SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1997
OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 1-9516

AMERICAN REAL ESTATE PARTNERS, L.P.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE<br>(State or other jurisdiction of incorporation or organization) | 13-3398766<br>(IRS Employer Identification No.) |
| 100 South Bedford Road, Mt. Kisco, New York<br>(Address of principal executive offices) | 10549<br>(Zip Code) |

(914) 242-7700
(AREP's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Depositary Units Representing Limited Partner Interests | New York Stock Exchange |
| 5% Cumulative Pay-in-Kind Redeemable Preferred Units Representing Limited Partner Interests | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether AREP (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.
YES X NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Based upon the closing price of Depositary Units on March 2, 1998, as reported on the New York Stock Exchange Composite Tape (as reported by The Wall Street Journal), the aggregate market value of AREP's Depositary Units held by nonaffiliates of AREP as of such date was $162,433,343.

Based upon the closing price of Preferred Units on February 27, 1998, as reported on the New York Stock Exchange Composite Tape (as reported by The Wall Street Journal), the aggregate market value of AREP's Preferred Units held by nonaffiliates of AREP as of such date was $7,635,889.

Number of Depositary Units outstanding as of March 2, 1998: 46,198,284.

Number of Preferred Units outstanding as of March 2, 1998:  7,311,054.



PART I

Item 1.  Business.

Introduction

American Real Estate Partners, L.P. ("AREP") was formed in Delaware on February 17, 1987. Pursuant to an exchange offer (the "Exchange Offer") which was consummated on July 1, 1987, AREP acquired the real estate and other assets, subject to the liabilities, of thirteen limited partnerships (the "Predecessor Partnerships"). The Predecessor Partnerships acquired such assets between 1972 and 1985. A registration statement on Form S-4 relating to the Exchange Offer (Registration No. 33-13943) was filed with the Securities and Exchange Commission (the "SEC") and declared effective May 18, 1987.

AREP's general partner is American Property Investors, Inc. (the "General Partner"), a Delaware corporation which is wholly owned by Carl C. Icahn ("Icahn"). The General Partner's principal business address is 100 South Bedford Road, Mt. Kisco, New York 10549, and its telephone number is (914) 242-7700. AREP's business is conducted through a subsidiary limited partnership, American Real Estate Holdings Limited Partnership (the "Subsidiary" or "AREH"), in which AREP owns a 99% limited partnership interest. The General Partner also acts as the general partner for the Subsidiary. The General Partner has a 1% general partnership interest in each of AREP and the Subsidiary. References to AREP herein include the Subsidiary, unless the context otherwise requires.

As described below, AREP is primarily engaged in the business of acquiring and managing real estate and activities related thereto. On August 16, 1996, an amendment (the "Amendment") to the Partnership's Amended and Restated Agreement of Limited Partnership (the "Partnership Agreement") became effective which permits AREP to make non-real estate related investments. As described below, the Amendment permits AREP to invest in securities issued by companies that are not necessarily engaged as one of their primary activities in the ownership, development or management of real estate to further diversify its investments while remaining in the real estate business and continuing to pursue suitable investments in the real estate markets.

General Description of Business

AREP is primarily engaged in the business of acquiring and managing real estate and activities related thereto. Such acquisitions may be accomplished by purchasing assets outright or by acquiring securities of entities which hold significant real estate related assets. Historically, the properties owned by AREP have been primarily office, retail, industrial, residential and hotel properties. Most of the real estate assets currently owned by AREP were acquired from the Predecessor Partnerships and such assets generally are net-leased to single, corporate tenants. As of March 2, 1998, AREP owned 205 separate real estate assets primarily consisting of fee and leasehold interests in 35 states.





For each of the years ended December 31, 1997, 1996 and 1995, no single real estate asset or series of assets leased to the same lessee accounted for more than 10% of the gross revenues of AREP. However, at December 31, 1997, 1996 and 1995, Portland General Electric Company ("PGEC") occupied a property (the "PGEC Property") which represented more than 10% of AREP's total real estate assets. See Item 2 - "Properties."

AREP's primary investment strategy in recent periods has been to seek to acquire undervalued assets including residential development projects, land parcels for future residential and commercial development, commercial properties, non-performing loans and securities of entities which own, manage or develop significant real estate assets, including limited partnership units and securities issued by real estate investment trusts, debt or equity securities of companies which may be undergoing restructuring and sub-performing properties that may require active asset management and significant capital improvements.

In addition to holding real property, AREP may consider the acquisition or seek effective control of land development companies and other real estate operating companies which may have a significant inventory of assets under development, as well as experienced personnel. AREP may originate or purchase mortgage loans including non-performing mortgage loans. AREP will normally acquire non-performing mortgage loans with a view to acquiring title to or control over the underlying properties. AREP also may retain purchase money mortgages in connection with its sale of portfolio properties, with such terms as the General Partner deems appropriate at the time of sale. Certain of AREP's investments may be owned by special purpose subsidiaries formed by AREP or by joint ventures (including joint ventures with affiliates of the General Partner).

In August 1996, AREP amended the Partnership Agreement to permit non-real estate investments which, while AREP continues to seek undervalued investment opportunities in the real estate market, will permit it to take advantage of investment opportunities it believes exist outside of the real estate market in order to seek to maximize Unitholder value and further diversify its assets. Investments in non-real estate assets will consist of equity and debt securities of domestic and foreign issuers that are not necessarily engaged as one of their primary activities in the ownership, development or management of real estate, and may include, for example, lower rated securities which may provide the potential for higher yields and therefore may entail higher risk. AREP will conduct these activities in such a manner so as not to be deemed an investment company under the Investment Company Act of 1940 (the "1940 Act"). Generally, this means that no more than 40% of AREP's total assets will be invested in securities. In addition, AREP will structure its investments so as to continue to be taxed as a partnership rather than as a corporation under the applicable publicly-traded partnership rules of the Internal Revenue Code.

All decisions with respect to the improvement, expansion, acquisition, disposition, development, management, financing or refinancing of properties or other investments are at the sole discretion of the General Partner.





1997 Rights Offering

On September 25, 1997, AREP completed a rights offering (the "1997 Offering"), pursuant to which it raised approximately $267 million, net of related expenses. In addition, in connection therewith the General Partner contributed $5,419,382 in accordance with the terms of the Partnership Agreement. Pursuant to the terms of the 1997 Offering, holders of depositary units representing limited partner interests (the "Depositary Units") on the record date received one transferable subscription right (each a "Right") for each five Depositary Units held. Each Right was exercisable at a subscription price of $52 for a combination of securities consisting of four Depositary Units and one 5% cumulative pay-in-kind redeemable preferred unit representing a limited partner interest (the "Preferred Units"). High Coast Limited Partnership, a Delaware limited partnership which is controlled by Icahn, acted as guarantor of the offering ("High Coast"). Initially, High Coast acquired 11,116,568 Depositary Units and 2,779,142 Preferred Units as a result of exercising Rights received based upon its ownership of Depositary Units. In addition, High Coast exercised an over-subscription privilege and pursuant to the foregoing and its subscription guaranty it acquired a total of 6,502,764 additional Depositary Units and 1,625,691 additional Preferred Units; as a result, the 1997 Offering was fully subscribed.

The 1997 Offering enabled AREP to increase its available liquidity so that it will be in a better position to take advantage of investment opportunities and to further diversify its portfolio of assets. Additionally, AREP may determine to reduce the debt of certain properties where the interest rate is considered to be in excess of current market rates.

As described below, the types of investments AREP will pursue include residential/commercial development, debt or equity securities of companies which may be undergoing restructuring and subperforming assets that may require active asset management and significant capital expenditures. These investments may not be readily financeable and may not generate immediate positive cash flow for AREP. As such, they require AREP to maintain a strong capital base in order to react quickly to these market opportunities as well as to allow AREP the financial strength to develop or reposition these assets.

The Amendment

On August 16, 1996, the Amendment became effective which permits AREP to make non-real estate related investments. Pursuant to the Amendment, AREP, while continuing to pursue suitable investments in the real estate markets as described, may invest a portion of its funds in securities of issuers that are not necessarily engaged as one of their primary activities in the ownership, development or management of real estate. Such investments may include equity and debt securities of domestic and foreign issuers. The investment objective of AREP with respect to such investments will be to purchase undervalued securities, so as to maximize total return consisting of current income and/or capital appreciation. Undervalued securities are those which AREP believes may have greater inherent value than indicated by their then current trading price and/or may lend themselves to "activist" shareholder involvement. The equity securities in which AREP may invest may include common stocks, preferred stocks





and securities convertible into common stocks, as well as warrants to purchase such securities. The debt securities in which AREP may invest may include bonds, debentures, notes, mortgage-related securities and municipal obligations. Certain of such securities may include lower rated securities which may provide the potential for higher yields and therefore may entail higher risk. AREP will conduct its investment activities in such a manner so as not to be deemed an investment company under the 1940 Act. While the General Partner believes that investments pursuant to the Amendment may result in increased Unitholder value and further diversification of the Partnership's assets, there can be no assurances thereof and there are significant risks which may also attend the Amendment. See Item 1 - "Investment Opportunities and Strategies - Non-Real Estate Related Investments" below and Note 1 to the Financial Statements contained herein for more information relating to the Amendment.

Investment Opportunities and Strategies

AREP believes that it will benefit from diversification of its portfolio of assets. By the end of the year 2000, net leases representing approximately 18% of AREP's net annual rentals from its real estate portfolio will be due for renewal, and by the end of the year 2002, net leases representing approximately 32% of AREP's net annual rentals will be due for renewal. Since most of AREP's properties are net-leased to single corporate tenants, it may be difficult and time consuming to re-lease or sell those properties that existing tenants decline to re-let or purchase and that AREP may be required to incur expenditures to renovate such properties for new tenants. In addition, AREP may become responsible for the payment of certain operating expenses, including maintenance, utilities, taxes, insurance and environmental compliance costs associated with such properties which are presently the responsibility of the tenant. As a result, AREP could experience an adverse impact on net cash flow from such properties in the future.

Real Estate Investments

As mentioned above, in selecting future real estate investments, AREP intends to focus on assets that it believes are undervalued in the real estate market, which investments may require substantial liquidity to maintain a competitive advantage. Despite the substantial capital pursuing real estate opportunities, management believes that there are still opportunities available to acquire investments that are undervalued. This may include commercial properties, residential and commercial development projects, land parcels for future residential and commercial development, non-performing loans and the securities of entities which own, manage or develop significant real estate assets, including limited partnership units and securities issued by REITS, and debt or equity securities of companies which may be undergoing restructuring and subperforming properties that may require active asset management and significant capital improvements. Management believes that, in the current market, investments requiring some degree of active management or development activity have the greatest potential for growth, both in terms of capital appreciation and the generation of cash flow. In order to further these investment objectives, AREP may consider the acquisition or seek effective control of land development companies and other real estate operating companies which may have a significant





inventory of assets under development, as well as experienced personnel. This may enhance AREP's ability to further diversify its portfolio of properties and gain access to additional operating and development capabilities. Such acquisitions may include those from affiliates of the General Partner, provided the terms thereof are fair and reasonable and are approved by the Audit Committee of the Board of Directors of the General Partner (the "Audit Committee"). In this regard, in 1997, an offer was made by AREP acting through its Audit Committee to purchase a land development company owned by Icahn for approximately $48.5 million, which offer was not accepted. While the Audit Committee may consider having AREP make a higher offer for the land development company and may consider making such offer in Units of AREP (the number of Units could be conditioned upon the Audit Committee's obtaining a fairness opinion), there can be no assurances thereof or whether the transaction will be pursued.

Other real estate investment opportunities AREP may pursue include entering into joint venture arrangements or providing financing to developers for the purpose of developing single-family homes, luxury garden apartments or commercial properties. The loans may provide for a contractual rate of interest to be paid as well as providing for a participation in the profits of the development and/or an equity participation. Additionally, AREP will seek to acquire underperforming properties through outright purchase or the purchase of the debt or securities of such entities. For example, AREP may elect to establish an ownership position by first acquiring debt secured by targeted assets and then negotiate for the ownership or effective control of some or all of the underlying equity in such assets. AREP may also seek to establish a favorable economic and negotiating position through the acquisition of other rights or interests that provide it with leverage in negotiating the acquisition of targeted assets. AREP will also seek to acquire assets that are not in financial distress but due to the particular circumstances of their ownership, use or location, present substantial opportunities for development or long-term growth. AREP may also consider acquiring additional net-leased properties at appropriate yields or to effectuate tax-free exchanges.

As mentioned, AREP has invested and expects to invest in undeveloped land and development properties. In particular, AREP expects to continue to pursue this year the development of two residential sites it owns in Armonk, New York and East Hampton, New York. The Armonk site is comprised of approximately 43 residential building lots, and the East Hampton site is comprised of approximately 16 residential building lots. Undeveloped land and development properties involve more risk than properties on which development has been completed. Undeveloped land and development properties do not generate any operating revenue, while costs are incurred to develop the properties. In addition, undeveloped land and development properties incur expenditures prior to completion, including property taxes and development costs. Also, construction may not be completed within budget or as scheduled and projected rental levels or sales prices may not be achieved and other unpredictable contingencies beyond the control of AREP could occur. AREP will not be able to recoup any of such costs until such time as these properties, or parcels thereof, are either disposed of or developed into income-producing assets. Accordingly, the greater the length of time it takes to develop or dispose of these properties, or such parcels, the greater will be the costs incurred by AREP without the benefit of income from these properties, which may adversely affect the ability of AREP to successfully develop such properties. Furthermore, the ultimate disposition price of these properties may be less than the costs incurred by AREP with respect thereto.





AREP may continue to purchase real estate limited partnership interests by pursuing negotiated agreements or commencing tender offers. The illiquidity of many of these securities and their "informal" trading market enable entities such as AREP to purchase these interests at what may be significant discounts to the value of their underlying real estate in many instances. It should also be noted, however, that such illiquidity may adversely affect AREP's ability to profit from these investments in the near term, although AREP believes that such investments provide opportunities for long term appreciation.

Further, as reported generally, recent global economic and monetary conditions, especially in Asia, may create opportunities for value-added investors in those markets. AREP has begun to consider additional opportunities in foreign markets, but there can be no assurance that any such transactions will be pursued or consummated. It should be noted that such investments may be subject to additional considerations relating to foreign political and regulatory risks, as well as currency and exchange risks, which may affect the liquidity and value of any such investments in the near term, although AREP believes that such investments provide opportunities for long term appreciation.

As discussed below, AREP recently made a $42.8 million investment in First Mortgage Notes issued by Stratosphere Corporation ("Stratosphere"), which owns the Stratosphere Tower, Casino & Hotel. In addition to the Stratosphere transaction, AREP may consider additional investment opportunities in the gaming industry. See Item 1 - Recent Acquisitions - Investment in Mortgages and Notes Receivable for a further discussion on Stratosphere, as well as a discussion on AREP's recent investments in the Sands Hotel and Casino and the Claridge Hotel and Casino. It should be noted that investments in the gaming industry involve significant risks, including those relating to competitive pressures and political and regulatory considerations. In recent years, there have been several new gaming establishments opened as well as facility expansions, providing increased supply of competitive products and properties in the industry, which may adversely affect the operating margins and investment returns. As new openings and expansion projects have been completed, supply has grown more quickly than demand in some areas, and competition has increased. Likewise, an increase in supply often leads to increases in complimentary and promotional expenses in the industry. While the increase in supply and competition may provide additional investment opportunities for investors such as AREP, such investments may require additional capital expenditures and restructurings (such as in the case of Stratosphere) and there can be no assurance that such investments will not be adversely affected by such pressures or prove to be successful. Furthermore, federal, state and local jurisdictions from time to time consider legislation regarding the gaming industry which could adversely impact gaming operations. AREP believes, however, that investments in the gaming industry provide AREP with opportunities for long term appreciation.

While AREP believes opportunities in real estate acquisitions continue to remain available, such acquisition opportunities for value-added investors are becoming more competitive to source and the increased competition may have some impact on the spreads and the ability to find quality assets that provide returns that are sought. These investments may not be readily financeable and may not generate immediate positive cash flow for AREP. As such, they require AREP to maintain a strong capital base in order to react quickly to these market opportunities as well as to allow AREP the financial strength to develop or reposition these assets. While this may impact cash flow in the near term and there can be no assurance that any asset acquired by AREP will increase in value or generate positive cash flow, AREP intends to focus on assets that it believes may provide opportunities for long-term growth and further its objective to diversify its portfolio.

Non-Real Estate Related Investments

In selecting future investments, AREP may, while remaining in the real estate business and continuing to pursue suitable investments for AREP in the real estate markets, invest a portion of its funds available for investment in securities of issuers that are not necessarily engaged as one of their primary activities in the ownership, development or management of real estate. Such investments may include equity and debt securities of domestic and foreign issuers. The investment objective of AREP with respect to such investments will be to purchase undervalued securities, so as to maximize total returns consisting of current income and/or capital appreciation. Undervalued securities are those which AREP believes may have greater inherent value than indicated by their then current trading price and/or may lend themselves to "activist" shareholder involvement. These securities may be undervalued due to market inefficiencies, may relate to opportunities wherein economic or market trends have not been identified and reflected in market value, or may include those in complex or not readily followed securities. Less favorable financial reports, lowered credit ratings, revised industry forecasts





or sudden legal complications may result in market inefficiencies and undervalued situations. As is the case with real estate related investments, with regard to non-real estate related investments, AREP may determine to establish an ownership position through the purchase of debt or equity securities of such entities and then negotiate for the ownership or effective control of some or all of the underlying equity in such assets.

The equity securities in which AREP may invest may include common stocks, preferred stocks and securities convertible into common stocks, as well as warrants to purchase such securities. The debt securities in which AREP may invest may include bonds, debentures, notes, mortgage-related securities and municipal obligations. Certain of such securities may include lower rated securities which may provide the potential for higher yields and therefore may entail higher risk. In addition, AREP may engage in various investment techniques, such as options and futures transactions, foreign currency transactions and leveraging for either hedging or other purposes.

AREP will conduct its investment activities in such a manner so as not to be deemed an investment company under the 1940 Act. Generally, this means that AREP does not intend to enter the business of investing in securities and that no more than 40% of AREP's total assets will be invested in securities. The portion of AREP's assets invested in each type of security or any single issuer or industry will not be limited. Investments may be made directly by AREP or indirectly through entities in which it has an interest.

AREP will concentrate on undervalued securities, which may include, for example, high yield securities and neglected securities, and AREP's investments may be subject to significant amounts of business, financial, market and other risks. There can be no assurance that AREP will correctly evaluate such investments and their attendant risks or that such investments will be profitable to AREP. In addition, the securities in which AREP may invest are subject to the following inherent risks:

Equity Securities. Equity securities fluctuate in value, often based on factors unrelated to the issuer of the securities, and such fluctuations can be pronounced.

Fixed-Income Securities. Even though interest-bearing securities are investments which may promise a stable stream of income, the prices of such securities generally are inversely affected by changes in interest rates and, therefore, are subject to the risk of market price fluctuations. The value of fixed-income securities also may be affected by changes in the credit rating or financial condition of the issuer.

Lower Rated Securities. AREP may invest a portion of its funds in higher yielding (and, therefore, higher risk) securities (commonly known as junk bonds). Such investments generally may be subject to certain risks with respect to the issuing entity and to greater market fluctuations than certain lower yielding, higher rated convertible debt securities. The secondary market for these securities may be less liquid than that of higher rated securities; adverse conditions could make it difficult at times for AREP to sell certain securities or could result in lower prices.





Foreign Markets. Foreign securities and other markets generally are not as developed or efficient as those in the United States. Securities of some foreign issuers are less liquid and more volatile than securities of comparable U.S. issuers. Similarly, volume and liquidity in most foreign securities markets are less than in the United States and, at times, volatility of price can be greater than in the United States. Since foreign securities often are purchased with and payable in currencies of foreign countries, the value of these assets measured in U.S. dollars may be affected favorably or unfavorably by changes in currency rates and exchange control regulations.

Use of Leverage. Use of borrowed funds to leverage acquisitions can exaggerate the effect of any increase or decrease in market value. Such borrowings would be subject to interest costs which may not be recovered by appreciation in value of the securities purchased.

Use of Derivatives. AREP may use derivatives ("Derivatives"), which are financial instruments which derive their performance, at least in part, from the performance of an underlying asset, index or interest rate, such as options and mortgage-related securities. While Derivatives can be used effectively in furtherance of AREP's investment objectives such as by providing a hedging technique, under certain market conditions they can increase the volatility or decrease the liquidity of AREP's assets.

Natural Resources Investments. AREP may consider investments in oil and gas and other mineral or natural resource businesses. Income and gains derived from the exploration, development, mining, production, processing, refining, transportation or marketing of oil, gas, minerals or other natural resources is qualifying income for purposes of maintaining AREP's tax classification as a partnership. Accordingly, investments in these lines of business may be done by AREP on a tax efficient basis. Management notes that an investment in any of these lines of businesses will be subject to the inherent investment risks of that business. AREP may determine to conduct any such business through a subsidiary limited liability company or limited partnership to limit the exposure of its other investments. At present, there can be no assurance that any such transactions will be pursued or consummated, or the type of such transaction.

Partnership Distributions

On March 26, 1998, AREP announced that no distributions on its Depositary Units are expected to be made in 1998. No distributions were made in 1997, 1996 or 1995. In making its announcement, AREP noted that it intends to continue to apply available cash flow toward its operations, repayment of maturing indebtedness, tenant requirements and other capital expenditures and creation of cash reserves for contingencies facing AREP, including environmental matters and scheduled lease expirations. As previously reported, by the end of the year 2000, net leases representing approximately 18% of AREP's net annual rentals from its portfolio will be due for renewal, and by the end of the year 2002, 32% of such rentals will be due for renewal. In making its decision, AREP also considered the number of properties that are leased to retail tenants (approximately 29% of AREP's net annual rentals from its portfolio) some of which are experiencing cash flow difficulties and restructurings. Further, AREP noted that the types of investments AREP is pursuing, including assets that may not be readily financeable or generating positive cash flow, such as development properties, non-performing mortgage loans or securities of companies which may be undergoing restructuring or require significant capital investments, require AREP to maintain a strong capital base in order to own, develop and reposition those assets. See Item 5 - "Market for AREP's Common Equity and Related Security Holder Matters - Distributions" and Item 7





- - "Management's Discussion and Analysis of the Financial Condition and Results of Operations - Capital Resources and Liquidity."

On March 31, 1997, AREP distributed to holders of record of its Preferred Units as of March 14, 1997 approximately 103,721 additional Preferred Units. Pursuant to the terms of the Preferred Units, on February 27, 1998, AREP declared its scheduled annual preferred unit distribution payable in additional Preferred Units at the rate of 5% of the liquidation preference of $10.00. The distribution is payable March 31, 1998 to holders of record as of March 13, 1998.

Recent Acquisitions

Investment in Mortgages and Notes Receivable

In June, 1997 AREP invested approximately $42.8 million to purchase approximately $55 million face value of 14 1/4% First Mortgage Notes, due May

15, 2002, issued by the Stratosphere, which has approximately $203 million of such notes outstanding. An affiliate of the General Partner owns approximately $46.6 million face value of the Stratosphere First Mortgage Notes.

Stratosphere owns and operates the Stratosphere Tower, Casino & Hotel, a destination resort complex located in Las Vegas, Nevada, containing a 97,000 square foot casino and 1,444 hotel rooms and suites and other attractions.

Stratosphere and its wholly owned subsidiary Stratosphere Gaming Corp. filed voluntary petitions on January 27, 1997, for Chapter 11 reorganization pursuant to the United States Bankruptcy Code (the "Bankruptcy Code"). Stratosphere and its subsidiary are acting as debtors in possession on behalf of their respective bankrupt estates and are authorized as such to operate their business subject to bankruptcy court supervision.

Stratosphere recently filed a Second Amended Plan of Reorganization which, as proposed, would provide holders of the First Mortgage Notes with 100% of the equity in the reorganized entity. If such plan is approved by the Bankruptcy Court, it would provide AREP and an affiliate of the General Partner with a controlling interest in such reorganized entity.

If such transaction were consummated AREP and the affiliate of the General Partner would enter into a joint venture regarding such Stratosphere investment, with such venture to be managed by such affiliate of the General Partner on terms fair and reasonable to AREP; AREP's investment will be structured to comply with applicable regulatory requirements. Furthermore, AREP understands that Stratosphere may seek approximately $100 million for expansion of its hotel facility, a portion of which may be provided by AREP and the affiliate of the General Partner.





AREP, the General Partner and the directors and officers of the General Partner are currently in the process of pursuing gaming applications to obtain licenses from the Nevada Gaming Authority. AREP understands that the application process may take a number of months. AREP has no reason to believe it will not obtain its necessary license; however, AREP understands that the licensing applications of the affiliate of the General Partner may be reviewed by the authorities earlier than its application. In an effort to facilitate the consummation of the Stratosphere reorganization process if approved by the court in advance of the obtaining of such license by AREP, AREP may transfer its interests in Stratosphere to an affiliate of the General Partner at a price equal to AREP's cost for such Stratosphere First Mortgage Notes. Such transfer will be made to accommodate such reorganization process only if the affiliate of the General Partner receives its license but AREP does not receive its license, by the time of Stratosphere's reorganization as described. However, in such event, the affiliate of the General Partner would be obligated to sell back to AREP, and AREP would be obligated to repurchase, such interests (or their equivalent) in Stratosphere at the same price (together with a commercially reasonable interest factor) when the appropriate licenses are obtained for AREP. AREP believes that there should be no problem for AREP to obtain its license, and thereupon such Stratosphere interests (if so transferred to the affiliate of the General Partner) would be transferred back to AREP; however, in order to secure AREP, if such Stratosphere interests are not so transferred back to AREP then any net gains (less such interest) from the subsequent sale by the affiliate of the General Partner of such Stratosphere interests previously held by AREP will be paid to AREP. Presently, AREP understands that the Stratosphere First Mortgage Notes are trading at less than AREP's cost for such notes, and at December 31, 1997, AREP recorded a $9,790,000 provision for loss on its investment in Stratosphere (See Note 8).

Furthermore, in January, 1998, AREP acquired an interest in the Sands Hotel and Casino (the "Sands") located in Atlantic City, New Jersey by purchasing the principal amount of $17.5 million of First Mortgage Notes issued by GB Property Funding Corp. ("GB Property"). GB Property was organized as a special purpose entity for the borrowing of funds by Greate Bay Hotel and Casino, Inc. ("Greate Bay"). The purchase price for such notes was approximately $14.3 million. Notes in the amount of $185 million were issued, which bear interest at 10.875% per annum and are due on January 15, 2004.

Greate Bay owns and operates the Sands, a destination resort complex, containing a 76,000 foot casino and 532 hotel rooms and other amenities. On January 5, 1998, GB Property and Greate Bay filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code to restructure its long term debt.

In January, 1998, AREP also acquired an interest in the Claridge Hotel and Casino (the "Claridge Hotel") located in Atlantic City, New Jersey by purchasing the principal amount of $15 million of First Mortgage Notes of the Claridge Hotel and Casino Corporation (the "Claridge Corporation"). The purchase price of such notes was approximately $14.1 million. Notes in the amount of $85 million were issued, which bear interest at 11.75% payable annually and are due February 1, 2002.

The Claridge Corporation through its wholly-owned subsidiary, the Claridge at Park Place, Incorporated, operates the Claridge Hotel, a destination resort complex, containing a 59,000 foot casino on three levels and 502 hotel rooms and other attractions.

See Item 1 - "Investment Opportunities and Strategies - Real Estate Investments", above, for a discussion of certain considerations relating to the gaming industry.

Investment in Real Estate Assets

On August 18, 1997, a wholly-owned subsidiary of AREP acquired five notes and mortgages for approximately $10,745,000 with an aggregate face amount of approximately $14,340,000, excluding accrued and unpaid interest and penalties owed by the borrower that are estimated to total approximately an additional $8,200,000. The notes are secured by certain real property belonging to the borrower, New Seabury Company Limited Partnership ("New Seabury"). The loans are currently non-performing and the debtor has filed a Chapter 11 petition for relief in the United States Bankruptcy Court, District of Massachusetts. The properties are part of a master planned community situated in the town of Mashpee located on Cape Cod in Massachusetts. AREP is attempting to foreclose on the underlying collateral pertaining to all of the above mentioned notes.

On September 26, 1997, a wholly-owned subsidiary of AREP acquired four additional notes and mortgages for a purchase price of approximately $5,000,000 with an outstanding principal balance of approximately $8,320,000, excluding accrued and unpaid interest and penalties owed by the borrower that are estimated to total approximately an additional $3,000,000 to $4,000,000. The notes are secured by certain real property belonging to the





borrower, New Seabury. The loans also are currently non-performing and subject to the debtor's Chapter 11 proceeding. The properties are part of a master planned community situated in the Town of Mashpee located in Cape Cod in Massachusetts.

On June 30, 1997, AREP acquired two adjacent medical office buildings located in Nashville, Tennessee, both of which are net leased to Baptist Hospitals, Inc. ("Baptist"). The total purchase price was approximately $34,616,000 which included the assumption of existing mortgages on each building totalling approximately $31,666,000. The lease term, which commenced June 28, 1996, is for 22.5 years with seven 10-year renewal periods at approximately $3,032,000 per annum paid semi-annually. The mortgages bear interest at the rate of 7.84% per annum, self-liquidate on December 31, 2018, and have total debt service of approximately $3,070,000 payable semi-annually.

On September 26, 1997 AREP purchased a retail property located in Schaumburg, Illinois. The purchase price was approximately $9,138,000 which was paid all in cash. The completed building, which is approximately 100,000 square feet, is to be tenanted by Bed Bath & Beyond, Inc., and Golfsmith International, Inc. Bed Bath & Beyond's lease is for an initial term of fifteen years starting at $565,896 per year for their approximately 71,000 square foot store with four five-year renewal options at increased rentals. Golfsmith International's lease is for an initial term of fifteen years starting at $375,450 per year with three five-year renewal options at increased rentals. The rent commencement date for both tenants occurred in the fourth quarter of 1997. A mortgage loan commitment has been entered into to provide funding of approximately $7,150,000 for this property.

In December, 1997, AREP purchased two multi-tenant industrial buildings located in Hebron, Kentucky for approximately $19 million. Net rental income for such properties is estimated to be approximately $1.75 million per annum. AREP has entered into a commitment to obtain a mortgage of approximately $12.6 million with interest at 7.21% per annum payable on a 30 year basis due in 124 months.

AREP also entered into a contract to purchase for approximately $21 million a third single tenant building in the Hebron complex subject to certain contingencies including substantial completion by October, 1998. A mortgage loan commitment has been executed to provide funding of $19.4 million in connection with this acquisition.

Investment in Real Estate Limited Partnership Units

In June 1996, AREP entered into an agreement with non-affiliated third parties and became a member of a limited liability company, Beattie Place LLC ("Beattie"). The purpose of Beattie is to acquire, hold, and ultimately dispose of limited partnership units in ten Balcor Limited Partnerships (the "Balcor Units") in connection with previously commenced tender offers. These Balcor limited partnerships own and operate commercial and multi-family real estate properties nationwide. AREP agreed to purchase a non-voting membership interest in Beattie of approximately 71.5%. As of December 31, 1997, Beattie purchased approximately 119,000 Balcor Units of which approximately 85,000 Balcor Units represent AREP's pro rata





share. A total of approximately $9,834,000 was invested by AREP in this venture. AREP received return of capital distributions of approximately $2,476,000 in excess of its original investment.

