

Edgar Filing: Spirit Realty Capital, Inc. - Form 10-Q

Spirit Realty Capital, Inc.  
Form 10-Q  
August 06, 2014

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

Form 10-Q

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

For the quarterly period ended June 30, 2014

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 001-36004

\_\_\_\_\_  
SPIRIT REALTY CAPITAL, INC.  
(Exact name of registrant as specified in its charter)

\_\_\_\_\_  
Maryland 20-1676382  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification Number)

16767 North Perimeter Drive, Suite 210, Scottsdale, (480) 606-0820  
Arizona 85260  
(Address of principal executive offices; zip code) (Registrant's telephone number, including area code)

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

\_\_\_\_\_  
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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

Large accelerated filer ☐ Accelerated filer ☐  
Non-accelerated filer ☒ (Do not check if smaller reporting company) Smaller reporting company ☐

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

Yes ☐ No ☒

As of August 1, 2014, there were 398,809,443 shares of common stock, par value \$0.01, of Spirit Realty Capital, Inc. outstanding.

Table of Contents

SPIRIT REALTY CAPITAL, INC.

INDEX

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Condensed Consolidated Balance Sheets as of June 30, 2014 (Unaudited) and December 31, 2013 3

Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2014 and 2013 (Unaudited) 4

Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2014 and 2013 (Unaudited) 5

Condensed Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2014 (Unaudited) 6

Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013 (Unaudited) 7

Notes to Condensed Consolidated Financial Statements (Unaudited) 8

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 28

Item 3. Quantitative and Qualitative Disclosures About Market Risk 55

Item 4. Controls and Procedures 55

PART II — OTHER INFORMATION

Item 1. Legal Proceedings 55

Item 1A. Risk Factors 56

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 56

Item 3. Defaults Upon Senior Securities 56

Item 4. Mine Safety Disclosures 56

Item 5. Other Information 56

Item 6. Exhibits 57

Signatures 60

## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

## SPIRIT REALTY CAPITAL, INC.

## Condensed Consolidated Balance Sheets

(In Thousands, Except Share and Per Share Data)

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Investments:		
Real estate investments:		
Land and improvements	\$2,453,528	\$2,330,510
Buildings and improvements	4,356,795	4,188,783
Total real estate investments	6,810,323	6,519,293
Less: accumulated depreciation	(679,453)	(590,067)
	6,130,870	5,929,226
Loans receivable, net	113,321	117,721
Intangible lease assets, net	599,107	618,121
Real estate assets under direct financing leases, net	56,729	58,760
Real estate assets held for sale, net	40,955	19,611
Net investments	6,940,982	6,743,439
Cash and cash equivalents	120,976	66,588
Deferred costs and other assets, net	147,528	129,597
Goodwill	291,421	291,421
Total assets	\$7,500,907	\$7,231,045
Liabilities and stockholders' equity		
Liabilities:		
Revolving credit facilities, net	\$15,528	\$35,120
Mortgages and notes payable, net	3,202,853	3,743,098
Convertible senior notes, net	691,711	—
Intangible lease liabilities, net	216,714	220,114
Accounts payable, accrued expenses and other liabilities	111,753	114,679
Total liabilities	4,238,559	4,113,011
Commitments and contingencies (see Note 8)		
Stockholders' equity:		
Common stock, \$0.01 par value; 399,030,681 shares issued; 398,812,745 outstanding shares at June 30, 2014 and 370,570,565 shares issued; 370,363,803 outstanding shares at December 31, 2013	3,990	3,706
Capital in excess of par value	4,208,376	3,859,823
Accumulated deficit	(946,705)	(742,915)
Accumulated other comprehensive loss	(1,261)	(638)
Treasury stock, at cost	(2,052)	(1,942)
Total stockholders' equity	3,262,348	3,118,034
Total liabilities and stockholders' equity	\$7,500,907	\$7,231,045
See accompanying notes.		

**SPIRIT REALTY CAPITAL, INC.**
**Condensed Consolidated Statements of Operations**

(In Thousands, Except Share and Per Share Data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Revenues:				
Rentals	\$143,142	\$70,050	\$280,621	\$139,826
Interest income on loans receivable	1,821	1,128	3,658	2,241
Earned income from direct financing leases	838	—	1,684	—
Tenant reimbursement income	2,921	—	6,240	—
Interest income and other	3,067	1,236	3,558	1,315
Total revenues	151,789	72,414	295,761	143,382
Expenses:				
General and administrative	10,451	9,151	21,501	16,119
Finance restructuring costs	13,016	—	13,033	—
Merger costs	—	5,020	—	11,557
Property costs	6,576	327	11,858	1,267
Real estate acquisition costs	226	129	1,507	218
Interest	55,992	39,552	110,391	75,991
Depreciation and amortization	61,968	29,700	122,517	56,639
Impairments (recoveries)	27,627	(185)	) 29,334	(185)
Total expenses	175,856	83,694	310,141	161,606
Loss from continuing operations before other expense and income tax expense	(24,067)	) (11,280)	) (14,380)	) (18,224)
Other expense:				
Loss on debt extinguishment	(64,708)	) —	(64,708)	) —
Total other expense	(64,708)	) —	(64,708)	) —
Loss from continuing operations before income tax expense	(88,775)	) (11,280)	) (79,088)	) (18,224)
Income tax expense	127	68	344	142
Loss from continuing operations	(88,902)	) (11,348)	) (79,432)	) (18,366)
Discontinued operations:				
Income (loss) from discontinued operations	279	(130)	) 3,333	(1,624)
Gain (loss) on dispositions of assets	92	(191)	) 85	(11)
Income (loss) from discontinued operations	371	(321)	) 3,418	(1,635)
Loss before dispositions of assets	(88,531)	) (11,669)	) (76,014)	) (20,001)
(Loss) gain on dispositions of assets	(1,290)	) —	432	—
Net loss	\$(89,821)	) \$(11,669)	) \$(75,582)	) \$(20,001)
Net (loss) income per share of common stock—basic and diluted:				
Continuing operations	\$(0.24)	) \$(0.08)	) \$(0.21)	) \$(0.12)
Discontinued operations	—	—	0.01	(0.01)
Net loss per share	\$(0.24)	) \$(0.08)	) \$(0.20)	) \$(0.13)
Weighted average common shares outstanding:				
Basic and diluted	381,775,203	159,430,126	375,266,233	159,425,775
Dividends declared per common share issued	\$0.16625	\$0.16410	\$0.33250	\$0.32820

See accompanying notes.

SPIRIT REALTY CAPITAL, INC.

Condensed Consolidated Statements of Comprehensive Loss

(In Thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net loss	\$(89,821	) \$(11,669	) \$(75,582	) \$(20,001
Other comprehensive (loss) income:				
Change in net unrealized (losses) or gains on cash flow hedges	(875	) 502	(1,277	) 470
Net cash flow hedge losses reclassified to operations	331	95	654	210
Total comprehensive loss	\$(90,365	) \$(11,072	) \$(76,205	) \$(19,321
See accompanying notes.				

## SPIRIT REALTY CAPITAL, INC.

## Condensed Consolidated Statement of Stockholders' Equity

(In Thousands, Except Share Data)

(Unaudited)

	Common Stock			Treasury Stock				Total Stockholders' Equity
	Shares	Par Value	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Shares	Value	
Balances, December 31, 2013	370,570,565	\$ 3,706	\$ 3,859,823	\$ (742,915 )	\$ (638 )	(206,762 )	\$(1,942)	\$ 3,118,034
Net loss	—	—	—	(75,582 )	—	—	—	(75,582 )
Other comprehensive loss	—	—	—	—	(623 )	—	—	(623 )
Dividends declared on common stock	—	—	—	(127,928 )	—	—	—	(127,928 )
Repurchase of common shares	—	—	—	—	—	(11,174 )	(110 )	(110 )
Issuance of common shares	28,024,320	280	287,174	—	—	—	—	287,454
Embedded conversion premium of convertible notes	—	—	55,131	—	—	—	—	55,131
Exercise of stock options	20,000	—	183	—	—	—	—	183
Stock-based compensation, net	415,796	4	6,065	(280 )	—	—	—	5,789
Balances, June 30, 2014	399,030,681	\$ 3,990	\$ 4,208,376	\$ (946,705 )	\$ (1,261 )	(217,936 )	\$(2,052)	\$ 3,262,348

See accompanying notes.

## SPIRIT REALTY CAPITAL, INC.

## Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Operating activities		
Net loss	\$(75,582)	\$(20,001)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	122,517	59,229
Impairments	29,334	3,704
Amortization of deferred financing costs	2,297	10,130
Amortization of interest rate hedge losses and derivative net settlements	(50)	(32)
Amortization of debt (premiums) discounts	(1,043)	5,929
Stock-based compensation expense	5,484	4,102
Loss (gain) on debt extinguishment	64,708	(1,028)
Debt extinguishment costs	(59,069)	—
Gains on dispositions of real estate and other assets, net	(517)	(207)
Non-cash revenue	(8,344)	(1,278)
Other	242	192
Changes in operating assets and liabilities:		
Deferred costs and other assets	(2,352)	(2,284)
Accounts payable, accrued expenses and other liabilities	(9,062)	1,944
Net cash provided by operating activities	68,563	60,400
Investing activities		
Acquisitions/investments in real estate	(345,109)	(95,150)
Collections of principal on loans receivable and real estate assets under direct financing leases	3,286	8,030
Proceeds from dispositions of real estate and other assets	14,218	4,947
Transfers of sale proceeds and loan principal collections (to) from restricted account	(13,054)	10,589
Net cash used in investing activities	(340,659)	(71,584)
Financing activities		
Borrowings under lines of credit	405,535	26,555
Repayments under lines of credit	(425,127)	(63)
Borrowings under mortgages and notes payable	757,500	35,140
Repayments under mortgages and notes payable	(553,882)	(21,511)
Deferred financing costs	(20,000)	(8,123)
Proceeds from issuance of common stock, net of offering costs	287,704	(293)
Proceeds from exercise of stock options	183	—
Offering costs paid on equity component of convertible debt	(1,609)	—
Purchase of treasury stock	(110)	—
Consent fees paid to lenders	—	(1,586)
Dividends paid to stockholders	(123,207)	(54,757)
Transfers (to) from escrow deposits with lenders	(503)	285
Net cash provided by (used in) financing activities	326,484	(24,353)
Net increase (decrease) in cash and cash equivalents	54,388	(35,537)
Cash and cash equivalents, beginning of period	66,588	73,568
Cash and cash equivalents, end of period	\$120,976	\$38,031
See accompanying notes.		





SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements

June 30, 2014

(Unaudited)

Note 1. Organization

Company Organization and Operations

Spirit Realty Capital, Inc. (the "Company") is a Maryland corporation and operates as a self-administered and self-managed REIT that seeks to generate and deliver sustainable and attractive returns for stockholders by investing primarily in and managing a portfolio of single-tenant, operationally essential real estate throughout the United States that is generally leased on a long-term, triple-net basis primarily to tenants engaged in retail, service and distribution industries. Single tenant, operationally essential real estate generally refers to free-standing, commercial real estate facilities where tenants conduct activities that are essential to the generation of their sales and profits.

On July 17, 2013, the Company merged with and into Cole Credit Property Trust II, Inc. ("Cole II"), a Maryland Corporation, pursuant to the Merger Agreement ("Merger").

The Company's operations are carried out through its operating partnership, Spirit Realty, L.P. (the "Operating Partnership"). Spirit General OP Holdings, LLC ("OP Holdings"), one of the Company's wholly owned subsidiaries, is the sole general partner and owns 1.0% of the Operating Partnership. The Company and a wholly-owned subsidiary are the sole limited partner and own the remaining 99.0% of the Operating Partnership.

As of June 30, 2014, our undepreciated gross investment in real estate and loans totaled approximately \$7.55 billion, representing investments in 2,369 properties, including properties securing our mortgage loans. Of this amount, 98.5% consisted of our gross investment in real estate, representing ownership of 2,224 properties, and the remaining 1.5% consisted of commercial mortgage loans receivable secured by the remaining 145 properties or other related assets.

Recent Developments

Common Stock and Convertible Notes Offerings

On May 20, 2014, the Company completed a secondary public offering of 26,450,000 shares of the Company's common stock (the "Shares"), par value \$0.01 per share, pursuant to an underwriting agreement dated May 14, 2014 (the "Common Stock Offering"). The Shares sold in the offering include 3,450,000 shares of common stock sold to the underwriters pursuant to their 30-day option to purchase additional Shares of common stock to cover over-allotments, which was exercised in full on May 16, 2014.

