(a) and SBA 504 loans. The yield on the overall loan portfolio fell 20 basis points to 4.86 percent for the six months ended June 30, 2014, compared to 5.06 percent for the same period in the prior year. This decrease was the result of new loan volume at lower rates and existing variable rate loan products repricing lower as rates remain low.

SBA 7(a) loans, on which the SBA historically has provided guarantees of up to 90 percent of the principal balance, are considered a higher risk loan product for the Company than its other loan products. These loans are made for the purposes of providing working capital or financing the purchase of equipment, inventory or commercial real estate. Generally, an SBA 7(a) loan has a deficiency in its credit profile that would not allow the borrower to qualify for a traditional commercial loan, which is why the SBA provides the guarantee. The deficiency may be a higher loan to value (“LTV”) ratio, lower debt service coverage (“DSC”) ratio or weak personal financial guarantees. In addition, many SBA 7(a) loans are for start up businesses where there is no history or financial information. Finally, many SBA borrowers do not have an ongoing and continuous banking relationship with the Bank, but merely work with the Bank on a single transaction. The guaranteed portion of the Company’s SBA loans are generally sold in the secondary market with the nonguaranteed portion held in the portfolio as a loan held for investment.

SBA 7(a) loans held for sale, carried at the lower of cost or market, amounted to $6.4 million at June 30, 2014, a decrease of $229 thousand from $6.7 million at December 31, 2013. SBA 7(a) loans held to maturity amounted to $46.9 million at June 30, 2014, a decrease of $2.0 million from $48.9 million at December 31, 2013. The yield on SBA loans, which are generally floating and adjust quarterly to the Prime rate, was 4.51 percent for the six months ended June 30, 2014, compared to 4.84 percent in the prior year.

The guarantee rates on SBA 7(a) loans range from 50 percent to 90 percent, with the majority of the portfolio having a guarantee rate of 75 percent at origination. The guarantee rates are determined by the SBA and can vary from year to year depending on government funding and the goals of the SBA program. The carrying value of SBA loans held for sale represents the guaranteed portion to be sold into the secondary market. The carrying value of SBA loans held to maturity represents the unguaranteed portion, which is the Company's portion of SBA loans originated, reduced by the guaranteed portion that is sold into the secondary market. Approximately $93.7 million and $96.4 million in SBA loans were sold but serviced by the Company at June 30, 2014 and December 31, 2013, respectively, and are not included on the Company’s balance sheet. There is no relationship or correlation between the guarantee percentages and the level of charge-offs and recoveries on the Company’s SBA 7(a) loans. Charge-offs taken on SBA 7(a) loans effect the unguaranteed portion of the loan. SBA loans are underwritten to the same credit standards irrespective of the guarantee percentage.

The SBA 504 program consists of real estate backed commercial mortgages where the Company has the first mortgage and the SBA has the second mortgage on the property. Generally, the Company has a 50 percent LTV ratio on SBA 504 program loans at origination. At June 30, 2014, SBA 504 loans totaled $34.5 million, an increase of $2.9 million from $31.6 million at December 31, 2013. The yield on SBA 504 loans decreased 40 basis points to 5.07 percent for the six months ended June 30, 2014, from 5.47 percent for the same period in 2013.

Commercial loans are generally made in the Company’s marketplace for the purpose of providing working capital, financing the purchase of equipment, inventory or commercial real estate and for other business purposes. These loans amounted to $376.0 million at June 30, 2014, an increase of $12.6 million from year-end 2013. The yield on commercial loans was 5.13 percent for the six months ended June 30, 2014, compared to 5.37 percent for the same period in 2013.

Residential mortgage loans consist of loans secured by 1 to 4 family residential properties. These loans amounted to $196.2 million at June 30, 2014, an increase of $14.1 million from year-end 2013. Sales of mortgage loans totaled $28.6 million for the six months ended June 30, 2014. Approximately, $10.1 million of the sold loans were from our portfolio, with the remainder consisting of new production. The yield on residential mortgages was 4.49 percent for the six months ended June 30, 2014, compared to 4.57 percent for the same period in 2013.

Consumer loans consist of home equity loans and loans for the purpose of financing the purchase of consumer goods, home improvements, and other personal needs, and are generally secured by the personal property being purchased. These loans amounted to $48.9 million, an increase of $2.8 million from year-end 2013. The yield on consumer loans was 4.47 percent for the six months ended June 30, 2014, compared to 4.43 percent for the same period in 2013.