On July 17, 1996, AREP and Bayswater Realty and Capital Corp. ("Bayswater"), an affiliate of Icahn, became partners of Boreas Partners, L.P. ("Boreas"), a Delaware limited partnership. AREP's total partnership interests in Boreas is 70%. Boreas together with unaffiliated third parties entered into an agreement and became limited partners of Raleigh Capital Associates, L.P. ("Raleigh") for the purpose of making a tender offer for outstanding limited partnership and assignee interests of Arvida/JMB Partners, L.P. ("Arvida") a real estate partnership. Boreas and an affiliated general partner have a total interest in Raleigh of 33 1/3%. A total of approximately $13,729,000 invested by AREP in these ventures representing approximately 35,000 Arvida units, net of a return of capital distribution of approximately $4,629,000. See Note 7 to the Financial Statements contained herein.

As of December 31, 1997, AREP had participated in four other tender offers for limited partnership units. AREP has invested approximately $9,192,000 in these partnerships.

In February 1998, AREH formed Olympia Investors, L.P. ("Olympia"), a Delaware limited partnership, the general partner of which is Olympia-GP, Inc., a Delaware corporation also formed in February 1998 and wholly-owned by AREH, and the sole limited partner of which is AREH. On March 12, 1998, Olympia commenced tender offers for units of limited partnership interest ("IR Units") of the following limited partnerships (the "IR Partnerships"), representing approximately 40% of each of the IR Partnerships: (i) Integrated Resources High Equity Partners - Series 85; (ii) High Equity Partners L.P. - Series 86; and (iii) High Equity Partners L.P. - Series 88. The offers aggregate approximately $52.6 million. The offers are scheduled to expire at 12:00 midnight, New York City time, on April 8, 1998, unless extended. There can be no assurance that such offers for the IR Units will be successful.

In connection with the making of the Offers, AREH and Olympia entered into an agreement dated March 6, 1998 (the "Agreement") with Presidio Capital Corp. ("Presidio"), a corporation organized in the British Virgin Islands which directly or indirectly controls the general partners of each of the IR Partnerships. Under the Agreement, among other things, Presidio has a call option to purchase 50% of the IR Units acquired by Olympia pursuant to the offers at a price per IR Unit equal to the lesser of the price paid by Olympia or 85% of net asset value (except the limitation of the call price to 85% of net asset value will not apply if Olympia raises its price above that amount in to meet or top competing third party bids), plus 50% of Olympia's costs associated with the offers. In addition, the Agreement contains buy/sell provisions pursuant to which either party can initiate buy/sell procedures by notifying the other of a specified price per IR Unit (not to exceed then current net asset value) and the other terms and conditions on which the non-initiating party would then be required to elect either to buy certain IR Units from the initiating party or to sell certain IR Units to the initiating party.





Investment in RJR

In 1996, AREP purchased 3,121,700 shares of RJR Nabisco Holdings Corp. ("RJR"), representing approximately 1.1% of the total outstanding RJR common shares, at a total cost of approximately $83,000,000, and at an average cost per share of $26.46 per share. Icahn owned (through affiliates) an additional 16,808,100 shares of RJR. In February 1997, AREP sold its entire interest in RJR for net proceeds of approximately $112,000,000 realizing a gain of approximately $29,000,000. See Note 6 to the Financial Statements contained herein. AREP's pro rata share of third party expenses relating to such RJR investment was approximately $2,154,000 which was approved by the Audit Committee and paid in 1997.

Financing Activities

During 1997, AREP had approximately $6,854,000 in maturing balloon mortgages due, all of which was repaid. Approximately $3,500,000 of additional balloon payments are due during 1998. During the period 1998 through 1999 approximately $9,000,000 in balloon mortgages will come due. AREP will seek to refinance a portion of these maturing mortgages, although it does not expect to refinance all of them and may repay them from cash flow and reserves created from time to time, thereby reducing cash flow otherwise available for other uses.

AREP also has maturing debt requirements under its two unsecured note agreements (the "Note Agreements") that it entered into in May 1988. Under the Note Agreements, AREP is required to make semi-annual interest payments and annual principal payments. In May 1994, AREP repaid $10,000,000, and in 1995 through 1997, repaid $11,308,000 each year in respect of the outstanding principal balance under the Note Agreements. A final principal payment of approximately $11,308,000 is due under such agreements in May, 1998. See Note 11 to the Financial Statements contained herein. See Item 2 - "Properties."

AREP is continuing to seek opportunities to refinance upon favorable terms and sell certain of its properties to generate proceeds for future investments. Management continues to seek to improve the long-term value of AREP's portfolio by, among other means, using its available cash and reinvesting capital transaction proceeds to maximize capital appreciation and diversification of the portfolio.

Leasing Activities

In 1997, seven leases covering seven properties and representing approximately $812,000 in annual rentals expired. Six of these leases, originally representing approximately $661,000 in annual rental income, were re-let or renewed for approximately $676,000 in annual rentals. Such renewals are generally for a term of five years. One property, with an approximate annual rental income of $151,000 is currently being marketed for sale or lease.





In 1998, 25 leases covering 25 properties and representing approximately $2,123,000 in annual rentals are scheduled to expire. Eleven of these leases, originally representing approximately $403,000 in annual rental income have been or will be re-let or renewed for approximately $414,000 in annual rentals. Such renewals are generally for a term of five years. Six properties with an approximate annual rental income of $947,000 will be marketed for sale or lease when the current lease term expires. Four properties with annual rental income of $210,000 will be purchased by their tenants pursuant to the exercise of purchase options. The status of four leases, with approximate annual rental income of $563,000 is uncertain at this time.

By the end of the year 2000, net leases representing approximately 18% of AREP's net annual rentals from its portfolio will be due for renewal, and by the end of the year 2002, net leases representing approximately 32% of AREP's net annual rentals will be due for renewal. In many of these leases, the tenant has an option to renew at the same rents they are currently paying and in many of the leases the tenant also has an option to purchase the property. AREP believes that tenants acting in their best interests will renew those leases which are at below market rents, and permit leases for properties that are less marketable (either as a result of the condition of the property or its location) or are at above-market rents to expire. AREP expects that it may be difficult and time consuming to re-lease or sell those properties that existing tenants decline to re-let or purchase and that AREP may be required to incur expenditures to renovate such properties for new tenants. AREP also may become responsible for the payment of certain operating expenses, including maintenance, utilities, taxes, insurance and environmental compliance costs associated with such properties which are presently the responsibility of the tenant. In addition, net leases representing approximately 29% of AREP's net annual rentals from its portfolio are with tenants in the retail sector, many of which are currently experiencing cash flow difficulties and a number of which are in bankruptcy. As a result, operating expenses may be incurred with respect to the properties underlying any such leases rejected in bankruptcy and those expenses, coupled with the effects of the downturn in the retail markets, could have an adverse impact on AREP's net cash flow.

Bankruptcies and Defaults

AREP is aware that 14 of its present and former tenants have been or are currently involved in some type of bankruptcy or reorganization. Under the Bankruptcy Code, a tenant may assume or reject its unexpired lease. In the event a tenant rejects its lease, the Bankruptcy Code limits the amount of damages a landlord, such as AREP, is permitted to to claim in the bankruptcy proceeding as a result of the lease termination. Generally, a claim resulting from a rejection of an unexpired lease is a general unsecured claim. When a tenant rejects a lease, there can be no assurance that AREP will be able to re-let the property at an equivalent rental. As a result of tenant bankruptcies, AREP has incurred and expects - at least in the near term - to continue to incur certain property expenses and other related costs. Thus far, these costs have consisted largely of legal fees, real estate taxes and property operating expenses. Of AREP's 14 present and former tenants involved in bankruptcy proceedings or reorganization, ten have rejected their leases, affecting 29 properties, all of which have been vacated. These rejections have had an adverse impact on annual net cash flow





(including both the decrease in revenues from lost rents, as well as increased operating expenses).

On June 23, 1995, Bradlees, a tenant leasing four properties owned by AREP, filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Bankruptcy Code. The annual rentals for these four properties is approximately $1,320,000. The tenant is current in its obligations under the leases. The tenant has not yet determined whether it will exercise its right to reject or affirm the leases, which will require an order of the Bankruptcy Court. There are existing assignors who are still obligated to fulfill all of the terms and conditions of the leases. At December 31, 1997, the carrying value of these four properties was approximately $6,978,000. One of the properties is encumbered by a nonrecourse mortgage payable of approximately $870,000.

On September 18, 1995, Caldor Corp., a tenant leasing a property owned by AREP, filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Federal Bankruptcy Code. The annual rental for this property is approximately $248,000. The tenant is current in its obligations under the lease with the exception of approximately $12,000 of pre-petition rent. The tenant has not yet determined whether it will exercise its right to reject or affirm the lease which will require an order of the Bankruptcy Court. At December 31, 1997, the property was vacant and had a carrying value of approximately $1,874,000 and is unencumbered by any mortgage.

On September 24, 1996 Best Products, a tenant leasing a property owned by AREP, filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Bankruptcy Code. The annual rental for this property was approximately $508,000. The tenant has exercised its right to reject the lease, effective April 30, 1997, which has been approved by the Bankruptcy Court. At December 31, 1997, the property was vacant and had a carrying value of approximately $3,300,000 and is unencumbered by any mortgage.

For a description of certain other tenant and mortgagor bankruptcies affecting AREP, please refer to Notes 9 and 15 to the Financial Statements contained herein. The General Partner monitors all tenant bankruptcies and defaults and may, when it deems it necessary or appropriate, establish additional reserves for such contingencies.

Environmental Matters

Under various federal, state and local laws, ordinances and regulations, an owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances released on or in its property. Such laws often impose such liability without regard to whether the owner or operator knew of, or was responsible for, the release of such hazardous substances. If any such substances were found in or on any property invested in by AREP, AREP could be exposed to liability and be required to incur substantial remediation costs. The presence of such substances or the failure to undertake proper remediation may adversely affect the ability to finance, refinance or dispose of such property. AREP will generally require that properties in which AREP invests have been subject to a Phase I




environmental site assessment, which involves record review, visual site assessment and personnel interviews, but does not involve invasive procedures such as air and soil sampling or groundwater analysis. There can be no assurance, however, that these evaluations will reveal all potential liabilities or that future property uses or conditions or changes in applicable environmental laws and regulations or activities at nearby properties will not result in the creation of environmental liabilities with respect to a property.

Additionally, pursuant to the Resource Conservation and Recovery Act 42 U.S.C. section 9601, et seq. and the regulations promulgated thereunder ("RCRA") certain owners, operators and other parties in control of a property that has a non-exempt underground storage tank ("UST") are required to remove, replace, retrofit or take such tanks out of service by December 22, 1998. Many of AREP's tenants have UST's that may be covered by this requirement. AREP is in the process of finalizing a notification protocol to address this situation. AREP believes that under the terms of its net leases with its tenants, the cost of, and obligation to comply with, this RCRA requirement generally would be the responsibility of its tenant. At this time, AREP cannot ascertain whether or not any of its tenants will refuse to assume and implement this obligation. Furthermore, with respect to vacated properties and prior lease terminations, there cannot be any assurance that AREP would not be deemed responsible for this RCRA requirement. There also can be no assurance that a tenant will bear the costs of, or undertake compliance with, this RCRA requirement.

Most of AREP's properties continue to be net-leased to single corporate tenants, and AREP believes these tenants would be responsible for any environmental conditions existing on the properties they lease. Normally, therefore, such conditions should not have a material adverse effect on the financial statements or competitive position of AREP. Many of the properties acquired by AREP in connection with the Exchange Offer were not subjected to any type of environmental site assessment at the time of the acquisition. Consequently, AREP undertook to have Phase I Environmental Site Assessments initiated at certain properties (approximately 160) in its portfolio. In addition, AREP conducted approximately 50 more Phase I Environmental Site

Assessments during 1997 on some of the properties in its portfolio which had not yet been assessed. AREP believes that under the terms of its net leases with its tenants, the costs of any environmental problems that may be discovered on these properties generally would be the responsibility of such tenants. However, while most tenants have assumed responsibility for the environmental conditions existing on their leased property, there can be no assurance that AREP would not be deemed to be a responsible party or that the tenant could bear the costs of remediation.

The Phase I Environmental Assessments received on these properties inconclusively indicate that certain sites may have environmental conditions that should be further reviewed. AREP has notified the responsible tenants to attempt to ensure that they cause any required investigation and/or remediation to be performed. It is possible that, in some instances, the tenant will either refuse to take appropriate action, or fail to respond at all, in which case AREP may be required to act. Therefore, if the tenants fail to perform responsibilities under their leases in respect of such sites, based solely upon the consultant's preliminary estimates resulting from its Phase I Environmental Site Assessments referred to above, it is presently estimated that AREP's exposure could amount to $2-3 million. However, as no Phase II Environmental Site





Investigations have been conducted by the consultant, there can be no accurate estimation of the need for or extent of any required remediation. Phase I Environmental Assessments will also be performed in connection with new acquisitions and with such property refinancings as AREP may deem necessary and appropriate.

In addition to conducting such Phase I Environmental Site Assessments, AREP has developed a site inspection program. This program is being conducted by two in-house employees (both of which are experienced construction managers and registered architects) who visit AREP's properties and visually inspect the premises to assess the physical condition of the properties in an effort to determine whether there are any obvious indications of environmental conditions which would potentially expose AREP to liability and to ensure that the physical condition of the property is being maintained properly. There is no assurance, however, that this program will in fact minimize any potential environmental or other cost exposure to AREP.

AREP could also become liable for environmental clean-up costs if a bankrupt or insolvent tenant were unable to pay such costs. Environmental problems may also delay or impair AREP's ability to sell, refinance or re-lease particular properties, resulting in decreased income and increased cost to AREP.

Other Property Matters

Under Title III of the Americans with Disabilities Act of 1990 and the rules promulgated thereunder (collectively, the "ADA"), in order to protect individuals with disabilities, owners and certain tenants of public accommodations (such as hotels, restaurants, offices and shopping centers) must remove architectural and communication barriers which are structural in nature from existing places of public accommodation to the extent "readily achievable" (as defined in the ADA). In addition, under the ADA, alterations to a place of public accommodation or a commercial facility are to be made so that, to the maximum extent feasible, such altered portions are readily accessible to and usable by disabled individuals.

Except for certain properties operated by AREP, the General Partner believes that the existing net leases require the tenants of many of AREP's properties to comply with the ADA. If a tenant does not comply with the ADA or rejects its lease in bankruptcy without complying with the ADA, AREP may ultimately have to bear the expense of complying with the ADA.

As AREP acquires more operating properties, it may be required to make expenditures to bring such properties into compliance with the ADA and other applicable laws.

Employees

Eighteen people, including three who are officers of the General Partner, presently perform services for AREP on a full-time basis. These people perform administrative services for AREP, including accounting, legal, financial, investor services, secretarial, real estate





management and other services. Management believes it currently has sufficient staffing to operate effectively the day-to-day business of AREP.

Competition

Competition in leasing and selling remains strong. As previously discussed, many of AREP's tenants have rights to renew at prior rental rates. AREP's experience is that tenants will renew below market leases and permit leases that are less marketable or at above market rents to expire, making it difficult for AREP to re-let or sell on favorable terms properties vacated by tenants. The real estate market continues to be weak in certain areas of the country, particularly in the retail category. The downturn in the retail markets and ongoing corporate consolidations have contributed to increasing vacancy rates and oversupply for retail tenants. AREP believes it is one of the largest real estate entities of its kind and that it will continue to compete effectively with other similar real estate companies, although there are real estate entities with greater financial resources than AREP.

Competition for investments of the type AREP intends to pursue has been increasing in recent years, including that from a number of investment funds and REITS that have raised additional capital for such investments, resulting in, among other things, higher prices for such investments. Such investments have become more competitive to source and the increased competition may have an adverse impact on the spreads and AREP's ability to find quality assets at appropriate yields. While AREP believes its capital base may enable it to gain a competitive advantage over certain other purchasers of real estate by allowing it to respond quickly and make all cash transactions without financing contingencies where appropriate, there can be no assurance that this will be the case.

Item 2. Properties.

As of March 2, 1998, AREP owned 205 separate real estate assets (primarily consisting of fee and leasehold interests and, to a limited extent, interests in real estate mortgages) in 35 states. These properties are generally net-leased to single corporate tenants. Approximately 90% of AREP's properties are currently net-leased, 3% are operating properties, 2% are in the process of being developed and 5% are vacant and being marketed for sale. See Note 10 to the Financial Statements contained herein for information on mortgages payable.

The following table summarizes the type, number per type and average net effective rent per square foot of AREP's properties:

| Type of Property | Number of Properties | Average Net Effective Rent Per Square Foot |
|---|---|---|
| Retail | 95 | $4.46(1) |
| Industrial | 21 | $2.25(1) |

| Type of Property | Number of Properties | Average Net Effective Rent Per Square Foot |
| --- | --- | --- |
| Office | 30 | $7.55(1) |
| Supermarkets | 20 | $3.36(1) |
| Banks | 8 | $5.20(1) |
| Other: | | |
| Properties That Collateralize Purchase Money Mortgages | 9 | N/A |
| Land | 15 | N/A |
| Truck Terminals | 4 | $3.72(1) |
| Hotels | 2 | N/A |
| Apartment Complexes | 1 | N/A |

- -----------------

(1) Based on net-lease rentals.

The following table summarizes the number of AREP's properties in each region specified below:

| Location of Property | Number of Properties |
| --- | --- |
| United States: | |
| Southeast | 92 |
| Northeast | 42 |
| South Central | 9 |
| Southwest | 15 |
| North Central | 41 |
| Northwest | 6 |

From January 1, 1997 through March 2, 1998, AREP sold or otherwise disposed of 25 properties. In connection with such sales and dispositions, AREP received an aggregate of approximately $47,000,000 in cash, net of closing costs and amounts utilized to satisfy mortgage indebtedness which encumbered such properties. As of December 31, 1997, AREP owned seven properties that were being actively marketed for sale. The aggregate net realizable value of such properties is estimated to be approximately $4,164,000.

On January 7, 1997 AREP sold three properties tenanted by Federal Realty Investment Trust ("FRIT") for a total selling price of approximately $9,363,000. Two first mortgages with principal balances outstanding of approximately $878,000 were repaid at closing. In addition, closing costs of approximately $40,000 were incurred. As a result, AREP recognized a gain of approximately $1,778,000 in 1997. In addition, on January 7, 1997, FRIT made a loan to AREP in the approximate amount of $8,759,000 secured by a fourth property tenanted by FRIT located in Broomal, Pennsylvania. Concurrently with this loan, AREP granted and FRIT exercised an option to purchase the Broomal property with a closing





to occur on or about June 30, 1998. The purchase price is the unpaid balance of the mortgage loan of approximately $8,500,000 at the closing date. The nonrecourse mortgage loan bears interest at the rate of 8% per annum and requires monthly debt service payments of approximately $72,000.

On January 16, 1997, AREP sold the Travelodge Hotel it had been operating since January 18, 1996 when the former tenant, Forte Hotels, Inc. entered into a Lease Termination and Mutual Release Agreement. The selling price was approximately $2,165,000 net of closing costs. A gain of $1,403,000 was recorded in 1997.

In April 1997, AREP sold the hotel property located in Phoenix, Arizona. The selling price was approximately $15,525,000 net of approximately $250,000 of closing costs. A gain of approximately $7,863,000 was recognized in 1997. See Item 1 -- "Investment in Real Estate Assets."

On December 12, 1997, AREP sold the property tenanted by Hancock Bank located in Baton Rouge, Louisiana. The selling price was $5,075,000 and closing costs of approximately $84,000 were incurred. As a result, AREP recognized a gain of approximately $1,345,000.

For each of the years ended December 31, 1997, 1996 and 1995, no single real estate asset or series of assets leased to the same lessee accounted for more than 10% of the gross revenues of AREP. However, at December 31, 1997, 1996 and 1995, PGEC occupied a property, which represented more than 10% of AREP's total real estate assets. PGEC is an electric utility engaged in the generation, purchase, transmission, distribution and sale of electricity, whose shares are traded on the NYSE.

The PGEC Property is an office complex consisting of three buildings containing an aggregate of approximately 803,000 square feet on an approximate 2.7 acre parcel of land located in Portland, Oregon. A Predecessor Partnership originally purchased the PGEC Property on September 11, 1978 for a price of approximately $57,143,000.

The PGEC Property is net-leased to a wholly owned subsidiary of PGEC for forty years, with two ten-year and one five-year renewal options. The annual rental is $5,137,309 until 2003, $4,973,098 until 2018 and $2,486,549 during each renewal option. PGEC has guaranteed the performance of its subsidiary's obligations under the lease. The lessee has an option to purchase the PGEC Property in September of 2003, 2008, 2013 and 2018 at a price equal to the fair market value of the PGEC Property determined in accordance with the lease and is required to make a rejectable offer to purchase the PGEC Property in September 2018 for a price of $15,000,000. A rejection of such offer will have no effect on the lease obligations or the renewal and purchase options.

On December 5, 1997 AREP executed a mortgage loan with Principal Mutual Life Insurance Company in the original principal amount of approximately $46.3 million, secured by, among other things, a first deed of trust, security agreement and assignment of rents on the PGEC Property. The loan replaced the existing mortgage loan on the complex with an





outstanding principal balance of approximately $24.2 million, bearing interest at 8.5% and maturing in 2002.

The interest rate is fixed at 7.51%. The entire net annual rent payable by PGEC of approximately $5,137,000 is required to be applied toward the debt service on the loan. The refinancing has a maturity date of September 10, 2008, at which time a remaining principal payment of approximately $20 million will be due from AREP.

## Item 3. Legal Proceedings.

### Unitholder Litigation

Two limited partners in AREP brought a derivative action against AREP, the General Partner, its directors and one of its officers, alleging breach of fiduciary duties by the defendants in connection with, inter alia, AREP's investments in Arvida and Stratosphere, Amanda & Kimberly Kahn v. Carl C. Icahn, et al., C.A. No. 15916 (Del. Ch.). Plaintiffs claim that defendant Icahn improperly diverted opportunities to participate in these investments from AREP to himself. Plaintiffs seek damages arising from these alleged breaches of fiduciary duty, attorneys fees and other relief. Management believes plaintiffs claims are without merit and are vigorously defending against them.

In August 1994, three class action complaints against AREP were filed with the Delaware Court of Chancery, New Castle County, in connection with the 1995 Offering, Allan Haymes, I.R.A. v. American Real Estate Partners, L.P., American Property Investors, Inc. and Carl C. Icahn and Steven Yavers v. American Real Estate Partners, L.P., American Property Investors, Inc. and Carl C. Icahn and Wilbert Schoomer v. American Real Estate Partners, L.P., American

Property Investors, Inc. and Carl C. Icahn (the "Complaints"). The Complaints were consolidated. The Complaints claimed defendants breached fiduciary and common law duties owed to plaintiffs and plaintiffs' class by self dealing and failing to disclose all relevant facts regarding the 1995 Offering, and sought declaratory and injunctive relief declaring the action was properly maintainable as a class action, declaring the defendants breached their fiduciary and other duties, enjoining the 1995 Offering, ordering defendants to account for all damages suffered by the class for alleged acts and transactions and awarding further relief as the court deemed appropriate. On April 7, 1995, defendants moved to dismiss the consolidated complaint as moot. On July 28, 1995, the parties submitted a stipulation of dismissal agreeing to dismiss the action as moot. The plaintiffs reserved their right to make application to the Court for fees and expenses. On August 3, 1995, the Court signed an order dismissing the plaintiffs' claims with prejudice as moot. The Court retained jurisdiction with respect to any application filed by the plaintiffs for fees and expenses.

In January 1997, the plaintiffs by their attorneys submitted an application for an award of attorneys' fees and reimbursement of expenses in the aggregate of $500,000. AREP opposed this application and on December 3, 1997, the Court awarded plaintiffs an award of attorneys fees and expenses in the amount of $158,566. AREP paid the award in January, 1998.





Environmental Litigation

Lockheed, a tenant of a formerly-held leasehold property in Palo Alto, California, has entered into a consent decree with the California Department of Toxic Substances ("CDTS") to undertake certain environmental remediation at this property. Lockheed has estimated that the environmental remediation costs may be up to approximately $14,000,000. In a non-binding determination by CDTS, Lockheed was found responsible for approximately 75% of such costs and the balance was allocated to other parties. AREP was allocated no responsibility for any such costs.

Lockheed previously served a notice that it may exercise its statutory right to have its liability reassessed in a binding arbitration proceeding. In this notice of arbitration, Lockheed stated that it would attempt to have allocated to AREP and to AREP's ground-lessor (which may have sought to claim a right of indemnity against AREP) approximately 9% and 17%, respectively, of the total remediation costs. In April 1995 Lockheed began ground water remediation at the leasehold property.

On February 19, 1998, the property was conveyed by AREP to Lockheed for a purchase price of $9,400,000. In connection with the sale, Lockheed executed a release and indemnity in favor of AREP and a stipulation dismissing the environmental arbitration, as against AREP. Leland Stanford Junior University (the fee owner/ground lessor) also executed a release in favor of AREP.

On December 11, 1995, Panos Sklavenitis commenced an action against the Subsidiary and others related to a shopping center that he purchased from a successor-in-interest to AREP. The action was brought in the United States District Court for the Central District of California, for reimbursement of the cost of remediating certain environmental contamination that appears to have been caused by a dry cleaner that was a tenant at the property; the amount of damages sought have not yet been quantified. Mr. Sklavenitis is suing the parties who are in the chain of ownership, as well as the dry cleaner and its predecessor. AREP is presently engaged in discussions to settle this matter and has made an offer of $10,000 toward an aggregate settlement, although there can be no assurances that such offer will be accepted.

Bankruptcies

AREP is aware that 14 of its present and former tenants have been or are currently involved in some type of bankruptcy or reorganization. Of AREP's 14 present and former tenants involved in bankruptcy proceedings or reorganization, nine have rejected their leases, affecting 29 properties, all of which have been vacated by such tenants. See also Notes 9 and 15 to the Financial Statements contained herein and "Business - Bankruptcies and Defaults" which describe various tenant and mortgagor bankruptcies for which AREP has filed claims.





Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of Unitholders during 1997.





PART II

Item 5. Market for AREP's Common Equity and Related Security Holder Matters.

Market Information

AREP's Depositary Units are traded on the NYSE under the symbol "ACP." Trading on the NYSE commenced July 23, 1987, and the range of high and low market prices for the Depositary Units on the New York Stock Exchange Composite Tape (as reported by The Wall Street Journal) from January 1, 1996 through December 31, 1997 is as follows:

| Quarter Ended: | High | Low |
|---|---|---|
| March 31, 1996 | $ 9.375 | $ 8.625 |
| June 30, 1996 | 9.125 | 8.875 |
| September 30, 1996 | 9.125 | 8.625 |
| December 31, 1996 | 9.25 | 8.875 |
| March 31, 1997 | 11.75 | 9.125 |
| June 30, 1997 | 14.25 | 9.875 |
| September 30, 1997 | 13.625 | 10.625 |
| December 31, 1997 | 11.375 | 9.4375 |

On March 2, 1998, the last sales price of the Depositary Units, as reported by the New York Stock Exchange Composite Tape (as reported by The Wall Street Journal) was $11.0625.

As of March 2, 1998, there were approximately 15,000 record holders of the Depositary Units.

Since January 1, 1994, AREP has made no cash distributions with respect to the Depositary Units.

Distributions

On March 26, 1998, the Board of Directors of the General Partner announced that no distributions are expected to be made in 1998. In making its announcement, AREP noted it plans to continue to apply available Partnership operating cash flow toward its operations, repayment of maturing indebtedness, tenant requirements and other capital expenditures and creation of cash reserves for Partnership contingencies, including environmental matters and scheduled lease expirations. As previously reported, by the end of the year 2000, net leases representing approximately 18% of AREP's net annual rentals from its portfolio will be due for renewal, and by the end of the year 2002, 32% of such rentals will be due for renewal. Another factor that AREP took into consideration was that net leases representing approximately 29% of AREP's net annual rentals from its portfolio are with tenants in the retail sector, some of which are currently experiencing cash flow difficulties and restructurings.

AREP further stated that it continues to believe that excess cash should be used to enhance long-term Unitholder value through investment in assets and companies with assets undervalued by the market. AREP believes that, in addition to acquiring development properties, non-performing mortgage obligations and securities of companies which may be undergoing restructuring or with real estate assets requiring significant capital investments, it should diversify its portfolio and seek to make acquisitions of land development companies and other real estate operating companies which may have significant assets under development and may enhance its ability to develop and manage these properties. These types of investments may involve debt restructuring, capital improvements and active asset management, and by their nature may not be readily financeable and may not generate immediate positive cash flow. As such, they require AREP to maintain a strong capital base both to react quickly to these market opportunities as well as to allow AREP to rework the assets to enhance their turnaround performance. See Item 7 - "Management's Discussion and Analysis of the Financial Condition and Results of Operations - Capital Resources and Liquidity."

As of March 2, 1998, there were 46,198,284 Depositary Units and 7,311,054 Preferred Units outstanding. Trading in the Preferred Units commenced March 31, 1995 on the NYSE under the symbol "ACP PR." The Preferred Units represent limited partner interests in AREP and have certain rights and designations, generally as follows. Each Preferred Unit has a liquidation preference of $10.00 and entitles the holder thereof to receive distributions thereon, payable solely in additional Preferred Units, at a rate of 5% of the liquidation preference thereof, payable annually on March 31 of each year (each, a "Payment Date"), commencing March 31, 1996. On any Payment Date commencing with the Payment Date on March 31, 2000, AREP, with the approval of the Audit Committee, may opt to redeem all, but not less than all, of the Preferred Units for a price, payable either in all cash or by issuance of additional Depositary Units, equal to the liquidation preference of the Preferred Units, plus any accrued but unpaid distributions thereon. On March 31, 2010, AREP must redeem all, but not less than all, of the Preferred Units on the same terms as any optional redemption. Holders of Preferred Units will have no voting rights except as mentioned in Item 10 - "Directors and Executive Officers of AREP," below.

On March 31, 1997, AREP distributed to holders of record of its Preferred Units as of March 14, 1997, approximately 103,721 additional Preferred Units. Pursuant to the terms of the Preferred Units, on February 27, 1998, AREP declared its scheduled annual preferred unit distribution payable in additional Preferred Units at the rate of 5% of the liquidation preference of $10.00. The distribution is payable March 31, 1998 to holders of record as of March 13, 1998.

Each Depositary Unitholder will be taxed on the Unitholder's allocable share of AREP's taxable income and gains and, with respect to Preferred Unitholders, accrued guaranteed payments, whether or not any cash is distributed to the Unitholder.




Repurchase of Depositary Units

AREP announced in 1987 its intention to purchase up to 1,000,000 Depositary Units. On June 16, 1993, AREP increased the amount of shares authorized to be repurchased to 1,250,000 Depositary Units. As of March 2, 1998, AREP had purchased 1,037,200 Depositary Units at an aggregate cost of approximately $11,184,000. Management has not been acquiring Depositary Units for AREP, although AREP may from time to time acquire additional Depositary Units.

Item 6. Selected Financial Data.

