Spirit Realty Capital, Inc.
Form 10-Q
May 09, 2014

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

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-36004

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

Maryland (State or other jurisdiction of incorporation or organization)	20-1676382 (I.R.S. Employer Identification Number)
16767 North Perimeter Drive, Suite 210, Scottsdale, Arizona 85260 (Address of principal executive offices; zip code)	(480) 606-0820 (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 x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
As of May 6, 2014, there were 372,306,689 shares of common stock, par value $0.01, of Spirit Realty Capital, Inc. outstanding.

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SPIRIT REALTY CAPITAL, INC.
Condensed Consolidated Balance Sheets
(In Thousands, Except Share and Per Share Data)

	March 31, 2014 (Unaudited)	December 31, 2013
Assets		
Investments:		
Real estate investments:		
Land and improvements	$2,378,716	$2,330,510
Buildings and improvements	4,280,895	4,188,783
Total real estate investments	6,659,611	6,519,293
Less: accumulated depreciation	(636,748)	(590,067)
	6,022,863	5,929,226
Loans receivable, net	115,846	117,721
Intangible lease assets, net	613,162	618,121
Real estate assets under direct financing leases, net	56,803	58,760
Real estate assets held for sale, net	25,087	19,611
Net investments	6,833,761	6,743,439
Cash and cash equivalents	29,984	66,588
Deferred costs and other assets, net	120,229	129,597
Goodwill	291,421	291,421
Total assets	$7,275,395	$7,231,045
Liabilities and stockholders’ equity		
Liabilities:		
Revolving credit facilities, net	$135,606	$35,120
Mortgages and notes payable, net	3,738,053	3,743,098
Intangible lease liabilities, net	219,877	220,114
Accounts payable, accrued expenses and other liabilities	108,902	114,679
Total liabilities	4,202,438	4,113,011
Commitments and contingencies (see Note 8)		
Stockholders’ equity:		
Common stock, $0.01 par value; 370,949,721 shares issued; 370,732,369 outstanding shares at March 31, 2014 and 370,570,565 shares issued; 370,363,803 outstanding shares at December 31, 2013	3,710	3,706
Capital in excess of par value	3,862,454	3,859,823
Accumulated deficit	(790,444)	(742,915)
Accumulated other comprehensive loss	(717)	(638)
Treasury stock, at cost	(2,046)	(1,942)
Total stockholders’ equity	3,072,957	3,118,034
Total liabilities and stockholders’ equity	$7,275,395	$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 March 31,	
	2014	2013
Revenues:		
Rentals	$137,479	$69,776
Interest income on loans receivable	1,837	1,113
Earned income from direct financing leases	846	—
Tenant reimbursement income	3,319	—
Interest income and other	491	79
Total revenues	143,972	70,968
Expenses:		
General and administrative	11,067	6,968
Merger costs	—	6,537
Property costs	5,282	940
Real estate acquisition costs	1,281	89
Interest	54,399	36,439
Depreciation and amortization	60,549	26,939
Impairments	1,707	—
Total expenses	134,285	77,912
Income (loss) from continuing operations before income tax expense	9,687	(6,944)
Income tax expense	217	74
Income (loss) from continuing operations	9,470	(7,018)
Discontinued operations:		
Income (loss) from discontinued operations	3,054	(1,494)
(Loss) gain on dispositions of assets	(7)	180
Income (loss) from discontinued operations	3,047	(1,314)
Income (loss) before gain on dispositions of assets	12,517	(8,332)
Gain on dispositions of assets	1,722	—
Net income (loss)	$14,239	$(8,332)
Net income (loss) per share of common stock—basic and diluted:		
Continuing operations	$0.03	$(0.04)
Discontinued operations	0.01	(0.01)
Net income (loss) per share	$0.04	$(0.05)
Weighted average common shares outstanding:		
Basic	368,684,942	159,421,377
Diluted	369,387,638	159,421,377
Dividends declared per common share issued	$0.16625	$0.16406

See accompanying notes.

SPIRIT REALTY CAPITAL, INC.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(In Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Net income (loss)	$14,239	$(8,332)
Other comprehensive (loss) income:		
Change in net unrealized losses on cash flow hedges	(402)	(31)
Net cash flow hedge losses reclassified to operations	323	114
Total comprehensive income (loss)	$14,160	$(8,249)

See accompanying notes.