There are no concentrations of loans to any borrowers or group of borrowers exceeding 10 percent of the total loan portfolio and no foreign loans in the portfolio. As a preferred SBA lender, a portion of the SBA portfolio is to borrowers outside the Company’s lending area. During late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area.

In the normal course of business, the Company may originate loan products whose terms could give rise to additional credit risk. Interest-only loans, loans with high LTV ratios, construction loans with payments made from interest reserves and multiple loans supported by the same collateral (e.g. home equity loans) are examples of such products. However, these products are not material to the Company’s financial position and are closely managed via credit controls that mitigate their additional inherent risk. Management does not believe that these products create a concentration of credit risk in the Company’s loan portfolio. The Company does not have any option adjustable rate mortgage loans.

The majority of the Company’s loans are secured by real estate. Declines in the market values of real estate in the Company’s trade area impact the value of the collateral securing its loans. This could lead to greater losses in the event of defaults on loans secured by real estate. At June 30, 2014 and December 31, 2013, approximately 95 percent of the Company’s loan portfolio was secured by real estate.

Troubled Debt Restructurings

Troubled debt restructurings (“TDRs”) occur when a creditor, for economic or legal reasons related to a debtor’s financial condition, grants a concession to the debtor that it would not otherwise consider. These concessions typically include reductions in interest rate, extending the maturity of a loan, or a combination of both. When the Company modifies a loan, management evaluates for any possible impairment using either the discounted cash flows method, where the value of the modified loan is based on the present value of expected cash flows, discounted at the contractual interest rate of the original loan agreement, or by using the fair value of the collateral less selling costs. If management determines that the value of the modified loan is less than the recorded investment in the loan, impairment is recognized by segment or class of loan, as applicable, through an allowance estimate or charge-off to the allowance. This process is used, regardless of loan type, and for loans modified as TDRs that subsequently default on their modified terms.

At June 30, 2014, there were ten loans totaling $7.7 million that were classified as TDRs by the Company and deemed impaired, compared to ten such loans totaling $7.9 million at December 31, 2013. Nonperforming loans included $741 thousand of TDRs as of June 30, 2014, compared to $467 thousand at December 31, 2013. Restructured loans that are placed in nonaccrual status may be removed after 6 months of contractual payments and the business showing the ability to service the debt going forward. The remaining TDRs are in accrual status since they are performing in accordance with the restructured terms. There are no commitments to lend additional funds on these loans.

The following table presents a breakdown of performing and nonperforming TDRs by class as of June 30, 2014 and December 31, 2013:

	June 30, 2014			December 31, 2013		
(In thousands)	Performing TDRs	Nonperforming TDRs	Total TDRs	Performing TDRs	Nonperforming TDRs	Total TDRs
SBA loans held for investment	$ 460	$ 499	$ 959	$ 534	$ 467	$ 1,001
SBA 504 loans	1,799	-	1,799	1,827	-	1,827
Commercial real estate	4,706	242	4,948	5,091	-	5,091
Total	$ 6,965	$ 741	$ 7,706	$ 7,452	$ 467	$ 7,919

Through June, 2014, our TDRs consisted of interest rate reductions, interest only periods and maturity extensions. There has been no principal forgiveness.   The following table shows the types of modifications done to date by class through June 30, 2014:

	June 30, 2014			
(In thousands)	SBA held for investment	SBA 504	Commercial real estate	Total
Type of modification:				
Principal only	$ 15	$ -	$ -	$ 15
Interest only with reduced interest rate	-	-	2,684	2,684
Interest only with nominal principal	92	-	-	92
Interest with extra principal	-	-	1,414	1,414
Previously modified back to original terms	852	1,799	850	3,501
Total TDRs	$ 959	$ 1,799	$ 4,948	$ 7,706

Asset Quality

Inherent in the lending function is credit risk, which is the possibility a borrower may not perform in accordance with the contractual terms of their loan. A borrower's inability to pay their obligations according to the contractual terms can create the risk of past due loans and, ultimately, credit losses, especially on collateral deficient loans. The Company minimizes its credit risk by loan diversification and adhering to strict credit administration policies and procedures. Due diligence on loans begins when we initiate contact regarding a loan with a borrower. Documentation, including a borrower's credit history, materials establishing the value and liquidity of potential collateral, the purpose of the loan, the source of funds for repayment of the loan, and other factors, are analyzed before a loan is submitted for approval. The loan portfolio is then subject to on-going internal reviews for credit quality, as well as independent

credit reviews by an outside firm.