(Dollars in Thousands Except Per Unit Amounts)
Year Ended December 31,

| | 1997* | 1996* | 1995* | 1994* | 1993* |
|---|---|---|---|---|---|
| Total revenues | $ 70,918 | $ 71,774 | $ 69,920 | $ 61,551 | $ 60,157 |
| Earnings before property and securities transactions | $ 41,020 | $ 34,240 | $ 30,833 | $ 19,577 | $ 18,379 |
| Gain on sales and disposition of real estate | 16,051 | 24,517 | 5,091 | 4,174 | 4,760 |
| Gain on sales of marketable equity securities | 29,188 | -- | -- | -- | -- |
| Provision for loss on mortgages receivable | (9,790) | -- | -- | -- | -- |
| Provision for loss on real estate | (1,085) | (935) | (768) | (582) | (462) |
| Net earnings | $ 75,384 | $ 57,822 | $ 35,156 | $ 23,169 | $ 22,677 |
| Net earnings per limited partnership unit: | | | | | |
| Basic: | | | | | |
| Earnings before property and Securities transactions | $ 1.19 | $ 1.27 | $ 1.30 | $ 1.39 | $ 1.30 |
| Net gain from property and Securities transactions | 1.08 | .90 | .19 | .25 | .30 |
| Net earnings | $ 2.27 | $ 2.17 | $ 1.49 | $ 1.64 | $ 1.60 |
| Weighted average limited partnership units outstanding | 31,179,246 | 25,666,640 | 22,703,180 | 13,812,800 | 13,812,800 |
| Diluted: | | | | | |
| Earnings before property and securities transactions | $ 1.16 | $ 1.20 | $ 1.17 | $ 1.39 | $ 1.30 |
| Net gain from property and securities transactions | .97 | .82 | .16 | .25 | .30 |
| Net earnings | $ 2.13 | $ 2.02 | $ 1.33 | $ 1.64 | $ 1.60 |
| Weighted average limited partnership units and equivalent partnership units outstanding | 34,655,395 | 28,020,392 | 27,538,840 | 13,812,800 | 13,812,800 |
| Distributions to partners | $ -- | $ -- | $ -- | $ -- | $ 7,078 |
| At year end: | | | | | |
| Real estate leased to others | $ 387,252 | $ 357,184 | $ 412,075 | $ 437,699 | $ 444,409 |
| Hotel operating properties | $ 5,002 | $ 12,955 | $ 13,362 | $ 13,654 | $ 14,070 |
| Investment in treasury bills | $ 372,165 | $ -- | $ -- | $ -- | $ -- |
| Mortgages and note receivable | $ 59,970 | $ 15,226 | $ 15,056 | $ 8,301 | $ 20,065 |





| | | | | | |
|---|---|---|---|---|---|
| Total assets | $991,230 | $641,310 | $620,880 | $492,868 | $502,981 |
| Senior indebtedness | $ 11,308 | $ 22,616 | $ 33,923 | $ 45,231 | $ 55,231 |
| Mortgages payable | $156,433 | $115,911 | $163,968 | $174,096 | $195,274 |
| Partners' equity | $809,325 | $485,559 | $404,189 | $259,237 | $236,068 |

* To the extent financial information pertaining to AREP is reflected, such information is consolidated for AREP and its Subsidiary.

Item 7. Management's Discussion and Analysis of the Financial Condition and Results of Operations.

Forward-looking statements regarding management's present plans or expectations involve risks and uncertainties and changing economic or competitive conditions, as well as the negotiation of agreements with third parties, which could cause actual results to differ from present plans or expectations, and such differences could be material. Readers should consider that such statements speak only as to the date hereof.

General

AREP believes that it will benefit from diversification of its portfolio of assets. To further its investment objectives, AREP may consider the acquisition or seek effective control of land development companies and other real estate operating companies which may have a significant inventory of quality assets under development, as well as experienced personnel. From time to time AREP has discussed and in the future may discuss and may make such acquisitions from Icahn, the General Partner or their affiliates, provided the terms thereof are fair and reasonable to AREP. In this regard, in 1997 an offer was made by AREP acting through its Audit Committee to purchase a land development company owned by Icahn for approximately $48.5 million, which offer was not accepted. While the Audit Committee may consider having AREP make a higher offer for the land development company and may consider making such offer in Units of AREP (the number of Units would be conditioned upon the Audit Committee's obtaining a fairness opinion), there can be no assurances thereof or whether the transaction will be pursued. Additionally, in selecting future real estate investments, AREP intends to focus on assets that it believes are undervalued in the real estate market, which investments may require substantial liquidity to maintain a competitive advantage. Despite the substantial capital pursuing real estate opportunities, AREP believes that there are still opportunities available to acquire investments that are undervalued. These may include commercial properties, residential and commercial development projects, land, non-performing loans, the securities of entities which own, manage or develop significant real estate assets, including limited partnership units and securities issued by real estate investment trusts and debt or equity securities of companies which may be undergoing restructuring, and sub-performing properties that may require active asset management and significant capital improvements. AREP notes that while there are still opportunities available to acquire investments that are undervalued, acquisition opportunities in





the real estate market for value-added investors have become more competitive to source and the increased competition may have some impact on the spreads and the ability to find quality assets that provide returns that are sought. These investments may not be readily financeable and may not generate immediate positive cash flow for AREP. As such, they require AREP to maintain a strong capital base in order to react quickly to these market opportunities as well as to allow AREP the financial strength to develop or reposition these assets. While this may impact cash flow in the near term and there can be no assurance that any asset acquired by AREP will increase in value or generate positive cash flow, AREP intends to focus on assets that it believes may provide opportunities for long-term growth and further its objective to diversify its portfolio.

Historically, substantially all of AREP's real estate assets have been net-leased to single corporate tenants under long-term leases. With certain exceptions, these tenants are required to pay all expenses relating to the leased property and therefore AREP is not typically responsible for payment of expenses, such as maintenance, utilities, taxes and insurance associated with such properties.

By the end of the year 2000, net leases representing approximately 18% of AREP's net annual rentals from its portfolio will be due for renewal, and by the end of the year 2002, net leases representing approximately 32% of AREP's net annual rentals will be due for renewal. Since most of AREP's properties are net-leased to single, corporate tenants, it is expected that it may be difficult and time-consuming to re-lease or sell those properties that existing tenants decline to re-let or purchase and AREP may be required to incur expenditures to renovate such properties for new tenants. In addition, AREP may become responsible for the payment of certain operating expenses, including maintenance, utilities, taxes, insurance and environmental compliance costs associated with such properties, which are presently the responsibility of the tenant. As a result, AREP could experience an adverse impact on net cash flow in the future from such properties.

The Amendment became effective in August, 1996 and permits AREP to invest in securities issued by companies that are not necessarily engaged as one of their primary activities in the ownership, development or management of real estate while remaining in the real estate business and continuing to pursue suitable investments for AREP in the real estate market. AREP made an investment in accordance with the Amendment in the common stock of RJR and recognized a gain of approximately $29 million on the sale of this investment. In addition, AREP has invested approximately $42.8 million in Stratosphere. (See Note and see Item 1 - "Investment Opportunities and Strategies - Non-Real Estate Related Investments").

AREP raised funds through the 1997 Offering to increase its assets available for investment, take advantage of assets investment opportunities, further diversify its portfolio of assets and mitigate against the impact of potential lease expirations. The 1997 Offering was successfully completed in September 1997 and net proceeds of approximately $267 million were raised for investment purposes.

Expenses relating to environmental clean-up have not had a material effect on the earnings, capital expenditures, or competitive position of AREP. Management believes that substantially all such costs would be the responsibility of the tenants pursuant to lease terms.





While most tenants have assumed responsibility for the environmental conditions existing on their leased property, there can be no assurance that AREP will not be deemed to be a responsible party or that the tenant will bear the costs of remediation. Also, as AREP acquires more operating properties, its exposure to environmental clean-up costs may increase. AREP completed Phase I Environmental Site Assessments of certain of its properties by third-party consultants. Based on the results of these Phase I Environmental Site Assessments, the environmental consultant has recommended that certain sites may have environmental conditions that should be further reviewed. AREP has notified each of the responsible tenants to attempt to ensure that they cause any required investigation and/or remediation to be performed. If such tenants do not arrange for further investigations, or remediations, if required, AREP may determine to undertake the same at its own cost. If the tenants fail to perform responsibilities under their leases referred to above, based solely upon the consultant's estimates resulting from its Phase I Environmental Site Assessments referred to above, it is presently estimated that AREP's exposure could amount to $2-3 million, however, as no Phase II Environmental Site Assessments have been conducted by the consultants, there can be no accurate estimation of the need for or extent of any required remediation, or the costs thereof. In addition, AREP has conducted Phase I Environmental Site Assessments for approximately 50 more net leased properties during 1997. None of these studies has indicated any significant likelihood of environmental contamination from tenant operation although there can be no assurances thereof. Phase I Environmental Site Assessments will also be performed in connection with new acquisitions and with such property refinancings as AREP may deem necessary and appropriate. AREP is in the process of finalizing a protocol for notifying tenants of RCRA's December 22, 1998 requirements for UST's. If any tenants required to comply with RCRA fail to do so, AREP may determine to undertake same at its own cost. AREP may also, at its own cost, have to cause compliance with this RCRA requirement in connection with vacated properties, bankrupt tenants, as well as non-net leased properties and new acquisitions.

AREP is considering the potential impact of the year 2000 in the processing of date- sensitive information by AREP's computerized information systems. The year 2000 problem is the result of computer programs being written using two digits (rather than four) to define the applicable year. Any of AREP's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000, which could result in miscalculations or system failures. Based on preliminary information, costs of addressing potential problems are not currently expected to have a material adverse impact on AREP's financial position, results of operations or cash flows in future periods. However, if AREP, its tenants or vendors are unable to resolve such processing issues in a timely manner, it could result in a material financial risk. Accordingly, AREP anticipates devoting the necessary resources to resolve all significant year 2000 issues in a timely manner.





Results of Operations

Calendar Year 1997 Compared to Calendar Year 1996

Gross revenues decreased by approximately $856,000, or 1.2%, during the calendar year 1997 as compared to the same period in 1996. This decrease reflects approximate decreases of $3,945,000, or 39.3%, in hotel operating income, $3,382,000, or 16.9%, in rental income, $2,698,000 in other income and $927,000, or 3.6%, in interest income on financing leases partially offset by approximate increases of $6,860,000, or 69.5%, in interest income on treasury bills and other investments and $3,236,000 in dividend income. The decrease in hotel operating income is primarily attributable to the sale of the Phoenix Holiday Inn in April 1997. The decrease in rental income is primarily due to property sales. The decrease in other income is primarily due to the Travelodge lease termination in 1996. The decrease in interest income on financing leases is primarily attributable to normal lease amortization and property sales. The increase in interest income on treasury bills and other investments is primarily due to an increase in short-term investments as a result of the 1997 Offering. The increase in dividend income is due to AREP's investment in limited partnership units.

Expenses decreased by approximately $7,636,000, or 20.3%, during the calendar year 1997 compared to the same period in 1996. This decrease reflects decreases of approximately $3,654,000, or 21.7%, in interest expense, $2,709,000, or 35.4%, in hotel operating expenses, $954,000, or 21.6%, in property expenses and $568,000, or 10.0%, in depreciation and amortization partially offset by an increase of approximately $249,000, or 8.5%, in general and administrative expenses. The decrease in interest expense is primarily attributable to normal loan amortization and reductions due to repayments of maturing balloon debt obligations, including the Senior Unsecured Debt, as well as the sale of encumbered properties. The decrease in hotel operating expenses is primarily attributable to the sale of the Phoenix Holiday Inn in April 1997.

Earnings before property and securities transactions increased during the calendar year 1997 by approximately $6,780,000 compared to the same period in 1996, primarily due to increased interest income on treasury bills and other investments and dividend income and decreased property expenses and interest expense due to repayments of maturing debt obligations partially offset by decreased rental income, other income, net hotel operating income and interest income on financing leases.

Gain on property transactions decreased by approximately $8,466,000 during the calendar year 1997 as compared to the same period in 1996, due to differences in the size and number of transactions.

During the calendar year 1997, AREP recorded a provision for loss on real estate of approximately $1,085,000 as compared to $935,000 in the comparable period of 1996.

During the calendar year 1997, AREP recorded a provision for loss on mortgages receivable of $9,790,000 in connection with its investment in Stratosphere. There was no such provision in 1996.

During the calendar year 1997, AREP recorded a non-recurring gain on the sale of marketable securities of approximately $29,188,000 relating to its RJR stock. There was no such transaction in 1996.

Net earnings for the calendar year 1997 increased by approximately $17,562,000 as compared to net earnings for calendar year 1996 primarily due to the non-recurring gain on the sale of the RJR stock and increased earnings before property and securities transactions, partially offset by the provision for loss on mortgages receivable and decreased gain on sales of real estate.

Diluted earnings before property and securities transactions per weighted average limited partnership unit outstanding were $1.16 in 1997 compared to $1.20 in 1996, and diluted net gain from property and securities transactions was $.97 in 1997 compared to $.82 in 1996. Diluted net earnings per weighted average limited partnership unit outstanding totaled $2.13 in 1997 compared to $2.02 in 1996.

Calendar Year 1996 Compared to Calendar Year 1995

Gross revenues increased by approximately $1,853,000, or 2.7%, during the calendar year 1996 as compared to the same period in 1995. This increase reflects approximate increases of $2,641,000 in dividend income, $1,713,000, or 21.0%, in interest income on treasury bills and other investments, $357,000, or 1.8%, in rental income, $312,000 in other income, and $209,000, or 2.1%, in hotel operating income partially offset by a decrease of approximately $3,379,000, or 11.5%, in interest income on financing leases. The increase in dividend income is primarily due to AREP's investment in RJR common stock. The increase in interest income on treasury bills and other investments is primarily due to increased interest income earned on the 1995 Offering and sales proceeds and the investment in the Facility Agreement. The increase in rental income is primarily due to the joint ventures' properties which are now operating. The hotel operating revenues were generated by two hotels operated by AREP through a third party management company since August 7, 1992. The decrease in interest income on financing leases is primarily attributable to normal lease amortization and property sales.

Expenses decreased by approximately $1,554,000, or 4.0%, during the calendar year 1996 compared to the same period in 1995. This decrease reflects decreases of approximately $2,771,000, or 14.1%, in interest expense and $42,000, or .5%, in hotel operating expenses, partially offset by increases of approximately $584,000, or 15.2%, in property expenses, $342,000, or 6.4%, in depreciation and amortization, and $333,000, or 12.8%, in general and administrative expenses. The decrease in interest expense is primarily attributable to normal loan amortization and reductions due to repayments of maturing balloon debt obligations, including the Senior Unsecured Debt, as well as the sale of encumbered properties. The hotel expenses were generated from the hotels mentioned previously.

Earnings before property transactions increased during the calendar year 1996 by approximately $3,407,000 as compared to the same period in 1995, primarily due to increased dividend and interest income, decreased interest expense, partially offset by a decrease in financing lease income.

Gain on property transactions increased by approximately $19,425,000 during the calendar year 1996 as compared to the same period in 1995, due to differences in the size and number of transactions.

During the calendar year 1996, AREP recorded a provision for loss on real estate of $935,000 as compared to approximately $769,000 in the comparable period of 1995.





Net earnings for the calendar year 1996 increased by approximately $22,666,000 as compared to net earnings for the calendar year 1995. This increase is primarily attributable to the increase gain on property transactions due to differences in the size and number of transactions.

Diluted earnings before property and securities transactions per weighted average limited partnership unit outstanding were $1.20 in 1996 compared to $1.17 in 1995, and diluted net gain from property and securities transactions was $.82 in 1996 compared to $.16 in 1995. Diluted net earnings per weighted average limited partnership unit outstanding totalled $2.02 in 1996 compared to $1.33 in 1995.

Capital Resources and Liquidity

Generally, the cash needs of AREP for day-to-day operations have been satisfied from cash flow generated from current operations. In recent years, AREP has applied a significant portion of its cash flow to the repayment of maturing debt obligations. Cash flow from day-to-day operations represents net cash provided by operating activities (excluding working capital changes and non-recurring other income) plus principal payments received on financing leases as well as principal receipts on certain mortgages receivable reduced by periodic principal payments on mortgage debt.

AREP may not be able to re-let certain of its properties at current rentals. As previously discussed, net leases representing approximately 32% of AREP's net annual rentals will be due for renewal by the end of the year 2002. In 1997, seven leases covering seven properties and representing approximately $812,000 in annual rentals expired. Six of these leases originally representing approximately $661,000 in annual rental income have been or will be re-let or renewed for approximately $676,000 in annual rentals. Such renewals are generally for a term of five years. One property, with an approximate annual rental income of $151,000, is currently being marketed for sale or lease.

In 1998, 25 leases covering 25 properties and representing approximately $2,123,000 in annual rentals are scheduled to expire. Eleven of these leases originally representing approximately $403,000 in annual rental income have been or will be re-let or renewed for approximately $414,000 in annual rentals. Such renewals are generally for a term of five years. Six properties, with an approximate annual rental income of $947,000, will be marketed for sale or lease when the current lease term expires. Four properties with annual rental income of $210,000 will be purchased by their tenants pursuant to the exercise of purchase options. The status of four leases, with approximate annual rental income of $563,000, is uncertain at this time.

In 1997 AREP sold 22 properties representing approximately $2,596,000 of net operating cash flow for net proceeds of approximately $37.6 million which are being retained for reinvestment.

On March 26, 1998, the Board of Directors of the General Partner announced that no distributions on its Depositary Units are expected to be made in 1998. In making its announcement, AREP noted it plans to continue to apply available operating cash flow toward its operations, repayment of maturing indebtedness, tenant requirements and other capital expenditures and creation of cash reserves for contingencies including environmental matters and scheduled lease expirations. As previously reported, by the end of the year 2000, net leases representing approximately 18% of AREP's net annual rentals will be due for renewal, and by





the end of the year 2002, 32% of such rentals will be due for renewal. Another factor that AREP took into consideration was that net leases representing approximately 29% of AREP's annual rentals from its portfolio are with tenants in the retail sector, some of which are currently experiencing cash flow difficulties and restructurings. Further, AREP noted that the types of investments AREP is pursuing, including assets that may not be readily financeable or generating positive cash flow, such as development properties, non-performing mortgage loans or securities of companies which may be undergoing restructuring or require significant capital investments, require AREP to maintain a strong capital base in order to own, develop and reposition those assets.

During the year ended December 31, 1997, AREP generated approximately $38.7 million in cash flow from day-to-day operations which excludes approximately $3.9 million in interest earned on the 1997 Offering proceeds which will be retained for future acquisitions. During 1996, AREP generated approximately $31.9 million in such cash flow from day-to-day operations which excluded approximately $4 million in interest earned on the proceeds from 1995 Rights Offering.

Capital expenditures for real estate, excluding new acquisitions, were approximately $1,836,000 during 1997. During 1996, such expenditures totalled approximately $3,900,000.

Pursuant to the Note Agreements, AREP is required to make semi-annual interest payments and annual principal payments. The interest rate charged on the Senior Unsecured Debt is 9.6% per annum. As of December 31, 1997, AREP was in compliance with the terms of the Note Agreements. AREP has the final $11.3 million principal payment due on its Senior Unsecured Debt in May 1998 and approximately $3.5 million and $5.4 million of maturing balloon mortgages due in 1998 and 1999, respectively. During the year ended December 31, 1997, approximately $18.2 million of maturing debt obligations, including an $11.3 million payment on the Senior Unsecured Debt were repaid out of AREP's cash flow. During the year ended December 31, 1996, $26.5 million of maturing debt obligations were repaid out of AREP's cash flow which included a $11.3 million payment on the Senior Unsecured Debt. AREP may seek to refinance a portion of these maturing mortgages, although it does not expect to refinance all of them, and may repay them from cash flow and increase reserves from time to time, thereby reducing cash flow otherwise available for other uses.

During 1997, net cash flow after payment of maturing debt obligations and capital expenditures was approximately $18.7 million which was added to AREP's operating cash reserves. During 1996, net cash flow after payment of maturing debt obligation and capital expenditures was approximately $1.5 million which was added to AREP's operating cash reserves. AREP's operating cash reserves are approximately $43.2 million at December 31, 1997 (which does not include the cash from capital transactions that has increased primarily due to the sale of the RJR common stock which is being retained for investment or the cash from the 1997 Offering which was recently completed), which are being retained to meet maturing debt obligations, capitalized expenditures for real estate and certain contingencies facing AREP. AREP from time to time may increase its cash reserves to meet its maturing debt obligations, tenant requirements and other capital expenditures and to guard against scheduled lease expirations and other contingencies including environmental matters.

Sales proceeds from the sale or disposal of portfolio properties totalled approximately $37.6 million in 1997. During 1996, sales proceeds totalled approximately $40.7 million. During 1997, AREP received approximately $21 million of net proceeds from the refinancing





of the PGEC facility in Portland, Oregon. AREP intends to use asset sales, financing and refinancing proceeds for new investments.

In 1996 AREP invested approximately $83 million in the common stock of RJR. In February 1997, AREP sold its entire interest in RJR for net proceeds of approximately $112 million and realized a non-recurring gain of approximately $29 million. In addition to the non-recurring RJR gain, AREP has realized substantial gains on sales of real estate which may be non-recurring. There can be no assurance that AREP will be able to realize gains such as those from any of its investment activities. Recently, AREP invested approximately $42.8 million to purchase certain mortgage notes issued by Stratosphere having a face value of $55 million. In addition, an affiliate of the General Partner currently owns approximately $46.6 million face value of such Stratosphere mortgage notes. Stratosphere owns and operates the Stratosphere Tower, Casino & Hotel in Las Vegas, Nevada and has filed a voluntary proceeding for reorganization pursuant to Chapter 11 of the Bankruptcy Code. Stratosphere filed a Second Amended Plan of Reorganization which, as proposed, would provide holders of the First Mortgage Notes with 100% of the equity in the reorganized entity. It is presently anticipated that if such transaction is consummated that AREP and the affiliate of the General Partner would enter into a joint venture regarding such Stratosphere investment, with such venture to be managed by such affiliate of the General Partner on terms fair and reasonable to AREP and AREP's investment to be structured under applicable regulatory requirements. Furthermore, AREP understands that Stratosphere may seek approximately $100 million for expansion of its hotel facility, a portion of which may be provided by AREP and the affiliate of the General Partner. See Item 1 - "Recent Acquisitions - Investment in Mortgages and Notes Receivable." Furthermore, AREP recently invested approximately $14.3 million for interests in the Sands and approximately $14.1 million for interests in the Claridge Hotel. In addition, AREP invested approximately $15 million to purchase defaulted mortgage notes secured by real estate in Cape Cod, Massachusetts and is investigating possible tender offers for real estate operating companies and real estate limited partnership units However, no assurances can be made that such transactions will be pursued or that such investments will be made or prove to be profitable. Also, AREP understands that Stratosphere has been experiencing negative cash flow, and there can be no assurance that any plan of reorganization of Stratosphere out of bankruptcy will prove to be successful. Furthermore, at December 31, 1997, AREP recorded a $9,790,000 provision for loss in its Stratosphere investment. See Note 8. Also, see Item 1 - "Investment Opportunities and Strategies - Real Estate Investments," for a discussion of certain considerations relating to the gaming industry.

To further its investment objectives, AREP may consider the acquisition or seek effective control of land development companies and other real estate operating companies which may have a significant inventory of quality assets under development as well as experienced personnel. This may enhance its ability to further diversify its portfolio of properties and gain access to additional operating and development capabilities.

Pursuant to the 1997 Offering, which closed in September 1997, AREP raised approximately $267 million (in addition to approximately $5.4 million received from the General Partner) to increase its available liquidity so that it will be in a better position to take advantage of investment opportunities and to further diversity its portfolio. Additionally, AREP may determine to reduce debt of certain properties where the interest rate is considered to be in excess of current market rates. See Note .

AREP's cash and cash equivalents and investment in treasury bills increased by approximately $396 million during 1997, primarily due to $267 million (in addition to approximately $5.4 million received from the General Partner) from the 1997 Offering, approximately $112 million from the sale of RJR stock, approximately $60 million from sales and refinancings and approximately $18.7 million of net cash flow from





operations, partially offset by $70 million in acquisitions. The funds on hand reserves, are being retained for investment and AREP's operating cash reserves.





Item 8. Financial Statements

## INDEPENDENT AUDITORS' REPORT

The Partners
American Real Estate Partners, L.P:

We have audited the accompanying consolidated balance sheets of American Real Estate Partners, L.P. and subsidiary as of December 31, 1997 and 1996, and the related consolidated statements of earnings, changes in partners' equity, and cash flows for each of the years in the three-year period ended December 31, 1997. In connection with our audits of the consolidated financial statements, we also have audited the 1997 financial statement schedule as listed in the Index at Item 14 (a) 2. These consolidated financial statements and the financial statement schedule are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Real Estate Partners, L.P. and subsidiary as of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1997, in conformity with generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG Peat Marwick LLP

New York, New York
March 20, 1998





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 1997 and 1996 (in $000's)

| ASSETS | 1997 | 1996 |
|---|---|---|
| REAL ESTATE LEASED TO OTHERS: | | |
| Accounted for under the financing method (Notes 2, 4 and 9) | $265,657 | $253,782 |
| Accounted for under the operating method, net of accumulated depreciation (Notes 2, 5 and 9) | 121,595 | 103,402 |
| INVESTMENT IN TREASURY BILLS | 372,165 | -- |
| CASH AND CASH EQUIVALENTS (Note 2) | 129,147 | 105,543 |
| MORTGAGES AND NOTE RECEIVABLE (Notes 8 and 17) | 59,970 | 15,226 |
| INVESTMENT IN LIMITED PARTNERSHIPS (Note 7) | 22,970 | 29,948 |
| HOTEL OPERATING PROPERTIES, net of accumulated depreciation (Notes 5 and 9) | 5,002 | 12,955 |
| RECEIVABLES AND OTHER ASSETS (Note 17) | 7,838 | 8,605 |
| PROPERTY HELD FOR SALE (Notes 2, 9 and 16) | 4,164 | 3,698 |
| DEBT PLACEMENT COSTS - Net of accumulated amortization (Note 2) | 1,473 | 1,299 |
| CONSTRUCTION-IN-PROGRESS (Note 9) | 1,249 | 680 |
| MARKETABLE EQUITY SECURITIES (Note 6) | -- | 106,172 |
| TOTAL | $991,230 | $641,310 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 1997 and 1996 (in $000's) (Continued)

| | 1997 | 1996 |
|---|---|---|
| LIABILITIES AND PARTNERS' EQUITY | | |
| MORTGAGES PAYABLE (Notes 4, 5, 10 and 17) | $ 156,433 | $ 115,911 |
| SENIOR INDEBTEDNESS (Notes 11 and 17) | 11,308 | 22,616 |
| ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES (Notes 7, 9 and 17) | 10,929 | 12,249 |
| DEFERRED INCOME (Note 8) | 2,792 | 3,460 |
| DISTRIBUTIONS PAYABLE (Notes 3 and 18) | 443 | 1,515 |
| | 181,905 | 155,751 |
| COMMITMENTS AND CONTINGENCIES (Notes 3 and 15) | | |
| LIMITED PARTNERS: | | |
| Preferred units, $10 liquidation preference, 5% cumulative pay-in-kind redeemable; 9,400,000 authorized; 7,311,054 and 2,074,422 issued and outstanding as of December 31, 1997 and 1996 | 75,852 | 21,522 |
| Depositary units; 47,850,000 authorized; 47,235,484 and 26,703,840 outstanding as of December 31, 1997 and 1996 | 728,329 | 465,336 |
| GENERAL PARTNER | 16,328 | 9,885 |
| TREASURY UNITS AT COST: 1,037,200 depositary units | (11,184) | (11,184) |
| PARTNERS' EQUITY (Notes 2, 3 and 12) | 809,325 | 485,559 |
| TOTAL | $ 991,230 | $ 641,310 |

See notes to consolidated financial statements.





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF EARNINGS
YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995 (in $000's, except per unit amounts)

| REVENUES: | 1997 | 1996 | 1995 |
|---|---|---|---|
| Interest income on financing leases | $ 25,146 | $ 26,073 | $ 29,452 |
| Interest income on treasury bills and other investments | 16,726 | 9,866 | 8,153 |
| Rental income | 16,617 | 19,999 | 19,642 |
| Hotel operating income (Note 9) | 6,098 | 10,043 | 9,834 |
| Dividend income (Notes 6 and 7) | 5,877 | 2,641 | -- |
| Other income (Notes 8 and 9) | 454 | 3,152 | 2,839 |
| | 70,918 | 71,774 | 69,920 |
| EXPENSES: | | | |
| Interest expense | 13,189 | 16,843 | 19,614 |

| | | | |
|---|---|---|---|
| Depreciation and amortization | 5,112 | 5,680 | 5,338 |
| General and administrative expenses (Note 3) | 3,188 | 2,939 | 2,605 |
| Property expenses | 3,457 | 4,411 | 3,827 |
| Hotel operating expenses (Note 9) | 4,952 | 7,661 | 7,703 |
| | 29,898 | 37,534 | 39,087 |
| EARNINGS BEFORE PROPERTY AND SECURITIES TRANSACTIONS | 41,020 | 34,240 | 30,833 |
| PROVISION FOR LOSS ON MORTGAGES RECEIVABLE (Note 8) | (9,790) | -- | -- |
| PROVISION FOR LOSS ON REAL ESTATE (Notes 9 and 16) | (1,085) | (935) | (768) |
| GAIN ON SALE OF MARKETABLE EQUITY SECURITIES (Note 6) | 29,188 | -- | -- |
| GAIN ON SALES AND DISPOSITION OF REAL ESTATE (Note 9) | 16,051 | 24,517 | 5,091 |
| NET EARNINGS | $ 75,384 | $ 57,822 | $ 35,156 |
| NET EARNINGS ATTRIBUTABLE TO (Note 3): | | | |
| Limited partners | $ 73,884 | $ 56,671 | $ 34,456 |
| General partner | 1,500 | 1,151 | 700 |
| | $ 75,384 | $ 57,822 | $ 35,156 |





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF EARNINGS
YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995

| | 1997 | 1996 | 1995 |
|---|---|---|---|
| NET EARNINGS PER LIMITED PARTNERSHIP UNIT (Note 2): | | | |
| Basic earnings | $ 2.27 | $ 2.17 | $ 1.49 |
| WEIGHTED AVERAGE LIMITED PARTNERSHIP UNITS OUTSTANDING | 31,179,246 | 25,666,640 | 22,703,180 |
| Diluted earnings | $ 2.13 | $ 2.02 | $ 1.33 |
| WEIGHTED AVERAGE LIMITED PARTNERSHIP UNITS AND EQUIVALENT PARTNERSHIP UNITS OUTSTANDING | 34,655,395 | 28,020,392 | 27,538,840 |

See notes to consolidated financial statements.





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' EQUITY
YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995 (in $000's)

| | General Partner's Equity | Limited Partners' Equity: Depository Units | Limited Partners' Equity: Preferred Units | Held in Treasury: Amount | Held in Treasury: Units | Total Partners' Equity |
|---|---|---|---|---|---|---|
| BALANCE, DECEMBER 31, 1994 | $ 5,381 | $ 265,040 | $ -- | $(11,184) | 1,037 | $ 259,237 |
| Net earnings | 700 | 34,456 | -- | -- | -- | 35,156 |
| Rights offering (Note 12) | -- | 88,904 | 19,756 | -- | -- | 108,660 |
| Expenses of Rights offering (Note 12) | (21) | (1,049) | -- | -- | -- | (1,070) |
| Capital contribution (Note 12) | 2,206 | -- | -- | -- | -- | 2,206 |
| Pay-in-kind distribution (Note 12) | -- | (741) | 741 | -- | -- | -- |
| BALANCE, DECEMBER 31, 1995 | 8,266 | 386,610 | 20,497 | (11,184) | 1,037 | 404,189 |
| Net earnings | 1,151 | 56,671 | -- | -- | -- | 57,822 |
| Unrealized gains on securities available for sale (Note 6) | 468 | 23,080 | -- | -- | -- | 23,548 |
| Pay-in-kind distribution (Note 12) | -- | (1,025) | 1,025 | -- | -- | -- |
| BALANCE, DECEMBER 31, 1996 | 9,885 | 465,336 | 21,522 | (11,184) | 1,037 | 485,559 |
| Net earnings | 1,500 | 73,884 | -- | -- | -- | 75,384 |
| Rights offering (Note 12) | -- | 215,582 | 51,329 | -- | -- | 266,911 |
| Expenses of Rights offering (Note 12) | (8) | (392) | -- | -- | -- | (400) |
| Capital contribution (Note 12) | 5,419 | -- | -- | -- | -- | 5,419 |
| Sale of marketable equity securities available for sale (Note 6) | (468) | (23,080) | -- | -- | -- | (23,548) |
| Pay-in-kind distribution (Note 12) | -- | (3,001) | 3,001 | -- | -- | -- |
| BALANCE, DECEMBER 31, 1997 | $ 16,328 | $ 728,329 | $75,852 | $(11,184) | 1,037 | $ 809,325 |

See notes to consolidated financial statements.