Concurrent with the Common Stock Offering, on May 20, 2014, the Company completed public offerings of \$402.5 million aggregate principal amount of 2.875% Convertible Senior Notes due 2019 (the "2019 Notes") and \$345.0 million aggregate principal amount 3.75% Convertible Senior Notes due 2021 (the "2021 Notes" and, together with the 2019 Notes, the "Convertible Notes"), pursuant to an underwriting agreement dated May 14, 2014 (the "Convertible Notes Offering"). The Convertible Notes sold in the offering include \$52.5 million of the 2019 Notes and \$45.0 million of the 2021 Notes sold to the underwriters pursuant to their 30-day option to purchase additional notes to cover over-allotments, which was exercised in full on May 16, 2014.

The resulting net proceeds to the Company from the Common Stock Offering and Convertible Notes Offering were approximately \$271.2 million and \$726.2 million, respectively, after deducting the underwriting discount and other transaction costs. Net proceeds raised from the concurrent public offerings were partially used to extinguish senior mortgage notes payable with an aggregate principal balance of \$509.8 million, redeem \$18.0 million of net-lease mortgage notes which were not tendered in connection with the Exchange Offer, repay all amounts drawn against the Credit Facility and to fund future acquisitions and for general corporate purposes.



SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

Spirit Master Funding Notes Exchange Offer

On May 20, 2014 (the "Settlement Date"), the Company completed its offer to exchange (the "Exchange Offer") any and all of certain net-lease mortgage notes, (the "Old Notes") issued by one or more indirectly-owned special purpose, bankruptcy remote subsidiaries of the Company, for new notes under an amended trust indenture and property management agreement (the "New Notes"). The Exchange Offer was subject to a minimum tender condition of at least 98% of the outstanding principal of Old Notes. Of the \$912.4 million of Old Notes outstanding on the Settlement Date, \$894.4 million or 98% elected to exchange their Old Notes for New Notes and \$18.0 million of the Old Notes not tendered were redeemed.

The New Notes will maintain generally similar structural terms as the Old notes. The New Notes bear interest at the same rate, amortize at a slower rate and have a 17 year extension of the legal final payment date (although the anticipated repayment date remains the same). The New Notes are not insured by third party financial guaranty insurance and the associated insurance premium was eliminated. The New Notes are secured by substantially all of the assets owned by these entities.

Debt Defeasance

On June 5, 2014, two indirectly owned subsidiaries of the Company defeased the loans outstanding under a master loan agreement. The original amount under the loan agreement was \$545.7 million bearing interest at a fixed rate of 6.59% with a maturity date of June 5, 2016. On the defeasance date, the principal balance outstanding under the loan agreement was approximately \$488.7 million. Prior to the defeasance date, the obligations under the loan agreement had been secured by 112 properties and rents therefrom leased to a significant tenant, which had an aggregate gross book value of approximately \$917.7 million as of June 30, 2014. The Company funded the defeasance using a portion of the proceeds from the Convertible Notes Offering.

At the Market Common Stock Offering Program

On April 15, 2014, in connection with the commencement of a continuous equity offering, the Company filed with the Securities and Exchange Commission ("SEC") a prospectus supplement under which the Company may sell up to an aggregate of \$350.0 million of shares from time to time in "at the market" offerings (the "ATM Program"). The Company may sell the shares in amounts and at times to be determined by the Company from time to time, but has no obligation to sell any of the shares in the ATM Program. The ATM Program will operate pursuant to an equity distribution agreement entered into by the Company and the Operating Partnership with a number of sales agents for the offer and sale of the shares. During the quarter ended June 30, 2014, the company sold 1,574,320 shares under the program, raising proceeds of approximately \$16.6 million, net of \$0.3 million in sales agent compensation.

Acquisitions and dispositions

During the six months ended June 30, 2014, the Company purchased 190 properties, representing an aggregate gross investment in real estate properties of \$365.5 million, which includes \$1.8 million in revenue producing follow on investments in existing properties. During the same period, the Company sold seven properties for \$15.3 million in gross sales proceeds. See Note 3 for additional discussion of the Company's investments.

SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

Note 2. Summary of Significant Accounting Policies

Basis of Accounting and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements of Spirit Realty Capital, Inc. and its consolidated subsidiaries have been prepared pursuant to the rules and regulations of the SEC. In the opinion of management, the unaudited condensed consolidated financial statements include the normal, recurring adjustments necessary for a fair statement of the information required to be set forth therein. The results for interim periods are not necessarily indicative of the results for the entire year. Certain information and note disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP"), have been condensed or omitted from these statements pursuant to SEC rules and regulations and, accordingly, these financial statements should be read in conjunction with the Company's audited consolidated financial statements as filed with the SEC in its Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

The unaudited condensed consolidated financial statements include the accounts of Spirit Realty Capital, Inc. and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company has formed numerous special purpose entities to acquire and hold real estate subject to mortgage notes payable (see Note 5). As a result, the vast majority of the Company's consolidated assets are held in these wholly owned special purpose entities, and are subject to debt. Each special purpose entity is a separate legal entity, and is the sole owner of its assets and responsible for its liabilities. The assets of these special purpose entities are not available to pay, or otherwise satisfy obligations to, the creditors of any owner or affiliate of the special purpose entity. At June 30, 2014 and December 31, 2013, assets totaling \$6.3 billion and \$6.1 billion, respectively, were held, and liabilities totaling \$3.3 billion and \$3.8 billion, respectively, were owed by these special purpose entities and are included in the accompanying condensed consolidated balance sheets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although management believes its estimates are reasonable, actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to prior period balances to conform to the current period presentation.

Segment Reporting

Accounting Standards Codification Topic ("ASC") 280, Segment Reporting, established standards for the manner in which public enterprises report information about operating segments. The Company views its operations as one segment, which consists of net leasing operations. The Company has no other reportable segments.

Real Estate Investments

**Purchase Accounting and Acquisition of Real Estate** - When acquiring a property for investment purposes, the Company allocates the purchase price (including acquisition and closing costs) to land, building, improvements, and equipment based on their relative fair values. For properties acquired with in-place leases, the Company allocates the purchase price of real estate to the tangible and intangible assets and liabilities acquired based on their estimated fair values and acquisition costs are expensed as incurred. In making estimates of fair values for this purpose, the Company uses a number of sources, including independent appraisals and information obtained about each property as a result of its pre-acquisition due diligence and its marketing and leasing activities.

**Lease Intangibles** - Lease intangibles, if any, acquired in conjunction with the purchase of real estate represent the value of in-place leases and above- or below-market leases. For real estate acquired subject to existing lease agreements, in-place lease intangibles are valued based on the Company's estimates of costs related to tenant

acquisition and the carrying costs that would be incurred during the time it would take to locate a tenant if the property

10

---

SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

were vacant, considering current market conditions and costs to execute similar leases at the time of the acquisition, and are amortized on a straight-line basis over the remaining initial term of the related lease. Above- and below-market lease intangibles are recorded based on the present value of the difference between the contractual amounts to be paid pursuant to the leases at the time of acquisition of the real estate and the Company's estimate of current market lease rates for the property, measured over a period equal to the remaining initial term of the lease. Capitalized above-market lease intangibles are amortized over the remaining initial terms of the respective leases as a decrease to rental revenue. Below-market lease intangibles are amortized as an increase in rental revenue over the remaining initial terms of the respective leases plus any fixed-rate renewal periods on those leases. Should a lease terminate early, the unamortized portion of any related lease intangible is immediately recognized in the Company's condensed consolidated statements of operations.

Allowance for Doubtful Accounts

The Company reviews its rent receivables for collectability on a regular basis, taking into consideration changes in factors such as the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates, and economic conditions in the area where the property is located. In the event that the collectability of a receivable with respect to any tenant is in doubt, a provision for uncollectible amounts will be established or a direct write-off of the specific rent receivable will be made. The Company provided for reserves for uncollectible amounts totaling \$5.4 million and \$4.6 million at June 30, 2014 and December 31, 2013, respectively, against accounts receivable balances of \$18.8 million and \$14.3 million, respectively; receivables are recorded within deferred costs and other assets, net in the accompanying condensed consolidated balance sheets. For deferred rental revenues related to the straight-line method of reporting rental revenue, the Company performs a periodic review of receivable balances and established a provision for losses of \$10.8 million and \$9.6 million at June 30, 2014 and December 31, 2013, respectively, against deferred rental revenue receivables of \$42.0 million and \$35.3 million, respectively. The Company's periodic review includes management's estimates of amounts that will not be realized and an assessment of the risks inherent in the portfolio, giving consideration to historical experience and industry default rates for long-term receivables.

Loans Receivable

**Impairment and Allowance for Loan Losses** - The Company periodically evaluates the collectability of its loans receivable, including accrued interest, by analyzing the underlying property-level economics and trends, collateral value and quality, and other relevant factors in determining the adequacy of its allowance for loan losses. A loan is determined to be impaired when, in management's judgment based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Specific allowances for loan losses are provided for impaired loans on an individual loan basis in the amount by which the carrying value exceeds the estimated fair value of the underlying collateral less disposition costs. Delinquent loans receivable are written off against the allowance when all possible means of collection have been exhausted. There was no allowance for loan losses at June 30, 2014 or December 31, 2013.

A loan is placed on nonaccrual status when the loan has become 60 days past due, or earlier if management determines that full recovery of the contractually specified payments of principal and interest is doubtful. While on nonaccrual status, interest income is recognized only when received. As of June 30, 2014 and December 31, 2013, there were no mortgages or notes on nonaccrual status.

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

## Restricted Cash and Escrow Deposits

Restricted cash and deposits in escrow, classified within deferred costs and other assets, net in the accompanying condensed consolidated balance sheets consisted of the following at June 30, 2014 and December 31, 2013:

	June 30, 2014	December 31, 2013
Collateral deposits <sup>(1)</sup>	\$21,945	\$21,816
Tenant improvements, repairs, and leasing commissions <sup>(2)</sup>	12,035	10,297
Master trust release / title company escrow <sup>(3)</sup>	14,165	21,893
Loan impounds <sup>(4)</sup>	2,239	2,018
Other <sup>(5)</sup>	1,082	2,667
	\$51,466	\$58,691

<sup>(1)</sup> Funds held in reserve by lenders which, at their sole discretion, can be applied to the repayment of debt. Any funds remaining on deposit after the debt is paid in full are released to the borrower.

<sup>(2)</sup> Deposits held by lenders that are reserved to fund tenant improvements/repairs on collateral properties or when leasing commissions are incurred to secure a new tenant.

<sup>(3)</sup> Includes net sales proceeds from property dispositions held as collateral that can be released upon qualified re-investment.

<sup>(4)</sup> Funds held in lender controlled accounts generally used to meet future debt service or certain property cost requirements.

<sup>(5)</sup> Funds held in lender controlled accounts released within the following month after debt service requirements are met.

A significant amount of these reserves were established in connection with obtaining lender consents relating to our initial public offering during 2012 and Merger during 2013.

## Income Taxes

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended. As a REIT, the Company generally will not be subject to federal income tax provided it continues to satisfy certain tests concerning the Company's sources of income, the nature of its assets, the amounts distributed to its stockholders, and the ownership of Company stock. Management believes the Company has qualified and will continue to qualify as a REIT and therefore, no provision has been made for federal income taxes in the accompanying condensed consolidated financial statements. Even if the Company qualifies for taxation as a REIT, it may be subject to state and local income and franchise taxes, and to federal income tax and excise tax on its undistributed income.

Franchise taxes are included in general and administrative expenses on the accompanying condensed consolidated statements of operations. Taxable income from non-REIT activities managed through the Company's taxable REIT subsidiary is subject to federal, state, and local taxes, which are not material.

## New Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board ("FASB") or the SEC that are adopted by the Company as of the specified effective date. Unless otherwise discussed, these new accounting pronouncements entail technical corrections to existing guidance or affect guidance related to specialized industries or entities and therefore will have minimal, if any, impact on the Company's financial position or results of operations upon adoption.