The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. The current state of the economy and the downturn in the real estate market has resulted in increased loan delinquencies and defaults. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market.

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Nonperforming assets consist of nonperforming loans and other real estate owned ("OREO"). Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal, until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income. Loans past due 90 days or more and still accruing interest are not included in nonperforming loans. Loans past due 90 days or more and still accruing generally represent loans that are well collateralized and in a continuing process that are expected to result in repayment or restoration to current status.

The following table sets forth information concerning nonperforming assets and loans past due 90 days or more and still accruing interest at each of the periods presented:

(In thousands)	June 30, 2014	December 31, 2013	June 30, 2013
Nonperforming by category:			
SBA loans held for investment (1)	$ 5,113	$ 2,746	$ 3,524
SBA 504 loans	433	1,101	1,986
Commercial loans	1,325	4,029	2,678
Residential mortgage loans	4,134	5,727	4,215
Consumer loans	924	1,680	954
Total nonperforming loans (2)	$ 11,929	$ 15,283	$ 13,357
OREO	1,115	633	752
Total nonperforming assets	$ 13,044	$ 15,916	$ 14,109
Past due 90 days or more and still accruing interest:			
SBA loans held for investment	$ -	$ -	$ -
SBA 504 loans	-	-	425
Commercial loans	-	14	-
Residential mortgage loans	-	5	4
Consumer loans	-	-	-
Total past due 90 days or more and still accruing interest	$ -	$ 19	$ 429
Nonperforming loans to total loans	1.68 %	2.25 %	2.15 %
Nonperforming loans and TDRs to total loans (3)	2.67	3.35	3.86
Nonperforming assets to total loans and OREO	1.84	2.34	2.26
Nonperforming assets to total assets	1.40	1.73	1.71
(1) Guaranteed SBA loans included above	$ 2,305	$ 540	$ 736
(2) Nonperforming TDRs included above	741	467	1,658
(3) Performing TDRs	6,965	7,452	10,649

Nonperforming loans were $11.9 million at June 30, 2014, a $3.4 million decrease from $15.3 million at year-end 2013 and a $1.4 million decrease from $13.4 million at June, 2013. Since year-end 2013, nonperforming loans in all segments decreased, except SBA loans held for investment. Included in nonperforming loans at June 30, 2014 are approximately $2.3 million of loans guaranteed by the SBA, compared to $540 thousand at December 31, 2013 and $736 thousand at June 30, 2013. In addition, there were no loans past due 90 days or more and still accruing interest at June 30, 2014, compared to $19 thousand and $429 thousand at December 31, 2013 and June 30, 2013, respectively.

Other real estate owned ("OREO") properties totaled $1.1 million at June 30, 2014, an increase of $482 thousand from $633 thousand at year-end 2013 and a $363 thousand increase from $752 thousand at June 30, 2013. During the six months ended June 30, 2014, the Company took title to six new properties totaling $2.9 million with a valuation write down on one loan totaling $170 thousand. Four OREO properties were sold, resulting in a net loss of $222 thousand on the sales.

The Company also monitors potential problem loans. Potential problem loans are those loans where information about possible credit problems of borrowers causes management to have doubts as to the ability of such borrowers to comply with loan repayment terms. These loans are not included in nonperforming loans as they continue to perform. Potential problem loans totaled $6.2 million at June 30, 2014, an increase of $453 thousand from $5.7 million at December 31, 2013. The increase is due to the addition of seven loans totaling $4.8 million during the year, partially offset by the removal of six loans totaling $3.2 million.

See Note 8 to the accompanying Consolidated Financial Statements for more information regarding Asset Quality.