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995 (in 000's)

| | 1997 | 1996 | 1995 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net earnings | $ 75,384 | $ 57,822 | $ 35,156 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation and amortization | 5,112 | 5,680 | 5,338 |
| Amortization of deferred income | (26) | (26) | (26) |
| Gain on sale of marketable equity securities | (29,188) | -- | -- |
| Gain on sales and disposition of real estate | (16,051) | (24,517) | (5,091) |
| Provision for loss on mortgages receivable | 9,790 | -- | -- |
| Provision for loss on real estate | 1,085 | 935 | 768 |
| Changes in: | | | |
| (Decrease) increase in accounts payable and accrued expenses | (1,277) | 6,449 | (783) |
| Decrease in deferred income | (4) | (4) | (4) |
| Decrease (increase) in receivables and other assets | 1,188 | (2,357) | 72 |
| Net cash provided by operating activities | 46,013 | 43,982 | 35,430 |

| | | | |
|---|---|---|---|
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Increase in mortgages and note receivable | (56,345) | (570) | (7,396) |
| Net proceeds from the sales and disposition of real estate | 37,643 | 40,673 | 21,304 |
| Principal payments received on leases accounted for under the financing method | 7,683 | 7,314 | 7,205 |
| Construction in progress | (570) | (5,264) | (14,081) |
| Principal receipts on mortgages receivable | 332 | 330 | 301 |
| Property acquisitions | (63,064) | (103) | (3,280) |
| Capitalized expenditures for real estate | (1,836) | (3,855) | (2,068) |
| Investment in treasury bills | (372,165) | -- | -- |
| Disposition (acquisition) of marketable securities | 111,784 | (82,596) | -- |
| Decrease (increase) in investment in limited partnership interests | 6,977 | (29,948) | -- |
| Net cash (used in) provided by investing activities | (329,561) | (74,019) | 1,985 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Partners' equity: | | | |
| Proceeds from rights offering | 272,331 | -- | 110,866 |
| Expenses of the rights offering | (267) | (21) | (468) |
| Distribution to partners | (1,071) | (156) | (105) |
| Debt: | | | |
| Increase (decrease) in mortgages payable | 62,623 | (593) | 18,631 |
| Periodic principal payments | (7,578) | (8,091) | (8,959) |
| Balloon payments | (6,854) | (14,598) | (3,632) |
| Senior debt principal payment | (11,308) | (11,308) | (11,308) |
| Increase in construction loan payable | -- | 4,033 | 5,440 |
| Debt placement costs | (724) | 52 | (234) |
| Net cash provided by (used in) financing activities | 307,152 | (30,682) | 110,231 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 23,604 | (60,719) | 147,646 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 105,543 | 166,262 | 18,616 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 129,147 | $ 105,543 | $ 166,262 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995 (in 000's)

| | 1997 | 1996 | 1995 |
|---|---|---|---|
| SUPPLEMENTAL INFORMATION: | | | |
| Cash payments for interest | $ 12,377 | $ 16,510 | $ 19,904 |
| SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Property acquired in satisfaction of mortgages: | | | |
| Additions to property accounted for under the operating method | $ 6,646 | $ 36 | $ 256 |
| Decrease in mortgages receivable | (9,109) | (97) | (365) |
| Increase to property held for sale | 300 | -- | -- |
| Decrease in deferred income | 2,163 | 61 | 109 |
| | $ -- | $ -- | $ -- |
| Reclassification of real estate to operating lease | $ 4,001 | $ 10,207 | $ 15,140 |
| Reclassification of real estate from operating lease | (2,497) | (2,437) | (1,105) |
| Reclassification of real estate from financing lease | (4,001) | (235) | (669) |
| Reclassification of real estate from construction in progress | -- | (10,207) | (15,140) |
| Reclassification of real estate to property held for sale | 2,497 | 2,672 | 1,774 |
| | $ -- | $ -- | $ -- |

See notes to consolidated financial statements.





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1997, 1996 and
1995

1. ORGANIZATION AND BASIS OF PRESENTATION

On July 1, 1987, American Real Estate Holdings Limited Partnership (the "Subsidiary"), in connection with an exchange offer (the "Exchange"), entered into merger agreements with American Real Estate Partners, L.P. (the "Company") and each of American Property Investors, L.P., American Property Investors II, L.P., American Property Investors III, L.P., American Property Investors IV, L.P., American Property Investors V, L.P., American Property Investors VI, L.P., American Property Investors VII, L.P., American Property Investors VIII, L.P., American Property Investors IX, L.P., American Property Investors X, L.P., American Property Investors XI, L.P., American Property Investors 82, L.P. and American Property Investors 83, L.P. (collectively, the "Predecessor Partnerships"), pursuant to which the Subsidiary acquired all the assets, subject to the liabilities (known and unknown) of the Predecessor Partnerships.

The limited partners of the Predecessor Partnerships received limited partner interests in the Subsidiary. The number of such limited partner interests received by a limited partner was determined based upon his percentage ownership interest in the Predecessor Partnerships, the value of the Predecessor Partnerships' net assets and the number of limited partner interests allocable to the Predecessor Partnerships' general partners and their affiliates. The limited partner interests in the Subsidiary were contributed to the Company in exchange for limited partner interests therein. Limited partnership interests were allocable to the Predecessor Partnerships' general partners and their affiliates as a result of their rights: (i) to receive a portion of the cash flow of the Predecessor Partnerships by virtue of their ownership of interests in such partnerships and their entitlement to receive management fees and nonaccountable expense reimbursements and (ii) to share in the proceeds from the sale or liquidation of the assets of the Predecessor Partnerships and to receive real estate commissions with respect to the sale of properties by the Predecessor Partnerships. These rights of the Predecessor Partnerships' general partners and their affiliates were valued in connection with the Exchange. As a result of such valuation, and the assignment of the interests receivable by the corporate affiliates to American Property Investors, Inc. (the "General Partner"), an aggregate of 1,254,280 units and a 1% general partner interest in the Company were issued to the General Partner and 5,679 units were issued to noncorporate affiliates of the Predecessor Partnerships' general partners. In addition, the General Partner also received a 1% general partner interest in the Subsidiary.

By virtue of the Exchange, the Subsidiary owns the assets, subject to the liabilities, of the Predecessor Partnerships. The Company owns a 99% limited partner interest in the Subsidiary. The General Partner owns a 1% general partner interest in both the Subsidiary and the Company representing an aggregate 1.99% general partner interest in the Company and the Subsidiary.

The participation in the transaction by a Predecessor Partnership was conditioned upon obtaining the approval of a majority-in-interest of the limited partners in such Predecessor Partnership. Such approvals were obtained with respect to each of the Predecessor Partnerships prior to July 1, 1987.

During 1989, Integrated Resources, Inc. ("Integrated"), the former parent of the General Partner, experienced serious financial difficulties and, on February 13, 1990, it filed in the Bankruptcy Court for the Southern District of New York a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Federal Bankruptcy Code (the "Filing"). The General Partner was a separate entity and neither the General Partner nor any other subsidiary of Integrated was included in the Filing.

On September 13, 1990, in connection with its voluntary petition for reorganization pursuant to Chapter 11 of the Bankruptcy Code, Integrated entered into an agreement whereby it agreed to sell all of its stock in the General Partner to Meadowstar Holding Company, Inc. ("Meadowstar"). Neither the Company nor the General Partner was a party to such agreement. The sale of the stock of the General Partner to Meadowstar was approved by the Bankruptcy Court on October 22, 1990. On November 15, 1990, pursuant to the terms of the Acquisition Agreement, Meadowstar purchased all of the outstanding shares of Common Stock of the General Partner. In May 1993, Carl C. Icahn acquired all of Meadowstar's interest in the General Partner.

An amendment (the "Amendment") to the Company's Partnership Agreement became effective on August 16, 1996 which permits the Company to make non-real estate investments. The Amendment permits the Company to invest in securities issued by companies that are not necessarily engaged as one of their primary activities in the ownership, development or management of real estate to further diversify its investments while remaining in the real estate business and continuing to pursue suitable investments in the real estate markets. Under the Amendment, investments may include equity and debt securities of domestic and foreign issuers. The proportion of the Company's assets invested in any one type of security or any single issuer will not be limited. The investment objective of the Company with respect to such investments will be to purchase undervalued securities so as to maximize total returns consisting of current income and/or capital appreciation.

The Company will conduct its activities in such a manner so as not to be deemed an investment company under the Investment Company Act of 1940. Generally, this means that no more than 40% of the Company's total assets will be invested in securities. In addition, the Company will structure its investments so as to continue to be taxed as a partnership rather than as a corporation under the applicable publicly-traded partnership rules of the Internal Revenue Code.

As the Company will concentrate under the Amendment on undervalued securities, which may include, for example, high-yield securities and neglected securities, its investments may be subject to significant amounts of business, financial, market and other risks. Investments in securities issued by companies that are not engaged as one of their primary activities in the ownership, development or management of real estate will entail somewhat different risks from those associated with investments in real estate assets. The equity securities in which the Company may invest pursuant to the Amendment may include common stocks, preferred stocks and securities convertible into common stocks, as well as warrants to purchase those securities. The debt securities in which the Company may invest may include bonds, debentures, notes, mortgage-related securities and municipal obligations. Certain of such securities may include lower-rated securities which may provide the potential for higher yields and therefore may entail higher risk. In addition, the Company may engage in various investment techniques, such as options and futures transactions, foreign currency transactions and leveraging for either hedging or other purposes. Use of borrowed funds to leverage acquisitions can exaggerate the effect of any increase or decrease in market value. There can be no assurance that the Company will correctly evaluate such investments and their attendant risks or that such investments will be profitable to the Company.

Transactions under the Amendment may include transactions with affiliates of Carl Icahn

("Icahn"), the Chairman of the Board of its General Partner and, through High Coast, its principal unitholder, provided the terms thereof are fair and reasonable to the Company. Mr. Icahn has confirmed that neither he nor his affiliates would receive any fees from the Company for services rendered in connection with non-real estate related investments by the Company.

2. SIGNIFICANT ACCOUNTING POLICIES

Financial Statements and Principles of Consolidation - The consolidated financial statements are prepared on the accrual basis of accounting and include only those assets, liabilities and results of operations which relate to the Company and the Subsidiary. All material intercompany accounts and transactions have been eliminated in consolidation.

Registration Costs, Expenses of the Exchange and Rights Offering Expenses - Registration costs of the Predecessor Partnerships were charged against partners' equity upon the closing of the public offerings in accordance with prevalent industry practice. Expenses of the Exchange were charged against partners' equity upon consummation of the Exchange. Rights Offering Expenses were charged against partners' equity upon consummation of the Right's Offerings.

Net Earnings Per Limited Partnership Unit - In February 1997 the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards No. 128, "Earnings Per Share ("SFAS 128")". SFAS 128 became effective for financial statements for both interim and annual periods ending after December 15, 1997. It also required all prior period earnings per share data presented to be restated. Under SFAS 128, basic earnings per share are based on earnings after the preferred pay-in-kind distribution to Preferred Unitholders.

The resulting net earnings available for limited partners is divided by the weighted average number of shares of limited partnership units outstanding. Diluted earnings per share uses net earnings attributable to limited partner interests as the numerator with the denominator based on the weighted average number of units and equivalent units outstanding. The Preferred units are considered to be unit equivalents. The weighted average number of depositary units outstanding for basic earnings per share purposes for years ended December 31, 1997, 1996 and 1995 were 31,179,246, 25,666,640, and 22,703,180, respectively. The weighted average number of depositary units and equivalent units assumed outstanding for diluted earnings per share purposes for the years ended December 31, 1997 and 1996 were 34,655,395 and 28,020,392, respectively. The weighted average number of depositary units and equivalent units outstanding and subscribed for assumed outstanding for the year ended December 31, 1995 was 27,538,840. The number of limited partner units used in the calculation of diluted income per limited partner unit increased by 3,476,149, 2,353,752, and 4,835,660 limited partner units for the years ended December 31, 1997, 1996 and 1995, respectively to reflect the effects of the conversion of preferred units. The diluted earnings per share calculation for the year ended December 31, 1995 assumes the Depositary and Preferred Units subscribed for in the Rights Offering were outstanding at the beginning of the year. Also, with respect to the year ended December 31, 1995 calculation, net income has been increased by approximately $2,100,000 in accordance with the modified treasury stock method.

For the years ended December 31, 1997, 1996 and 1995, basic and diluted earnings per weighted average limited partnership unit outstanding are detailed as follows:

| | 1997 | 1996 | 1995 |
|---|---|---|---|
| Basic: | | | |
| Earnings before property and securities transactions...... | $1.19 | $1.27 | $1.30 |
| Net gain from property and securities transactions...... | 1.08 | .90 | .19 |

| | | | |
|---|---|---|---|
| Net earnings | $2.27 | $2.17 | $1.49 |
| | ===== | ===== | ===== |
| Diluted: | | | |
| Earnings before property and securities transactions | $1.16 | $1.20 | $1.17 |
| Net gain from property and securities transactions | .97 | .82 | .16 |
| | ----- | ----- | ----- |
| Net earnings | $2.13 | $2.02 | $1.33 |
| | ===== | ===== | ===== |

There were no distributions in 1997, 1996 or 1995.

Cash and Cash Equivalents - The Company considers short-term investments, which are highly liquid with original maturities of three months or less from date of purchase, to be cash equivalents.

Included in cash and cash equivalents at December 31, 1997 and 1996 are investments in government backed securities of approximately $127,805,000 and $102,270,000, respectively.





Marketable Equity Securities - Investments in equity securities classified as available for sale, for accounting purposes, are required to be carried at fair value on the Balance Sheet of the Company. Unrealized holding gains and losses are excluded from earnings and reported as a separate component of Partners' Equity.

Investment in Limited Partnership Units - Investment in Limited Partnership Units are accounted for under the cost method with income distributions reflected in earnings and return of capital distributions as a reduction of investment.

Income Taxes - No provision has been made for Federal, state or local income taxes since the Company is a partnership and, accordingly, such taxes are the responsibility of the partners.

Leases - The Company leases to others substantially all its real property under long-term net leases and accounts for these leases in accordance with the provisions of Financial Accounting Standards Board Statement No. 13, "Accounting for Leases," as amended. This Statement sets forth specific criteria for determining whether a lease is to be accounted for as a financing lease or operating lease.

a. Financing Method - Under this method, minimum lease payments to be received plus the estimated value of the property at the end of the lease are considered the gross investment in the lease. Unearned income, representing the difference between gross investment and actual cost of the leased property, is amortized to income over the lease term so as to produce a constant periodic rate of return on the net investment in the lease.

b. Operating Method - Under this method, revenue is recognized as rentals become due and expenses (including depreciation) are charged to operations as incurred.

Properties - Properties, other than those accounted for under the financing method, are carried at cost less accumulated depreciation unless declines in the values of the properties are considered other than temporary.

For each of the years ended December 31, 1997, 1996 and 1995 no individual or series of real estate assets leased to the same lessee accounted for more than 10% of the gross revenues of the Company. At December 31, 1997 and 1996, Portland General Electric Company occupied a property, consisting of corporate offices, which represented more than 10% of the Company's total real estate assets.

Depreciation - Depreciation on properties accounted for under the operating method is computed using the straight-line method over the estimated useful life of the particular property or property components, which range from 5 to 45 years. When properties are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the property account and the accumulated depreciation account, and any gain or loss on such sale or disposal is generally credited or charged to income (See Note 9).

Debt Placement Costs - Debt placement costs are amortized over the term of the respective indebtedness.

Use of Estimates - Management of the Partnership has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Assets Held for Sale - Assets held for sale are carried at the lower of cost or net realizable value.





Reclassifications - Certain amounts in the 1996 and 1995 financial statements have been reclassified to conform to the 1997 presentation.

Accounting by Creditors for Impairment of a Loan - On January 1, 1995, SFAS No. 114, Accounting by Creditors for Impairment of a Loan ("Statement 114"), as amended by SFAS 118. Accounting by Creditors for Impairment of a Loan - Income Recognition Disclosures, was adopted by the Company. In accordance with these standards, if it is probable that based upon current information that a creditor with be unable to collect all amounts due according to the contractual terms of a loan agreement, the asset is considered "impaired". Reserves are established against impaired loans in amounts equal to the difference between the recorded investment in the asset and either the present value of the cash flows expected to be received, or the fair value of the underlying collateral if foreclosure is deemed probable or if the loan is considered collateral dependent.

Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of - The Company has adopted Statement of Financial Accounting Standards 121, which was issued in March 1995 , and requires that long-lived assets and certain identifiable intangibles, and goodwill related to those assets to be held and used by an entity and long-lived assets and certain identifiable intangibles to be disposed of, be reviewed for impairment whenever events changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

In performing the review for recoverability, the Company estimates the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset an impairment loss is recognized. Otherwise, an impairment loss is not recognized. Measurement of an impairment loss for long-lived assets and identifiable intangibles that the Company expects to hold and use is based on the fair value of the asset. Long-lived assets and certain identifiable intangibles to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

3. CONFLICTS OF INTEREST AND TRANSACTIONS WITH RELATED PARTIES

a. The General Partner and its affiliates may realize substantial fees, commissions and other income from transactions involving the purchase, operation, management, financing and sale of the Partnership's properties, subject to certain limitations relating to properties acquired from the Predecessor Partnerships in the Exchange. Some of such amounts may be paid regardless of the overall profitability of the Partnership and whether any distributions have been made to Unitholders. As new properties are acquired, developed, constructed, operated, leased, financed and sold, the General Partner or its affiliates may perform acquisition functions, development and construction oversight and other land development services, property management and leasing services, either on a day-to-day basis or on an asset management basis, and other services and be entitled to fees and reimbursement of expenses relating thereto, including the Reinvestment Incentive Fee, property management fees, real estate brokerage and leasing commissions, fees for financing either provided or arranged by the General Partner and its affiliates, development fees, general contracting fees and construction management fees. The terms of any transactions between the Company and the General Partner or its affiliates must be fair and reasonable to the Company and customary to the industry.

Reinvestment incentive fees as payment for services rendered in connection with the acquisition of properties from July 1, 1987 through July 1, 1997 were 1% of the purchase price for the first five years and are 1/2% for the second five years.





Reinvestment incentive fees were only payable on an annual basis if the sum of (x), the sales price of all Predecessor Partnerships' properties (net of associated debt which encumbered such properties at the consummation of the Exchange) sold through the end of such year, and (y), the appraised value of all Predecessor Partnerships' properties which have been financed or refinanced (and not subsequently sold), net of the amount of any refinanced debt, through the end of such year determined at the time of such financings or refinancings, exceeded the aggregate values assigned to such Predecessor Partnerships' properties for purposes of the Exchange. If the subordination provisions were not satisfied in any year, payment of reinvestment incentive fees for such year were deferred. At the end of each year, a new determination was made with respect to subordination requirements (reflecting all sales, financings and refinancings from the consummation of the Exchange through the end of such year) in order to ascertain whether reinvestment incentive fees for that year and for any prior year, which had been deferred, may be paid.

From the commencement of the Exchange through June 30, 1997 the Company (i) sold or disposed of an aggregate of 159 properties of the Predecessor Partnerships for an aggregate of approximately $99,268,000, net of associated indebtedness which encumbered such properties at the consummation of the Exchange and (ii) refinanced 25 Predecessor Partnership properties with an aggregate appraised value, net of the amount of the refinanced debt, of approximately $37,672,000 for a sum total of approximately $136,940,000. Aggregate appraised values attributable to such properties for purposes of the Exchange were approximately $145,663,000. Eighteen properties have been acquired since the commencement of the exchange, including two properties acquired in June 1997 (see Note 9), for aggregate purchase prices of approximately $61,000,000. Reinvestment incentive fees of approximately $480,000 have previously been paid to the General Partner. Since the subordination requirements were not met as of June 30, 1997, the termination date of the right to receive such fee, no reinvestment incentive fee was due or payable to the General Partner for the two properties acquired in 1997.

b. The Company and certain affiliates of its General Partner entered into an agreement with the third-party landlord of its leased executive office space. The agreement provided for the Company and these affiliates to relocate their offices to an adjacent building also owned by the landlord which relocation occurred in September 1995. In accordance with the agreement, the Company entered into a lease, expiring in 2001, for 7,920 square feet of office space, at an annual rental of approximately $153,000. The Company has sublet to certain affiliates 3,205 square feet at an annual rental of approximately $62,000, resulting in a net annual rental of approximately $91,000. The prior lease, which was terminated, provided for approximately 6,900 square feet at an annual rental of $155,000. During the year ended December 31, 1996, the affiliates reimbursed the Company approximately $62,000 for rent in connection with the new lease.

In addition, in 1995, the Company and an affiliate received a lease termination fee of $350,000 which has been allocated

$175,000 to the Company and $175,000 to the affiliates. Such allocations and terms of the sublease were approved by the Audit Committee of the Board of Directors of the General Partner.





c. The Company was reimbursed by an affiliate of the General Partner for payroll and certain overhead expenses related to certain employees of the Company who provided services on a part-time basis in the amounts of approximately $34,000, $50,000 and $86,000 for the years ended December 31, 1997, 1996 and 1995, respectively. Such reimbursements were approved by the Audit Committee of the Board of Directors of the General Partner.

d. In addition, in 1997 the Company entered into a license agreement for a portion of office space from an affiliate of the General Partner. The license agreement dated as of February 1, 1997 expires May 22, 2004 unless sooner terminated in accordance with the agreement. Pursuant to the license agreement, the Company has the non-exclusive use of 3,547 square feet of office space and common areas (of an aggregate 21,123 rentable square feet sublet by such affiliate) for which it pays $17,068 per month, together with 16.79% of certain "additional rent". In 1997, the Company paid an affiliate of the General Partner $68,747 of rent in connection with this licensing agreement. In connection with the build-out of the space, the Company reimbursed such affiliate $486,989, representing the Company's allocable share of such costs net of a pro rata share of the sub-lessor's allowance for such build-out. The terms of such sublease were reviewed and approved by the Audit Committee.

4. REAL ESTATE LEASED TO OTHERS ACCOUNTED FOR UNDER THE FINANCING METHOD

Real estate leased to others accounted for under the financing method is summarized as follows (in $000's):

| | December 31, 1997 | December 31, 1996 |
|---|---|---|
| Minimum lease payments receivable | $342,131 | $321,414 |
| Unguaranteed residual value | 150,912 | 143,916 |
| | 493,043 | 465,330 |
| Less unearned income | 227,386 | 211,548 |
| | $265,657 | $253,782 |

The following is a summary of the anticipated future receipts of the minimum lease payments receivable at December 31, 1997 in ($000's):

| Year ending December 31, | Amount |
|---|---|
| 1998 | $ 33,645 |
| 1999 | 32,814 |
| 2000 | 31,452 |
| 2001 | 27,719 |
| 2002 | 24,329 |
| Thereafter | 192,172 |

| |
|---|
| $342,131 |

At December 31, 1997, approximately $192,446,000 of the net investment in financing leases was pledged to collateralize the payment of nonrecourse mortgages payable.





5. REAL ESTATE LEASED TO OTHERS ACCOUNTED FOR UNDER THE OPERATING METHOD

Real estate leased to others accounted for under the operating method is summarized as follows (in $000's):

| | December 31, | |
|---|---|---|
| | 1997 | 1996 |
| Land | $ 48,293 | $ 50,261 |
| Commercial building | 113,471 | 93,642 |
| | 161,764 | 143,903 |
| Less accumulated depreciation | 40,169 | 40,501 |
| | $121,595 | $103,402 |

As of December 31, 1997 and 1996, accumulated depreciation on the hotel operating properties (not included above) amounted to approximately $2,200,000 and $3,254,000, respectively (See Note 9).

The following is a summary of the anticipated future receipts of minimum lease payments under noncancelable leases at December 31, 1997 (in $000's):

| Year ending December 31, | Amount |
|---|---|
| 1998 | $ 10,015 |
| 1999 | 8,632 |
| 2000 | 7,031 |
| 2001 | 5,737 |
| 2002 | 4,768 |
| Thereafter | 18,232 |
| | $ 54,415 |

At December 31, 1997, approximately $43,873,000 of real estate leased to others was pledged to collateralize the payment of nonrecourse mortgages payable.

6. MARKETABLE EQUITY SECURITIES

In 1996, the Company purchased 3,121,700 shares of RJR Nabisco Holdings Corp. ("RJR") common stock at a cost of approximately $82,596,000 at an average cost per share of $26.46. As of December 31, 1996 the Company owned 3,121,700 shares of RJR, representing approximately 1.1% of the total outstanding RJR common shares. On December 31, 1996, the closing price of RJR common shares on the New York Stock Exchange was $34.00 representing a market value of approximately $106,000,000 and approximately 16.5% of the Company's total assets. Carl C. Icahn, the

Chairman of the Board of the General Partner, owned (through affiliates) an additional 16,808,100 shares of RJR, as of December 31, 1996, representing approximately 6.2% of the total outstanding RJR common shares.

The Company recorded "Dividend income" of $2,281,000 for the year ended December 31, 1996 on the 3,121,700 shares of RJR purchased in 1996.

Unrealized holding gains of approximately $23,548,000 were recorded as a separate component of Partners' Equity at December 31, 1996.

In February 1997, the Company sold its entire interest in RJR for net proceeds of approximately $111,784,000 realizing a gain of approximately $29,188,000. The Company's





pro rata share of third party expenses relating to such RJR investment was approximately $2,154,000 which was paid in the year ended December 31, 1997 and approved by the Audit Committee.

7. INVESTMENT IN LIMITED PARTNERSHIP UNITS

a. In June 1996, the Company entered into an agreement with non-affiliated third parties and became a member of a limited liability company, Beattie Place LLC ("Beattie"). The purpose of Beattie is to acquire, hold, and ultimately dispose of limited partnership units in ten Balcor Limited Partnerships (the "Balcor Units") in connection with previously commenced tender offers. These Balcor limited partnerships own and operate commercial and multi-family real estate properties nationwide. The Company agreed to purchase a non-voting membership interest in Beattie of approximately 71.5%. Beattie purchased approximately 119,000 Balcor Units of which approximately 85,000 Balcor Units represent the Company's pro rata share. As of December 31, 1997, the Company has received return of capital distributions of approximately $2,476,000 in excess of its original investment of $9,834,000. Such excess return of capital distributions have been recognized in "Dividend income" in the year ended December 31, 1997. Approximately $622,000 and $360,000 of income distributions were received and recorded in "Dividend income" for the years ended December 31, 1997 and 1996, respectively.

b. In July 1996, the Company's subsidiary, American Real Estate Holdings Limited Partnership ("AREH") and an affiliate of the General Partner, Bayswater Realty and Capital Corp. ("Bayswater") became partners of Boreas Partners, L.P., ("Boreas"), a Delaware limited partnership. AREH and Bayswater have a 69.999% and 30% limited and general partner interest, respectively, and a wholly owned subsidiary of AREH has a .001% interest as a general partner of Boreas. AREH's total interests are 70%. Boreas together with unaffiliated third parties entered into an agreement and became limited partners of Raleigh Capital Associates, L.P. ("Raleigh") for the purpose of making a tender offer for up to 46% of the outstanding limited partnership and assignee interests ("Units") of Arvida/JMB Partners, L.P. ("Arvida") a real estate partnership. Boreas and an affiliated general partner have a total interest in Raleigh of 33 1/3%. In 1996, Boreas made capital contributions of approximately $17,650,000 to Raleigh representing, as of December 31, 1996, approximately 27,000 of the outstanding Units. In February 1997, Raleigh returned approximately $3,625,000, together with interest earned thereon of approximately $29,000, of excess capital contribution. In April 1997, an additional contribution of approximately $4,333,000 was made representing 8,000 additional units. As of December 31, 1997, Boreas has invested approximately $13,729,000 in Raleigh, net of return of capital distributions of approximately $4,629,000. Boreas received approximately $1,333,000 of income distribution, representing Arvida's 1996 cash flow distribution, which was recorded as "Dividend income" in the year ended December 31, 1997.

The Company has consolidated Boreas in the accompanying financial statements and $4,149,000 representing Baywater's minority interest has been included in "Accounts payable, accrued expenses, and other liabilities."

c. As of December 31, 1997, the Company has participated in four other tender offers for limited partnership units. The Company has invested approximately $9,192,000 in these partnerships.





8. MORTGAGES AND NOTE RECEIVABLE
(in $000's)

| Collateralized by Property Tenanted by or Debtor | | Interest Rate | Maturity Date | Balance at Maturity | Monthly Payment Amount | Balance at December 31, 1997 | Balance at December 31, 1996 |
|---|---|---|---|---|---|---|---|
| Hardee's Food Systems, Inc. | (i) | 9.00% (a) | 11/05 | $ - | 1 (a) | $ 117 | $ 154 |
| Bank of Virginia | (i) | 9.00 (b) | 1/06 | 848 | 1 (b) | 359 | 354 |
| Best Products Co., Inc. | (i) | 9.00 (c) | 9/01 | - | - (c) | 173 | 197 |
| Data 100 Corp. | (i) | 9.00 | 12/10 | - (d) | 10 | - | 915 |
| | | 11.6087 | 12/19 | - (d) | - | - | 537 |
| Easco Corp. | (i) | 8.875 | 2/98 (e) | 3,587 | 27 (e) | 3,481 | 3,493 |
| Winchester Partnership | (i) | 9.00 | 11/01 | - | 34 | 1,336 | 1,610 |
| Queens Moat Houses, P.L. C. (Note receivable) | (f) | Variable | 12/00 | 9,839 (f) | - (f) | 5,600 | 7,966 |
| Stratosphere Corp. | | 14.25 | 5/02 | - (g) | - (g) | 33,021 | - |
| New Seabury Company, LP | | - | - | - (h) | - (h) | 15,883 | - |
| | | | | | | $59,970 | $ 15,226 |

(a) 5.75% is paid currently and 3.25% is deferred. The principal and deferred interest is payable in monthly installments from March 1999 until November 2005.

(b) 4.5% is paid currently and 4.5% is deferred until maturity.

(c) Payments are $46,931 through November 1, 1996 and $54,276 through September 1, 2001.

(d) In August 1997, the outstanding principal balance of the notes was paid off and a gain of approximately $950,000 was realized in the year ended December 31, 1997.

(e) As of January 31, 1997, the purchase money mortgage was amended. The maturity date was extended to February 1998; however, an additional extension is in the process of negotiation under similar terms.