In April 2014, the FASB issued Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360), Reporting Discontinued Operations and Disclosures of



Disposals of Components of an Entity, which amends the requirements for reporting discontinued operations. Under ASU 2014-08, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component or group of components meets the criteria to be classified as held for sale or when the component or group of components is disposed of by sale or other than by sale. In addition,

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

this ASU requires additional disclosures about both discontinued operations and the disposal of an individually significant component of an entity that does not qualify for discontinued operations presentation in the financial statements. The Company has early adopted the provisions of ASU 2014-08 beginning with the period ended March 31, 2014, and has applied the provisions prospectively.

In May 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers: Topic 606. This new guidance establishes a principles-based approach for accounting for revenue from contracts with customers. Lease contracts covered by Topic 840, Leases, are excluded from the scope of this new guidance. This new standard is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. The Company is currently evaluating the impact of this new standard on its financial statements.

## Note 3. Investments

## Real Estate Investments

At June 30, 2014 and December 31, 2013, the Company's gross investment in real estate properties and loans, including real estate assets held for sale, totaled approximately \$7.55 billion and \$7.24 billion, respectively. These investments are comprised of 2,369 and 2,186, respectively, owned or financed properties that are geographically dispersed throughout 49 states. Only one state, Texas, with a 13.0% investment, accounted for more than 10% of the total dollar amount of the Company's investment portfolio. At June 30, 2014 and December 31, 2013, respectively, the Company's gross investment portfolio was comprised of 2,224 and 2,041 owned properties. The Company also held 145 properties securing mortgage loans receivable with aggregate carrying amounts of \$112.9 million and \$117.3 million as of June 30, 2014 and December 31, 2013, respectively. Other unsecured loans receivable with aggregate carrying amounts of \$0.4 million were also held as of June 30, 2014 and December 31, 2013.

During the six months ended June 30, 2014, the Company had the following gross real estate and loan activity:

	Number of Properties Owned or Financed	Dollar Amount of Investments (1)  (In Thousands)
Balance, December 31, 2013	2,186	\$7,235,732
Acquisitions/improvements	190	365,893
Dispositions of real estate <sup>(2)</sup> (Note 11)	(7)	(16,498)
Principal payments and payoffs	—	(3,136)
Impairments	—	(28,847)
Loan premium amortization and other	—	(4,045)
Balance, June 30, 2014	2,369	\$7,549,099

The dollar amount of investments includes the gross investment in land, buildings and lease intangibles, as

(1) adjusted for any impairment, related to properties owned and the carrying amount of loans receivable and real estate assets held under direct financing leases.

(2) The total accumulated depreciation and amortization associated with dispositions of real estate was \$2.8 million for the six months ended June 30, 2014.

The properties that the Company owns are leased to tenants under long-term operating leases that typically include one or more renewal options. The leases are generally triple-net, which provides that the lessee is responsible for the payment of all property operating expenses, including property taxes, maintenance and repairs, and insurance costs; therefore, the Company is generally not responsible for repairs or other capital expenditures related to its properties, unless the property is not subject to a lease agreement. At June 30, 2014, 29 of the Company's properties were vacant,

not subject to a lease and in the Company's possession; three of these properties were held for sale. At December 31,

13

---

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

2013, 21 properties were vacant, not subject to a lease and in the Company's possession; six of these properties were held for sale.

Scheduled minimum future contractual rent to be received under the remaining non-cancelable term of operating leases at June 30, 2014 (in thousands):

Scheduled Future Rental Payments	June 30, 2014
Remainder of 2014	\$282,376
2015	557,731
2016	540,709
2017	525,579
2018	510,083
Thereafter	3,669,882
Total future minimum rentals	\$6,086,360

Because lease renewal periods are exercisable at the option of the lessee, the preceding table presents future minimum lease payments due during the initial lease term only. In addition, the future minimum rentals do not include any contingent rentals based on a percentage of the lessees' gross sales or lease escalations based on future changes in the consumer price index ("CPI").

Certain of the Company's leases contain tenant purchase options. Most of these options are at or above fair market value at the time the option is exercisable, and none of these purchase options represent bargain purchase options under GAAP.

## Loans Receivable

The following table details loans receivable, net of premium, as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014	December 31, 2013
Mortgage - principal	\$99,203	\$102,315
Mortgage - premium	13,713	14,976
Mortgages, net	112,916	117,291
Other notes - principal	405	430
Total loans receivable, net	\$113,321	\$117,721

## Real Estate Assets Under Direct Financing Leases

The components of investment assets held under direct financing leases as of June 30, 2014 and December 31, 2013 were as follows (in thousands):

	June 30, 2014	December 31, 2013
Minimum lease payments receivable	\$17,721	\$19,555
Estimated residual value of leased assets	55,858	57,739
Unearned income	(16,850)	(18,534)
Total	\$56,729	\$58,760

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

## Real Estate Assets Held for Sale

The following table shows the activity in real estate assets held for sale for the six months ended June 30, 2014:

	Number of Properties	Carrying Value (In Thousands)
Balance, December 31, 2013	11	\$19,611
Transfers from real estate investments	6	29,290
Sales (Note 11)	(5	) (7,946
Balance, June 30, 2014 <sup>(a)</sup>	12	\$40,955

<sup>(a)</sup> Includes six properties with a net carrying amount of \$29.1 million in which its operating results are reported in continuing operations.

The following table is a reconciliation of the major classes of assets and liabilities from discontinued operations included in real estate assets held for sale on the condensed consolidated balance sheets as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014	December 31, 2013
Assets		
Land and improvements	\$6,699	\$10,003
Buildings and improvements	7,460	14,178
Total real estate investments	14,159	24,181
Less: Accumulated depreciation	(2,613	) (4,819
Intangible lease assets, net	567	697
Other	228	—
Total assets	\$12,341	\$20,059
Liabilities		
Intangible lease liabilities, net	\$448	\$448
Total liabilities	\$448	\$448

## Impairments

The following table summarizes total impairment losses recognized for the three and six months ended June 30, 2014 and 2013 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Real estate and intangible asset impairment	\$24,610	\$1,481	\$26,247	\$3,584
Write-off of lease intangibles due to lease terminations	2,529	487	2,599	487
Loans receivable recovery	—	(367	) —	(367
Other impairment	488	—	488	—
Total impairment loss	\$27,627	\$1,601	\$29,334	\$3,704
continuing and discontinued operations				

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

## Note 4. Lease Intangibles, net

The following table details lease intangible assets and liabilities, net of accumulated amortization, as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014	December 31, 2013
In-place leases	\$667,434	\$663,027
Above-market leases	98,631	95,118
Less: accumulated amortization	(166,958)	(140,024)
Intangible lease assets, net	\$599,107	\$618,121
Below-market leases	\$247,262	\$243,237
Less: accumulated amortization	(30,548)	(23,123)
Intangible lease liabilities, net	\$216,714	\$220,114

The amounts amortized as a net increase to rental revenue for capitalized above- and below-market leases was \$3.0 million and \$0.7 million for the six months ended June 30, 2014 and 2013, respectively. Above- and below-market lease amortization from properties acquired in connection with the Merger contributed \$1.5 million of the increase during 2014. The value of in-place leases amortized and included in depreciation and amortization expense was \$26.9 million and \$8.8 million for the six months ended June 30, 2014 and 2013, respectively. Lease-in-place amortization from properties acquired in connection with the Merger contributed \$16.7 million of the increase in 2014.

## Note 5. Debt

The Company's debt is summarized below:

	Weighted Average Effective Interest Rates (1)	Weighted Average Stated Interest Rate (2)	June 30, 2014	December 31, 2013
(In Thousands)				
Revolving credit facilities (3)	5.31	% 4.00%	\$15,528	\$35,120
Master trust notes	6.13	% 5.35%	1,209,131	1,241,437
CMBS - fixed-rate	5.55	% 5.68%	1,876,187	2,387,532
CMBS - variable-rate (4)	3.34	% 3.28%	110,854	111,018
Unsecured fixed rate promissory note	10.00	% 7.00%	1,375	1,442
Convertible senior notes (5)	5.10	% 3.30%	747,500	—
			3,960,575	3,776,549
Unamortized net debt (discount) or premium			(50,483)	1,669
Total debt, net			\$3,910,092	\$3,778,218

(1) The effective interest rates include amortization of debt discount/premium, amortization of deferred financing costs and related debt insurer premiums, where applicable, calculated for the three months ended June 30, 2014.

(2) Represents the weighted average stated interest rate based on the outstanding principal balance as of June 30, 2014.

(3) Excluding the impact of non-cash amortization of deferred financing costs and non-utilization fee, the effective interest rate on the revolving credit facilities (Credit Facility and Line of Credit), was 2.96% as of June 30, 2014.

(4) Variable-rate notes are predominately hedged with interest rate swaps (see Note 6).

<sup>(5)</sup> The value of the embedded conversion premium of (\$55.8) million is included in net debt (discount).

SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

Revolving Credit Facilities

**\$400 million Credit Facility** - On July 17, 2013, the Operating Partnership and various affiliates thereof, entered into a three-year credit agreement ("Credit Facility") with various lenders and terminated the \$100.0 million secured revolving credit facility. The Operating Partnership may obtain loans and/or extensions of credit in an aggregate amount not exceeding \$400.0 million. The initial term expires on July 17, 2016 and may be extended for an additional 12 months subject to the satisfaction of specified requirements. The Credit Facility bears interest, at the Operating Partnership's option, of either (i) the "Base Rate" (as defined in the Credit Agreement) plus 1.00% to 2.00%; or (ii) LIBOR plus 2.00% to 3.00%, depending on the Operating Partnership's leverage ratio. The Operating Partnership is also required to pay a fee on the unused portion of the Credit Facility at a rate of either 0.25% or 0.35% per annum, based on percentage thresholds for the average daily unused balance during a fiscal quarter, which amounted to \$0.3 million and \$0.6 million for the three and six months ended June 30, 2014, respectively.

As a result of entering into the Credit Facility, the Company incurred origination costs of \$4.5 million. These costs are being amortized to interest expense, on a straight-line basis, over the remaining initial term of the Credit Facility. At June 30, 2014, \$3.1 million of the \$4.5 million is included in deferred costs and other assets, net on the accompanying condensed consolidated balance sheet. The effective interest rate on outstanding borrowings under the Credit Facility, which includes cash interest, non-cash amortization of deferred financing costs, and non-utilization fees, was 5.49% for the three months ended June 30, 2014. The interest rate, excluding the impact of non-cash amortization of deferred financing costs and non-utilization fee of the Credit Facility, was 2.78% for the three months ended June 30, 2014. As of June 30, 2014, there were no amounts outstanding on the Credit Facility.

The Company guarantees the Operating Partnership's obligations under the Credit Facility and, to the extent not prohibited by law, all of its assets and the Operating Partnership's assets, other than interests in subsidiaries that are contractually prohibited from being pledged, are pledged as collateral for obligations under the Credit Facility.

The ability to borrow under the Credit Facility is subject to the Operating Partnerships' ongoing compliance with a number of customary financial covenants. As of June 30, 2014, the Operating Partnership was in compliance with these financial covenants.

**Line of Credit** - As of June 30, 2014, a special purpose entity owned by the Company had access to a \$40.0 million secured revolving credit facility ("Line of Credit"). The initial term of the Line of Credit expires in March 2016, and each advance under the Line of Credit has a 24-month term. The interest rate is determined on the date of each advance and is the greater of (i) the stated prime rate plus 0.5% or (ii) the floor rate equal to 4.0%. The interest rate with respect to each advance resets on the annual anniversary date of each advance, and is subject to the same terms as above. As of June 30, 2014, \$15.5 million was outstanding on the Line of Credit under three separate advances, secured by 3 properties, at a weighted average stated rate of 4.0% and an effective interest rate for the three months ended June 30, 2014 of 4.22%. Each advance under the Line of Credit is secured only by its specified asset. The ability to borrow under the Line of Credit is subject to the Company's and special purposes entity's ongoing compliance with a number of customary financial covenants. As of June 30, 2014, the Company and special purpose entity were in compliance with these financial covenants.