Allowance for Loan Losses and Reserve for Unfunded Loan Commitments

Management reviews the level of the allowance for loan losses on a quarterly basis. The standardized methodology used to assess the adequacy of the allowance includes the allocation of specific and general reserves. Specific reserves are made to individual impaired loans, which have been defined to include all nonperforming loans and TDRs. The general reserve is set based upon a representative average historical net charge-off rate adjusted for certain environmental factors such as: delinquency and impairment trends, charge-off and recovery trends, volume and loan term trends, risk and underwriting policy trends, staffing and experience changes, national and local economic trends, industry conditions and credit concentration changes.

When calculating the five-year historical net charge-off rate, the Company weights the past three years more heavily. The Company believes using this approach is more indicative of future charge-offs. All of the environmental factors are ranked and assigned a basis points value based on the following scale: low, low moderate, moderate, high moderate, and high risk. The factors are evaluated separately for each type of loan. For example, commercial loans are broken down further into commercial and industrial loans, commercial mortgages, construction loans, etc. Each type of loan is risk weighted for each environmental factor based on its individual characteristics.

According to the Company’s policy, a loss (“charge-off”) is to be recognized and charged to the allowance for loan losses as soon as a loan is recognized as uncollectable. All credits which are 90 days past due must be analyzed for the Company's ability to collect on the credit. Once a loss is known to exist, the charge-off approval process is immediately expedited.

Beginning in 2013 and continuing in 2014, the Company has decreased its loan loss provision in response to improvements in the inherent credit risk within its loan portfolio. The improved inherent credit risk was evidenced by a decrease in delinquent and nonperforming loans, as the economy continued to improve.

The allowance for loan losses totaled $12.9 million at June 30, 2014, compared to $13.1 million and $14.3 million at December 31, 2013 and June 30, 2013, respectively, with resulting allowance to total loan ratios of 1.81 percent, 1.94 percent, and 2.30 percent, respectively. Net charge-offs amounted to $499 thousand for the three months ended June 30, 2014, compared to $336 thousand for the same period in 2013. Net charge-offs amounted to $1.4 million for the six months ended June 30, 2014 and 2013. Net charge-offs to average loan ratios are shown in the table below for each major loan category.

	For the three months ended June 30,		For the six months ended June 30,	
(In thousands, except percentages)	2014	2013	2014	2013

Balance, beginning of period	$	12,807		$	14,345		$	13,141		$	14,758
Provision for loan losses charged to expense		550			300			1,150			950
Less: Chargeoffs											
SBA loans held for investment		199			167			253			737
SBA 504 loans		-			200			92			400
Commercial loans		134			200			588			575
Residential mortgage loans		5			-			177			125
Consumer loans		203			-			382			59
Total chargeoffs		541			567			1,492			1,896
Add: Recoveries											
SBA loans held for investment		10			8			18			145
SBA 504 loans		-			154			-			179
Commercial loans		31			65			40			166
Residential mortgage loans		-			2			-			4
Consumer loans		1			2			1			3
Total recoveries		42			231			59			497
Net chargeoffs		499			336			1,433			1,399
Balance, end of period	$	12,858		$	14,309		$	12,858		$	14,309
Selected loan quality ratios:											
Net chargeoffs to average loans:											
SBA loans held for investment		1.40	%		1.01	%		0.87	%		1.86 %
SBA 504 loans		-			0.47			0.56			1.11
Commercial loans		0.11			0.17			0.30			0.27
Residential mortgage loans		0.01			(0.01)			0.19			0.17
Consumer loans		1.70			(0.02)			1.64			0.25
Total loans		0.29			0.22			0.42			0.47
Allowance to total loans		1.81			2.30			1.81			2.30
Allowance to nonperforming loans		107.79			107.13			107.79			107.13

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In addition to the allowance for loan losses, the Company maintains a reserve for unfunded loan commitments that is maintained at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the reserve are made through other expense and applied to the reserve which is maintained in other liabilities. At June 30, 2014, a $132 thousand commitment reserve was reported on the balance sheet as an “other liability”, compared to a $103 thousand commitment reserve at December 31, 2013.

See Note 9 to the accompanying Consolidated Financial Statements for more information regarding the Allowance for Loan Losses and Reserve for Unfunded Loan Commitments.

Deposits

Deposits, which include noninterest-bearing demand deposits, interest-bearing demand deposits, savings deposits and time deposits, are the primary source of the Company’s funds. The Company offers a variety of products designed to attract and retain customers, with primary focus on building and expanding relationships. The Company continues to focus on establishing a comprehensive relationship with business borrowers, seeking deposits as well as lending relationships.