(f) On August 15, 1995, the Company invested approximately $7.1 million in a note receivable by purchasing a portion (approximately 1.85%) of an unsecured Senior Term Facility Agreement ("Facility Agreement"). The borrower is Queens Moat Houses P.L.C. ("Queens Moat") and certain subsidiaries. Queens Moat is a United Kingdom based hotel operator with properties in the U.K., Germany, Netherlands, France and Belgium. The Company purchased its participation portion from Lazard Freres & Co. LLC at 71.75% of the face amount of the Company's pro rata portion of the Facility Agreement's outstanding senior advances on the acquisition date. The Facility Agreement's advances are denominated in Pounds Sterling, Deutsche Marks, Dutch Guilders, Belgian Francs and French Francs. The discount at acquisition date, based on the then existing spot rate, was approximately $2.8 million. The Facility Agreement matures December 31, 2000 and bears interest at LIBOR (London Interbank Offered Rate) plus 1.75% per annum for the relevant currencies. Interest accrued from July 1, 1995 to June 30, 1996, in the approximate amount of $622,000, has been capitalized into the note receivable in accordance with the terms of the Facility Agreement. Subsequent to June 30, 1996 interest periods and payments can vary from one month to two, three or six months at the discretion of the borrower. There are scheduled payments of the advances over the term of the loan. In addition, repayments are required when certain underlying assets are sold. During the years ended December 31, 1997 and 1996, these repayments totalled approximately $2,165,000 and $419,000, respectively.

The discount at acquisition date is being amortized over the term of the Facility Agreement. For the years ended December 31, 1997 and 1996, approximately $1,015,000 and $619,000 of discount was amortized including $626,000 and $122,000 as a result of repayments, respectively. In accordance with accounting policy, foreign exchange gains and losses will be recorded each quarter based on the prevailing exchange rates at each balance sheet date. Foreign exchange losses of approximately $979,000 and $253,000 and gains of approximately $158,000 have been recognized and are included in "Other Income" for the years ended December 31, 1997, 1996 and 1995, respectively.

(g) In June, 1997 the Company invested approximately $42.8 million to purchase approximately $55 million face value of 14 1/4% First Mortgage Notes, due May 15, 2002, issued by the Stratosphere Corporation ("Stratosphere"), which has approximately $203 million of such notes outstanding. An affiliate of the General Partner owns approximately $46.6 million face value of the Stratosphere First Mortgage Notes.

Stratosphere owns and operates the Stratosphere Tower, Casino & Hotel, a destination resort complex located in Las Vegas, Nevada, containing a 97,000 square foot casino and 1,444 hotel rooms and suites and other attractions.

Stratosphere and its wholly owned subsidiary Stratosphere Gaming Corp. filed voluntary petitions on January 27, 1997, for Chapter 11 Reorganization pursuant to the United States Bankruptcy Code. Stratosphere and its subsidiary are acting as debtors in possession on behalf of their respective bankrupt estates and are authorized as such to operate their business subject to bankruptcy court supervision. Stratosphere did not make the required November 15, 1996 interest payment due on the First Mortgage Notes and does not intend to accrue any interest on this debt subsequent to the bankruptcy filing until a plan of reorganization is confirmed by the bankruptcy court.

Stratosphere recently filed a Second Amended Plan of Reorganization which, as proposed, would provide holders of the First Mortgage Notes with 100% of the equity in the reorganized entity. If such plan is approved by the Bankruptcy Court, it would provide the Company and an affiliate of the General Partner with a controlling interest in such reorganized entity.

It is presently anticipated that if such transaction is pursued and consummated that the Company and the affiliate of the General Partner would enter into a joint venture regarding such Stratosphere investment, with such venture to be managed by such affiliate of the General Partner on terms fair and reasonable to the Company and the Company's investment to be structured under applicable regulatory requirements. Furthermore, the Company understands that Stratosphere may seek approximately $100 million for expansion of its hotel facility, a portion of which may be provided by the Company and the affiliate of the General Partner.

The Company, the General Partner, and the directors and officers of the General Partner are currently in the process of pursuing gaming applications to obtain licenses from the Nevada Gaming Authority.

The Company understands that the application process may take a number of months. The Company has no reason to believe it will not obtain its necessary license; however, the Company understands that the licensing application of the affiliate of the General Partner may be reviewed by the authorities earlier than its application. In an effort to facilitate the consummation of the Stratosphere reorganization process if approved by the court in advance of the obtaining of such license by the Company, the Company may transfer its interests in Stratosphere to an affiliate of the General Partner at a price equal to the Company's cost for such Stratosphere First Mortgage Notes. Such transfer will be made to accommodate such reorganization process only if the affiliate of the General Partner receives its license but the Company does not receive its license by the time of Stratosphere's reorganization as described. However, in such event, the affiliate of the General Partner would be obligated to sell back to the Company, and the Company would be obligated to repurchase such interests (or their equivalent) in Stratosphere at the same price (together with a commercially reasonable interest factor) when the appropriate licenses are obtained for the Company. The Company believes there should be no problem for the Company to obtain its license, and thereupon such Stratosphere interests would be transferred back to the Company; however, in order to secure the Company, if such Stratosphere interests are not transferred back to the Company then any net gains (less such interest) from the subsequent sale by the affiliate of the General Partner of such Stratosphere interests previously held by the Company will be paid to the Company. Presently, the Company understands that the Stratosphere First Mortgage Notes are trading at less than the Company's cost for such notes.

Based on current hotel and casino operations' management believes the fair value of this investment to be $33,021,000. As a result, the Company has recorded as provision for loss on mortgages receivable of $9,790,000 in the year ended December 31, 1997.

(h) On August 18, 1997, a wholly-owned subsidiary of the Company acquired five notes and mortgages for approximately $10,745,000 with an aggregate face amount of approximately $14,340,000, excluding accrued and unpaid interest and penalties owed by the borrower and estimated to total approximately an additional $8,200,000. The notes are secured by certain real property belonging to the borrower, New Seabury Company Limited Partnership ("New Seabury"). The loans are currently non-performing and the debtor has filed a Chapter 11 petition for relief in the United States Bankruptcy Court, District of Massachusetts. The properties are part of a master planned community situated in the town of Mashpee located on Cape Cod in Massachusetts. Subsequent to the closing, the Company received approximately $115,000 in cash flow from property operations from a portion of the underlying collateral which has been applied to the Company's investment.

On September 26, 1997, a wholly-owned subsidiary of the Company acquired four additional notes and mortgages for a purchase price of approximately $5,000,000 with an outstanding principal balance of approximately $8,320,000, excluding accrued and unpaid interest and penalties owed by the borrower and estimated to total approximately an additional $3,000,000 to $4,000,000. The notes are secured by certain real property belonging to the borrower, New Seabury. The loans also are currently non-performing and subject to the debtor's Chapter 11 proceeding. The properties are part of a master planned community situated in the Town of Mashpee located in Cape Cod in Massachusetts.

The Company is attempting to foreclose on the underlying collateral pertaining to all of the above mentioned notes.

(i) The Company has generally not recognized any profit in connection with the property sales in which the above purchase money mortgages receivable were taken back. Such profits are being deferred and will be recognized when the principal balances on the purchase money mortgages are received since profit recognition was not allowed under generally accepted accounting principles at the time of sale.

9. SIGNIFICANT PROPERTY TRANSACTIONS

Information on significant property transactions during the three-year period ended December 31, 1997 is as follows:

a. On July 14, 1992, Integra, a Hotel and Restaurant Company ("Integra"), which leased two hotel properties located in Miami, Florida and Phoenix, Arizona filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Bankruptcy Code. The tenant's petition, previously filed with the Bankruptcy Court, to reject the aforementioned leases, was approved on August 7, 1992, and the Company assumed operation of the properties on that date.

   At December 31, 1997, the property located in Miami Florida has a carrying value of approximately $5,004,000 and is unencumbered by any mortgages. This property is subject to a ground lease. Based on current conditions, management believes the carrying value of the Miami property is reasonably stated.

   In April 1997, the Company sold the hotel property located in Phoenix, Arizona. The selling price was $15,750,000 and a gain of approximately $7,863,000 was recognized in the year ended December 31, 1997. This property was encumbered by a nonrecourse mortgage with a principal balance outstanding of approximately $3,211,000 which was repaid at closing. A prepayment penalty of approximately $250,000 was also incurred.

   The Company entered into a management agreement for the operation of the hotels with a national management organization. Since August 7, 1992, the hotels have been classified as Hotel Operating Properties and their revenues and expenses separately disclosed in the Consolidated Statements of Earnings. Net hotel operations (hotel operating revenues less hotel operating expenses) totalled approximately $1,110,000, $2,382,000 and $2,131,000 for the years ended December 31, 1997, 1996 and 1995, respectively. Hotel operating expenses include all expenses except for approximately $527,000, $933,000 and $822,000 of depreciation and $83,000, $335,000 and $339,000 of interest expense for the years ended December 31, 1997, 1996 and 1995, respectively. These amounts are included in their respective captions in the Consolidated Statements of Earnings.

b. On July 31, 1992, Chipwich, Inc. ("Chipwich"), parent of Peltz Food Corporation, a tenant in a property owned by the Company filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Federal Bankruptcy Code. Chipwich then filed a motion for rejection of the lease and, pursuant to an order of the Bankruptcy Court, the lease was rejected on September 29, 1992. There was a guarantor of the lease and the Company settled its claim against the guarantor.

   In 1995, the guarantor paid the Company $2,200,000 in full satisfaction of its leasehold obligation which, net of related costs, resulted in approximately $2,034,000 of "Other income" in the year ended December 31, 1995. The Company reclassified this property to "Property held for sale" and reduced its carrying value to net realizable value by recording a provision for loss on real estate of $250,000 and $611,552 in the years ended December 31, 1996 and 1995, respectively. In October 1997, the Company sold this property and recognized a gain of approximately $94,000.

c. On June 17, 1993, the Company purchased two non-performing mortgage loans for a combined price of $13,000,000. Each loan was collateralized by a residential apartment complex located in Lexington, Kentucky. The face value of the non-performing loans was approximately $21,188,000.

   The first non-performing loan, purchased for $6,990,000, was collateralized by a 396 unit multi-family complex. The Company foreclosed on this property ("Stoney Falls"), and received the deed on October 11, 1993.

The second non-performing loan, purchased for $6,010,000, was collateralized by a 232 unit apartment complex. The Company foreclosed on this property ("Stoney Brooke") and received the deed on February 11, 1994. Subsequent to the acquisition, the Company received distributions from the seller of the note and began to receive cash flow from the property pertaining to the period prior to formal foreclosure, net of expenditures incurred by the Company, which were applied as a reduction to the initial cost of the loan. This cash flow, net of expenditures incurred by the Company, totalled approximately $735,000.

On September 17, 1996, the Company sold the two apartment complexes for $20,325,000. First mortgages with principal balances outstanding of approximately $9,800,000 were repaid at closing. As a result, the Company recognized a gain on the sale of these properties of approximately $6,723,000 in the year ended December 31, 1996.

d. The Company entered into two joint ventures in June 1994 with unaffiliated co-venturers for the purpose of developing luxury garden apartment complexes. The Alabama joint venture has been consolidated in the accompanying financial statements. The North Carolina joint venture sold its property in December 1996.

1. The first joint venture, formed as an Alabama Limited Liability Company, developed a 240 unit multi-family project situated on approximately twenty acres, currently owned by the joint venture, located in Hoover, Alabama, a suburb of Birmingham. The Company, which owns a 70% majority interest in the joint venture, contributed $1,750,000 in June 1994 and the co-venturer contributed $250,000. As of December 31, 1997 and 1996 approximately $81,000 and $135,000, respectively, representing the minority interest of the co-venturer has been included in "Accounts payable, accrued expenses, and other liabilities" in the accompanying financial statements. Distributions, which totaled $107,000 and $75,000 in 1997 and 1996, respectively, are made in proportion to ownership interests. The co-venturer was credited with $500,000 of additional capital in lieu of receiving a general contractor's fee. Permanent financing was obtained by the joint venture in the amount of $8,860,000 of which $360,000 is guaranteed by the co-venturer and personally by its principals. The complex was completed in September 1995, and all rental units were available for occupancy. The development totalled approximately $10,889,000, including the acquisition of land valued at approximately $1,138,000. An affiliate of the Company's co-venturer is managing the property.

For the years ended December 31, 1997, 1996 and 1995, net rental operations resulted in losses of approximately $14,000, $219,000 and $301,000, including approximately $472,000, $502,000 and $289,000 of depreciation and amortization, before consideration of the co-venturer's minority interest in such losses of approximately $4,000, $66,000 and $90,000, respectively. These amounts are included in their respective captions in the Consolidated Statements of Earnings.

A reinvestment incentive fee of approximately $38,000 was paid to the general partner upon completion of the project (See Note 3).





2. The second joint venture, a Delaware limited partnership, developed a 288 unit multi-family project situated on approximately thirty-three acres in Cary, North Carolina (Raleigh-Durham area). The Company, owned a ninety percent (90%) majority interest in the partnership, contributed approximately $4,022,000 and was a limited partner. Construction financing was

obtained by the joint venture in the amount of $12,205,000 and was guaranteed by the joint venture general partner and personally by its principals. The complex was completed in August 1996 and all rental units were available for occupancy. The total development costs including the acquisition of land, were approximately $16,000,000. In December 1996, the joint venture sold the property for $21,000,000.

The Company received approximately $8,300,000 of the net proceeds and recognized a gain of approximately $4,900,000.

A reinvestment incentive fee of approximately $72,000 was paid to the Company's general partner upon completion of the project (See Note 3).

e. On February 1, 1995, the Penske Corp. exercised its purchase option on three properties leased from the Company (two in New Jersey and one in New York). The selling price was approximately $4,535,000 and a gain of approximately $1,003,000 was recognized in the year ended December 31, 1996. Each property was encumbered by first and second mortgages which totalled approximately $1,152,000 and which were paid from the sales proceeds.

f. On March 24, 1995, the Company sold the property tenanted by Pace Membership Warehouse, Inc. in Taylor, Michigan. The selling price was $9,300,000 and a gain of approximately $3,307,000 was recognized in the year ended December 31, 1995. The property was encumbered by a nonrecourse mortgage payable of approximately $4,346,000 which the purchaser assumed.

g. On May 18, 1995, the Company purchased approximately 248 acres of partially improved land located in Armonk, New York. The purchase price was approximately $3,044,000. The Company intends to construct approximately 45 to 50 single-family detached luxury homes subject to subdivision and other required approvals. No material development costs have yet been incurred.

A reinvestment incentive fee of approximately $15,000 was paid to the Company's general partner in 1996 (See Note 3).

h. On June 28, 1995, General Signal Technology Corporation, a tenant of a property located in Andover, Massachusetts exercised its rights under the lease to purchase the property. The selling price was approximately $19,808,000 and a loss of approximately $125,000 was recognized in the year ended December 31, 1995. The property was encumbered by two nonrecourse mortgages payable which totalled approximately $10,670,000 and were paid from the sales proceeds.

i. On January 11, 1996, Forte Hotels, Inc. ("Forte") a/k/a Travelodge, a tenant in a property owned by the Company entered into a Lease Termination and Mutual Release Agreement ("Agreement") which required Forte to pay the Company $2,800,000.





As a result of the above settlement the Company recognized "Other income" of approximately $2,700,000, net of related costs, in the year ended December 31, 1996. In January 1997, the Company sold this property for approximately $2,165,000, net of closing costs. A gain of approximately $1,403,000 was recorded in the year ended December 31, 1997.

j. On May 10, 1996, the Company sold a property in Miami, Florida that was tenanted by the Cordis Corporation. The Company permitted an early exercise by the tenant of its purchase option as the Company believed the option price to be above the market price. The selling price for the property was $24,310,000. First and second mortgages with principal balances outstanding of approximately $14,416,000 were repaid at closing. In addition, closing costs of approximately $228,000 were incurred. As a result, the Company recognized a gain on the sale of this property of approximately $4,659,000.

In connection with the early extinguishment of the outstanding mortgage balances, the Company paid approximately $522,000 in prepayment penalties which were included in interest expense.

k. On July 24, 1996, the Company entered into a gross lease with AT&T Corp. for its Atlanta office building formerly leased to Days Inn of America, Inc. The initial term of the lease is for five years at $1,478,923 per annum plus operating expense escalations with two five-year renewal periods. The renewal rent is the initial term rent plus 50% of the increase in the Consumer Price Index. Tenant improvements, allowances and commissions incurred in connection with this lease were approximately $2,500,000. The lease commenced on November 25, 1996.

l. On July 29, 1996, the Company sold a property in Woodbury, NY that was tenanted by Pioneer Standard Electronics, Inc. The selling price was $2,000,000 and the Company recognized a gain of approximately $1,040,000 in the year ended December 31, 1996.

m. On August 15, 1996, the Company sold a property in Philadelphia, Pennsylvania that was tenanted by A&P and Ginos. The selling price for the property was $3,500,000. A first mortgage with a principal balance outstanding of approximately $301,000 was repaid at closing. In addition, closing costs of approximately $194,000 were incurred. As a result, the Company recognized a gain on the sale of this property of approximately $2,198,000.

n. On September 30, 1996, the Company sold a property in Southfield, Michigan that was tenanted by the Penske Corporation. The selling price for the property was $4,700,000 and the Company recognized a gain on the sale of this property of approximately $3,253,000.

o. On January 7, 1997, the Company sold three properties tenanted by Federal Realty Investment Trust ("FRIT") for a total selling price of approximately $9,363,000. Two first mortgages with principal balances outstanding of approximately $878,000 were repaid at closing. In addition, closing costs of approximately $40,000 were incurred. As a result, the Company recognized a gain of approximately $1,778,000.

In addition, on January 7, 1997, FRIT made a loan to the Company in the approximate amount of $8,759,000 secured by a fourth property tenanted by FRIT located in Broomal, PA. Concurrently with this loan, the Company granted and FRIT exercised an option to purchase the Broomal property with a closing to occur on or about June 30, 1998. The purchase price will be the unpaid balance of the mortgage loan of approximately $8,500,000 at the closing date. The nonrecourse mortgage loan bears interest at the rate of 8% per annum and requires monthly debt service payments of approximately $72,000.





p. On June 30, 1997, the Company acquired two adjacent medical office buildings located in Nashville, Tennessee, both of which are net leased to Baptist Hospitals, Inc. ("Baptist"). The total purchase price was approximately $34,616,000 which included the assumption of existing mortgages on each building totaling approximately $31,666,000.

The lease term, which commenced June 28, 1996, is for 22.5 years with seven 10-year renewal periods at approximately $3,032,000 per annum paid semi-annually. The mortgages bear interest at the rate of 7.84% per annum, self liquidate December 31, 2018, and have total debt service of approximately $3,070,000 payable semi-annually. Cash flow from these properties is approximately break-even.

q. On September 26, 1997 the Company purchased a retail property located in Schaumburg, Illinois for approximately $9,138,000 cash. The completed building, which is approximately 100,000 square feet, is tenanted by Bed Bath & Beyond, Inc., and Golfsmith International, Inc.

Bed Bath & Beyond's lease is for an initial term of fifteen years starting at $565,896 per year for their approximately 71,000 square foot store with four five year renewal options at increased rentals. Golfsmith International's lease is for an initial term of fifteen years starting at $375,450 per year with three five year renewal options at increased rentals. The rent commencement date for both tenants occurred in November 1997.

A mortgage loan commitment has been entered into to provide funding of approximately $7,150,000 for this property.

r. On December 12, 1997, the Company sold the property tenanted by Hancock Bank located in Baton Rouge, Louisiana. The selling price was $5,075,000. As a result, the Company recognized a gain of approximately $1,345,000.

s. In December 1997, the Company purchased for approximately $19 million, two multi-tenant industrial buildings, located in Hebron, Kentucky. Net rental income is approximately $1.75 million per annum. The Company entered into a commitment to obtain a mortgage of approximately $12.6 million with interest at 7.21% per annum payable on a 30 year basis due in 124 months.

The Company also entered into a contract to purchase for approximately $21 million a third single tenant building in the Hebron complex subject to certain contingencies including substantial completion by October 1998. A mortgage loan commitment has been executed to provide funding of approximately $19.4 million in connection with this acquisition.





10. MORTGAGES PAYABLE

At December 31, 1997, mortgages payable, all of which are nonrecourse to the Company, are summarized as follows (in $000's):

| Number of Mortgages | Range of Interest Rates | Range of Maturities | Annual Principal and Interest Payment | Balance at December 31, 1997 | Balance at December 31, 1996 |
|---|---|---|---|---|---|
| 14 | 7.080% - 8.790% | 6/30/99 - 12/31/18 | $ 13,064 | $ 104,737 | $ 57,952 |
| 32 | 9.000 - 10.750 | 4/30/98 - 12/13/13 | 8,547 | 51,132 | 55,073 |
| 2 | 11.500 - 12.000 | 10/31/05 - 12/31/05 | 84 | 564 | 2,886 |
| | | | $ 21,695 | $ 156,433 | $ 115,911 |

The following is a summary of the anticipated future principal payments of the mortgages:

| Year ending December 31, | Amount |
|---|---|
| 1998 | $ 20,233 |
| 1999 | 14,102 |
| 2000 | 19,907 |
| 2001 | 8,314 |
| 2002 | 6,664 |
| 2003 - 2007 | 33,513 |
| 2008 - 2012 | 37,679 |
| 2013 - 2017 | 11,753 |
| 2018 | 4,268 |
| | $156,433 |

In December 1997, the Company executed a new mortgage loan and obtained funding in the principal amount of $46.3 million, which is secured by a mortgage on a three building office/retail/conference center complex net leased by the Company to a subsidiary of Portland General Electric Corporation ("PGE") in Portland, Oregon, The complex contains approximately 800,000 square feet on approximately 2.7 acres. The loan replaces an existing mortgage loan on the complex with an outstanding principal balance of approximately $24.2 million, bearing interest at 8.5% and maturing in 2002.

The interest rate on the new mortgage loan is 7.51%. The entire net annual rent payable by PGE of approximately $5,137,000 will be applied by the Company towards the debt service on the loan. The new loan has a maturity date of September, 2008, at which time the remaining principal payment of approximately $20 million will be due from the Company. Debt placement costs of approximately $574,000 were incurred.

11. SENIOR INDEBTEDNESS

On May 27, 1988, the Company closed a $50,000,000, 10-year senior unsecured debt financing. The notes bear interest at 9.6%, payable semiannually, 2% of which was deferred and added to the principal at the Company's option during the first five years. In May 1995, 1996 and 1997, the Company repaid approximately $11,308,000 each year of the outstanding principal balance of the notes. The Company is required to make its final principal repayment of approximately $11,308,000 on the final payment date of May 27, 1998.

The note agreements also place limitations on the Company with respect to, among other





things, additional debt and the use of proceeds from property sales. In addition, distributions and the amounts used to purchase partnership interests cannot exceed cash flow, as defined in the agreements, plus $15,000,000. The Company is also required to maintain, among other things, specified levels of (i) net annual rentals, as defined in the agreements, on properties unencumbered by mortgage financing and (ii) net cash flow.

12. RIGHTS OFFERINGS

a. A registration statement relating to the 1995 Rights Offering (the "1995 Offering") was filed with the Securities and Exchange Commission and declared effective February 23, 1995.

On March 1, 1995, the Company issued to record holders of its Depositary Units one transferable subscription right (a "Right"), for each seven Depositary Units of the Company held on February 24, 1995, the record date. The Rights entitled the holders thereof (the "Rights Holders") to acquire during the subscription period at a subscription price of $55, six Depositary Units and one 5% cumulative pay-in-kind redeemable preferred unit representing a limited partner interest ("Preferred Units"). The subscription period commenced on March 1, 1995 and expired at the close of business on March 30, 1995.

The Preferred Units have certain rights and designations, generally as follows. Each Preferred Unit has a liquidation preference of $10.00 and entitles the holder thereof to receive distributions thereon, payable solely in additional Preferred Units, at the rate of $.50 per Preferred Unit per annum (which is equal to a rate of 5% of the liquidation preference thereof), payable annually on March 31 of each year (each, a "Payment Date"). On any Payment Date commencing with the Payment Date on March 31, 2000, the Company with the approval of the Audit Committee of the Board of Directors of the General Partner may opt to redeem all, but not less than all, of the Preferred Units for a price, payable either in all cash or by issuance of additional Depositary Units, equal to the liquidation preference of the

Preferred Units, plus any accrued but unpaid distributions thereon. On March 31, 2010, the Company must redeem all, but not less than all, of the Preferred Units on the same terms as any optional redemption. The first Payment Date was April 1, 1996 on which 98,782 additional Preferred Units were issued. On March 31, 1997, the distribution of 103,721 additional Preferred Units were issued to holders of record as of March 14, 1997.

1,975,640 Rights were issued in the 1995 Offering of which 418,307 were exercised. 190,554 Depositary Units and 31,759 Preferred Units were subscribed for through the exercise of the Over-Subscription Privilege by Rights Holders other than High Coast Limited Partnership ("High Coast"), a Delaware limited partnership.

High Coast acted as guarantor for the 1995 Offering and is an affiliate of Carl C. Icahn, ("Icahn"), the Chairman of American Property Investors, Inc., ("API"), the general partner of the Company. API is also the general partner of the guarantor and the two limited partners are affiliates of and are controlled by Icahn. Pursuant to its subscription guaranty, High Coast oversubscribed for a total of 9,343,998 Depositary Units and 1,557,333 Preferred Units. As a result, the 1995 Offering was fully subscribed. The proceeds received by the Company, after deduction of expenses of approximately $1.1 million incurred by the Company in connection with the 1995 Offering, were approximately $107.6 million.





In addition, in accordance with the terms of the Company's and its subsidiary's partnership agreements, API was required to contribute approximately $2.2 million in order to maintain its aggregate 1.99% general partnership interest.

On April 12, 1995, the Company received approximately $108.7 million, the gross proceeds of the 1995 Offering, from its subscription agent and approximately $2.2 million from API. The Company issued 1,975,640 Preferred Units and an additional 11,853,840 Depositary Units. Trading in the Preferred Units commenced March 31, 1995 on the New York Stock Exchange ("NYSE") under the symbol "ACP PR". The Depositary Units trade on the NYSE under the symbol "ACP".

b. In September 1997, the Company completed its 1997 Rights Offering (the "1997 Offering") to holders of its Depositary Units. The aggregate amount raised in the 1997 Offering was approximately $267 million, which is expected to be used primarily for additional investment opportunities.

Record date holders were issued one transferable right for each five Depositary Units held. Each right (the "Primary Subscription Right") entitled the holder thereof to acquire during the subscription period, at a subscription price of $52, four Depositary Units and one 5% cumulative pay-in-kind redeemable Preferred Unit representing a limited partner interest. The subscription period commenced August 13, 1997 and expired at the close of business on September 11, 1997.

5,132,911 Rights were issued in the 1997 Offering of which 3,307,512 were exercised. 798,832 Depositary Units and 199,708 Preferred Units were subscribed for through the exercise of the Over-Subscription Privilege by Rights Holders other than High Coast.

High Coast acted as the guarantor for the offering. Pursuant to its subscription guaranty, High Coast agreed to subscribe for and purchase all of the Depositary Units and Preferred Units not otherwise purchased by Rights Holders. As a result, the offering was fully subscribed. Pursuant to its subscription guaranty, High Coast over-subscribed for a total of 6,502,764 Depositary Units and 1,625,691 Preferred Units.

In addition, in accordance with the terms of the Company's and its subsidiary's partnership agreements, API was required to contribute approximately $5.4 million in order to maintain its aggregate 1.99% general partnership interest.

On September 25, 1997 the Company received approximately $267 million, the gross proceeds of the 1997 Offering, from its subscription agent and approximately $5.4 million from API. Expenses incurred in connection with the 1997 Offering were approximately $400,000. The Company issued an additional 5,132,911 Preferred Units and 20,531,644 Depositary Units. The Preferred and Depositary Units trade on the New York Stock Exchange under the symbols "ACP PR" and "ACP", respectively.

As of December 31, 1997, High Coast owns 6,325,778 Preferred Units and 31,515,044 Depositary Units.





13. RECONCILIATION OF NET EARNINGS PER FINANCIAL STATEMENTS TO TAX REPORTING (in $000's)

| | 1997 | 1996 | 1995 |
|---|---|---|---|
| Net earnings per financial statements | $ 75,384 | $ 57,822 | $ 35,156 |
| Minimum lease payments received, net of income earned on leases accounted for under the financing method | 7,683 | 7,314 | 7,205 |
| Gain on real estate transactions for tax purposes (lesser than)/greater than that for financial statement purposes | (5,594) | 8,867 | 9,739 |
| Provision for loss for financial statement purposes | 10,875 | 935 | 769 |
| Difference attributed to joint ventures and minority interest | (46) | (143) | (86) |
| Difference between expense accruals, net of income accruals, at beginning of year and end of year | (2,094) | 807 | (994) |
| Depreciation and amortization for tax purposes in excess of that for financial statement purposes due to leases accounted for under the financing method | (4,464) | (5,215) | (7,071) |
| Other | (26) | (26) | (26) |
| Taxable income | $ 81,718 | $ 70,361 | $ 44,692 |





14. QUARTERLY FINANCIAL DATA (UNAUDITED) (IN $ THOUSANDS, EXCEPT PER UNIT DATA)

| | Three Months Ended | | | |
|---|---|---|---|---|
| | March 31, | | June 30, | |
| | 1997 | 1996 | 1997 | 1996 |

| | | | | |
|---|---|---|---|---|
| Revenues | $17,299 | $ 20,592 | $ 15,523 | $ 16,976 |
| Earnings before property and securities transactions | $ 8,605 | $ 10,949 | $ 8,369 | $ 7,126 |
| Gains on property transactions | 2,957 | 52 | 7,967 | 5,454 |
| Gain (loss) on sale of marketable equity securities | 29,227 | -- | (39) | -- |
| Provision for loss on real estate | -- | -- | (362) | (175) |
| Net earnings | $40,789 | $ 11,001 | $ 15,935 | $ 12,405 |
| Net earnings per limited partnership unit: | | | | |
| Basic earnings | $ 1.55 | $ .41 | $ .61 | $ .46 |
| Diluted earnings | $ 1.43 | $ .39 | $ .57 | $ .43 |

| | Three Months Ended | | | |
|---|---|---|---|---|
| | September 30, | | December 31, | |
| | 1997 | 1996 | 1997 | 1996 |
| Revenues | $ 16,054 | $16,760 | $ 22,042 | $ 17,446 |
| Earnings before property and securities transactions | $ 8,894 | $ 7,841 | $ 15,152 | $ 8,325 |
| Gains on property transactions | 2,364 | 13,595 | 2,764 | 5,415 |
| Gain (loss) on sale of marketable equity securities | -- | -- | -- | -- |
| Provision for loss on mortgages receivable | -- | -- | (9,790) | -- |
| Provision for loss on real estate | (343) | -- | (380) | (760) |
| Net earnings | $ 10,915 | $21,436 | $ 7,746 | $ 12,980 |
| Net earnings per limited partnership unit: | | | | |
| Basic earnings | $ .36 | $ .81 | $ .14 | $ .49 |
| Diluted earnings | $ .36 | $ .75 | $ .14 | $ .45 |

Net earnings per unit is computed separately for each period and, therefore, the sum of such quarterly per unit amounts may differ from the total for the year.





15. COMMITMENTS AND CONTINGENCIES

a. Lockheed Missile and Space Company, Inc. ("Lockheed"), a tenant of the Company's leasehold property in Palo Alto, California, has entered into a consent decree with the California Department of Toxic Substances Control ("CDTS") to undertake certain environmental remediation at this property. Lockheed has estimated that the environmental remediation costs may be up to approximately $14,000,000. In a non-binding determination by the CDTS, Lockheed was found responsible for approximately 75% of such costs and the balance was allocated to other parties. The Company was allocated no responsibility for any such costs.

Lockheed previously served a notice that it may exercise its statutory right to have its liability reassessed in a binding arbitration proceeding. In this notice, Lockheed stated that it would attempt to have allocated to the Company and to the Company's ground-lessor (which may have sought to claim a right of indemnity against the Company) approximately 9% and 17%, respectively, of the total remediation costs.