Master Trust Notes

On May 20, 2014, the Company completed its Exchange Offer for the outstanding principal balance of certain net-lease mortgage notes issued by indirect wholly-owned subsidiaries Spirit Master Funding, LLC, Spirit Master Funding II, LLC and Spirit Master Funding III, LLC under the Company's Spirit Master Funding program. Of the \$912.4 million of Old Notes outstanding as of the Settlement Date, \$894.4 million elected to exchange their Old Notes for New Notes. Approximately \$18.0 million of outstanding principal balance immediately prior to the Settlement Date were redeemed by the Company due to non-tender. The terms of the New Notes remain generally similar to the



Old Notes including the interest rate and anticipated final repayment dates, however, the New Notes generally amortize more slowly than the Old Notes and have a legal final payment date that is 17 years later than the Old Notes. The New Notes are not insured by third party financial guaranty insurance and the associated insurance premium was eliminated. The revisions to the Spirit Master Funding Program in connection with the issuance of the New Notes, also generally provide the Company more administrative flexibility as property manager and special servicer.

**SPIRIT REALTY CAPITAL, INC.**
**Notes to Condensed Consolidated Financial Statements - (continued)**

June 30, 2014

(Unaudited)

The following table summarizes certain key terms under the Old Notes and the New Notes (post exchange):

Old Notes					New Notes				
Issuer	Principal Amount	Interest Rate	Anticipated payment date	Legal Maturity Date	Issuer	Principal Amount	Interest Rate	Anticipated payment date	Legal Maturity Date
SMF, 2005-1, Class A-1	\$94,264	5.05 %	July 2020	July 2023	SMF, 2014-1, Class A-1	\$81,309	5.05 %	July 2020	July 2040
SMF, 2005-1, Class A-2	258,300	5.37 %	July 2020	July 2023	SMF, 2014-1, Class A-2	253,300	5.37 %	July 2020	July 2040
SMF II, 2006-1, Class A <sup>(1)</sup>	246,915	5.76 %	March 2021	March 2024	SMF II, 2014-2, Class A	246,915	5.76 %	March 2021	March 2041
SMF III, 2007-1, Class A	312,944	5.74 %	March 2022	March 2025	SMF III, 2014-3, Class A	312,944	5.74 %	March 2022	March 2042
	\$912,423					\$894,468			

<sup>(1)</sup> Principal amounts include \$12.3 million of SMF II, Class A notes repurchased by the Company in 2010, which is shown net on the condensed consolidated balance sheets.

As of June 30, 2014, the Series 2014-1, Class A-1, Series 2014-1, Class A-2, Series 2014-2 and Series 2014-3 have outstanding balances of \$80.5 million, \$253.3 million, \$234.4 million and \$312.9 million, respectively, and are secured by 719 properties, including 82 properties securing mortgage loans.

In December 2013, Spirit Master Funding VII, LLC ("SMF VII") issued new investment grade rated \$330 million net-lease mortgage notes under a new securitization platform. The issue was comprised of \$125.0 million of 3.89% Series 2013-1 Class A interest only, net-lease mortgage notes expected to be repaid in December 2018 and \$205.0 million of 5.27% Series 2013-2 Class A amortizing net-lease mortgage notes expected to be repaid in December 2023. The notes are secured by the assets of SMF VII and are non-recourse. The Company used the proceeds of the issue to replace shorter-term debt, fund acquisitions and for general corporate purposes. As of June 30, 2014, the Series 2013-1 and Series 2013-2 notes have outstanding balances of \$125.0 million and \$203.0 million, respectively, and are secured by 318 properties, including 79 properties securing mortgage loans.

**CMBS**

The Company has 229 fixed and 26 variable rate CMBS loans that are secured by mortgages on certain of the leased properties and related assets. The stated interest rates as of June 30, 2014 for the fixed rate notes ranged from 3.90% to 8.39% with a weighted average stated rate of 5.68%. The variable rate notes ranged from 2.65% to 3.56% with a weighted average stated rate of 3.28%. As of June 30, 2014, the fixed and variable rate loans have balances outstanding of \$1.9 billion and \$110.9 million, respectively, and are secured by 736 and 123 properties, respectively.

**Convertible Senior Notes**

On May 20, 2014, the Company completed public offerings of \$402.5 million aggregate principal amount of 2.875% Convertible Notes due in 2019 and \$345.0 million aggregate principal amount of 3.75% Convertible Notes due in 2021. Interest on the Notes is payable semiannually in arrears on May 15 and November 15 of each year, beginning on November 15, 2014. The 2019 Notes will mature on May 15, 2019 and the 2021 Notes will mature on May 15, 2021. The Company loaned the net proceeds from the Convertible Notes Offering to the Operating Partnership in

exchange for promissory notes with substantially the same terms as the Notes.

The Convertible Notes are convertible only during certain periods and, subject to certain circumstances, into cash, shares of Spirit Realty Capital's common stock, or a combination thereof. The initial conversion rate applicable to each series is 76.3636 per \$1,000 principal note (equivalent to an initial conversion price of \$13.10 per share of common stock, representing a 22.5% premium above the public offering price). Earlier conversion may be triggered if shares of Spirit Realty Capital common stock trade higher than the established thresholds or certain corporate events as

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

defined occur.

In connection with the issuance of the Convertible Notes, the Company recorded a discount of \$56.7 million, which represents the estimated value of the embedded conversion option feature for each of the Convertible Notes. The discount is shown net against the aggregate gross value of the Convertible Notes on the accompanying condensed consolidated balance sheets within mortgages and notes payable, net. The equity component of the conversion feature is recorded in additional paid-in-capital, net of financing costs. The discount will be amortized to interest expense using the effective interest method over a period of approximately 5 years for the 2019 Notes and 7 years for the 2021 Notes. As of June 30, 2014, the unamortized discount was \$55.8 million. The Company also incurred \$19.6 million in deferred financing costs in connection with the Convertible Notes Offering. This amount has been allocated on a pro-rata basis to each of the Convertible Notes and is being amortized to interest expense over the term of each note.

## Debt Extinguishment

Net proceeds raised from the concurrent public offerings were partially used to retire senior mortgage notes payable with an aggregate principal balance of \$509.8 million, redeem \$18.0 million of net-lease mortgage notes which were not tendered in connection with the Exchange Offer, and repay all amounts drawn against the Credit Facility. The Company defeased approximately \$488.7 million aggregate principal amount of senior mortgage indebtedness included in the total above. The defeased notes had contractual interest rates of 6.59% and upcoming maturities in 2016. As a result of these transactions, the Company recognized a loss on extinguishment of debt of approximately \$64.7 million.

## Debt Maturities

As of June 30, 2014, scheduled debt maturities of the Company's revolving credit facilities, mortgages and notes payable, including balloon payments, are as follows (in thousands):

	Scheduled Principal	Balloon Payment	Total
Remainder of 2014	\$16,723	\$29,761	\$46,484
2015	32,799	245,794	278,593
2016	31,108	299,963	331,071
2017	28,389	905,262	933,651
2018	27,284	248,851	276,135
Thereafter	96,334	1,998,307	2,094,641
Total	\$232,637	\$3,727,938	\$3,960,575

Balloon payments subsequent to 2018 are as follows: \$452.0 million due in 2019, \$288.0 million due in 2020, \$554.8 million due in 2021, \$351.4 million due in 2022, \$352.1 million due in 2023. As of June 30, 2014, the remaining weighted average maturity of the Company's outstanding indebtedness was 5.1 years.

The following table summarizes interest expense on the related borrowings (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest expense – revolving credit facilities	\$1,100	\$271	\$1,820	\$376
Interest expense – mortgages and notes payable	53,649	29,615	107,245	59,086
Interest expense – other	33	469	72	470
Amortization of deferred financing costs	1,324	6,229	2,297	10,130

Edgar Filing: Spirit Realty Capital, Inc. - Form 10-Q

Amortization of debt (premium)/discount	(114	) 2,968	(1,043	) 5,929
Total interest expense	\$55,992	\$39,552	\$110,391	\$75,991

19

---

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

Debt (premium)/discount net is amortized to interest expense using the effective interest method over the terms of the related notes. The financing costs related to the establishment of debt are deferred and amortized to interest expense using the effective interest method over the term of the related debt instrument. Unamortized financing costs totaled \$41.8 million and \$23.8 million at June 30, 2014 and December 31, 2013, respectively, and are included in deferred costs and other assets, net on the accompanying condensed consolidated balance sheets.

## Note 6. Derivative and Hedging Activities

The Company uses interest rate derivative contracts to manage its exposure to changes in interest rates on its variable rate debt. These derivatives are considered cash flow hedges and are recorded on a gross basis at fair value and included in the accompanying condensed consolidated balance sheets. Assessments of hedge effectiveness are performed quarterly using regression analysis and the measurement of hedge ineffectiveness is based on the hypothetical derivative method. The effective portion of changes in fair value are recorded in accumulated other comprehensive loss ("AOCL") and subsequently reclassified to earnings when the hedged transactions affect earnings. The ineffective portion is recorded immediately in earnings in general and administrative expenses.

The following table summarizes the notional amount and fair value of the Company's derivative instruments (in thousands):

						Fair Value of Liability	
Derivatives Designated as Hedging Instruments	Balance Sheet Location	Notional Amount	Interest Rate	Effective Date	Maturity Date	June 30, 2014	December 31, 2013
Interest Rate Swap	Accounts payable, accrued expenses and other liabilities	\$ 10,924	4.62 %	06/28/12	07/06/17	\$(80 )	\$(42 )
Interest Rate Swap	Accounts payable, accrued expenses and other liabilities	\$ 6,746	5.75 %	07/17/13	03/01/16	(260 )	(326 )
Interest Rate Swap	Accounts payable, accrued expenses and other liabilities	\$ 32,400	3.15 %	07/17/13	09/05/15	(162 )	(178 )
Interest Rate Swaps <sup>(a)</sup>	Accounts payable, accrued expenses and other liabilities	\$ 61,758	5.14 %	01/02/14	12/13/18	(863 )	(246 )
						\$(1,365 )	\$(792 )

<sup>(a)</sup>Represents a tranche of eight individual interest rate swap agreements with notional amounts ranging from \$7.6 million to \$7.9 million. The swap agreements contain the same payment terms, stated interest rate, effective date, and maturity date.

The following tables provide information about the amounts recorded in AOCL, as well as the loss recorded in operations, when reclassified out of AOCL or recognized in earnings immediately, for the three and six months ended ended June 30, 2014 and 2013, respectively (in thousands):

Amount of (Loss) or Gain Recognized in AOCL on Derivative (Effective Portion)	
Three Months Ended June 30,	Six Months Ended June 30,

Edgar Filing: Spirit Realty Capital, Inc. - Form 10-Q

Derivatives in Cash Flow Hedging Relationships	2014	2013	2014	2013
Interest rate swaps	\$(875	) \$502	\$(1,277	) \$470

Amount of Loss Reclassified from  
AOCL into Operations  
(Effective Portion)

	Three Months Ended June 30,		Six Months Ended June 30,	
Location of Loss Reclassified from AOCL into Operations	2014	2013	2014	2013
Interest expense	\$(331	) \$(95	) \$(654	) \$(188
General and administrative expense	—	—	—	(22

Amount of Gain or (Loss) Recognized in  
Operations on Derivative  
(Ineffective Portion)

	Three Months Ended June 30,		Six Months Ended June 30,	
Location of (Loss) or Gain Recognized in Operations on Derivatives	2014	2013	2014	2013
General and administrative expense	\$(3	) \$54	\$(3	) \$54

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

Approximately \$1.2 million of the remaining balance in AOCL is estimated to be reclassified as an increase to interest expense during the next 12 months. The Company does not enter into derivative contracts for speculative or trading purposes.

The Company is exposed to credit risk in the event of non-performance by its derivative counterparties. The Company believes it mitigates its credit risk by entering into agreements with counterparties it considers credit-worthy. As of June 30, 2014 and December 31, 2013, there were no termination events or events of default related to the interest rate swaps.

## Note 7. Stockholders' Equity

## Issuance of Common Stock

In May 2014, the Company issued 26.5 million shares of common stock at a price of \$10.69 per share, including 3.5 million shares purchased by the underwriters upon the exercise of their overallotment option. After underwriting discounts and other offering costs, net proceeds totaled \$271.2 million.

During the three months ended June 30, 2014, the Company sold 1.6 million shares of its common stock at the weighted average share price of \$10.70 under its ATM Program, for net proceeds of \$16.3 million.