Total deposits decreased $10.6 million to $728.1 million at June 30, 2014, from $738.7 million at December 31, 2013. This decrease in deposits was due to decreases of $20.2 million and $9.5 million in interest-bearing demand deposits and savings deposits, respectively, partially offset by increases of $10.3 million in time deposits and $8.8 million in noninterest-bearing demand deposits. The decreases in interest-bearing demand deposits and savings deposits were due to declines in municipal deposits of $16.4 million and $14.2 million, respectively, from year-end.

The Company’s deposit composition at June 30, 2014, consisted of 35.3 percent savings deposits, 29.6 percent time deposits, 19.9 percent noninterest-bearing demand deposits and 15.2 percent interest-bearing demand deposits.

Borrowed Funds and Subordinated Debentures

Borrowed funds consist primarily of fixed rate advances from the Federal Home Loan Bank (“FHLB”) of New York and repurchase agreements. These borrowings are used as a source of liquidity or to fund asset growth not supported by deposit generation. Residential mortgages and investment securities collateralize the borrowings from the FHLB, while investment securities are pledged against the repurchase agreements.

Borrowed funds and subordinated debentures totaled $140.5 million and $122.5 million at June 30, 2014 and December 31, 2013, respectively, and are broken down in the following table:

(In thousands)	June 30, 2014	December 31, 2013
FHLB borrowings:		
Fixed rate advances	$ 40,000	$ 30,000
Overnight advances	50,000	32,000
Repurchase agreements	20,000	30,000
Other repurchase agreements	15,000	15,000
Subordinated debentures	15,465	15,465

At June 30, 2014, the Company had $47.2 million of additional credit available at the FHLB. Pledging additional collateral in the form of 1 to 4 family residential mortgages or investment securities can increase the line with the FHLB.

Interest Rate Sensitivity

The principal objectives of the asset and liability management function are to establish prudent risk management guidelines, evaluate and control the level of interest-rate risk in balance sheet accounts, determine the level of appropriate risk given the business focus, operating environment, capital, and liquidity requirements, and actively manage risk within the Board approved guidelines. The Company seeks to reduce the vulnerability of the operations to changes in interest rates, and actions in this regard are taken under the guidance of the Asset/Liability Management Committee ("ALCO") of the Board of Directors. The ALCO reviews the maturities and re-pricing of loans, investments, deposits and borrowings, cash flow needs, current market conditions, and interest rate levels.

The Company utilizes Modified Duration of Equity and Economic Value of Portfolio Equity ("EVPE") models to measure the impact of longer-term asset and liability mismatches beyond two years. The modified duration of equity measures the potential price risk of equity to changes in interest rates. A longer modified duration of equity indicates a greater degree of risk to rising interest rates. Because of balance sheet optionality, an EVPE analysis is also used to dynamically model the present value of asset and liability cash flows with rate shocks of 200 basis points. The economic value of equity is likely to be different as interest rates change. Results falling outside prescribed ranges require action by the ALCO. The Company's variance in the economic value of equity, as a percentage of assets with rate shocks of 200 basis points at June 30, 2014, is a decline of 0.87 percent in a rising-rate environment and an increase of 0.62 percent in a falling-rate environment. The variances in the EVPE at June 30, 2014 are within the Board-approved guidelines of +/- 3.00 percent. At December 31, 2013, the economic value of equity as a percentage of assets with rate shocks of 200 basis points was a decline of 1.09 percent in a rising-rate environment and an increase of 0.45 percent in a falling-rate environment.

Liquidity

Consolidated Bank Liquidity

Liquidity measures the ability to satisfy current and future cash flow needs as they become due. A bank's liquidity reflects its ability to meet loan demand, to accommodate possible outflows in deposits and to take advantage of interest rate opportunities in the marketplace. Our liquidity is monitored by management and the Board of Directors through a Risk Management Committee, which reviews historical funding requirements, our current liquidity position, sources and stability of funding, marketability of assets, options for attracting additional funds, and anticipated future funding needs, including the level of unfunded commitments. Our goal is to maintain sufficient asset-based liquidity to cover potential funding requirements in order to minimize our dependence on volatile and potentially unstable funding markets.