On February 19, 1998, the property was conveyed by the Company to Lockheed for a purchase price of $9,400,000. A gain of approximately $4 million will be recorded in the first quarter of 1998. In connection with the sale, Lockheed executed a release and indemnity in favor of the Company and a stipulation dismissing the environmental arbitration, as against the Company. Leland Stanford Junior University (the fee owner/ground lessor) also executed a release in favor of the Company.

b. On June 23, 1995, Bradlees Stores, Inc., a tenant leasing four properties owned by the Company, filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Federal Bankruptcy Code. The annual rentals for these four properties is approximately $1,320,000. The tenant is current in its obligations under the leases. The tenant has not yet determined whether it will exercise its right to reject or affirm the leases which will require an order of the Bankruptcy Court. There are existing assignors who are still obligated to fulfill all of the terms and conditions of the leases.

   At December 31, 1997, the carrying value of these four properties is approximately $6,978,000. One of the properties is encumbered by a nonrecourse mortgage payable of approximately $870,000.

c. On September 18, 1995, Caldor Corp., a tenant in a property owned by the Company, filed a voluntary petition for reorganization pursuant to the provisions of Chapter 11 of the Federal Bankruptcy Code. The annual rental for this property is approximately $248,000. The tenant is current in its obligations under the lease with the exception of approximately $12,000 of prepetition rent. The tenant has not yet determined whether it will exercise its right to reject or affirm the leases which will require an order of the Bankruptcy Court. At December 31, 1997, the property has a carrying value of approximately $1,874,000 and is unencumbered by any mortgage.

d. On September 24, 1996, Best Products, a tenant leasing a property owned by the Company, filed a voluntary petition for reorganization pursuant to the provision of Chapter 11 of the Federal Bankruptcy Code. The annual rental for this property was approximately $508,000. The tenant has exercised its right to reject the lease, effective April 30, 1997, which has been approved by the Bankruptcy Court. At December 31, 1997, the property was vacant and has a carrying value of approximately $3,300,000 and is unencumbered by any mortgage.





16. PROPERTY HELD FOR SALE

At December 31, 1997, the Company owned seven properties that were being actively marketed for sale. The aggregate value of the properties is estimated to be approximately $4,164, 000 after incurring a provision for loss on real estate in the amount of $240,000 in the year ended December 31, 1997. At December 31, 1996, the aggregate value of twelve properties was estimated to be approximately $3,698,000 after incurring a provision for loss on real estate in the amount of $275,000 in 1996.

17. FAIR VALUE OF FINANCIAL INSTRUMENTS

Cash and Cash Equivalents, Investment in Treasury Bills, Accounts Receivable, Mortgages Payable and Accounts Payable, Accrued Expenses and Other Liabilities

The carrying amount of cash and cash equivalents, investment in treasury bills, accounts receivable, mortgages payable and accounts payable, accrued expenses and other liabilities are carried at cost, which approximates their fair value.

Mortgages Receivable

The fair values of the mortgages receivable past due, in process of foreclosure, or for which foreclosure proceedings are pending, are based on the discounted cash flows of the underlying lease. The fair values of the mortgages receivable satisfied subsequent to year end are based on the amount of the net proceeds received.

The fair values of the mortgages receivable which are current are based on the discounted cash flows of their respective payment streams.

The approximate estimated fair values of the mortgages receivable held as of December 31, 1997 are summarized as follows (in 000's):

| | At December 31, 1997 | |
|---|---|---|
| Collateralized by Property Tenanted by or debtor | Net Investment | Estimated Fair Value |
| Hardee's Food Systems, Inc. | $ 15 | $ 187 |
| Bank of Virginia | 359 | 474 |
| Best Products Co., Inc. | 173 | 169 |
| Easco Corp. | 916 | 3,450 |
| Winchester Partnership | 1,336 | 1,336 |
| Stratosphere Corp. | 33,021 | 33,021 |
| New Seabury Company, L.P. | 15,883 | 17,240 |





| | At December 31, 1996 | |
|---|---|---|
| Collateralized by Property Tenanted by or debtor | Net Investment | Estimated Fair Value |
| Hardee's Food Systems, Inc. | $ 51 | $ 177 |
| Bank of Virginia | 353 | 445 |
| Best Products Co., Inc. | 197 | 198 |
| Data 100 Corp. | 788 | 1,065 |
| Easco Corp. | 928 | 3,450 |
| Winchester Partnership | 1,609 | 1,593 |

The net investment at December 31, 1997 and 1996 is equal to the carrying amount of the mortgage receivable less any deferred income recorded.

Marketable Equity Securities

Marketable equity securities vailable for sale are carried at fair market value.

Senior Indebtedness

The approximate fair value and carrying value of the Company's senior indebtedness at December 31, 1997 and 1996 is $11,756,000 and $11,308,000, $22,756,000 and $22,616,000, respectively. The estimated fair value is based on the amount of future cash flows associated with the instrument discounted using the rate at which the Company believes it could currently replace the senior indebtedness.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

18. DISTRIBUTIONS PAYABLE

Distributions payable represent amounts accrued and unpaid due to non-consenting investors ("Non-consents"). Non-consents are those investors who have not yet exchanged their limited partnership interest in the various Predecessor Partnerships for limited partnership units of American Real Estate Partners, L.P. In the year ended December 31, 1997, approximately $1,020,000 of distributions due to non-consents were paid to certain states pursuant to local escheatment laws.

19. SUBSEQUENT EVENTS

a. Pursuant to the terms of the Preferred Units, on February 27, 1998, the Company declared its scheduled annual preferred unit distribution payable in additional Preferred Units at the rate of 5% of the liquidation preference of $10. The distribution is payable March 31, 1998 to holders of record as of March 13, 1998.





b. On January 21 and 28, 1998, the Company acquired an interest in the Sands Hotel and Casino (the "Sands") located in Atlantic City, New Jersey by purchasing the principal amount of $17.5 million of First Mortgage Notes issued by GB Property Funding Corp. ("GB Property"). GB Property was organized as a special purpose entity for the borrowing of funds by Greate Bay Hotel and Casino, Inc. ("Greate Bay"). The purchase price for such notes was approximately $14.3 million. Notes in the amount of $185 million were issued, which bear interest at 10.875% per annum and are due on January 15, 2004.

   Greate Bay owns and operates the Sands, a destination resort complex, containing a 76,000 foot casino and 532 hotel rooms and other amenities. On January 5, 1998, GB Property and Greate Bay filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code to restructure its long term debt.

c. In January, 1998, the Company acquired an interest in the Claridge Hotel and Casino (the "Claridge Hotel") located in Atlantic City, New Jersey by purchasing the principal amount of $15 million of First Mortgage Notes of the Claridge Hotel and Casino Corporation (the "Claridge Corporation"). The purchase price of such notes was approximately $14.1 million. Notes in the amount of $85 million were issued, which bear interest at 11.75% payable annually and are due February 1, 2002.

   The Claridge Corporation through its wholly-owned subsidiary, the Claridge at Park Place, Incorporated, operates the Claridge Hotel, a destination resort complex, containing a 59,000 foot casino on three levels and 502 hotel rooms and other attractions

d. In March 1998, the Company executed a contract, with contingencies for the sale of the property tenanted by AT&T Corp. The sales price is $8,600,000.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None





# PART III

Item 10. Directors and Executive Officers of AREP.

The names, offices held and the ages of the directors and executive officers of the General Partner are as follows:

| Name | Age | Office |
|---|---|---|
| Carl C. Icahn | 62 | Chairman of the Board |
| Alfred D. Kingsley | 55 | Director |
| William A. Leidesdorf | 52 | Director |
| Jack G. Wasserman | 61 | Director |
| John P. Saldarelli | 56 | Vice President, Secretary and Treasurer |

Carl C. Icahn has been Chairman of the Board of the General Partner since November 15, 1990. He is also President and a Director of Starfire Holding Corporation (formerly Icahn Holding Corporation), a Delaware corporation ("SHC") and Chairman of the Board and a Director of various of SHC's subsidiaries, including ACF Industries, Inc., a New Jersey corporation ("ACF"). SHC is primarily engaged in the business of holding, either directly or through subsidiaries, a majority of the common stock of ACF and its address is 100 South Bedford Road, Mount Kisco, New York 10549. Mr. Icahn has also been Chairman of the Board of Directors of ACF since October 29, 1984 and a Director of ACF since June 29, 1984. ACF is a railroad freight and tank car leasing, sales and manufacturing company. He has also been Chairman of the Board of Directors and President of Icahn & Co., Inc. since 1968. Icahn & Co., Inc. is a registered broker-dealer and a member of the National Association of Securities Dealers. In 1979, Mr. Icahn acquired control and presently serves as Chairman of the Board of Directors of Bayswater Realty & Capital Corp., which is a real estate investment and development company. ACF, Icahn & Co., Inc. and Bayswater Realty & Capital Corp. are deemed to be directly or indirectly owned and controlled by Carl C. Icahn. Mr. Icahn was Chief Executive Officer and Member of the Office of the Chairman of Trans World Airlines, Inc. ("TWA") from November 8, 1988 to January 8, 1993; Chairman of the Board of Directors of TWA from January 3, 1986 to January 8, 1993 and Director of TWA from September 27, 1985 to January 8, 1993. Mr. Icahn also serves as a director of Cadus Pharmaceutical Corporation, a public biotechnology company. Mr. Icahn also has substantial equity interests in and controls various partnerships and corporations which invest in publicly traded securities.





Alfred D. Kingsley has served as Director of the General Partner since November 15, 1990. He was also Vice Chairman of the Board of Directors of TWA from February 1, 1989 to January 8, 1993 and a Member of the Office of the Chairman from November 8, 1988 to January 8, 1993. Mr. Kingsley was a Director of TWA from September 27, 1985 to January 8, 1993. He also was a Director and Executive Officer and Director of Research at Icahn & Co., Inc. and related entities from 1968 until December 1994. He also has been Vice Chairman of the Board of Directors of ACF since October 29, 1984 and a Director of ACF since June 29, 1984. Mr. Kingsley has also been a Senior Managing Director of Greenway Partners, L.P. since May 1993, which invests in publicly traded securities. Since September 30, 1997, Mr. Kingsley has served as Chairman of the Board of Outboard Marine Corporation, a privately held company engaging in the manufacturing of outboard motors and boats.

William A. Leidesdorf has served as Director of the General Partner since March 26, 1991. Since April 1995, Mr. Leidesdorf has acted as an independent real estate investment banker. From January 1, 1994 through April 1995, Mr. Leidesdorf was Managing Director of RFG Financial, Inc., a commercial mortgage company. From September 30, 1991 to December 31, 1993, Mr. Leidesdorf was Senior Vice President of Palmieri Asset Management Group. From May 1, 1990 to September 30, 1991, Mr. Leidesdorf was Senior Vice President of Lowe Associates, Inc., a real estate development company, where he was involved in the acquisition of real estate and the asset management workout and disposition of business areas. He also acted as the Northeast Regional Director for Lowe Associates, Inc. From June 1985 to January 30, 1990, Mr. Leidesdorf was Senior Vice President and stockholder of Eastdil Realty, Inc., a real estate company, where he was involved in the asset management workout, disposition of business and financing areas. During the interim period from January 30, 1990 through May 1, 1990, Mr. Leidesdorf was an independent contractor for Eastdil Realty, Inc. on real estate matters.

Jack G. Wasserman has served as a Director of the General Partner since December 3, 1993. Mr. Wasserman is an attorney and a member of the New York State Bar and has been with the New York based law firm of Wasserman, Schneider & Babb since 1966, where he is currently a senior partner. Mr. Wasserman also serves as a director of Cadus Pharmaceutical Corporation, a public biotechnology company.

John P. Saldarelli has served as Vice President, Secretary and Treasurer of the General Partner since March 18, 1991. Mr. Saldarelli was also President of Bayswater Realty Brokerage Corp. from June 1987 until November 19, 1993 and Vice President of Bayswater Realty & Capital Corp. from September 1979 until April 15, 1993, both of which are deemed to be directly or indirectly owned and, controlled by Carl C. Icahn.

William Leidesdorf, Jack G. Wasserman and Alfred D. Kingsley are on the Audit Committee of the Board of Directors of the General Partner.

Each of Messrs. Icahn and Kingsley served on the Board of Directors of TWA. On January 31, 1992, TWA filed a petition for bankruptcy in the U.S. Bankruptcy Court in Delaware, seeking reorganization under Chapter 11 of the Bankruptcy Code. In connection therewith, the Pension Benefit Guaranty Corporation asserted that there existed in the TWA defined benefit plans an underfunding deficiency, and that if the Plans were terminated, TWA and all members of the controlled group of which TWA was a member, including the General





Partner, would be liable, jointly and severally, for approximately $1.2 billion. On January 8, 1993, TWA, the Pension Benefit Guaranty Corporation, Mr. Icahn and the members of the controlled group, among others, settled all claims and potential claims which they had against each other.

Each executive officer and director will hold office until the next annual meeting of the General Partner and until his or her successor is elected and qualified. Directors who are not employed by AREP or certain affiliates, receive fees of $3,000 for attendance at each quarterly meeting of the Board of Directors. Mr. Kingsley, Mr. Leidesdorf and Mr. Wasserman each received $9,000 for attendance at such meetings in 1997. In addition, directors who are not employed by AREP or certain affiliates may receive additional fees for special meetings of or services rendered on behalf of the Audit Committee. Mr. Kingsley, Mr. Leidesdorf and Mr. Wasserman each received $35,000 for participation in such special meetings on behalf of the Audit Committee in 1997.

Each of the executive officers of the General Partner performs services for other affiliates of the General Partner.

There are no family relationships between or among any of the directors and/or executive officers of the General Partner.

If distributions (which are payable in kind) are not made to the holders of Preferred Units on any two Payment Dates (which need not be consecutive), the holders of more than 50% of all outstanding Preferred Units, including the General Partner and its affiliates, voting as a class, will be entitled to appoint two nominees for the Board of Directors of the General Partner. Holders of Preferred Units owning at least 10% of all outstanding Preferred Units, including the General Partner and its affiliates to the extent that they are holders of Preferred Units, may call a meeting of the holders of Preferred Units to elect such nominees. Once elected, the nominees will be appointed to the Board of Directors of the General Partner by Icahn. As directors, the nominees will, in addition to their other duties as directors, be specifically charged with reviewing all future distributions to the holders of the Preferred Units. Such additional directors shall serve until the full distributions accumulated on all outstanding Preferred Units have been declared and paid or set apart for payment. If and when all accumulated distributions on the Preferred Units have been declared and paid or set aside for payment in full, the holders of Preferred Units shall be divested of the special voting rights provided by the failure to pay such distributions, subject to revesting in the event of each and every subsequent default. Upon termination of such special voting rights attributable to all holders of Preferred Units with respect to payment of distributions, the term of office of each director nominated by the holders of Preferred Units (the "Preferred Unit Directors") pursuant to such special voting rights shall terminate and the number of directors constituting the entire Board of Directors shall be reduced by the number of Preferred Unit Directors. The holders of the Preferred Units have no other rights to participate in the management of AREP and are not entitled to vote on any matters submitted to a vote of the holders of Depositary Units.





Filing of Reports

To the best of AREP's knowledge, no director, executive officer or beneficial owner of more than 10% of AREP's Depositary Units failed to file on a timely basis reports required by section 16(a) of the Securities Exchange Act of 1934, as amended, during the year ended December 31, 1996.

Item 11. Executive Compensation.(1)

The following table sets forth information in respect of the compensation of the Chief Executive Officer and each of the other four most highly compensated executive officers of AREP for services in all capacities to AREP for the fiscal years ended December 31, 1997, 1996 and 1995.(2)

SUMMARY COMPENSATION TABLE

Annual Compensation

| (a) Name and Principal Position | (b) Year | (c) Salary ($) |
|---|---|---|
| John P. Saldarelli(3) | 1997 | 136,000 |
| Vice President, Secretary and Treasurer | 1996 | 132,300 |
| | 1995 | 126,000 |

- --------

(1) Pursuant to applicable regulations, certain columns of the Summary Compensation Table and each of the remaining tables have been omitted, as there has been no compensation awarded to, earned by or paid to any of the named executive officers by AREP or by the General Partner, which was subsequently reimbursed by AREP, required to be reported in those columns or tables.

(2) Carl C. Icahn, the Chief Executive Officer, received no compensation as such for the periods indicated. In addition, other than John P. Saldarelli, no other executive officer received compensation in excess of $100,000 from AREP for the applicable period.

(3) On March 18, 1991, Mr. Saldarelli was elected Vice President, Secretary and Treasurer of the General Partner. Mr. Saldarelli devotes substantially all of his time to the performance of services for AREP and the General Partner. The other executive officers and directors of the General Partner devote only a portion of their time to performance of services for AREP.

In February 1993, AREP adopted a 401K plan pursuant to which AREP will make a matching contribution to an employee's individual plan account in the amount of one-third (1/3) of the first six (6%) percent of gross salary contributed by the employee.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

As of March 2, 1998, High Coast, which is controlled by Icahn, owned 31,515,044 Depositary Units, or approximately 68.2% of the outstanding Depositary Units and 6,325,778 Preferred Units or approximately 86.5% of the outstanding Preferred Units.

The affirmative vote of Unitholders holding more than 75% of the total number of all Units then outstanding, including Depositary Units held by the General Partner and its affiliates, is required to remove the General Partner. Thus, since Icahn, through High Coast, holds approximately 68.2% of the Depositary Units outstanding, the General Partner will not be able to be removed pursuant to the terms of the Partnership Agreement without Icahn's consent. Moreover, under the Partnership Agreement, the affirmative vote of the General Partner and Unitholders owning more than 50% of the total number of all outstanding Depositary Units then held by Unitholders, including High Coast, is required to approve, among other things, selling or otherwise disposing of all or substantially all of AREP's assets in a single sale or in a related series of multiple sales, dissolving AREP or electing to continue AREP in certain instances, electing a successor general partner, making certain amendments to the Partnership Agreement or causing AREP, in its capacity as sole limited partner of the Subsidiary, to consent to certain proposals submitted for the approval of the limited partners of the Subsidiary. Accordingly, as High Coast holds in excess of 50% of the Depositary Units outstanding, Icahn, through High Coast, will have effective control over such approval rights.

As of February 4, 1998, to the best knowledge of AREP, Schneider Capital Management Corporation, a Pennsylvania corporation, which filed a Schedule 13-G on February 4, 1998, owned 3,614,974 Depositary Units, or approximately 7.825% of the outstanding Depositary Units.





The following table provides information, as of March 2, 1998, as to the beneficial ownership of the Depositary Units and Preferred Units of AREP for each director of the General Partner, and all directors and executive officers of the General Partner as a group.

| Name of Beneficial Owner | Beneficial Ownership of Depositary Units | Percent of Class | Beneficial Ownership of Preferred Units | Percent of Class |
|---|---|---|---|---|
| Carl C. Icahn(1) | 31,515,044 | 68.2% | 6,325,778 | 86.5% |
| All directors and executive officers as a group (6 persons) | 31,515,044 | 68.2% | 6,325,778 | 86.5% |

- ---------------

(1) Carl C. Icahn, through High Coast, is the beneficial owner of the 31,515,044 Depositary Units set forth above and may also be deemed to be the beneficial owner of the 39,971 Depositary Units owned of record by API Nominee Corp., which in accordance with state law are in the process of being turned over to the relevant state authorities as unclaimed property; however, Mr. Icahn disclaims such beneficial ownership. The foregoing is exclusive of a 1.99% ownership interest in AREP which the General Partner holds by virtue of its 1% General Partner interest in each of AREP and the Subsidiary, but inclusive of the Depositary Units High Coast acquired through the 1997 Offering.

Furthermore, pursuant to a registration rights agreement entered into by High Coast in connection with the 1997 Offering, AREP has agreed to pay any expenses incurred in connection with two demand and unlimited piggy-back registrations requested by High Coast.

Item 13. Certain Relationships and Related Transactions.

Related Transactions with the General Partner and its Affiliates

Icahn, in his capacity as majority Unitholder, will not receive any additional benefit with respect to distributions and allocations of profits and losses not shared on a pro rata basis by all other Unitholders. In addition, Icahn has confirmed to AREP that neither he nor any of his affiliates will receive any fees from AREP in consideration for services rendered in connection with non-real estate related investments by AREP such as advice to purchase RJR shares which generated $29 million of profits for AREP in 1997. AREP may determine to make investments in which Icahn or his affiliates have independent investments in such assets; in addition, AREP may enter into other transactions with the General Partner and its affiliates, including, without limitation, buying and selling assets from or to the General Partner or its affiliates and participating in joint venture investments in assets with the General Partner or its affiliates, whether real estate or non-real estate related, provided the terms of all such transactions are fair and reasonable to AREP. Furthermore, it should be noted that the Partnership Agreement provides that the General Partner and its affiliates are permitted to have other business interests and may engage in other business ventures of any nature whatsoever, and may compete directly or indirectly with the business of AREP. Icahn and his affiliates currently invest in and perform





investment management services with respect to assets that may be similar to those AREP may invest in and intend to continue to do so; pursuant to the Partnership Agreement, however, AREP shall not have any right to participate therein or receive or share in any income or profits derived therefrom. See Item 1. "Business - Investment in RJR" and "Investment in Limited Partnership Units."

For the years ended December 31, 1997 and 1996, AREP made no payments with respect to the Depositary Units owned by the General Partner. However, in 1997 and 1996 the General Partner was allocated approximately $1,500,000 and approximately $1,151,000, respectively, of the income of AREP as a result of its 1.99% general partner interest in AREP.

On March 31, 1997, Icahn received 91,473 Preferred Units as part of AREP's scheduled annual preferred unit distribution and is expected to receive an additional 316,289 Preferred Units in March 1998 as part of such scheduled annual preferred unit distribution.

In May 1995, AREP and an affiliate of the General Partner ("Affiliate") entered into an agreement with the third-party landlord of its leased executive office space. The agreement provided for AREP and the Affiliate to relocate their offices to an adjacent building also owned by the landlord which relocation occurred in September 1995. In accordance with the agreement, AREP entered into a lease, expiring in 2001, for 7,920 square feet of office space, at an annual rental of approximately $153,000. AREP has sublet to certain affiliates of the General Partner 3,205 square feet at an annual rental of approximately $62,000, resulting in a net annual rental of approximately $91,000. Affiliates of the General Partner reimbursed AREP for approximately $62,000 in rent paid by AREP on its behalf during 1997 in connection with the new lease. The prior lease, which was terminated, provided for approximately 6,900 square feet at an annual rental of $155,000 to AREP. In addition, AREP and the Affiliate received a lease termination fee of $350,000 allocated $175,000 to AREP and $175,000 to the Affiliate. Such allocations and the terms of the sublease were reviewed and approved by the Audit Committee. In addition, in 1997 AREP entered into a license agreement for a portion of office space from an affiliate of the General Partner. The license agreement dated as of February 1, 1997 expires May 22, 2004 unless sooner terminated in accordance with the agreement. Pursuant to the license agreement, AREP has the non-exclusive use of approximately 3,547 square feet of office space and common areas (of an aggregate 21,123 rentable square feet sublet by such affiliate) for which it pays $17,067.78 per month, together with 16.79% of certain "additional rent". In

1997, AREP paid an affiliate of the General Partner $68,747 of rent in connection with this licensing agreement. In connection with the build-out of the space, AREP reimbursed such affiliate $486,989, representing AREP's allocable share of such costs net of a pro rata share of the sub-lessor's allowance for such build-out. The terms of such sublease were reviewed and approved by the Audit Committee. For a discussion of the offer made by AREP to an affiliate of the General Partner for the purchase of a land development company, see Item 7 -"Management's Discussion and Analysis of the Financial Condition and Results of Operations."





Property Management and Other Related Transactions

The General Partner and its affiliates may receive fees in connection with the acquisition, sale, financing, development, construction, marketing and management of new properties acquired by AREP. As development and other new properties are acquired, developed, constructed, operated, leased and financed, the General Partner or its affiliates may perform acquisition functions, including the review, verification and analysis of data and documentation with respect to potential acquisitions, and perform development and construction oversight and other land development services, property management and leasing services, either on a day-to-day basis or on an asset management basis, and may perform other services and be entitled to fees and reimbursement of expenses relating thereto, provided the terms of such transactions are fair and reasonable to AREP in accordance with the Partnership Agreement and customary to the industry. It is not possible to state precisely what role, if any, the General Partner or any of its affiliates may have in the acquisition, development or management of any new investments. Consequently, it is not possible to state the amount of the income, fees or commissions the General Partner or its affiliates might be paid in connection with the investment of the 1997 Offering proceeds since the amount thereof is dependent upon the specific circumstances of each investment, including the nature of the services provided, the location of the investment and the amount customarily paid in such locality for such services. However, Unitholders may expect that, subject to the specific circumstances surrounding each transaction and the overall fairness and reasonableness thereof to AREP, the fees charged by the General Partner and its affiliates for the services described below generally will be within the ranges set forth below:

- Property Management and Asset Management Services. To the extent that AREP acquires any properties requiring active management (e.g., operating properties that are not net- leased) or asset management services, including on site services, it may enter into management or other arrangements with the General Partner or its affiliates. Generally, it is contemplated that under property management arrangements, the entity managing the property would receive a property management fee (generally 3% to 6% of gross rentals for direct management, depending upon the location) and under asset management arrangements, the entity managing the asset would receive an asset management fee (generally .5% to 1% of the appraised value of the asset for asset management services, depending upon the location) in payment for its services and reimbursement for costs incurred.

- Brokerage and Leasing Commissions. AREP also may pay affiliates of the General Partner real estate brokerage and leasing commissions (which generally may range from 2% to 6% of the purchase price or rentals depending on location; this range may be somewhat higher for problem properties or lesser-valued properties).

- Lending Arrangements. The General Partner or its affiliates may lend money to, or arrange loans for, AREP. Fees payable to the General Partner or its affiliates in connection with such activities include mortgage brokerage fees (generally .5% to 3% of the loan amount), mortgage origination fees (generally .5% to 1.5% of the loan amount) and loan servicing fees (generally .10% to .12% of the loan amount), as well as interest on any amounts loaned by the General Partner or its affiliates to AREP.

- Development and Construction Services. The General Partner or its affiliates may also receive fees for development services, generally 1% to 4% of development costs, and general contracting services or construction management services, generally 4% to 6% of construction costs.

AREP has commenced discussions with Bayswater Realty & Capital Corp., an affiliate of the General Partner, to perform development, construction management, marketing and sales services with respect to two residential development sites located in Armonk, New York and East Hampton, New York respectively. The Armonk site is comprised of approximately 43 residential building lots, and the East Hampton site is comprised of 16 residential building lots. It is presently anticipated that Bayswater would be reimbursed a pro rata portion of the salaries, benefits and related expenses for the personnel performing such services, plus all reasonable and customary out of pocket expenses incurred in connection with performing such services. Such reimbursements will be subject to review and approval by the Audit Committee.

In addition, through July 1, 1997, subject to the limitations described below, the General Partner was entitled to receive a specified reinvestment incentive fee (a "Reinvestment Incentive Fee") for performing acquisition services equal to a percentage of the purchase price (whether paid in cash, Depositary Units, other securities and/or with mortgage financing) of properties (other than Predecessor Properties) acquired from July 1, 1987 through July 1, 1997. This percentage was 1% for the first five years and 1/2% for the second five years. Although a Reinvestment Incentive Fee accrued each time a property was acquired, Reinvestment Incentive Fees were only payable on an annual basis, within 45 days after the end of each calendar year, if the following subordination provisions were satisfied. Reinvestment Incentive Fees accrued in any year were only payable if the sum of (x) the sales price of all Predecessor Properties (net of associated debt which encumbered these Properties at the consummation of the Exchange) sold through the end of that year and (y) the appraised value of all Predecessor Properties which have been financed or refinanced (and not subsequently sold), net of the amount of any refinanced debt through the end of that year determined at the time of such financings or refinancings, exceeds the aggregate values assigned to those Predecessor Properties for purposes of the Exchange. If the subordination provisions were not satisfied in any year, payment of Reinvestment Incentive Fees for that year were deferred. Through December 31, 1997, an aggregate of (i) 159 Predecessor Properties were sold or disposed of for an aggregate amount of approximately $99,268,000 net of associated indebtedness which encumbered these Properties at the consummation of the Exchange, and (ii) 25 Predecessor Properties were refinanced at an aggregate appraised value, net of the amount of the refinanced debt, of approximately $37,672,000 for a sum total of approximately $136,940,000. Aggregate appraised values attributable to these Predecessor Properties for purposes of the Exchange were approximately $145,663,000. Two properties were acquired in June 1997. Since the subordination requirements were not met as of June 30, 1997, the termination date of the right to receive such fee, no reinvestment incentive fee is due or payable to the General Partner for such properties.





AREP may also enter into other transactions with the General Partner and its affiliates, including, without limitation, buying and selling properties and borrowing and lending funds from or to the General Partner or its affiliates, joint venture developments and issuing securities to the General Partner or its affiliates in exchange for, among other things, assets that they now own or may acquire in the future, provided the terms of such transactions are fair and reasonable to AREP. The General Partner is also entitled to reimbursement by AREP for all allocable direct and indirect overhead expenses (including, but not limited to, salaries and rent) incurred in connection with the conduct of AREP's business.

In addition, employees of AREP may, from time to time, provide services to affiliates of the General Partner, with AREP being reimbursed therefor. Reimbursement to AREP by such affiliates in respect of such services is subject to review and approval by the Audit Committee. In 1997 such amounts were approximately $34,000, which reimbursement was approved by the Audit Committee. In addition, an affiliate of the General Partner provided certain administrative services to AREP in the amount of approximately $3,000 in 1997.

The Audit Committee meets on an annual basis, or more often if necessary, to review any conflicts of interest which may arise, including the payment by AREP of any fees to the General Partner or any of its affiliates. The General Partner and its affiliates may not receive duplicative fees.





## Part IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a)(1) Financial Statements:

The following financial statements of American Real Estate Partners, L.P. are included in Part II, Item 8:



(a)(2) Financial Statement Schedules:



All other Financial Statement schedules have been omitted because the required financial information is not applicable or the information is shown in the Financial Statements or Notes thereto.

(a)(3) Exhibits:

3.1 Certificate of Limited Partnership of AREP, dated February 17, 1987 (filed as Exhibit No. 3.1 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference).





3.2 Amended and Restated Agreement of Limited Partnership of AREP, dated as of May 12, 1987 (filed as Exhibit No. 3.2 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference).

3.3 Amendment No. 1 to the Amended and Restated Agreement of Limited Partnership of AREP (filed as Exhibit 3.3 to AREP's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference).