## Dividends Declared

For the six months ended June 30, 2014, our Board of Directors declared the following dividends:

Declaration Date	Dividend Per Share	Record Date	Total Amount <sup>(1)</sup> (in thousands)	Payment Date
March 18, 2014	\$0.16625	March 31, 2014	61,629	April 15, 2014
June 16, 2014	\$0.16625	June 30, 2014	66,299	July 15, 2014

<sup>(1)</sup> Excludes estimated forfeitures for dividends declared on employee restricted stock awards that are reported in general and administrative on the accompanying condensed consolidated statement of operations.

The dividend declared on June 16, 2014 was paid on July 15, 2014 and is included in accounts payable, accrued expenses and other liabilities as of June 30, 2014.

## Note 8. Commitments and Contingencies

The Company is periodically subject to claims or litigation in the ordinary course of business, including claims generated from business conducted by tenants on real estate owned by the Company. In these instances, the Company is typically indemnified by the tenant against any losses that might be suffered, and the Company and/or the tenant are insured against such claims.

As of June 30, 2014, there were no outstanding claims against the Company that are expected to have a material adverse effect on the Company's financial position, results of operations or cash flows.

As of June 30, 2014, the Company had commitments totaling \$31.3 million, of which \$28.2 million relates to future acquisitions and the remainder to fund improvements on properties the Company currently owns. All of these commitments are expected to be funded by December 31, 2014. In addition, the Company is contingently liable for \$5.7 million of debt owed by one of its tenants and is indemnified by that tenant for any payments the Company may be required to make on such debt.

The Company estimates future costs for known environmental remediation requirements when it is probable that the Company has incurred a liability and the related costs can be reasonably estimated. The Company considers various



factors when estimating its environmental liabilities, and adjustments are made when additional information becomes available that affects the estimated costs to study or remediate any environmental issues. When only a wide range of

**SPIRIT REALTY CAPITAL, INC.**
**Notes to Condensed Consolidated Financial Statements**

June 30, 2014

(Unaudited)

estimated amounts can be reasonably established and no other amount within the range is better than another, the low end of the range is recorded in the financial statements.

**Note 9. Fair Value Measurements**

The Company's assets and liabilities that are required to be measured at fair value in the accompanying condensed consolidated financial statements are summarized below.

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2014 and December 31, 2013 (in thousands):

	Fair Value	Fair Value Hierarchy Level		
		Level 1	Level 2	Level 3
June 30, 2014:				
Derivatives:				
Interest rate swaps financial liabilities	\$(1,365 )	\$—	\$(1,365 )	\$—
December 31, 2013:				
Derivatives:				
Interest rate swaps financial liabilities	\$(792 )	\$—	\$(792 )	\$—

The interest rate swaps are measured using a market approach, using prices obtained from a nationally recognized pricing service and pricing models with market observable inputs such as interest rates and equity index levels. These measurements are classified as Level 2 of the fair value hierarchy.

The following table sets forth the Company's assets that were accounted for at fair value on a nonrecurring basis as of June 30, 2014 and December 31, 2013 (in thousands):

Description	Fair Value	Dispositions	Fair Value Hierarchy Level			Impairment Charges <sup>(1)</sup>
			Level 1	Level 2	Level 3	
June 30, 2014:						
Long-lived assets held and used	\$34,257	\$—	\$—	\$—	\$34,257	\$(17,844 )
Lease intangible assets	2,631	—	—	—	2,631	(3,457 )
Long-lived assets held for sale	23,110	—	—	—	23,110	(8,033 )
						\$(29,334 )
December 31, 2013:						
Lease intangible assets	\$—	\$—	\$—	\$—	\$—	\$(182 )
Long-lived assets held for sale	11,198	(26,832 )	—	—	38,030	(7,134 )
						\$(7,316 )

<sup>(1)</sup> Impairment charges are presented for the six months ended June 30, 2014 and for the year ended December 31, 2013.

The fair values of impaired real estate and intangible assets were determined by using the following information, depending on availability, in order of preference: signed purchase and sale agreements or letters of intent; recently quoted bid or ask prices, or market prices for comparable properties; estimates of cash flow, which consider, among other things, contractual and forecasted rental revenues, leasing assumptions, and expenses based upon market conditions; and expectations for the use of the real estate. Based on these inputs, the Company determined that its valuation of the impaired real estate and intangible assets falls within Level 3 of the fair value hierarchy.

## SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

In addition to the disclosures for assets and liabilities required to be measured at fair value at the balance sheet date, companies are required to disclose the estimated fair values of all financial instruments, even if they are not carried at their fair values. The fair values of financial instruments are estimates based upon market conditions and perceived risks at June 30, 2014 and December 31, 2013. These estimates require management's judgment and may not be indicative of the future fair values of the assets and liabilities.

Financial assets and liabilities for which the carrying values approximate their fair values include cash and cash equivalents, restricted cash and escrow deposits, and accounts receivable and payable. Generally, these assets and liabilities are short-term in duration and are recorded at fair value on the accompanying condensed consolidated balance sheets.

The estimated fair values of the fixed-rate mortgage and other loans receivable, revolving credit facilities and the fixed-rate mortgages and notes payable have been derived based on market quotes for comparable instruments or discounted cash flow analyses using estimates of the amount and timing of future cash flows, market rates and credit spreads. The mortgage and other loans receivable, revolving credit facilities and the mortgages and notes payable were measured using a market approach from nationally recognized financial institutions with market observable inputs such as interest rates and credit analytics. These measurements are classified as Level 2 of the fair value hierarchy.

The following table discloses fair value information for these financial instruments (in thousands):

	June 30, 2014		December 31, 2013	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Loans receivable, net	\$113,321	\$121,670	\$117,721	\$131,587
Revolving credit facilities, net	15,528	15,711	35,120	34,911
Mortgages and notes payable, net	3,202,853	3,279,436	3,743,098	3,892,621
Convertible senior notes, net <sup>(1)</sup>	691,711	747,066	—	—

<sup>(1)</sup> The carrying amount of the convertible senior notes is net of an embedded conversion premium totaling \$55.8 million.

## Note 10. Significant Credit and Revenue Concentration

As of June 30, 2014 and December 31, 2013, the Company's real estate investments are operated by 404 and 377 tenants, respectively, that engage in retail, service and distribution activities across various industries throughout the United States. Shopko Stores/Shopko Hometown ("Shopko"), operates in the general merchandise industry and represent the Company's largest tenant. Total revenues from Shopko for the three months ended June 30, 2014 and 2013, contributed 13.8% and 28.9% of the Company's total revenues (from both continuing and discontinued operations), respectively. No other tenant contributed 10% or more of the Company's total revenues during any of the periods presented. As of June 30, 2014 and December 31, 2013, the properties that are operated by Shopko represent approximately 13.8% and 14.4%, respectively, of the Company's total investment portfolio.

## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

## Note 11. Discontinued Operations

In April 2014, the FASB issued ASU 2014-08, which amends the requirements for reporting discontinued operations (see Note 2). Under ASU 2014-08, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The Company has early adopted the provisions of ASU 2014-08 beginning with the period ended March 31, 2014, and will apply the provisions prospectively. Properties that were reported as held for sale as of December 31, 2013, will continue to be reported under the prior standards and will be presented in discontinued operations until they are disposed of.

As a result, net gains or losses from the disposition of these properties, as well as the current and prior period operations, of these properties will continue to be reclassified to discontinued operations. The results of discontinued operations for the three and six months ended June 30, 2014 and 2013, are summarized below (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Revenues:				
Rent	\$309	\$2,228	\$617	\$4,450
Non-cash rent	2	(143)	(27)	(125)
Other	33	7	2,950	7
Total revenues	344	2,092	3,540	4,332
Expenses:				
General and administrative	9	7	12	16
Property costs	56	266	195	340
Interest	—	—	—	194
Depreciation and amortization	—	1,213	—	2,590
Impairments	—	1,786	—	3,889
Total expenses	65	3,272	207	7,029
Gain (loss) from discontinued operations before other income	279	(1,180)	3,333	(2,697)
Other income:				
Gain on debt extinguishment	—	1,028	—	1,028
Other	—	22	—	45
Total other income	—	1,050	—	1,073
Income (loss) from discontinued operations	279	(130)	3,333	(1,624)
Gain (loss) on dispositions of assets	92	(191)	85	(11)
Total discontinued operations	\$371	\$(321)	\$3,418	\$(1,635)
Number of properties disposed of during period <sup>(a)</sup>	3	4	5	10

<sup>(a)</sup> During the six months ended June 30, 2014, seven properties were sold, but only five of them were held for sale at December 31, 2013 and qualified for discontinued operations under ASU 2014-08.

## SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

## Note 12. Supplemental Cash Flow Information

	Six Months Ended	
	June 30,	
	2014	2013
	(in thousands)	
Supplemental Disclosures of Non-Cash Investing and Financing Activities:		
Distributions declared and unpaid	\$(66,299)	\$(26,514)
Reduction of debt through sale of certain real estate properties	—	974
Real estate properties acquired under 1031 exchange	20,784	—
Embedded conversion premium of convertible notes	(56,740)	—
Reduction of debt, net of assets surrendered to lender	—	1,028
Accrued equity offering costs	(250)	—
Accrued deferred financing costs	(281)	(9,814)

## Note 13. Incentive Award Plan and Stock Option Plan

Under the Company's Incentive Award Plan (the "Plan"), the Company may grant equity incentive awards to eligible employees, directors and other service providers. Awards under the Plan may be in the form of stock options, restricted stock, dividend equivalents, restricted stock units, stock appreciation rights, performance awards, stock payment awards, performance share awards, LTIP units and other incentive awards. If an award under the Plan is forfeited, expires or is settled for cash, any shares subject to such award may, to the extent of such forfeiture, expiration or cash settlement, be used again for new grants under the Plan. As of June 30, 2014, 2.6 million shares remained available for award under the Plan.

## Restricted Shares of Common Stock

During the six months ended June 30, 2014, the Company granted 0.4 million shares under the Plan to certain named executive officers and employees. The Company recorded \$3.8 million in deferred compensation associated with these grants. As of June 30, 2014, approximately 2.0 million non-vested restricted shares of common stock were outstanding.

## Performance Share Awards

During the six months ended June 30, 2014, in connection with the 2014 bonus program, the Compensation Committee of the Board of Directors approved an initial target grant of 242,883 performance shares to the named executive officers of the Company. The performance period of this grant runs from January 1, 2014 through December 31, 2016. Pursuant to the performance share award agreement, each participant is eligible to vest in and receive shares of the Company's common stock based on the initial target number of shares granted multiplied by a percentage range between 0% and 250%. The percentage range is based on the attainment of total shareholder return of the Company compared to a specified peer group of companies during the performance period. In addition, each performance share award entitles its holder to a cash payment equal to the aggregate dividends that would have been outstanding on each dividend record date over the performance period. Based on the grant date fair value, the Company expects to recognize \$3.3 million in compensation expense on a straight-line basis over the requisite service period associated with this grant.

As of June 30, 2014, under each separate annual performance award, the Company's total shareholder return compared to the specified peer group during the performance periods would have resulted in the release of 1.1 million shares, in the aggregate. In addition, approximately \$0.4 million in dividend rights have been accrued. The projected shares to be released are not considered issued under the Plan until the performance period has ended and the actual number of shares to be released is determined. The performance shares and dividend rights are subject to forfeiture in the event of a non-qualifying termination of a participant prior to the performance period end date.



## SPIRIT REALTY CAPITAL, INC.

## Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

## Stock compensation

For the three and six months ended June 30, 2014, the Company recognized \$3.0 million and \$5.5 million, respectively, in stock-based compensation expense, which is included in general and administrative expenses in the accompanying condensed consolidated statements of operations. For the three and six months ended June 30, 2013, the Company recognized \$1.8 million and \$3.6 million, respectively in stock-based compensation expense. As of June 30, 2014 and December 31, 2013, the remaining unamortized stock-based compensation expense, including amounts relating to the performance awards, totaled \$17.4 million and \$15.6 million, respectively, which is recognized as the greater of the amount amortized on a straight-line basis over the service period of each applicable award or the amount vested over the vesting periods.

## Note 14. Loss Per Share

Loss per share has been computed using the two-class method. Loss per common share under the two-class method is computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities based on the weighted average shares outstanding during the period. Classification of the Company's unvested restricted stock, which contain rights to receive nonforfeitable dividends, are deemed participating securities under the two-class method. Under the two class method, earnings attributable to unvested restricted shares are deducted from loss from continuing operations and net loss attributable to common stockholders in the computation of loss per share for each.