The principal sources of funds at the Bank are deposits, scheduled amortization and prepayments of investment and loan principal, sales and maturities of investment securities and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit inflows and outflows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Consolidated Statement of Cash Flows provides detail on the Company's sources and uses of cash, as well as an indication of the Company's ability to maintain an adequate level of liquidity. At June 30, 2014, the balance of cash and cash equivalents was $95.3 million, a decrease of $4.1 million from December 31, 2013. A discussion of the cash provided by and used in operating, investing and financing activities follows.

Operating activities provided $3.6 million and $4.3 million in net cash for the six months ended June 30, 2014 and 2013, respectively. The primary sources of funds were net income from operations and adjustments to net income, such as the provision for loan losses, depreciation and amortization, and proceeds from the sale of mortgage and SBA loans held for sale, partially offset by originations of mortgage and SBA loans held for sale.

Investing activities used $14.8 million and $45.9 million in net cash for the six months ended June 30, 2014 and 2013, respectively. Cash was primarily used to purchase securities, and fund new loans, partially offset by cash inflows from maturities and paydowns on securities and proceeds from the sale of securities and OREO.

- × Securities. The Consolidated Bank's available for sale investment portfolio amounted to $68.6 million and $81.0 million at June 30, 2014 and December 31, 2013, respectively. This excludes the Parent Company's securities discussed under the heading "Parent Company Liquidity" below. Projected cash flows from securities over the next twelve months are $17.4 million.
- × Loans. The SBA loans held for sale portfolio amounted to $6.4 million and $6.7 million at June 30, 2014 and December 31, 2013, respectively. Sales of these loans provide an additional source of liquidity for the Company.
- × Outstanding Commitments. The Company was committed to advance approximately $132.0 million to its borrowers as of June 30, 2014, compared to $103.2 million at December 31, 2013. At June 30, 2014, $45.3 million of these commitments expire within one year, compared to $45.6 million at December 31, 2013. The Company had $1.4 million in standby letters of credit at both June 30, 2014 and December 31, 2013, which are included in the commitments amount noted above. The estimated fair value of these guarantees is not significant. The Company believes it has the necessary liquidity to honor all commitments. Many of these commitments will expire and never be funded.

Financing activities provided $7.2 million in net cash for the six months ended June 30, 2014, compared to $3.7 million for the same period in the prior year, primarily due to an increase in the Company's deposits and proceeds from new borrowings partially offset by repayments of borrowings.

× Deposits. As of June 30, 2014, deposits included $54.7 million of Government deposits, as compared to $82.5 million at year-end 2013. These deposits are generally short in duration and are very sensitive to price competition. The Company believes that the current level of these types of deposits is appropriate. Included in the portfolio were $49.1 million of deposits from ten municipalities. The withdrawal of these deposits, in whole or in part, would not create a liquidity shortfall for the Company.

× Borrowed Funds. Total FHLB borrowings amounted to $110.0 million and $92.0 million as of June 30, 2014 and December 31, 2013, respectively. Third party repurchase agreements totaled $15.0 million as of both June 30, 2014 and December 31, 2013. As a member of the Federal Home Loan Bank of New York ("FHLB"), the Company can borrow additional funds based on the market value of collateral pledged. At June 30, 2014, pledging provided an additional $47.2 million in borrowing potential from the FHLB. In addition, the Company can pledge additional collateral in the form of 1 to 4 family residential mortgages or investment securities to increase this line with the FHLB.

Parent Company Liquidity

The Parent Company's cash needs are funded by dividends paid by the Bank. Other than its investment in the Bank and Unity Statutory Trusts II and III, the Parent Company does not actively engage in other transactions or business. Only expenses specifically for the benefit of the Parent Company are paid using its cash, which typically includes the payment of operating expenses and cash dividends on common stock and, prior to the redemption of the preferred stock issued as part of the CPP, cash dividends on the preferred stock issued to the U.S. Treasury.

At June 30, 2014, the Parent Company had $623 thousand in cash and cash equivalents and $175 thousand in investment securities valued at fair market value, compared to $724 thousand in cash and cash equivalents and $167 thousand in investment securities at December 31, 2013.