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|---|---|
| 3.4 | Certificate of Limited Partnership of American Real Estate Holdings Limited Partnership (the "Subsidiary"), dated February 17, 1987, and amendment thereto, dated March 12, 1987 (filed as Exhibit No. 3.3 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |
| 3.5 | Amended and Restated Agreement of Limited Partnership of the Subsidiary, dated as of July 1, 1987 (filed as Exhibit No. 3.4 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |
| 4.1 | Depositary Agreement among AREP, the General Partner and Registrar and Transfer Company, dated as of July 1, 1987 (filed as Exhibit No. 4.1 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |
| 4.2 | Amendment No. 1 to the Depositary Agreement (filed as Exhibit 4.2 to AREP's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference). |
| 4.3 | Specimen Depositary Receipt (filed as Exhibit No. 4.2 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |
| 4.4 | Form of Transfer Application (filed as Exhibit No. 4.3 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |
| 4.5 | Specimen Certificate representing Preferred Units (filed as Exhibit No. 4.9 to AREP's Registration Statement on Form S-3 (Registration No. 33-54767) and incorporated herein by reference). |
| 10.1 | Nonqualified Unit Option Plan (filed as Exhibit No. 10.1 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |





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|---|---|
| 10.2 | Distribution Reinvestment Plan (filed as Exhibit No. 10.3 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |
| 10.3 | Note Purchase Agreements, dated as of May 27, 1988 among AREP, the Subsidiary and The Prudential Insurance Company of America (the "Note Agreements") (filed as Exhibit Nos. 2a and 2b to AREP's Current Report on Form 8-K dated May 27, 1988 and incorporated herein by reference). |
| 10.4 | Amendment No. 1 to the Note Agreements dated November 17, 1988 (filed as Exhibit No. 10.2 to AREP's Registration Statement on Form S-3 (Registration No. 33-54767) and incorporated herein by reference). |
| 10.5 | Amendment No. 2 to the Note Agreements dated November 17, 1988 (filed as Exhibit No. 10.3 to AREP's Registration Statement on Form S-3 (Registration No. 33-54767) and incorporated herein by reference). |
| 10.6 | Amendment No. 3 to the Note Agreements dated as of June 21, 1994 (filed as Exhibit No. 10.4 to AREP's Registration Statement on Form S-3 (Registration No. 33-54767) and incorporated herein by reference). |
| 10.7 | Amendment No. 4 to the Note Agreements dated as of August 12, 1994 (filed as Exhibit No. 10.5 to AREP's Registration Statement on Form S-3 (Registration No. |

33-54767) and incorporated herein by reference).

| | |
|---|---|
| 10.8 | 9.6% Senior Promissory Note of AREP and the Subsidiary due May 27, 1998 payable to The Prudential Insurance Company of America (filed as Exhibit No. 2c to AREP's Current Report on Form 8-K dated May 27, 1988 and incorporated herein by reference). |
| 10.9 | 9.6% Senior Promissory Note of AREP and the Subsidiary due May 27, 1998 payable to Prudential Property and Casualty Insurance Company (filed as Exhibit No. 2d to AREP's Current Report on Form 8-K dated May 27, 1988 and incorporated herein by reference). |
| 10.10 | Subscription Guaranty Agreement between AREP and High Coast Limited Partnership (the "Guarantor") (filed as Exhibit 4.10 to AREP's Registration Statement on Form S-3 (Registration No. 33-54767) and incorporated herein by reference). |
| 10.11 | Registration Rights Agreement between AREP and the Guarantor (filed as Exhibit 4.11 to AREP's Registration Statement on Form S-3 (Registration No. 33-54767) and incorporated herein by reference). |





| | |
|---|---|
| 10.12 | Amended and Restated Agency Agreement (filed as Exhibit 10.12 to AREP's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference). |
| 10.13 | Subscription Agent Agreement (filed as Exhibit 10.13 to AREP's Annual Report on Form 10-K for the year ended December 31, 1994 and incorporated herein by reference). |
| 10.14 | Subscription Guaranty Agreement between AREP and the Guarantor (filed as Exhibit 4.10 to Amendment No. 1 to AREP's Registration Statment on Form S-3 (Registration No. 333-31561) and incorporated herein by reference). |
| 10.15 | Registration Rights Agreement between AREP and the Guarantor (filed as Exhibit 4.11 to Amendment No. 1 to AREP's Registration Statment on Form S-3 (Registration No. 333-31561) and incorporated herein by reference). |
| 10.16 | Subscription Agent filed as Exhibit 99.1 to AREP's Registration Statment on Form S-3 (Registration No. 333-31561) and incorporated herein by reference. |
| 16 | Letter dated September 27, 1991 of Deloitte & Touche regarding change in accountants (filed as Exhibit No. A to AREP's Current Report on Form 8-K dated October 3, 1991 and incorporated herein by reference). |
| 22 | List of Subsidiaries (filed as Exhibit No. 22 to AREP's Annual Report on Form 10-K for the year ended December 31, 1987 and incorporated herein by reference). |

(b) Reports on Form 8-K:

(1) A Form 8-K was filed on July 18, 1997 regarding the Company's filing of a registration statement on Form S-3 ("Registration Statement") with the Securities and Exchange Commission regarding a proposed rights offering (the "1997 Offering") by the Registrant to holders of its depositary units.

(2) A Form 8-K was filed on July 24, 1997 regarding announcing the record date for the proposed 1997 Offering.

(3) A Form 8-K was filed on August 7, 1997 announcing that the Securities and Exchange Commission declared effective the Registration Statement relating to the 1997 Offering.





AMERICAN REAL ESTATE PARTNERS, LP
a limited partnership

Schedule III
PAGE 1

## REAL ESTATE OWNED AND REVENUES EARNED

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | | | | Operating Method | | |
|---|---|---|---|---|---|---|
| | State | No. of Locations | Amount of Encumbrances | Initial Cost to Company | Cost of Improvements | Amount Carried at close of period |
| COMMERCIAL PROPERTY LAND AND BUILDING | | | | | | |
| Acme Markets, Inc. and FPBT of Penn. | PA | 1 | | $2,004,393 | | $2,004,393 |
| Alabama Power Company | AL | 5 | $4,292,790 | | | |
| Amer Stores and The Fidelity Bank | PA | 1 | | | | |
| Amer Stores, Grace, & Shottenstein Stores | NJ | 1 | | 2,043,567 | | 2,043,567 |
| American Recreation Group, Inc. | NC | 1 | | 642,771 | (342,771) | 300,000 |
| Amterre Ltd. Partnership | NJ | 1 | | | | |
| Amterre Ltd. Partnership | PA | 2 | | | | |
| Amterre Ltd. Partnership | PA | 1 | 8,581,485 | | | |
| Best Products Co., Inc. | VA | 1 | | 3,358,053 | (54,500) | 3,303,553 |
| Caldor, Inc. | MA | 1 | | | | |
| Chesebrough-Pond's Inc. | CN | 1 | | 1,549,805 | | 1,549,805 |
| Chomerics, Inc. | MA | 1 | | | | |
| Collins Foods International, Inc. | OR | 3 | | 169,048 | | 169,048 |
| Collins Foods International, Inc. | CA | 1 | | 87,810 | | 87,810 |
| David Miller of California | CA | 1 | | 1,036,681 | | 1,036,681 |
| Dillon Companies, Inc. | MO | 1 | | 546,681 | | 546,681 |
| Dillon Companies, Inc. | LA | 6 | | 1,555,112 | | 1,555,112 |
| Druid Point Bldg. | GA | 1 | | 6,139,692 | 114,890 | 6,254,582 |
| Duke Power Co. | NC | 1 | 2,903,279 | | | |
| European American Bank and Trust Co. | NY | 1 | | 1,355,210 | | 1,355,210 |
| Farwell Bldg. | MN | 1 | 939,773 | 5,073,279 | | 5,073,279 |
| Federated Department Stores, Inc. | CA | 1 | | 363,342 | | 363,342 |
| First National Supermarkets, Inc. | CT | 1 | 13,933,727 | | | |
| First Union National Bank | NC | 1 | | | | |
| Fisher Scientific Company | IL | 1 | | 597,806 | | 597,806 |
| Foodarama Supermarkets, Inc. | PA | 1 | | | | |
| Forte Hotels International, Inc. | NJ | 1 | 216,914 | | | |
| Forte Hotels International, Inc. | TX | 1 | | | | |
| Fox Grocery Company | WV | 1 | 1,193,998 | | | |
| Gino's, Inc. | MO | 1 | 13,662 | 209,213 | | 209,213 |
| Gino's, Inc. | CA | 1 | 15,711 | 225,100 | | 225,100 |
| Gino's, Inc. | OH | 1 | 14,627 | 201,938 | | 201,938 |
| Gino's, Inc. | IL | 1 | 16,986 | 235,972 | | 235,972 |
| Gino's, Inc. | NJ | 1 | | | | |
| Golf Road | IL | 1 | | 9,292,656 | | 9,292,656 |

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | Operating Method | | Financing Method | |
|---|---|---|---|---|
| | Reserve for Depreciation | Rent due and accrued or received in advance at end of period | Net Investment | Minimum lease payments due and accrued at end of period |
| COMMERCIAL PROPERTY LAND AND BUILDING | | | | |
| Acme Markets, Inc. and FPBT of Penn. | $1,389,613 | ($13,407) | | |
| Alabama Power Company | | | $7,517,553 | ($92,771) |
| Amer Stores and The Fidelity Bank | | | 633,667 | (11,083) |
| Amer Stores, Grace, & Shottenstein Stores | 1,525,255 | (10,228) | | |
| American Recreation Group, Inc. | | | | |
| Amterre Ltd. Partnership | | | | |
| Amterre Ltd. Partnership | | | | |
| Amterre Ltd. Partnership | | | 5,958,448 | (72,990) |
| Best Products Co., Inc. | | | | |
| Caldor, Inc. | | | 1,873,574 | |

| | | | | |
|---|---|---|---|---|
| Chesebrough-Pond's Inc. | 1,110,025 | (11,770) | | |
| Chomerics, Inc. | | | 6,202,655 | |
| Collins Foods International, Inc. | | | 81,764 | |
| Collins Foods International, Inc. | | | 46,444 | |
| David Miller of California | 494,648 | | | |
| Dillon Companies, Inc. | 310,198 | (3,272) | | |
| Dillon Companies, Inc. | 854,145 | (34,946) | | |
| Druid Point Bldg. | 883,216 | | | |
| Duke Power Co. | | | 4,716,271 | |
| European American Bank and Trust Co. | 1,284,888 | | | |
| Farwell Bldg. | 1,088,188 | | | |
| Federated Department Stores, Inc. | | | 208,036 | |
| First National Supermarkets, Inc. | | | 23,685,974 | (221,459) |
| First Union National Bank | | | 577,217 | |
| Fisher Scientific Company | 143,004 | | | |
| Foodarama Supermarkets, Inc. | | | | |
| Forte Hotels International, Inc. | | | 6,412,979 | (59,447) |
| Forte Hotels International, Inc. | | | | |
| Fox Grocery Company | | | 3,258,447 | |
| Gino's, Inc. | | | 165,655 | |
| Gino's, Inc. | | | 151,721 | |
| Gino's, Inc. | | | 135,210 | |
| Gino's, Inc. | | | 137,724 | |
| Gino's, Inc. | | | | |
| Golf Road | 55,756 | | | |

Part 2 - Revenues earned for the Year ended December 31, 1997

| | Total revenue applicable to period | Expended for interest, taxes, repairs and expenses | Net income applicable to period |
|---|---|---|---|
| COMMERCIAL PROPERTY LAND AND BUILDING | | | |
| Acme Markets, Inc. and FPBT of Penn. | $245,888 | $46,729 | $199,159 |
| Alabama Power Company | 797,599 | 417,135 | 380,464 |
| Amer Stores and The Fidelity Bank | 81,172 | 0 | 81,172 |
| Amer Stores, Grace, & Shottenstein Stores | 157,735 | 130,451 | 27,284 |
| American Recreation Group, Inc. | 48,164 | 10,100 | 38,064 |
| Amterre Ltd. Partnership | 0 | 208 | (208) |
| Amterre Ltd. Partnership | 0 | 11,357 | (11,357) |
| Amterre Ltd. Partnership | 597,424 | 814,130 | (216,706) |
| Best Products Co., Inc. | 109,134 | 327,333 | (218,199) |
| Caldor, Inc. | 167,527 | 1,612 | 165,915 |
| Chesebrough-Pond's Inc. | 141,236 | 19,580 | 121,656 |
| Chomerics, Inc. | 792,465 | 0 | 792,465 |
| Collins Foods International, Inc. | 35,411 | 21,234 | 14,177 |
| Collins Foods International, Inc. | 11,455 | 31,123 | (19,668) |
| David Miller of California | 63,482 | 20,750 | 42,732 |
| Dillon Companies, Inc. | 65,268 | 13,688 | 51,580 |
| Dillon Companies, Inc. | 183,340 | 12,184 | 171,156 |
| Druid Point Bldg. | 1,351,918 | 1,242,925 | 108,993 |
| Duke Power Co. | 482,477 | 296,475 | 186,002 |
| European American Bank and Trust Co. | 175,000 | 13,384 | 161,616 |
| Farwell Bldg. | 957,184 | 554,753 | 402,431 |
| Federated Department Stores, Inc. | 63,418 | 0 | 63,418 |
| First National Supermarkets, Inc. | 2,194,767 | 1,355,148 | 839,619 |
| First Union National Bank | 53,820 | 0 | 53,820 |
| Fisher Scientific Company | 176,583 | 22,426 | 154,157 |
| Foodarama Supermarkets, Inc. | 81,014 | 13,040 | 67,974 |
| Forte Hotels International, Inc. | 585,869 | 56,984 | 528,885 |
| Forte Hotels International, Inc. | (11,423) | 2,403 | (13,826) |
| Fox Grocery Company | 290,442 | 114,824 | 175,618 |
| Gino's, Inc. | 33,514 | 3,762 | 29,752 |
| Gino's, Inc. | 42,735 | 8,081 | 34,654 |
| Gino's, Inc. | 39,120 | 3,529 | 35,591 |
| Gino's, Inc. | 45,689 | 4,353 | 41,336 |
| Gino's, Inc. | 33,010 | (1,081) | 34,091 |
| Golf Road | 108,494 | 135,636 | (27,142) |

AMERICAN REAL ESTATE PARTNERS, LP
a limited partnership



## REAL ESTATE OWNED AND REVENUES EARNED

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | State | No. of Locations | Amount of Encumberances | Operating Method: Initial Cost to Company | Operating Method: Cost of Improvements | Operating Method: Amount Carried at close of period |
|---|---|---|---|---|---|---|
| Grand Union Co. | NJ | 1 | | 430,664 | | 430,664 |
| Grand Union Co. | MD | 1 | | 372,383 | | 372,383 |
| Grand Union Co. | NY | 3 | | 1,110,120 | (19,100) | 1,091,020 |
| Grand Union Co. | NY | 1 | | | | |
| Grand Union Co. | VA | 1 | | 266,468 | | 266,468 |
| Grand Union Co. | NY | 1 | 4,473,221 | | | |
| Gunite | IN | 1 | 148,230 | 1,134,565 | | 1,134,565 |
| G.D. Searle & Co. | MD | 1 | | 299,229 | | 299,229 |
| G.D. Searle & Co. | MN | 1 | | 261,918 | | 261,918 |
| G.D. Searle & Co. | AL | 1 | | 0 | | 0 |
| G.D. Searle & Co. | IL | 1 | | 256,295 | | 256,295 |
| G.D. Searle & Co. | FL | 1 | | 0 | | 0 |
| G.D. Searle & Co. | MN | 1 | | 339,358 | | 339,358 |
| G.D. Searle & Co. | IL | 1 | | 323,559 | | 323,559 |
| G.D. Searle & Co. | TN | 1 | | 214,421 | | 214,421 |
| G.D. Searle & Co. | TN | 1 | | 0 | | 0 |
| G.D. Searle & Co. | MD | 1 | | 325,891 | | 325,891 |
| Hancock | LA | 1 | | | | |
| Haverty Furniture Companies, Inc. | GA | 1 | 245,234 | | | |
| Haverty Furniture Companies, Inc. | FL | 1 | 185,175 | | | |
| Haverty Furniture Companies, Inc. | VA | 1 | 232,724 | | | |
| Holiday Inn | AZ | 1 | | | | |
| Integra A Hotel and Restaurant Co. | AL | 2 | | 245,625 | | 245,625 |
| Integra A Hotel and Restaurant Co. | IL | 1 | | 198,392 | | 198,392 |
| Integra A Hotel and Restaurant Co. | IN | 1 | | 231,513 | | 231,513 |
| Integra A Hotel and Restaurant Co. | OH | 1 | | | | |
| Integra A Hotel and Restaurant Co. | MO | 1 | | 224,837 | | 224,837 |
| Integra A Hotel and Restaurant Co. | TX | 1 | | 228,793 | | 228,793 |
| Integra A Hotel and Restaurant Co. | MI | 1 | | 234,464 | | 234,464 |
| Intermountain Color | KY | 1 | 11,180 | 559,644 | | 559,644 |
| J.C. Penney Company, Inc. | MA | 1 | | 2,484,262 | | 2,484,262 |
| Kelley Springfield Tire Company | TN | 1 | | 120,946 | | 120,946 |
| K-Mart Corporation | LA | 1 | | | | |
| K-Mart Corporation | WI | 1 | | | | |
| K-Mart Corporation | FL | 1 | | | | |
| K-Mart Corporation | MN | 1 | 530,000 | | | |
| K-Mart Corporation | FL | 1 | | 2,760,118 | | 2,760,118 |

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | Operating Method: Reserve for Depreciation | Operating Method: Rent due and accrued or received in advance at end of period | Financing Method: Net Investment | Financing Method: Minimum lease payments due and accrued at end of period |
|---|---|---|---|---|
| Grand Union Co. | | | 427,410 | |
| Grand Union Co. | 249,742 | | | |
| Grand Union Co. | | | 1,101,687 | |
| Grand Union Co. | | | | |
| Grand Union Co. | 178,999 | | | |
| Grand Union Co. | | | 7,310,207 | |
| Gunite | 1,065,034 | (17,340) | | |
| G.D. Searle & Co. | 145,833 | (2,383) | | |
| G.D. Searle & Co. | 174,337 | (2,551) | | |
| G.D. Searle & Co. | 0 | | | |
| G.D. Searle & Co. | 161,229 | (3,835) | | |
| G.D. Searle & Co. | 0 | | | |
| G.D. Searle & Co. | 147,266 | (1,847) | | |
| G.D. Searle & Co. | 223,483 | (2,360) | | |
| G.D. Searle & Co. | 145,172 | 1,562 | | |
| G.D. Searle & Co. | 0 | | | |
| G.D. Searle & Co. | 146,800 | (2,250) | | |
| Hancock | | (28,024) | | |
| Haverty Furniture Companies, Inc. | | | 616,002 | |
| Haverty Furniture Companies, Inc. | | | 466,667 | (749) |
| Haverty Furniture Companies, Inc. | | | 594,370 | |
| Holiday Inn | | | | |
| Integra A Hotel and Restaurant Co. | | | 1,397,060 | |
| Integra A Hotel and Restaurant Co. | | | 461,675 | 859 |
| Integra A Hotel and Restaurant Co. | | | 604,563 | |
| Integra A Hotel and Restaurant Co. | | | 620,765 | |
| Integra A Hotel and Restaurant Co. | | | 469,913 | |

| | | | |
|---|---|---|---|
| Integra A Hotel and Restaurant Co. | | | 576,867 |
| Integra A Hotel and Restaurant Co. | | | 577,240 |
| Intermountain Color | 434,676 | | |
| J.C. Penney Company, Inc. | 1,588,326 | (41,707) | |
| Kelley Springfield Tire Company | 75,200 | | |
| K-Mart Corporation | | | 1,684,293 |
| K-Mart Corporation | | | 1,919,517 |
| K-Mart Corporation | | | 2,224,386 |
| K-Mart Corporation | | | 1,780,445 |
| K-Mart Corporation | 1,688,401 | | |

Part 2 - Revenues earned for the Year ended December 31, 1997

| | Total revenue applicable to period | Expended for interest, taxes, repairs and expenses | Net income applicable to period |
|---|---|---|---|
| Grand Union Co. | 85,502 | 1,900 | 83,602 |
| Grand Union Co. | 33,750 | 19,576 | 14,174 |
| Grand Union Co. | 220,389 | 6,234 | 214,155 |
| Grand Union Co. | 7,083 | 128,895 | (121,812) |
| Grand Union Co. | 24,150 | 3,579 | 20,571 |
| Grand Union Co. | 676,977 | 460,329 | 216,648 |
| Gunite | 208,080 | 33,042 | 175,038 |
| G.D. Searle & Co. | 27,000 | 5,372 | 21,628 |
| G.D. Searle & Co. | 22,162 | 3,519 | 18,643 |
| G.D. Searle & Co. | 0 | 1,263 | (1,263) |
| G.D. Searle & Co. | 23,013 | 5,990 | 17,023 |
| G.D. Searle & Co. | 0 | (645) | 645 |
| G.D. Searle & Co. | 30,614 | 5,551 | 25,063 |
| G.D. Searle & Co. | 28,319 | 4,656 | 23,663 |
| G.D. Searle & Co. | 18,740 | 0 | 18,740 |
| G.D. Searle & Co. | 0 | 5,193 | (5,193) |
| G.D. Searle & Co. | 28,598 | 5,365 | 23,233 |
| Hancock | 450,785 | 152,045 | 298,740 |
| Haverty Furniture Companies, Inc. | 55,885 | 25,361 | 30,524 |
| Haverty Furniture Companies, Inc. | 42,337 | 19,150 | 23,187 |
| Haverty Furniture Companies, Inc. | 54,193 | 24,410 | 29,783 |
| Holiday Inn | 2,138,010 | 1,699,352 | 438,658 |
| Integra A Hotel and Restaurant Co. | 239,858 | 4,600 | 235,258 |
| Integra A Hotel and Restaurant Co. | 103,757 | 2,470 | 101,287 |
| Integra A Hotel and Restaurant Co. | 121,983 | 2,300 | 119,683 |
| Integra A Hotel and Restaurant Co. | 89,986 | 2,330 | 87,656 |
| Integra A Hotel and Restaurant Co. | 108,409 | 2,330 | 106,079 |
| Integra A Hotel and Restaurant Co. | 139,420 | 2,360 | 137,060 |
| Integra A Hotel and Restaurant Co. | 138,537 | 2,300 | 136,237 |
| Intermountain Color | 81,330 | 29,063 | 52,267 |
| J.C. Penney Company, Inc. | 250,244 | 79,496 | 170,748 |
| Kelley Springfield Tire Company | 11,449 | 8,155 | 3,294 |
| K-Mart Corporation | 141,806 | 516 | 141,290 |
| K-Mart Corporation | 173,164 | 0 | 173,164 |
| K-Mart Corporation | 213,781 | 0 | 213,781 |
| K-Mart Corporation | 146,038 | 46,819 | 99,219 |
| K-Mart Corporation | 236,480 | 278,694 | (42,214) |





AMERICAN REAL ESTATE PARTNERS, LP
a limited partnership



REAL ESTATE OWNED AND REVENUES EARNED

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | State | No. of Locations | Amount of Encumberances | Operating Method: Initial Cost to Company | Operating Method: Cost of Improvements | Operating Method: Amount Carried at close of period |
|---|---|---|---|---|---|---|
| K-Mart Corporation | IA | 1 | | | | |
| K-Mart Corporation | FL | 2 | | 2,636,000 | | 2,636,000 |
| K-Mart Corporation | IL | 1 | 263,859 | | | |
| Kobacker Stores, Inc. | MI | 4 | | 215,148 | | 215,148 |
| Kobacker Stores, Inc. | KY | 1 | 66,777 | 88,364 | | 88,364 |
| Kobacker Stores, Inc. | OH | 5 | 65,759 | 354,030 | | 354,030 |
| Kraft, Inc. | NC | 1 | | | | |
| Landmark Bancshares Corporation | MO | 1 | | | | |
| Levitz Furniture Corporation | NY | 1 | | 988,463 | | 988,463 |
| Lockheed Corporation | CA | 1 | | 2,449,469 | | 2,449,469 |
| Louisiana Power and Light Company | LA | 8 | 3,464,338 | | | |
| Louisiana Power and Light Company | LA | 7 | 2,075,693 | 3,491,431 | | 3,491,431 |
| Macke Co. | VA | 1 | | | | |
| Marsh Supermarkets, Inc. | IN | 1 | | 5,001,933 | | 5,001,933 |
| Montgomery Ward, Inc. | PA | 1 | | 3,289,166 | | 3,289,166 |
| Montgomery Ward, Inc. | NJ | 1 | | | | |
| Morrison, Inc. | AL | 1 | | 324,288 | | 324,288 |
| Morrison, Inc. | GA | 1 | | 347,404 | | 347,404 |
| Morrison, Inc. | FL | 1 | | 375,392 | | 375,392 |
| Morrison, Inc. | VA | 2 | | 363,059 | | 363,059 |
| M.C.O. Properties | CO | 1 | | | | |
| North Carolina National Bank | SC | 6 | | 2,938,008 | | 2,938,008 |
| Occidental Petroleum Corp. | CA | 1 | 1,857,296 | | | |
| Ohio Power Co. Inc. | OH | 1 | | | | |
| Old National Bank of Washington | WA | 1 | | 4,190,632 | | 4,190,632 |
| Park West | KY | 1 | | 19,020,000 | | 19,020,000 |
| Penske Corp. | OH | 1 | 108,036 | | | |
| Pneumo Corp. | OH | 1 | 878,314 | | | |
| Portland General Electric Company | OR | 1 | 46,177,752 | | | |
| Rouse Company | MD | 1 | 3,320,839 | | | |
| Safeway Stores, Inc. | LA | 1 | | 1,782,885 | | 1,782,885 |
| Sams | MI | 1 | 5,543,256 | 8,844,225 | | 8,844,225 |
| Smith's Management Corp. | NV | 1 | 371,047 | | | |
| Southland Corporation | FL | 5 | | 1,162,971 | | 1,162,971 |
| Staples | NY | 1 | | 2,455,975 | 1,607 | 2,457,582 |
| Stop 'N Shop Co., Inc. | NY | 1 | | 5,013,507 | | 5,013,507 |
| Stop 'N Shop Co., Inc. | VA | 1 | 869,612 | | | |

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | Operating Method: Reserve for Depreciation | Operating Method: Rent due and accrued or received in advance at end of period | Financing Method: Net Investment | Financing Method: Minimum lease payments due and accrued at end of period |
|---|---|---|---|---|
| K-Mart Corporation | | | 1,367,760 | |
| K-Mart Corporation | 1,765,878 | | 1,831,105 | |
| K-Mart Corporation | | | 977,099 | |
| Kobacker Stores, Inc. | | (416) | 423,743 | (1,133) |
| Kobacker Stores, Inc. | | | 100,094 | |
| Kobacker Stores, Inc. | | | 613,834 | |
| Kraft, Inc. | | | | |
| Landmark Bancshares Corporation | | | 4,586,844 | |
| Levitz Furniture Corporation | | (13,017) | 2,149,353 | (27,661) |
| Lockheed Corporation | | (52,793) | 4,143,163 | (107,624) |
| Louisiana Power and Light Company | | | 12,443,623 | |
| Louisiana Power and Light Company | | | 4,321,049 | |
| Macke Co. | | 15,484 | | |
| Marsh Supermarkets, Inc. | 2,133,683 | | | |
| Montgomery Ward, Inc. | 2,120,374 | | | |
| Montgomery Ward, Inc. | | | 1,570,578 | (4,105) |
| Morrison, Inc. | | | 720,862 | |
| Morrison, Inc. | | | 690,199 | |
| Morrison, Inc. | | | 728,153 | |
| Morrison, Inc. | | | 1,785,553 | |
| M.C.O. Properties | | | | |
| North Carolina National Bank | 1,008,024 | (3,926) | | |
| Occidental Petroleum Corp. | | | | |
| Ohio Power Co. Inc. | | | 3,962,361 | (38,220) |
| Old National Bank of Washington | 2,816,843 | | | |
| Park West | | | | |
| Penske Corp. | | | 573,940 | |
| Pneumo Corp. | | | 2,272,594 | |
| Portland General Electric Company | | | 52,081,512 | |
| Rouse Company | | | 6,362,762 | |
| Safeway Stores, Inc. | 1,061,233 | (7,096) | | |
| Sams | 1,371,772 | (90,412) | | |
| Smith's Management Corp. | | | 838,205 | |
| Southland Corporation | 657,550 | | | |
| Staples | 37,661 | | | |
| Stop 'N Shop Co., Inc. | 3,589,887 | | | |
| Stop 'N Shop Co., Inc. | | | 2,815,364 | (30,930) |

Part 2 - Revenues earned for the Year ended December 31, 1997

| | Total revenue applicable to period | Expended for interest, taxes, repairs and expenses | Net income applicable to period |
|---|---|---|---|
| K-Mart Corporation | 128,806 | 0 | 128,806 |
| K-Mart Corporation | 413,734 | 36,563 | 377,171 |
| K-Mart Corporation | 78,194 | 24,912 | 53,282 |
| Kobacker Stores, Inc. | 62,971 | 7,805 | 55,166 |
| Kobacker Stores, Inc. | 19,192 | 10,975 | 8,217 |
| Kobacker Stores, Inc. | 92,644 | 18,822 | 73,822 |
| Kraft, Inc. | 50,414 | (39,646) | 90,060 |
| Landmark Bancshares Corporation | 644,743 | 466 | 644,277 |
| Levitz Furniture Corporation | 354,406 | 563 | 353,843 |
| Lockheed Corporation | 847,243 | 0 | 847,243 |
| Louisiana Power and Light Company | 1,567,252 | 372,734 | 1,194,518 |
| Louisiana Power and Light Company | 1,007,611 | 225,702 | 781,909 |
| Macke Co. | 74,516 | 6,739 | 67,777 |
| Marsh Supermarkets, Inc. | 506,300 | 231,479 | 274,821 |
| Montgomery Ward, Inc. | 314,280 | 61,698 | 252,582 |
| Montgomery Ward, Inc. | 147,710 | 54 | 147,656 |
| Morrison, Inc. | 134,559 | 2,300 | 132,259 |
| Morrison, Inc. | 134,750 | 0 | 134,750 |
| Morrison, Inc. | 142,096 | 2,300 | 139,796 |
| Morrison, Inc. | 276,296 | 4,943 | 271,353 |
| M.C.O. Properties | 12,974 | 33,144 | (20,170) |
| North Carolina National Bank | 224,823 | 51,285 | 173,538 |
| Occidental Petroleum Corp. | 0 | 253,333 | (253,333) |
| Ohio Power Co. Inc. | 370,060 | 0 | 370,060 |
| Old National Bank of Washington | 677,222 | 496,555 | 180,667 |
| Park West | 0 | 187 | (187) |
| Penske Corp. | 84,821 | 12,474 | 72,347 |
| Pneumo Corp. | 223,429 | 93,346 | 130,083 |
| Portland General Electric Company | 4,497,800 | 2,268,352 | 2,229,448 |
| Rouse Company | 563,969 | 347,415 | 216,554 |
| Safeway Stores, Inc. | 85,150 | 13,751 | 71,399 |
| Sams | 1,127,521 | 712,492 | 415,029 |
| Smith's Management Corp. | 75,545 | 37,115 | 38,430 |
| Southland Corporation | 127,573 | 15,424 | 112,149 |
| Staples | 277,966 | 94,494 | 183,472 |
| Stop 'N Shop Co., Inc. | 454,145 | 71,754 | 382,391 |
| Stop 'N Shop Co., Inc. | 254,630 | 85,787 | 168,843 |