The table below is a reconciliation of the numerator and denominator used in the computation of basic and diluted loss per share (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Basic and diluted loss:				
Loss from continuing operations	\$(88,902)	\$(11,348)	\$(79,432)	\$(18,366)
(Loss) gain on dispositions of assets	(1,290)	—	432	—
Less: income attributable to unvested restricted stock	(334)	(352)	(667)	(698)
Loss used in basic and diluted income (loss) per share from continuing operations	(90,526)	(11,700)	(79,667)	(19,064)
Income (loss) from discontinued operations	371	(321)	3,418	(1,635)
Net loss attributable to common stockholders used in basic and diluted income (loss) per share	\$(90,155)	\$(12,021)	\$(76,249)	\$(20,699)

## Basic and diluted weighted average shares of common stock outstanding:

Weighted average shares of common stock outstanding	383,810,017	161,598,986	377,209,471	161,599,476
Less: unvested weighted average shares of restricted stock	(2,034,814)	(2,168,860)	(1,943,238)	(2,173,701)
Weighted average number of shares outstanding used in basic and diluted loss per share	381,775,203	159,430,126	375,266,233	159,425,775

Edgar Filing: Spirit Realty Capital, Inc. - Form 10-Q

Potentially dilutive shares of common stock

Unvested shares of restricted stock	911,962	950,097	800,773	838,293
Unvested performance shares	708,823	—	703,262	—
Stock options	4,416	—	4,830	—
Total	1,625,201	950,097	1,508,865	838,293

26

---



SPIRIT REALTY CAPITAL, INC.

Notes to Condensed Consolidated Financial Statements - (continued)

June 30, 2014

(Unaudited)

The Company intends to satisfy its exchange obligation for the principal amount of the Convertible Notes to the exchange note holders entirely in cash. As the Company intends to settle the principal amount of the Convertible Notes in cash, the "if-converted" method to include convertible debt in diluted EPS is not applicable and the treasury stock method is being used. As the Company's stock price is below the conversion price, there are no potentially dilutive shares associated with the Convertible Notes.



## Table of Contents

### Overview

Spirit Realty Capital, Inc. (the "Company") is a Maryland corporation and operates as a self-administered and self-managed REIT that seeks to generate and deliver sustainable and attractive returns for stockholders by investing primarily in and managing a portfolio of single-tenant, operationally essential real estate throughout the United States that is generally leased on a long-term, triple-net basis primarily to tenants engaged in retail, service and distribution industries. Single tenant, operationally essential real estate generally refers to free-standing, commercial real estate facilities where tenants conduct activities that are essential to the generation of their sales and profits.

On July 17, 2013, the Company merged with and into Cole Credit Property Trust II, Inc. ("Cole II"), a Maryland Corporation, pursuant to the Merger Agreement ("Merger").

The Company's operations are carried out through its operating partnership, Spirit Realty, L.P. (the "Operating Partnership"). Spirit General OP Holdings, LLC ("OP Holdings"), one of the Company's wholly owned subsidiaries, is the sole general partner and owns 1.0% of the Operating Partnership. The Company and a wholly-owned subsidiary are the sole limited partner and own the remaining 99.0% of the Operating Partnership.

We have elected to be taxed as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 2005. We believe that we have been organized and have operated in a manner that has allowed us to qualify as a REIT for federal income tax purposes commencing with such taxable year, and we intend to continue operating in such a manner.

We generate our revenue primarily by leasing our properties to our tenants. As of June 30, 2014, our undepreciated gross investment in real estate and loans totaled approximately \$7.55 billion, representing investment in 2,369 properties, including properties securing our mortgage loans. Of this amount, 98.5% consisted of our gross investment in real estate, representing ownership of 2,224 properties, and the remaining 1.5% consisted of commercial mortgage and equipment loans receivable secured by 145 properties or related assets. As of June 30, 2014, our owned properties were approximately 98.7% occupied (based on number of properties), and our leases had a weighted average non-cancelable remaining lease term (based on annual contractual rent) of approximately 10.1 years. Our leases are generally originated with long lease terms, typically non-cancelable initial terms of 15 to 20 years and tenant renewal options for additional years. As of June 30, 2014, approximately 87% of our single-tenant properties (based on annual rent) provided for increases in future annual base contractual rent.

### 2014 Highlights

For the second quarter ended June 30, 2014, Spirit Realty Capital:

- Recognized revenues of \$151.8 million, more than double the revenues reported in the second quarter of 2013 largely due to the Merger completed on July 17, 2013.

- Generated Adjusted Funds from Operations (AFFO) of \$0.20 per share, Funds from Operations (FFO) of less than \$0.01 per share, and net loss of \$0.24 per share.

- Closed 24 real estate transactions and invested \$207.7 million (including \$1.2 million follow on investments in existing properties) which added 86 properties to our portfolio, earning an initial cash yield of approximately 7.72% under leases with an average remaining term of 18.0 years.

- Strengthened the balance sheet and acquisition capacity by:

- Issuing \$402.5 million of 2.875% Convertible Senior Notes due 2019 and \$345.0 million of 3.75% Convertible Senior Notes due 2021, resulting in net proceeds of approximately \$726.2 million.

- Completing a secondary offering of 26,450,000 shares of common stock, resulting in net proceeds of approximately \$271.2 million.

- Establishing an at-the-market program (ATM) allowing for the periodic issuance of its common stock which raised \$16.6 million on 1.6 million shares sold during the quarter.

- Completing an exchange offer for \$912.4 million outstanding principal balance of certain net-lease mortgage notes issued under its Spirit Master Funding Program, with each class of new notes having a rating of "A+" by Standard & Poor's Rating Services (S&P).

- Extinguishing \$527.8 million of debt with a weighted average interest rate of 6.54% and weighted average remaining term of 25 months.



## Table of Contents

Declared cash dividends for the second quarter of \$0.16625 per share, which equates to an annualized dividend of \$0.6650 per share.

Maintained essentially full occupancy at 99%.

For the six months ended June 30, 2014:

Generated revenues of \$295.8 million, more than double the revenues reported in the second quarter of 2013 primarily the result of our Merger.

Generated AFFO of \$0.41 per share, FFO of \$0.20 per share and net loss of \$0.20 per share.

Invested \$365.5 million (including \$1.8 million in follow on investments in existing properties) with an initial cash yield of 7.76% and an average remaining lease term of 15.5 years. Added 190 properties to our portfolio through new investments.

Raised over \$1 billion through a combination of registered offerings of common stock and unsecured convertible notes.

### Factors that May Influence Our Operating Results

#### Rental Revenue

Our revenues are generated predominantly from receipt of rental revenue. Our ability to grow rental revenue will depend on our ability to acquire additional properties, increase rental rates and/or occupancy. Approximately 87% of our single-tenant properties contain rent escalators, or provisions that periodically increase the base rent payable by the tenant under the lease. Generally, our rent escalators increase rent at specified dates by: (1) a fixed amount; or (2) the lesser of (a) 1 to 1.25 times any increase in the CPI over a specified period, or (b) a fixed percentage, typically 1% to 2% per year. As of June 30, 2014, 98.7% of our owned properties (based on number of properties) were occupied.

For the three months ended June 30, 2014, Shopko contributed 13.8% of our total revenue. Walgreen Company ("Walgreens"), our next largest tenant, contributed 3.9% of our total revenue for the three months ended June 30, 2014. Because a significant portion of our revenues are derived from rental revenues received from Shopko and Walgreens, defaults, breaches or delay in payment of rent by these tenants may materially and adversely affect us.

Without giving effect to the exercise of tenant renewal options, the weighted average remaining term of our leases as of June 30, 2014 was 10.1 years (based on annual rent). Approximately 11.5% of our leases (based on annual rent) as of June 30, 2014 will expire prior to January 1, 2018. The stability of our rental revenue generated by our properties depends principally on our tenants' ability to pay rent and our ability to collect rents, renew expiring leases or re-lease space upon the expiration or other termination of leases, lease currently vacant properties and maintain or increase rental rates at our leased properties. Adverse economic conditions, particularly those that affect the markets in which our properties are located, or downturns in our tenants' industries could impair our tenants' ability to meet their lease obligations to us and our ability to renew expiring leases or re-lease space. In particular, the bankruptcy of one or more of our tenants could adversely affect our ability to collect rents from such tenant and maintain our portfolio's occupancy.

Our ability to grow revenue will depend, to a significant degree, on our ability to acquire additional properties. We primarily focus on opportunities to provide capital to small and middle market companies that we conclude have stable and proven operating histories and attractive credit characteristics, but lack the access to capital that large companies often have. We believe our experience, in-depth market knowledge and extensive network of long-standing relationships in the real estate industry will provide us access to an ongoing pipeline of attractive investment opportunities.

#### Our Triple-Net Leases

We generally lease our properties to tenants pursuant to long-term, triple-net leases that require the tenant to pay all property operating expenses, such as real estate taxes, insurance premiums and repair and maintenance costs. As of June 30, 2014, approximately 85% of our single tenant properties (based on annual rent) are subject to triple-net leases. Occasionally, we have entered into a lease pursuant to which we retain responsibility for the costs of structural repairs and maintenance. Although these instances are infrequent and have not historically resulted in significant costs to us, an increase in costs related to these responsibilities could negatively influence our operating results. Similarly,

an increase in the vacancy rate of our portfolio would increase our costs, as we would be responsible for costs that our tenants are currently required to pay. Additionally, contingent rents based on a percentage of the tenant's gross sales have been historically negligible, contributing less than 1% of our rental revenue. Approximately 43.2% of our annual rent is attributable to master leases, where multiple properties are leased to a single tenant on an "all or none"

## Table of Contents

basis and which contain cross-default provisions. Where appropriate, we seek to use master leases to prevent a tenant from unilaterally giving up underperforming properties while maintaining well performing properties.

### Interest Expense

As of June 30, 2014, we had an approximately \$4.0 billion principal balance outstanding of largely secured, fixed-rate mortgage notes payable and borrowings under our revolving credit facilities. As of June 30, 2014, the weighted average stated interest rate on our fixed and variable-rate debt, excluding non-utilization fees, the amortization of deferred financing costs and debt discounts/premiums, was approximately 5.06%. Our fixed-rate debt structure will provide us with a stable and predictable cash requirement related to our debt service. The variable rate debt consists of 26 mortgage notes. We entered into interest rate swaps that effectively fixed the interest rates at approximately 4.55% on a significant portion of this variable rate debt. We amortize the deferred financing costs and debt discounts/premiums associated with our fixed-rate debt to interest expense using the effective interest rate method over the terms of the related notes. For the six months ended June 30, 2014, non-cash interest expense recognized on our revolving credit facilities, mortgages and notes payable totaled approximately \$1.3 million and our non-utilization fee on our Credit Facility was \$0.6 million. Any changes to our debt structure, including borrowings under the \$400.0 million Credit Facility or debt financing associated with property acquisitions, could materially influence our operating results depending on the terms of any such indebtedness. Most of our debt provides for scheduled principal payments. As principal is repaid, our interest expense decreases.

### General and Administrative Expenses

General and administrative expenses include employee compensation costs, professional fees, consulting, portfolio servicing costs and other general and administrative expenses. As a public company, our annual general and administrative expenses have increased due to added legal, insurance, accounting and other expenses related to corporate governance, SEC reporting and other compliance matters.

### Transaction Costs

As we acquire properties, we may incur transaction costs that we may be required to expense. For properties acquired with in-place leases, we allocate the purchase price of real estate to the tangible and intangible assets and liabilities based on their estimated fair values and acquisition costs are expensed as incurred. For properties acquired in connection with a sale leaseback, transaction costs are capitalized and amortized over the term of the lease as reduction to rental revenue. As a result, acquisition transaction costs may vary between periods depending on the nature of the acquisition.

### Impact of Inflation

Our leases typically contain provisions designed to mitigate the adverse impact of inflation on our results of operations. Since tenants are typically required to pay all property operating expenses, increases in property-level expenses at our leased properties generally do not adversely affect us. However, increased operating expenses at vacant properties and the limited number of properties that are not subject to full triple-net leases could cause us to incur additional operating expense. Additionally, our leases generally provide for rent escalators (see “Rental Revenue” above) designed to mitigate the effects of inflation over a lease’s term. However, since some of our leases do not contain rent escalators and many that do limit the amount by which rent may increase, any increase in our rental revenue may not keep up with the rate of inflation.

### Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires our management to use judgment in the application of accounting policies, including making estimates and assumptions. We base estimates on the best information available to us at the time, our experience and on various other assumptions believed to be reasonable under the circumstances. These estimates affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions or other matters had been different, it is possible that different accounting would have been applied, resulting in a different presentation of our condensed consolidated financial statements. From time to time, we re-evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments

are made in subsequent periods to reflect more current estimates and assumptions about matters that are inherently uncertain. A summary of our critical accounting policies is included in our Annual Report on Form



Table of Contents

10-K for the fiscal year ended December 31, 2013 in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We have not made any material changes to these policies during the periods covered by this quarterly report.

## Results of Operations

Comparison of the Three Months Ended June 30, 2014 to Three Months Ended June 30, 2013

The following discussion includes the results of our continuing operations as summarized in the table below:

	Three Months Ended June 30,		Change	%	
	2014	2013			
	(In Thousands)				
Revenues:					
Rentals	\$ 143,142	\$ 70,050	\$ 73,092	104.3	%
Interest income on loans receivable	1,821	1,128	693	61.4	%
Earned income from direct financing leases	838	—	838	NM	
Tenant reimbursement income	2,921	—	2,921	NM	
Interest income and other	3,067	1,236	1,831	148.1	%
Total revenues	151,789	72,414	79,375	109.6	%
Expenses:					
General and administrative	10,451	9,151	1,300	14.2	%
Finance restructuring costs	13,016	—	13,016	NM	
Merger costs	—	5,020	(5,020)	(100.0)	)%
Property costs	6,576	327	6,249	1,911.0	%
Real estate acquisition costs	226	129	97	75.2	%
Interest	55,992	39,552	16,440	41.6	%
Depreciation and amortization	61,968	29,700	32,268	108.6	%
Impairments (recoveries)	27,627	(185)	27,812	NM	
Total expenses	175,856	83,694	92,162	110.1	%
Loss from continuing operations before other expense and income tax expense	(24,067)	(11,280)	(12,787)	(113.4)	)%
Other expense					
Loss on debt extinguishment	(64,708)	—	(64,708)	NM	
Total other expense	(64,708)	—	(64,708)	NM	
Loss from continuing operations before income tax expense	(88,775)	(11,280)	(77,495)	(687.0)	)%
Income tax expense	127	68	59	86.8	%
Loss from continuing operations	\$(88,902)	\$(11,348)	\$(77,554)	(683.4)	)%
Loss on dispositions of assets	\$(1,290)	\$—	\$(1,290)	NM	

## Total Revenues

For the three months ended June 30, 2014, approximately 94.3% of our total revenues were attributable to long-term leases. Total revenue increased by \$79.4 million to \$151.8 million for the three months ended June 30, 2014 as compared to \$72.4 million for same period in 2013. The increase in revenue was due primarily to \$62.3 million of additional revenue provided by the properties acquired in the Merger. The remaining increase is attributable to an increase in base rental revenue resulting from \$678.5 million of non-merger real estate acquisitions subsequent to June 30, 2013 and contractual rent escalations on our owned real estate properties.

## Table of Contents

### Rentals

Rental revenue increased by \$73.1 million to \$143.1 million for the three months ended June 30, 2014 as compared to \$70.1 million for the same period in 2013. The increase was primarily attributable to \$57.6 million of rental income generated from properties acquired in the the Merger. Non-cash rentals for the three months ended June 30, 2014 and 2013 were \$5.0 million and \$0.6 million, respectively. These amounts represent approximately 3.5% and 0.8% of total rental revenue from continuing operations for each of the three months ended June 30, 2014 and 2013, respectively. Additionally, subsequent to June 30, 2013, we acquired 344 properties with a gross investment value of \$678.5 million, which contributed to the rental increase. Contractual rent escalations subsequent to June 30, 2013 also contributed to the increase.

As of June 30, 2014, 98.7% of our owned properties were occupied (based on number of properties). The majority of our nonperforming leases were in the restaurant industry. We regularly review and analyze the operational and financial condition of our tenants and the industries in which they operate in order to identify underperforming properties that we may seek to selectively dispose of in an effort to mitigate risks in the portfolio. As of June 30, 2014, 29 of our properties representing approximately 1.3% of our owned properties were vacant and not generating rent compared to 13 vacant properties, representing 1.5% of our owned properties, as of June 30, 2013.

### Interest income on loans receivable and other income

Interest income on loans receivable increased by \$0.7 million to \$1.8 million for the three months ended June 30, 2014 as compared to \$1.1 million for the same period in 2013. The increase was attributable to \$1.0 million of additional income from loans receivable acquired in the Merger, which was partially offset by the decrease in income related to the prepayment of three notes as well as scheduled maturities and amortization subsequent to June 30, 2013. In connection with the Merger, the Company acquired 13 properties accounted for as direct financing leases which generated earned income of \$0.8 million for the three months ended June 30, 2014. Prior to the Merger, the Company did not own any properties that were accounted for as direct financing leases.

As part of the Merger, the Company acquired a number of non-triple-net leases that require the tenants to reimburse the Company for certain property costs the Company incurs. The revenues recorded for the three months ended June 30, 2014 of \$2.9 million are offset by expenses recorded under property costs in the accompanying condensed consolidated statements of operations.

Interest income and other contributed \$3.1 million and \$1.2 million for the three months ended June 30, 2014 and 2013, respectively. The increase is primarily attributable to income of \$2.7 million from a legal settlement associated with the resolution of a dispute with a tenant. During the same period in 2013, \$0.9 million was attributable to a lease termination fee received from a tenant.

### Total Expenses

#### General and administrative

General and administrative expenses increased \$1.3 million to \$10.5 million for the three months ended June 30, 2014, as compared to \$9.2 million for the same period in 2013. During the three months ended June 30, 2014, the Company incurred higher compensation and related benefits of \$1.9 million due primarily to the hiring of additional personnel in connection with the Merger and \$1.1 million of higher non-cash stock-based compensation. During the three months ended June 30, 2014, we incurred higher operational costs including insurance, licenses and franchise taxes as a result of our growth and the integration of the net assets acquired in the Merger. The increase in costs during the period were offset by a decrease in the Company's allowance for doubtful accounts of approximately \$1.0 million.

#### Finance Restructuring Costs

In connection with the Exchange Offer, the Company incurred costs of approximately \$13.0 million during the three months ended June 30, 2014, which include legal, accounting and financial advisory services, and other third-party expenses. No such costs were incurred during the same period in 2013.



Table of Contents**Merger Costs**

In connection with the Merger, the Company incurred Merger costs of approximately \$5.0 million for the three months ended June 30, 2013, which include legal, accounting and financial advisory services, and other third-party expenses. Additional Merger related costs of \$6.4 million, arising from amortization of financing commitments obtained for the Merger, are reported in interest. No such costs were incurred during the same period in 2014.

**Property costs**

Our leases are generally triple-net and provide that the tenant is responsible for the payment of all property operating expenses, such as real estate taxes, insurance premiums and repair and maintenance costs. Therefore, historically, we were generally not responsible for operating costs related to the properties, unless a property is not subject to a triple-net lease or is vacant. The Merger resulted in the acquisition of a limited number of single and double-net leases that require the Company to initially incur certain expenses which are billed and subsequently received from the tenants, subject to certain caps and other limitations as provided in the leases. Property costs increased \$6.2 million to \$6.6 million for the three months ended June 30, 2014, as compared to \$0.3 million for the same period in 2013. Of this increase, most is attributable to reimbursable costs, before any allowance, associated with acquired non-triple-net leases. The remaining increase is primarily attributable to higher insurance premiums, legal fees, and repair and maintenance costs associated with managing the expanded portfolio.

**Interest**

Interest expense increased by \$16.4 million to \$56.0 million for the three months ended June 30, 2014, as compared to \$39.6 million for the same period in 2013. The increase in interest expense was primarily due to the increase in total indebtedness of approximately \$2.0 billion at June 30, 2014 compared to the same period in 2013. The majority of our increased indebtedness was the assumption of debt in connection with our Merger.

The following table summarizes our interest expense and related borrowings from continuing operations:

	Three Months Ended June 30,	
	2014	2013
	(In Thousands)	
Interest expense – revolving credit facilities	\$1,100	\$271
Interest expense – mortgages and notes payable	53,649	29,615
Interest expense – other	33	469
Amortization of deferred financing costs	1,324	6,229
Amortization of debt (premium) discount	(114)	2,968
Total interest expense	\$55,992	\$39,552
Weighted average mortgages and notes outstanding excluding debt premium or discount <sup>(1)</sup>	\$3,894,568	\$1,951,990
Weighted average revolving credit facilities	111,338	21,698
Weighted average debt outstanding	\$4,005,906	\$1,973,688
Adjusted mortgages and notes interest <sup>(2)</sup> / weighted average mortgages and notes payable	5.51	% 6.07
Revolving credit facilities interest <sup>(3)</sup> / weighted average revolving credit facilities balance	3.95	% 5.00

<sup>(1)</sup> Excludes debt associated with discontinued operations.

<sup>(2)</sup> Excludes interest expense associated with amortization of deferred financing costs and debt discounts/(premiums).

<sup>(3)</sup> Excludes interest expense associated with amortization of deferred financing costs and debt discounts/(premiums), and includes approximately \$0.3 million and \$0.1 million of non-utilization fees for the three months ended June 30, 2014 and 2013, respectively.

**Depreciation and amortization**

Depreciation and amortization expense relates primarily to depreciation on the commercial buildings and improvements we own and to amortization of the related lease intangibles. Depreciation and amortization expense

increased by \$32.3 million to \$62.0 million for the three months ended June 30, 2014 as compared to \$29.7 million for the same period in 2013. Of the total increase, a significant portion relates to depreciation and amortization on assets acquired

Table of Contents

in the Merger, with the remainder related to non-merger acquisitions. The following table summarizes our depreciation and amortization expense from continuing operations:

	Three Months Ended June 30,	
	2014	2013
	(In Thousands)	
Depreciation of real estate assets	\$48,378	\$25,249
Other depreciation	94	30
Amortization of lease intangibles	13,496	4,421
Total depreciation and amortization	\$61,968	\$29,700

**Impairment**

During the three months ended June 30, 2014, we recorded impairment losses of \$27.6 million. These charges included \$7.2 million on the impairment of three properties that were held for sale, including one non-core multi-tenant property, \$2.5 million of lease intangible write-offs following lease terminations and \$17.9 million of impairment on eight properties which were underperforming. Of the eight underperforming properties, seven were in the manufacturing industry relating to one original tenant, and one was in the quick service restaurant industry. As of January 1, 2014, as a result of our adoption of ASU 2014-8 (see Note 2), impairment losses incurred on properties classified as held for sale will be prospectively reported in continuing operations. In reporting periods prior to January 1, 2014, impairment losses incurred on properties that were held for sale continue to be reflected in discontinued operations during those periods.

**Other expense**

During the three months ended June 30, 2014, we recorded a loss on debt extinguishment of \$64.7 million recorded in other expense. The loss on debt extinguishment related to the retirement of certain senior mortgage notes payable with an aggregate principal balance of \$509.8 million and the redemption of \$18.0 million of net-lease mortgage notes which were not tendered in connection with the Exchange Offer. The debt extinguished had a weighted average interest rate of 6.54% and remaining term of 25 months. We used proceeds from our recent convertible senior notes offering, with a weighted average stated interest rate of 3.30%, to fund the extinguishment. No such items were recognized during the same period in 2013.

**Income tax expense**

Income tax expense remained relatively consistent at \$0.1 million for the three months ended June 30, 2014 and 2013.

**Discontinued operations**

Gains and losses from property dispositions during a period or expected losses from properties classified as held for sale at the end of the period, as well as all operations from those properties, are reclassified to and reported as part of “discontinued operations” so long as they meet certain criteria set forth in ASU 2014-08 (see Note 2). Properties that were reported as held for sale as of December 31, 2013, will continue to be reported under the prior standards and will be presented in discontinued operations until they are disposed of.

We recognized income from discontinued operations of \$0.4 million for three months ended June 30, 2014 as compared to a loss of \$0.3 million for the same period in 2013. Non-cash impairment charges included in income (loss) from discontinued operations for the three months ended June 30, 2013 were \$1.8 million. No such charges were incurred during the same period in 2014.