Regulatory Capital

A significant measure of the strength of a financial institution is its capital base. Federal regulators have classified and defined capital into the following components: (1) tier 1 capital, which includes tangible shareholders' equity for common stock, qualifying preferred stock and certain qualifying hybrid instruments, and (2) tier 2 capital, which includes a portion of the allowance for loan losses, subject to limitations, certain qualifying long-term debt, preferred stock and hybrid instruments, which do not qualify for tier 1 capital. The parent company and its subsidiary bank are subject to various regulatory capital requirements administered by banking regulators. Quantitative measures of capital adequacy include the leverage ratio (tier 1 capital as a percentage of tangible assets), tier 1 risk-based capital ratio (tier 1 capital as a percent of risk-weighted assets) and total risk-based capital ratio (total risk-based capital as a percent of total risk-weighted assets).

Minimum capital levels are regulated by risk-based capital adequacy guidelines, which require the Company and the Bank to maintain certain capital as a percentage of assets and certain off-balance sheet items adjusted for predefined credit risk factors (risk-weighted assets). Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action applicable to banks, the Company and the Bank must meet specific capital guidelines. Prompt corrective action provisions are not applicable to bank holding companies. At a minimum, tier 1 capital as a percentage of risk-weighted assets of 4 percent and combined tier 1 and tier 2 capital as a percentage of risk-weighted assets of 8 percent must be maintained.

In addition to the risk-based guidelines, regulators require that a bank or holding company, which meets the regulator's highest performance and operation standards, maintain a minimum leverage ratio of 3 percent. For those institutions with higher levels of risk or that are experiencing or anticipating significant growth, the minimum leverage ratio will be proportionately increased. Minimum leverage ratios for each institution are evaluated through the ongoing regulatory examination process.

On April 15, 2014, the Company filed an S-1 registration statement announcing a common stock rights offering to existing shareholders. On June 30, 2014, the Company filed a press release announcing that it has commenced the previously disclosed rights offering. On or about July 7, 2014, the company distributed to holders of its common stock 1 right for each share of common stock owned as of June 26, 2014. Each subscription right entitles its holder to purchase 0.10 shares of common stock of the Company at a subscriptions price of $8.30 per share. Assuming the rights offering is fully subscribed, the Company estimates that it will receive net proceeds of approximately $6.2 million. The Company intends to use the proceeds for general corporate purposes, which may include, among other things, funding our expansion plans, working capital and pursuing strategic opportunities which may be presented to us from time to time.

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
(In thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2014						
Leverage ratio	$ 74,108	8.24 %	≥ $35,965	4.00 %	N/A	N/A
Tier I risk-based capital ratio	74,108	10.86	27,284	4.00	N/A	N/A
Total risk-based capital ratio	82,690	12.12	54,569	8.00	N/A	N/A
As of December 31, 2013						
Leverage ratio	$ 70,852	8.08 %	≥ $35,084	4.00 %	N/A	N/A
Tier I risk-based capital ratio	70,852	10.74	26,400	4.00	N/A	N/A
Total risk-based capital ratio	79,164	11.99	52,800	8.00	N/A	N/A

The Bank's capital amounts and ratios are presented in the following table:

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
(In thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2014						
Leverage ratio	$ 64,836	7.22 %	≥ $35,940	4.00 %	≥ $44,925	5.00 %
Tier I risk-based capital ratio	64,836	9.51	27,259	4.00	40,888	6.00
Total risk-based capital ratio	81,909	12.02	54,517	8.00	68,146	10.00
As of December 31, 2013						
Leverage ratio	$ 61,493	7.02 %	≥ $35,058	4.00 %	≥ $43,823	5.00 %
Tier I risk-based capital ratio	61,493	9.33	26,373	4.00	39,560	6.00
Total risk-based capital ratio	78,296	11.88	52,747	8.00	65,933	10.00

The Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, adopted Basel III in September 2010, which constitutes a set of capital reform measures designed to strengthen the regulation, supervision and risk management of banking organizations worldwide. In order to implement Basel III and certain additional capital changes required by the Dodd-Frank Act, on July 9, 2013, the FDIC approved, as an interim final rule, the regulatory capital requirements for U.S. state nonmember banks, such as us, substantially similar to final rules issued by the Board of Governors of the Federal Reserve System ("Federal Reserve") and the Office of the Comptroller of the Currency.