AMERICAN REAL ESTATE PARTNERS, LP
a limited partnership

Schedule III
PAGE 4

REAL ESTATE OWNED AND REVENUES EARNED

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | | | | Operating Method | | |
|---|---|---|---|---|---|---|
| | State | No. of Locations | Amount of Encumberances | Initial Cost to Company | Cost of Improvements | Amount Carried at close of period |
| Super Foods Services, Inc. | MI | 1 | 6,635,566 | | | |
| SuperValu Stores, Inc. | MN | 1 | | 1,370,965 | | 1,370,965 |
| SuperValu Stores, Inc. | OH | 1 | | 3,000,671 | | 3,000,671 |
| SuperValu Stores, Inc. | GA | 1 | | 2,344,836 | | 2,344,836 |
| SuperValu Stores, Inc. | IN | 1 | | 2,267,573 | | 2,267,573 |
| Telecom Properties, Inc. | OK | 1 | 44,630 | | | |
| Telecom Properties, Inc. | KY | 1 | 115,678 | 281,253 | | 281,253 |
| The A&P Company | MI | 1 | | | | |
| The TJX Companies, Inc. | IL | 1 | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Toys "R" Us, Inc. | MA | 1 | | | | | |
| Toys "R" Us, Inc. | IL | 1 | | | | | |
| Toys "R" Us, Inc. | NY | 1 | | | | | |
| Toys "R" Us, Inc. | TX | 1 | 856,725 | 501,836 | | 501,836 | |
| Toys "R" Us, Inc. | MI | 1 | | | | | |
| Toys "R" Us, Inc. | TX | 1 | | | | | |
| Trafalgar Industries, Inc. | NY | 1 | | | | | |
| USA Petroleum Corporation | SC | 2 | | 163,161 | | 163,161 | |
| USA Petroleum Corporation | OH | 1 | | 78,443 | | 78,443 | |
| USA Petroleum Corporation | GA | 2 | | 138,062 | | 138,062 | |
| Waban | NY | 1 | 3,608,807 | 8,378,095 | | 8,378,095 | |
| Watkins | MO | 1 | | 965,741 | | 965,741 | |
| Webcraft Technologies | MD | 1 | 487,877 | 780,774 | | 780,774 | |
| Wetterau, Inc. | PA | 1 | | | | | |
| Wetterau, Inc. | NJ | 2 | | | | | |
| Wickes Companies, Inc. | CA | 2 | 1,507,459 | 2,447,297 | | 2,447,297 | |
| RESIDENTIAL PROPERTY LAND AND BUILDING | | | | | | | |
| Crown Cliffs | AL | 1 | 8,504,936 | 10,944,883 | 120,992 | 11,065,875 | (2) |

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | Operating Method | | Financing Method | |
|---|---|---|---|---|
| | Reserve for Depreciation | Rent due and accrued or received in advance at end of period | Net Investment | Minimum lease payments due and accrued at end of period |
| Super Foods Services, Inc. | | | 10,213,426 | |
| SuperValu Stores, Inc. | 211,948 | | | |
| SuperValu Stores, Inc. | 474,489 | | | |
| SuperValu Stores, Inc. | 367,453 | | | |
| SuperValu Stores, Inc. | 354,965 | | | |
| Telecom Properties, Inc. | | | 115,990 | |
| Telecom Properties, Inc. | | | 101,212 | |
| The A&P Company | | | 1,678,976 | |
| The TJX Companies, Inc. | | | 2,661,258 | (54,094) |
| Toys "R" Us, Inc. | | | | |
| Toys "R" Us, Inc. | | | | |
| Toys "R" Us, Inc. | | | | |
| Toys "R" Us, Inc. | | | 1,107,437 | |
| Toys "R" Us, Inc. | | | | |
| Toys "R" Us, Inc. | | | | |
| Trafalgar Industries, Inc. | | | | |
| USA Petroleum Corporation | | | 167,972 | |
| USA Petroleum Corporation | | | 88,832 | |
| USA Petroleum Corporation | | | 146,749 | |
| Waban | 500,930 | | | |
| Watkins | 81,047 | (9,650) | | |
| Webcraft Technologies | 117,371 | | | |
| Wetterau, Inc. | | | 823,756 | |
| Wetterau, Inc. | | | 1,780,342 | |
| Wickes Companies, Inc. | 1,250,994 | (18,970) | | |
| RESIDENTIAL PROPERTY LAND AND BUILDING | | | | |
| Crown Cliffs | 1,173,049 | | | |

Part 2 - Revenues earned for the Year ended December 31, 1997

| | Total revenue applicable to period | Expended for interest, taxes, repairs and expenses | Net income applicable to period |
|---|---|---|---|
| Super Foods Services, Inc. | 1,087,412 | 578,888 | 508,524 |
| SuperValu Stores, Inc. | 114,885 | 26,679 | 88,206 |
| SuperValu Stores, Inc. | 319,834 | 58,394 | 261,440 |
| SuperValu Stores, Inc. | 224,215 | 45,631 | 178,584 |
| SuperValu Stores, Inc. | 193,024 | 44,128 | 148,896 |
| Telecom Properties, Inc. | 10,965 | 4,663 | 6,302 |
| Telecom Properties, Inc. | 37,044 | 12,120 | 24,924 |
| The A&P Company | 176,747 | 0 | 176,747 |
| The TJX Companies, Inc. | 238,968 | 3,701 | 235,267 |
| Toys "R" Us, Inc. | 82,445 | 55,006 | 27,439 |
| Toys "R" Us, Inc. | 101,865 | 71,337 | 30,528 |
| Toys "R" Us, Inc. | 104,136 | 80,361 | 23,775 |
| Toys "R" Us, Inc. | 108,188 | 78,725 | 29,463 |
| Toys "R" Us, Inc. | 77,087 | 56,207 | 20,880 |
| Toys "R" Us, Inc. | 142,913 | 64,402 | 78,511 |

| | | | |
|---|---|---|---|
| Trafalgar Industries, Inc. | 0 | 31,226 | (31,226) |
| USA Petroleum Corporation | 39,312 | 1,035 | 38,277 |
| USA Petroleum Corporation | 18,900 | 0 | 18,900 |
| USA Petroleum Corporation | 33,264 | 0 | 33,264 |
| Waban | 659,262 | 421,042 | 238,220 |
| Watkins | 114,800 | 26,234 | 88,566 |
| Webcraft Technologies | 171,353 | 80,549 | 90,804 |
| Wetterau, Inc. | 88,039 | 12,352 | 75,687 |
| Wetterau, Inc. | 187,312 | 2,254 | 185,058 |
| Wickes Companies, Inc. | 588,030 | 281,054 | 306,976 |
| RESIDENTIAL PROPERTY LAND AND BUILDING | | | |
| Crown Cliffs | 1,741,608 | 1,760,276 | (18,668) |





AMERICAN REAL ESTATE PARTNERS, LP
a limited partnership

Schedule III
PAGE 5

REAL ESTATE OWNED AND REVENUES EARNED

PART 1 - REAL ESTATE OWNED AT DECEMBER 31, 1997 - ACCOUNTED FOR UNDER THE:

| | | | | Operating Method | | |
|---|---|---|---|---|---|---|
| | State | No. of Locations | Amount of Encumberances | Initial Cost to Company | Cost of Improvements | Amount Carried at close of period |
| COMMERCIAL PROPERTY - LAND | | | | | | |
| Easco Corp. | NC | 1 | | 157,560 | | 157,560 |
| Foodarama supermarkets, Inc. | NY | 1 | | 140,619 | | 140,619 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Foodarama supermarkets, Inc. | PA | 1 | | 112,554 | | 112,554 |
| Gino's, Inc. | MD | 1 | | 86,027 | | 86,027 |
| Gino's, Inc. | PA | 1 | | 36,271 | | 36,271 |
| Gino's, Inc. | MI | 1 | | 71,160 | | 71,160 |
| Gino's, Inc. | MA | 2 | | 102,048 | | 102,048 |
| Gino's, Inc. | NJ | 1 | | 61,050 | | 61,050 |
| J.C. Penney Company, Inc. | NY | 1 | | 51,009 | | 51,009 |
| Levitz Furniture Corporation | CA | 2 | | 1,134,836 | | 1,134,836 |
| Levitz Furniture Corporation | KS | 1 | | 460,490 | | 460,490 |
| COMMERCIAL PROPERTY - BUILDING | | | | | | |
| Bank South | GA | 1 | | | | |
| Harwood Square | IL | 1 | | 6,803,769 | | 6,803,769 |
| Holiday Inn | FL | 1 | | 6,846,683 | 357,299 | 7,203,982 |
| Lockheed Corporation | CA | 1 | | | | |
| Safeway Stores, Inc. | CA | 1 | | 558,652 | | 558,652 |
| Toys "R" Us, Inc. | RI | 1 | | | | |
| United Life & Accident Ins. Co. | NH | 1 | | | | |
| Wickes Companies, Inc. | PA | 1 | | | | |
| Weigh-Tronix, Inc. | CA | 1 | | | | |
| Baptist Hospital 1 | TN | 1 | 23,089,860 | | | |
| Baptist Hospital 2 | TN | 1 | 8,569,902 | | | |

PART 1 - REAL ESTATE OWNED AT DECEMBER 31, 1997 - ACCOUNTED FOR UNDER THE:

| | Operating Method | | Financing Method | |
|---|---|---|---|---|
| | Reserve for Depreciation | Rent due and accrued or received in advance at end of period | Net Investment | Minimum lease payments due and accrued at end of period |
| COMMERCIAL PROPERTY - LAND | | | | |
| Easco Corp. | | (26,750) | | |
| Foodarama supermarkets, Inc. | | | | |
| Foodarama supermarkets, Inc. | | | | |
| Gino's, Inc. | | | | |
| Gino's, Inc. | | | | |
| Gino's, Inc. | | | | |
| Gino's, Inc. | | | | |
| Gino's, Inc. | | | | |
| J.C. Penney Company, Inc. | | | | |
| Levitz Furniture Corporation | | (17,443) | | |
| Levitz Furniture Corporation | | | | |
| COMMERCIAL PROPERTY - BUILDING | | | | |
| Bank South | | | 3,755,472 | |
| Harwood Square | 2,997,054 | | | |
| Holiday Inn | 2,200,324 | | | |
| Lockheed Corporation | | | 5,293,023 | |
| Safeway Stores, Inc. | 513,925 | | | |
| Toys "R" Us, Inc. | | | 1,027,896 | |
| United Life & Accident Ins. Co. | | | 4,396,908 | (43,667) |
| Wickes Companies, Inc. | | | 3,240,160 | (46,366) |
| Weigh-Tronix, Inc. | | | 2,501,135 | |
| Baptist Hospital 1 | | | 25,234,428 | 1,105,517 |
| Baptist Hospital 2 | | | 9,365,708 | 410,318 |

PART 2 - REVENUES EARNED FOR THE YEAR ENDED DECEMBER 31, 1997

| | Total revenue applicable to period | Expended for interest, taxes, repairs and expenses | Net income applicable to period |
|---|---|---|---|
| COMMERCIAL PROPERTY - LAND | | | |
| Easco Corp. | 12,400 | 710 | 11,690 |
| Foodarama supermarkets, Inc. | 14,000 | 1,786 | 12,214 |
| Foodarama supermarkets, Inc. | 12,000 | 0 | 12,000 |
| Gino's, Inc. | 7,143 | 0 | 7,143 |
| Gino's, Inc. | 7,143 | 0 | 7,143 |

| | | | |
|---|---|---|---|
| Gino's, Inc. | 7,143 | 480 | 6,663 |
| Gino's, Inc. | 14,286 | 0 | 14,286 |
| Gino's, Inc. | 7,143 | 0 | 7,143 |
| J.C. Penney Company, Inc. | 5,500 | 0 | 5,500 |
| Levitz Furniture Corporation | 99,302 | 7,095 | 92,207 |
| Levitz Furniture Corporation | 47,009 | 0 | 47,009 |
| COMMERCIAL PROPERTY - BUILDING | | | |
| Bank South | 382,109 | 220,716 | 161,393 |
| Harwood Square | 737,149 | 271,064 | 466,085 |
| Holiday Inn | 3,959,694 | 4,145,683 | (185,989) |
| Lockheed Corporation | 676,617 | 4,653 | 671,964 |
| Safeway Stores, Inc. | 26,900 | 20,691 | 6,209 |
| Toys "R" Us, Inc. | 98,014 | 0 | 98,014 |
| United Life & Accident Ins. Co. | 372,115 | 0 | 372,115 |
| Wickes Companies, Inc. | 457,648 | 0 | 457,648 |
| Weigh-Tronix, Inc. | 259,859 | 0 | 259,859 |
| Baptist Hospital 1 | 994,844 | 905,141 | 89,703 |
| Baptist Hospital 2 | 369,279 | 335,940 | 33,339 |





AMERICAN REAL ESTATE PARTNERS, LP
a limited partnership

Schedule III
PAGE 6

REAL ESTATE OWNED AND REVENUES EARNED

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | | | | Operating Method | | |
|---|---|---|---|---|---|---|
| | State | No. of Locations | Amount of Encumbrances | Initial Cost to Company | Cost of Improvements | Amount Carried at close of period |
| DEVELOPMENT PROPERTY | | | | | | |
| Dellwood | NY | 1 | | 3,120,317 | | 3,120,317 |
| Grassy Hollow | NY | 1 | | 601,135 | | 601,135 |
| East Syracuse | NY | 1 | | 138,108 | | 138,108 |
| | | | $156,432,734 | $168,789,822 | $178,417 | $168,968,239(1) |

Part 1 - Real estate owned at December 31, 1997 - Accounted for under the:

| | Operating Method | | Financing Method | |
|---|---|---|---|---|
| | Reserve for Depreciation | Rent due and accrued or received in advance at end of period | Net Investment | Minimum lease payments due and accrued at end of period |
| DEVELOPMENT PROPERTY | | | | |
| Dellwood | | | | |
| Grassy Hollow | | | | |
| East Syracuse | | | | |

| | | | |
|---|---|---|---|
| $42,369,888(1) | ($399,347) | $265,656,836 | $704,395 |

Part 2 - Revenues earned for the Year ended December 31, 1997

| | Total revenue applicable to period | Expended for interest, taxes, repairs and expenses | Net income applicable to period |
|---|---|---|---|
| DEVELOPMENT PROPERTY | | | |
| Dellwood | 0 | 0 | 0 |
| Grassy Hollow | 0 | 0 | 0 |
| East Syracuse | 0 | 0 | 0 |
| | $47,857,010 | $24,041,366 | $23,815,644 |

(1) Amount shown includes hotel operating properties.

(2) The Company owns a 70% interest in the joint venture which owns this property.





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND REVENUES EARNED
YEAR ENDED DECEMBER 31, 1997

1a. A reconciliation of the total amount at which real estate owned, accounted for under the operating method and hotel operating properties, was carried at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1997 | $ 160,112,640 |
| Additions during period | 28,946,473 |
| Write downs | (704,782) |
| Reclassifications during period from financing leases | 4,000,824 |
| Reclassifications during period to assets held for sale | (3,763,071) |
| Disposals during period | (19,623,845) |
| Balance - December 31, 1997 | $ 168,968,239 |

b. A reconciliation of the total amount of accumulated depreciation at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1997 | $ 43,754,936 |

| | |
|---|---|
| Depreciation during period | 3,849,795 |
| Disposals during period | (3,752,894) |
| Reclassifications during period to assets held for sale | (1,481,949) |
| Balance - December 31, 1997 | $ 42,369,888 |

Depreciation on properties accounted for under the operating method is computed using the straight-line method over the estimated useful life of the particular property or property components, which range from 5 to 45 years.

2. A reconciliation of the total amount at which real estate owned, accounted for under the financing method, was carried at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1997 | $ 253,781,903 |
| Additions during period | 34,750,966 |
| Write downs | (380,000) |
| Reclassifications during period | (4,000,824) |
| Disposals during period | (10,812,126) |
| Amortization of unearned income | 25,146,392 |
| Minimum lease rentals received | (32,829,475) |
| Balance - December 31, 1997 | $ 265,656,836 |

3. The aggregate cost of real estate owned for Federal income tax purposes is $361,474,634.

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND REVENUES EARNED
YEAR ENDED DECEMBER 31, 1997

4. Net income applicable to the period in Schedule III is reconciled with net earnings as follows:

| | |
|---|---|
| Net income applicable to financing and operating leases | $ 23,815,644 |
| Add interest income - other and dividend income | 23,060,868 |
| | 46,876,512 |
| Deduct expenses not allocated: | |
| General and administrative expenses | 3,187,794 |
| Nonmortgage interest expense | 1,525,796 |
| Other | 1,143,306 |
| | 5,856,896 |

| | |
|---|---|
| Earnings before gain on property and securities transactions | 41,019,616 |
| Provision for loss on mortgages receivable | (9,790,000) |
| Provision for loss on property | (1,084,782) |
| Gain on sales of real estate | 16,051,491 |
| Gain on sale of marketable equity securities | 29,188,087 |
| Net earnings | $ 75,384,412 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND REVENUES EARNED
YEAR ENDED DECEMBER 31, 1996

1a. A reconciliation of the total amount at which real estate owned, accounted for under the operating method and hotel operating properties, was carried at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1996 | $ 193,311,259 |
| Additions during period | 11,991,211 |
| Write downs | (660,000) |
| Reclassifications during period from financing leases | 233,879 |
| Reclassifications during period to assets held for sale | (6,110,905) |
| Disposals during period | (38,652,804) |
| Balance - December 31, 1996 | $ 160,112,640 |

b. A reconciliation of the total amount of accumulated depreciation at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1996 | $ 49,406,334 |
| Depreciation during period | 4,895,252 |
| Disposals during period | (6,530,965) |
| Reclassifications during period to assets held for sale | (4,015,685) |
| Balance - December 31, 1996 | $ 43,754,936 |

Depreciation on properties accounted for under the operating method is computed using the straight-line method over the estimated useful life of the particular property or property components, which range from 5 to 45 years.

2. A reconciliation of the total amount at which real estate owned, accounted for under the financing method, was carried at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1996 | $ 281,532,52 |
| Other | (988) |
| Reclassifications during period | (233,879) |

| | |
|---|---|
| Disposals during period | (20,201,810) |
| Amortization of unearned income | 26,073,205 |
| Minimum lease rentals received | (33,387,154) |
| Balance - December 31, 1996 | $ 253,781,903 |

3. The aggregate cost of real estate owned for Federal income tax purposes is $340,405,247.

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND REVENUES EARNED
YEAR ENDED DECEMBER 31, 1996

4. Net income applicable to the period in Schedule III is reconciled with net earnings as follows:

| | |
|---|---|
| Net income applicable to financing and operating leases | $ 27,911,271 |
| Add interest income - other and dividend income | 12,949,679 |
| | 40,860,950 |
| Deduct expenses not allocated: | |
| General and administrative expenses | 2,938,684 |
| Nonmortgage interest expense | 2,604,345 |
| Other | 1,077,736 |
| | 6,620,765 |
| Earnings before gain on property transactions | 34,240,185 |
| Provision for loss on property | (935,000) |
| Gain on sales of real estate | 24,516,867 |
| Net earnings | $ 57,822,052 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND REVENUES EARNED
YEAR ENDED DECEMBER 31, 1995

1a. A reconciliation of the total amount at which real estate owned, accounted for under the operating method and hotel operating properties, was carried at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1995 | $ 185,327,608 |
| Additions during period | 22,019,288 |
| Write downs | (768,701) |
| Reclassifications during period to assets held for sale | (3,227,355) |
| Disposals during period | (10,039,581) |
| Balance - December 31, 1995 | $ 193,311,259 |

b. A reconciliation of the total amount of accumulated depreciation at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1995 | $ 48,234,722 |
| Depreciation during period | 4,731,153 |
| Disposals during period | (2,106,287) |
| Reclassifications during period to property held for sale | (1,453,254) |
| Balance - December 31, 1995 | $ 49,406,334 |

Depreciation on properties accounted for under the operating method is computed using the straight-line method over the estimated useful life of the particular property or property components, which range from 5 to 45 years.

2. A reconciliation of the total amount at which real estate owned, accounted for under the financing method, was carried at the beginning of the period, with the total at the close of the period, is shown below:

| | |
|---|---|
| Balance - January 1, 1995 | $ 314,260,786 |
| Reclassifications during period | (1,280,739) |
| Disposals during period | (24,242,668) |
| Amortization of unearned income | 29,452,066 |
| Minimum lease rentals received | (36,656,916) |
| Balance - December 31, 1995 | $ 281,532,529 |

3. The aggregate cost of real estate owned for Federal income tax purposes is $376,471,538.

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND REVENUES EARNED
YEAR ENDED DECEMBER 31, 1995

4. Net income applicable to the period in Schedule III is reconciled with net earnings as follows:

| | |
|---|---|
| Net income applicable to financing and operating leases | $ 29,312,510 |
| Add interest income - other | 8,398,380 |
| | 37,710,890 |
| Deduct expenses not allocated: | |
| General and administrative expenses | 2,605,331 |
| Nonmortgage interest expense | 3,696,889 |
| Other | 575,794 |
| | 6,878,014 |
| Earnings before gain on property transactions | 30,832,876 |
| Provision for loss on property | (768,701) |
| Gain on sales of real estate | 5,091,445 |
| Net earnings | $ 35,155,620 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED BY STATE (ACCOUNTED FOR UNDER THE FINANCING METHOD) DECEMBER 31, 1997

| State | Net Investment |
|---|---|
| Alabama | $ 9,635,475 |
| California | 12,344,143 |
| Connecticut | 23,685,974 |
| Florida | 5,250,311 |
| Georgia | 5,208,422 |
| Illinois | 4,241,657 |
| Indiana | 604,563 |
| Iowa | 1,367,760 |
| Kentucky | 201,306 |
| Louisiana | 18,448,966 |
| Maryland | 6,362,762 |
| Massachusetts | 8,076,230 |
| Michigan | 12,892,840 |
| Minnesota | 1,780,445 |
| Missouri | 5,216,755 |
| Nevada | 838,750 |
| New Hampshire | 4,396,908 |
| New Jersey | 10,191,310 |
| New York | 10,561,246 |
| North Carolina | 5,293,488 |

| | |
|---|---|
| Ohio | 8,268,594 |
| Oklahoma | 115,990 |
| Oregon | 52,163,782 |
| Pennsylvania | 10,656,031 |
| Rhode Island | 1,027,896 |
| South Carolina | 167,972 |
| Tennessee | 34,599,708 |
| Texas | 1,684,305 |
| Virginia | 5,195,283 |
| West Virginia | 3,258,447 |
| Wisconsin | 1,919,517 |
| | $265,656,836 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND RESERVE FOR DEPRECIATION BY STATE
(ACCOUNTED FOR UNDER THE OPERATING METHOD)
DECEMBER 31, 1997

| State | Amount at which Carried at Close of Year | Reserve for Depreciation |
|---|---|---|
| Alabama | $ 11,635,789 | $ 1,173,049 |
| California | 8,303,187 | 2,259,567 |
| Connecticut | 1,549,805 | 1,110,025 |
| Florida | 14,138,464 | 6,312,153 |
| Georgia | 9,084,883 | 1,250,669 |
| Illinois | 17,708,445 | 3,580,526 |
| Indiana | 8,635,584 | 3,553,683 |
| Kansas | 460,490 | -- |
| Kentucky | 19,949,261 | 434,676 |
| Louisiana | 6,829,427 | 1,915,376 |
| Maryland | 1,864,304 | 659,746 |
| Massachusetts | 2,586,310 | 1,588,326 |
| Michigan | 9,364,998 | 1,371,772 |
| Minnesota | 7,045,520 | 1,621,739 |
| Missouri | 1,946,471 | 391,245 |
| New Jersey | 2,535,281 | 1,525,255 |
| New York | 23,335,066 | 5,413,367 |
| North Carolina | 457,560 | -- |
| Ohio | 3,635,082 | 474,489 |
| Oregon | 169,048 | -- |
| Pennsylvania | 5,442,384 | 3,509,988 |
| South Carolina | 3,101,170 | 1,008,024 |
| Tennessee | 335,367 | 220,371 |
| Texas | 730,630 | -- |
| Virginia | 3,933,081 | 178,999 |
| Washington | 4,190,632 | 2,816,843 |
| | $168,968,239 | $42,369,888 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED BY STATE (ACCOUNTED FOR UNDER THE FINANCING METHOD)
DECEMBER 31, 1996

| State | Net Investment |
|---|---|
| Alabama | $ 10,064,256 |
| California | 13,300,742 |
| Connecticut | 24,148,717 |
| Florida | 5,492,092 |
| Georgia | 5,491,906 |
| Illinois | 5,391,892 |
| Indiana | 641,103 |
| Iowa | 1,406,004 |
| Kentucky | 210,480 |
| Louisiana | 19,222,737 |
| Maryland | 6,546,154 |
| Massachusetts | 9,089,554 |
| Michigan | 14,240,540 |
| Minnesota | 1,826,407 |
| Missouri | 5,367,699 |
| Nevada | 861,937 |
| New Hampshire | 4,548,793 |
| New Jersey | 14,030,998 |
| New York | 12,059,006 |
| North Carolina | 6,331,611 |
| Ohio | 8,635,226 |
| Oklahoma | 121,075 |
| Oregon | 52,830,039 |
| Pennsylvania | 13,140,285 |
| Rhode Island | 1,055,043 |
| South Carolina | 288,980 |
| Texas | 3,237,774 |
| Virginia | 8,835,855 |
| West Virginia | 3,395,645 |
| Wisconsin | 1,969,353 |
| | $253,781,903 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND RESERVE FOR DEPRECIATION BY STATE
(ACCOUNTED FOR UNDER THE OPERATING METHOD)
DECEMBER 31, 1996

| State | Amount at which Carried at Close of Year | Reserve for Depreciation |
|---|---|---|
| Alabama | $ 11,514,796 | $ 734,307 |
| Arizona | 9,364,129 | 1,582,362 |
| California | 10,867,240 | 2,579,786 |
| Connecticut | 1,549,805 | 1,090,444 |
| Florida | 13,781,164 | 5,698,752 |
| Georgia | 8,969,994 | 983,665 |
| Illinois | 8,931,657 | 3,295,252 |
| Indiana | 8,635,584 | 3,263,763 |
| Kansas | 460,490 | -- |
| Kentucky | 929,261 | 413,759 |
| Louisiana | 11,313,683 | 2,620,111 |
| Maryland | 1,864,304 | 612,717 |
| Massachusetts | 2,916,915 | 1,508,830 |
| Michigan | 9,364,998 | 1,210,388 |
| Minnesota | 7,045,520 | 1,335,146 |
| Missouri | 1,946,471 | 357,347 |
| New Jersey | 4,437,341 | 1,507,397 |
| New York | 23,833,344 | 5,185,550 |
| North Carolina | 1,591,685 | 1,072,369 |
| Ohio | 3,635,082 | 416,095 |
| Oregon | 218,713 | -- |
| Pennsylvania | 7,400,025 | 4,258,004 |
| South Carolina | 3,101,170 | 957,698 |
| Tennessee | 335,367 | 214,904 |
| Texas | 730,630 | -- |
| Virginia | 1,182,640 | 532,630 |
| Washington | 4,190,632 | 2,323,660 |
| | $160,112,640 | $43,754,936 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED BY STATE (ACCOUNTED FOR UNDER THE FINANCING METHOD)
DECEMBER 31, 1995

| State | Net Investment |
|---|---|
| Alabama | $ 10,442,132 |
| California | 14,214,432 |
| Connecticut | 24,571,019 |
| Florida | 25,524,549 |
| Georgia | 5,659,651 |
| Illinois | 5,582,313 |
| Indiana | 660,868 |
| Iowa | 1,440,868 |
| Kentucky | 218,831 |
| Louisiana | 19,908,683 |
| Maryland | 6,714,267 |
| Massachusetts | 9,324,902 |
| Michigan | 14,507,001 |

| | |
|---|---|
| Minnesota | 1,868,777 |
| Missouri | 5,496,349 |
| Nevada | 883,647 |
| New Hampshire | 4,688,575 |
| New Jersey | 14,444,858 |
| New York | 13,044,999 |
| North Carolina | 6,705,397 |
| Ohio | 8,925,929 |
| Oklahoma | 125,713 |
| Oregon | 53,486,728 |
| Pennsylvania | 13,639,937 |
| Rhode Island | 1,079,730 |
| South Carolina | 308,267 |
| Texas | 3,320,904 |
| Virginia | 9,206,882 |
| West Virginia | 3,521,376 |
| Wisconsin | 2,014,945 |
| | $281,532,529 |

(Continued)





AMERICAN REAL ESTATE PARTNERS, L.P. AND SUBSIDIARY

REAL ESTATE OWNED AND RESERVE FOR DEPRECIATION BY STATE
(ACCOUNTED FOR UNDER THE OPERATING METHOD)
DECEMBER 31, 1995

| State | Amount at which Carried at Close of Year | Reserve for Depreciation |
|---|---|---|
| Alabama | $ 11,459,096 | $ 265,568 |
| Arizona | 9,028,875 | 1,141,233 |
| California | 13,574,684 | 3,861,125 |
| Connecticut | 1,549,805 | 1,070,864 |
| Florida | 13,772,389 | 5,122,422 |
| Georgia | 7,750,258 | 797,977 |
| Illinois | 8,850,494 | 3,065,734 |
| Indiana | 8,635,584 | 2,954,479 |
| Kansas | 460,490 | -- |
| Kentucky | 14,851,240 | 1,052,938 |
| Louisiana | 11,313,683 | 2,479,819 |
| Maryland | 1,864,304 | 565,688 |
| Massachusetts | 2,916,915 | 1,429,333 |
| Michigan | 12,649,448 | 2,865,957 |
| Minnesota | 8,023,299 | 1,722,126 |
| Missouri | 1,946,471 | 323,448 |
| New Jersey | 4,437,341 | 1,489,539 |
| New York | 23,410,097 | 4,944,535 |
| North Carolina | 8,580,112 | 1,120,666 |
| Ohio | 3,635,082 | 357,702 |
| Oregon | 298,451 | -- |
| Pennsylvania | 10,386,463 | 6,045,388 |
| South Carolina | 3,101,170 | 907,373 |
| Tennessee | 335,367 | 205,951 |
| Texas | 4,302,872 | 2,810,501 |
| Virginia | 1,986,638 | 975,491 |
| Washington | 4,190,631 | 1,830,477 |

| | |
|---|---|
| $193,311,259 | $49,406,334 |
| ============ | =========== |





SIGNATURES

Pursuant to the requirements of Section 13 or 15(a) of the Securities Exchange Act of 1934, AREP has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 30th day of March, 1998.

AMERICAN REAL ESTATE PARTNERS, L.P.

By: AMERICAN PROPERTY INVESTORS, INC.
General Partner

By: /s/ Carl C. Icahn
-------------------------
Carl C. Icahn
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of AREP and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/Carl C. Icahn<br>Carl C. Icahn | Chairman of the Board<br>(Principal Executive Officer) | March 30, 1998 |
| /s/Alfred D. Kingsley<br>Alfred D. Kingsley | Director | March 30, 1998 |
| /s/William A. Leidesdorf<br>William A. Leidesdorf | Director | March 30, 1998 |
| /s/Jack G. Wasserman<br>Jack G. Wasserman | Director | March 30, 1998 |
| /s/John P. Saldarelli<br>John P. Saldarelli | Treasurer<br>(Principal Financial Officer and Principal Accounting Officer) | March 30, 1998 |

<ARTICLE> 5
<MULTIPLIER> 1,000

| | | |
|---|---|---|
| <PERIOD-TYPE> | YEAR | |
| <FISCAL-YEAR-END> | | DEC-31-1997 |
| <PERIOD-END> | | DEC-31-1997 |
| <CASH> | | 129,147 |
| <SECURITIES> | | 372,165 |
| <RECEIVABLES> | | 0 |
| <ALLOWANCES> | | 0 |
| <INVENTORY> | | 0 |
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| <PP&E> | | 434,624 |
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| <TOTAL-ASSETS> | | 991,230 |
| <CURRENT-LIABILITIES> | | 0 |
| <BONDS> | | 167,741 |
| <PREFERRED-MANDATORY> | | 0 |
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| <COMMON> | | 0 |
| <OTHER-SE> | | 809,325 |
| <TOTAL-LIABILITY-AND-EQUITY> | | 991,230 |
| <SALES> | | 0 |
| <TOTAL-REVENUES> | | 70,918 |
| <CGS> | | 0 |
| <TOTAL-COSTS> | | 13,521 |
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| <INTEREST-EXPENSE> | | 13,189 |
| <INCOME-PRETAX> | | 75,384 |
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| <EXTRAORDINARY> | | 0 |
| <CHANGES> | | 0 |
| <NET-INCOME> | | 75,384 |
| <EPS-PRIMARY> | | 2.27 |
| <EPS-DILUTED> | | 2.13 |