Loss on dispositions of assets

During the three months ended June 30, 2014, we recorded losses totaling \$1.3 million from continuing operations on the disposition of certain real estate assets. These losses relate to disposed properties that did not qualify for discontinued operations under the guidance set forth in ASU 2014-08. Previous to the adoption of ASU 2014-08, which was applied on a prospective basis beginning January 1, 2014, these losses would have been recorded as a part of discontinued operations.

# Table of Contents

## Results of Operations

### Comparison of the Six Months Ended June 30, 2014 to Six Months Ended June 30, 2013

The following discussion includes the results of our continuing operations as summarized in the table below:

	Six Months Ended June 30,		Change	%	
	2014	2013			
	(In Thousands)				
Revenues:					
Rentals	\$280,621	\$139,826	\$140,795	100.7	%
Interest income on loans receivable	3,658	2,241	1,417	63.2	%
Earned income from direct financing leases	1,684	—	1,684	NM	
Tenant reimbursement income	6,240	—	6,240	NM	
Interest income and other	3,558	1,315	2,243	170.6	%
Total revenues	295,761	143,382	152,379	106.3	%
Expenses:					
General and administrative	21,501	16,119	5,382	33.4	%
Finance restructuring costs	13,033	—	13,033	NM	
Merger costs	—	11,557	(11,557)	(100.0)	)%
Property costs	11,858	1,267	10,591	835.9	%
Real estate acquisition costs	1,507	218	1,289	591.3	%
Interest	110,391	75,991	34,400	45.3	%
Depreciation and amortization	122,517	56,639	65,878	116.3	%
Impairments (recoveries)	29,334	(185)	29,519	NM	
Total expenses	310,141	161,606	148,535	91.9	%
Loss from continuing operations before other income (expense) and income tax expense	(14,380)	(18,224)	3,844	(21.1)	)%
Other expense					
Loss on debt extinguishment	(64,708)	—	(64,708)	NM	
Total other expense	(64,708)	—	(64,708)	NM	
Loss from continuing operations before income tax expense	(79,088)	(18,224)	(60,864)	334.0	%
Income tax expense	344	142	202	142.3	%
Loss from continuing operations	\$(79,432)	\$(18,366)	\$(61,066)	332.5	%
Gains on dispositions of assets	\$432	\$—	\$432	NM	

## Revenues

For the six months ended June 30, 2014, approximately 94.9% of our total revenues were attributable to long-term leases. Total revenue increased by \$152.4 million to \$295.8 million for the six months ended June 30, 2014 as compared to \$143.4 million for same period in 2013. The increase in revenue was due primarily to \$125.7 million of additional revenue provided by the properties acquired in the Merger. The remaining increase is attributable to an increase in base rental revenue resulting from \$678.5 million of non-merger real estate acquisitions subsequent to June 30, 2013 and contractual rent escalations on our owned real estate properties.



## Table of Contents

### Rentals

Rental revenue increased by \$140.8 million to \$280.6 million for the six months ended June 30, 2014 as compared to \$139.8 million for the same period in 2013. The increase was primarily attributable to \$115.8 million of rental income generated from properties acquired in the the Merger. Non-cash rentals for the six months ended June 30, 2014 and 2013 were \$9.6 million and \$1.2 million, respectively, representing approximately 3.4% and 0.9% of total rental revenue from continuing operations for each of the six months ended June 30, 2014 and 2013, respectively. Additionally, subsequent to June 30, 2013, we acquired 344 properties with a gross investment value of \$678.5 million, which contributed to the rental increase. Furthermore, contractual rent escalations subsequent to June 30, 2013 also contributed to the increase.

As of June 30, 2014, 98.7% of our owned properties were occupied (based on number of properties). The majority of our nonperforming leases were in the restaurant industry. We regularly review and analyze the operational and financial condition of our tenants and the industries in which they operate in order to identify underperforming properties that we may seek to selectively dispose of in an effort to mitigate risks in the portfolio. As of June 30, 2014, 29 properties representing approximately 1.3% of our owned properties were vacant and not generating rent compared to 13 vacant properties, representing 1.5% of our owned properties, as of June 30, 2013.

### Interest income on loans receivable and other income

Interest income on loans receivable increased by \$1.4 million to \$3.7 million for the six months ended June 30, 2014 as compared to \$2.2 million for the same period in 2013. The increase was attributable to \$2.0 million of additional income from loans receivable acquired in the Merger, which was partially offset by the decrease in income related to the prepayment of three notes as well as scheduled maturities and amortization subsequent to June 30, 2013.

In connection with the Merger, the Company acquired 13 properties accounted for as direct financing leases which generated earned income of \$1.7 million for the six months ended June 30, 2014. Prior to the Merger, the Company did not own any properties that were accounted for as direct financing leases.

As part of the Merger, the Company acquired a number of non-triple-net leases that require the tenants to reimburse the Company for certain property costs the Company incurs. The revenues recorded for the six months ended June 30, 2014 of \$6.2 million are offset by expenses recorded under property costs in the accompanying condensed consolidated statements of operations.

Interest income and other contributed \$3.6 million and \$1.3 million for the six months ended June 30, 2014 and 2013, respectively. The increase is primarily attributable to income of \$2.7 million from a legal settlement associated with the resolution of a dispute with a tenant. During the same period in 2013, \$0.9 million was attributable to a lease termination fee received from a tenant.

### Expenses

#### General and administrative

General and administrative expenses increased \$5.4 million to \$21.5 million for the six months ended June 30, 2014, as compared to \$16.1 million for the same period in 2013. During the six months ended June 30, 2014, the Company incurred higher compensation and related benefits of \$3.6 million due primarily to the hiring of additional personnel in connection with the Merger along with \$1.8 million of higher non-cash stock-based compensation. Professional fees, technology costs, outside consulting services, and franchise taxes increased \$2.7 million during 2014 primarily due to higher costs incurred for compliance and consulting fees resulting from the integration of the net assets acquired in the Merger. These increases were partially offset by a decrease in the Company's allowance for doubtful accounts of approximately \$1.0 million.

### Finance Restructuring Costs

In connection with the Exchange Offer, the Company incurred costs of approximately \$13.0 million during the six months ended June 30, 2014, which include legal, accounting and financial advisory services, and other third-party expenses. No such costs were incurred during the same period in 2013.



## Table of Contents

### Merger Costs

In connection with the Merger, the Company incurred merger costs of approximately \$11.6 million for the six months ended June 30, 2013, which include legal, accounting and financial advisory services, and other third-party expenses. Additional Merger related costs of \$10.1 million, arising from amortization of financing commitments obtained for the Merger, are reported in interest. No such costs were incurred during the same period in 2014.

### Property costs

Our leases are generally triple-net and provide that the tenant is responsible for the payment of all property operating expenses, such as real estate taxes, insurance premiums and repair and maintenance costs. Therefore, historically, we were generally not responsible for operating costs related to the properties, unless a property is not subject to a triple-net lease or is vacant. The Merger resulted in the acquisition of a limited number of single and double-net leases that require the Company to initially incur certain expenses which are billed and subsequently received from the tenants, subject to certain caps and other limitations as provided in the leases. Property costs increased \$10.6 million to \$11.9 million for the six months ended June 30, 2014, as compared to \$1.3 million for the same period in 2013. Of this increase, most is attributable to reimbursable costs, before any allowance, associated with acquired non-triple-net leases. The remaining increase is primarily attributable to higher insurance premiums, legal fees, and repair and maintenance costs associated with managing the expanded portfolio.

### Interest

Interest expense increased by \$34.4 million to \$110.4 million for the six months ended June 30, 2014, as compared to \$76.0 million for the same period in 2013. The increase in interest expense was primarily due to the increase in total indebtedness of approximately \$2.0 billion at June 30, 2014 compared to the same period in 2013. The majority of our increased indebtedness was the assumption of debt in connection with our Merger.

The following table summarizes our interest expense and related borrowings from continuing operations:

	Six Months Ended June 30,	
	2014	2013
	(In Thousands)	
Interest expense – revolving credit facilities	\$1,820	\$376
Interest expense – mortgages and notes payable	107,245	59,086
Interest expense – other	72	470
Amortization of deferred financing costs	2,297	10,130
Amortization of debt (premium) discount	(1,043)	5,929
Total interest expense	\$110,391	\$75,991
Weighted average mortgages and notes outstanding excluding debt premium or discount <sup>(1)</sup>	\$3,817,962	\$1,956,834
Weighted average revolving credit facilities	85,743	10,909
Weighted average debt outstanding	\$3,903,705	\$1,967,743
Adjusted mortgages and notes interest <sup>(2)</sup> / weighted average mortgages and notes payable	5.62	% 6.04
Revolving credit facilities interest <sup>(3)</sup> / weighted average revolving credit facilities balance	4.25	% 6.89

<sup>(1)</sup> Excludes debt associated with discontinued operations.

<sup>(2)</sup> Excludes interest expense associated with amortization of deferred financing costs and debt discounts/(premiums).

<sup>(3)</sup> Excludes interest expense associated with amortization of deferred financing costs and debt discounts/(premiums), and includes approximately \$0.6 million and \$0.1 million of non-utilization fees for the six months ended June 30, 2014 and 2013.

### Depreciation and amortization

Depreciation and amortization expense relates primarily to depreciation on the commercial buildings and improvements we own and to amortization of the related lease intangibles. Depreciation and amortization expense increased by \$65.9 million to \$122.5 million for the six months ended June 30, 2014 as compared to \$56.6 million for the same

Table of Contents

period in 2013. Of the total increase, a significant portion relates to depreciation and amortization on assets acquired in the Merger, with the remainder related to non-merger acquisitions. The following table summarizes our depreciation and amortization expense from continuing operations:

	Six Months Ended June 30,	
	2014	2013
	(In Thousands)	
Depreciation of real estate assets	\$95,394	\$47,741
Other depreciation	188	57
Amortization of lease intangibles	26,935	8,841
Total depreciation and amortization	\$122,517	\$56,639

**Impairment**

During the six months ended June 30, 2014, we recorded Impairment losses of \$29.3 million. These charges included \$8.0 million on the impairment of four properties that were held for sale, including one non-core multi-tenant property, \$2.6 million of lease intangible write-offs following lease terminations and \$18.7 million of impairment on 10 properties which were underperforming. Of the 10 underperforming properties, seven were in the manufacturing industry relating to one original tenant and three were in the quick service restaurant industry. As of January 1, 2014, as a result of our adoption of ASU 2014-8 (see Note 2), impairment losses incurred on properties classified as held for sale will be prospectively reported in continuing operations. In reporting periods prior to January 1, 2014, impairment losses incurred on properties that were held for sale continue to be reflected in discontinued operations during those periods.

**Other income (expense)**

During the second quarter 2014, we recorded a loss on debt extinguishment of \$64.7 million which is recorded in other expense. The loss on debt extinguishment related to the retirement of certain senior mortgage notes payable with an aggregate principal balance of \$509.8 million and the redemption of \$18.0 million of net-lease mortgage notes which were not tendered in connection with the Exchange Offer. The debt that was extinguished had a weighted average interest rate of 6.54% and remaining term of 25 months. We used proceeds from our recent convertible senior notes offering, with a weighted average stated interest rate of 3.30%, to fund the extinguishment. No such items were recognized during the same period in 2013.

**Income tax expense**

Income tax expense increased \$0.2 million to \$0.3 million for the six months ended June 30, 2014, as compared to \$0.1 million for the same period in 2013. The increase was primarily due to an increase in state and local taxes as a result of the increased portfolio size.

**Discontinued operations**

Gains and losses from property dispositions during a period or expected losses from properties classified as held for sale at the end of the period, as well as all operations from those properties, are reclassified to and reported as part of “discontinued operations” so long as they meet certain criteria set forth in ASU 2014-08 (see Note 2). Properties that were reported as held for sale as of December 31, 2013, will continue to be reported under the prior standards and will be presented in discontinued operations until they are disposed of.

We recognized income from discontinued operations of \$3.4 million for six months ended June 30, 2014 as compared to a loss of \$1.6 million for the same period in 2013. For the six months ended June 30, 2014, \$2.9 million of income was attributable to the receipt of a lease termination fee related to a property that was sold. For the same period in

2013, \$2.8 million of loss was attributable to the properties held for sale. Non-cash impairment charges included in income (loss) from discontinued operations for the six months ended June 30, 2013 were \$3.9 million. No such charges were incurred during the sam