The interim final rule includes new risk-based capital and leverage ratios that will be phased-in from 2015 to 2019 for most state nonmember banks, including us. The rule includes a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets, which is in addition to the Tier 1 and Total risk-based capital requirements. The interim final rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and requires a minimum leverage ratio of 4.0%. The required minimum ratio of total capital to risk-weighted assets will remain 8.0%. The new risk-based capital requirements (except for the capital conservation buffer) will become effective for the Bank on January 1, 2015. The capital conservation buffer will be phased in over four years beginning on January 1, 2016, with a maximum buffer of 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

The following chart compares the risk-based capital required under existing rules to those prescribed under the interim final rule under the phase-in period described above:

	Current Treatment		Treatment in Final Rule	
Leverage ratio	4.00	%	4.00	%
Common equity tier 1 capital (CET1) ratio	N/A		4.50	%
Additional tier 1	N/A		1.50	%
Tier 1 capital ratio	4.00	%	6.00	%
Tier 2	4.00	%	2.00	%
Total capital ratio	8.00	%	8.00	%
Capital conservation buffer	N/A		2.50	%

The interim final rule also implements revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses and instruments that will no longer qualify as Tier 1 capital. The interim final rule also sets forth certain changes for the calculation of risk-weighted assets that the Bank will be required to implement beginning January 1, 2015. Management is currently evaluating the provisions of the interim final rule and its expected impact. Based on our current capital composition and levels, management does not presently anticipate that the interim final rule presents a material risk to our financial condition or results of operations.

Shareholders' Equity

Shareholders' equity increased $3.3 million to $60.5 million at June 30, 2014 compared to $57.2 million at December 31, 2013. Items impacting shareholders' equity included net income of $2.8 million, $284 thousand from the issuance of common stock under employee benefit plans, and a $483 thousand increase in other comprehensive income related to unrealized gains on available for sale securities, partially offset by a decrease of $284 thousand due to common stock dividends paid. The issuance of common stock under employee benefit plans includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

Repurchase Plan

On October 21, 2002, the Company authorized the repurchase of up to 10 percent of its outstanding common stock. The amount and timing of purchases is dependent upon a number of factors, including the price and availability of the Company's shares, general market conditions and competing alternate uses of funds. There were no shares repurchased during the three and six month periods ended June 30, 2014 or 2013.

Impact of Inflation and Changing Prices

The financial statements and notes thereto, presented elsewhere herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of the operations. Unlike most industrial companies, nearly all the Company’s assets and liabilities are monetary. As a result, interest rates have a greater impact on performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

ITEM 3Quantitative and Qualitative Disclosures about Market Risk

During the six months ended June 30, 2014, there have been no significant changes in the Company's assessment of market risk as reported in Item 6 of the Company's Annual Report on Form 10-K for the year ended December 31, 2013. (See Interest Rate Sensitivity in Management's Discussion and Analysis Herein.)

ITEM 4Controls and Procedures

a) The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2014. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for recording, processing, summarizing and reporting the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms.
b) No significant change in the Company’s internal control over financial reporting has occurred during the quarterly period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s controls over financial reporting.

PART IIOTHER INFORMATION

ITEM 1Legal Proceedings

From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the business, financial condition, or the results of the operation of the Company.

ITEM 1ARisk Factors

Information regarding this item as of June 30, 2014 appears under the heading, “Risk Factors” within the Company’s Form 10-K for the year ended December 31, 2013.

ITEM 2Unregistered Sales of Equity Securities and Use of Proceeds - None

ITEM 3Defaults upon Senior Securities - None

ITEM 4Mine Safety Disclosures - N/A

ITEM 5Other Information - None

ITEM 6Exhibits

(a) Exhibits	Description
Exhibit 31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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.

		UNITY BANCORP, INC.
Dated:	August 8, 2014	/s/ Alan J. Bedner, Jr.
		Alan J. Bedner, Jr.
		Executive Vice President and Chief Financial Officer

EXHIBIT INDEX

QUARTERLY REPORT ON FORM 10-Q

Exhibit No.	Description
31.1	Exhibit 31.1-Certification of James A. Hughes. Required by Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Exhibit 31.2-Certification of Alan J. Bedner, Jr. Required by Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Exhibit 32.1-Certification of James A. Hughes and Alan J. Bedner, Jr. Required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document