SPIRIT REALTY CAPITAL, INC.
Condensed Consolidated Statement of Stockholders' Equity
(In Thousands, Except Share Data)
(Unaudited)

	Common Stock					Treasury Stock		
	Shares	Par Value	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Shares	Value	Total Stockholders' Equity
Balances, December 31, 2013	370,570,565	$ 3,706	$ 3,859,823	$ (742,915)	$ (638)	(206,762)	$ (1,942)	$ 3,118,034
Net income	—	—	—	14,239	—	—	—	14,239
Other comprehensive loss	—	—	—	—	(79)	—	—	(79)
Dividends declared on common stock	—	—	—	(61,628)	—	—	—	(61,628)
Repurchase of common shares	—	—	—	—	—	(10,590)	(104)	(104)
Exercise of stock options	20,000	—	183	—	—	—	—	183
Stock-based compensation, net	359,156	4	2,448	(140)	—	—	—	2,312
Balances, March 31, 2014	370,949,721	$ 3,710	$ 3,862,454	$ (790,444)	$ (717)	(217,352)	$ (2,046)	$ 3,072,957

See accompanying notes.

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SPIRIT REALTY CAPITAL, INC.
Condensed Consolidated Statements of Cash Flows
(In Thousands)
(Unaudited)

	Three Months Ended March 31, 2014	2013
Operating activities		
Net income (loss)	$14,239	$(8,332)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	60,549	28,316
Impairments	1,707	2,103
Amortization of deferred financing costs	973	3,901
Amortization of interest rate hedge losses and derivative net settlements	(26)	22
Amortization of debt (premiums) discounts	(929)	2,961
Stock-based compensation expense	2,452	1,772
Gains on dispositions of real estate and other assets, net	(1,715)	(202)
Non-cash revenue	(3,962)	(521)
Other	121	(14)
Changes in operating assets and liabilities:		
Deferred costs and other assets	(1,510)	(3,103)
Accounts payable, accrued expenses and other liabilities	(6,055)	1,329
Net cash provided by operating activities	65,844	28,232
Investing activities		
Acquisitions/improvements of real estate	(137,188)	(56,854)
Collections of principal on loans receivable and real estate assets under direct financing leases	1,319	763
Proceeds from dispositions of real estate and other assets	6,243	2,829
Transfers of sale proceeds and loan principal collections (to) from restricted account	(6,345)	14,081
Net cash used in investing activities	(135,971)	(39,181)
Financing activities		
Borrowings under lines of credit	180,535	11,400
Repayments under lines of credit	(80,049)	—
Borrowings under mortgages and notes payable	10,000	24,800
Repayments under mortgages and notes payable	(14,116)	(10,839)
Deferred financing costs	(503)	(4,113)
Proceeds from exercise of stock options	183	—
Stock issuance costs	—	(293)
Purchase of treasury stock	(104)	—
Consent fees paid to lenders	—	(222)
Dividends paid/distributions to equity owners	(61,573)	(28,247)
Transfers (to) from escrow deposits with lenders	(850)	250
Net cash provided by (used in) financing activities	33,523	(7,264)
Net decrease in cash and cash equivalents	(36,604)	(18,213)
Cash and cash equivalents, beginning of period	66,588	73,568
Cash and cash equivalents, end of period	$29,984	$55,355

See accompanying notes.

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements
March 31, 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 is the sole limited partner and owns the remaining 99.0% of the Operating Partnership.

As of March 31, 2014, our undepreciated gross investment in real estate and loans totaled approximately $7.38 billion, representing investments in 2,287 properties, including properties securing our mortgage loans. Of this amount, 98.4% consisted of our gross investment in real estate, representing ownership of 2,142 properties, and the remaining 1.6% consisted of commercial mortgage loans receivable secured by the remaining 145 properties or other related assets.

Acquisitions and dispositions

During the three months ended March 31, 2014, the Company purchased 104 properties, representing an aggregate gross investment in real estate properties of $157.1 million. During the same period, the Company sold or disposed of three properties for $6.3 million in gross sales proceeds. See Note 3 for additional discussion of the Company's investments.

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 Securities and Exchange Commission (“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

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements - (continued)
March 31, 2014
(Unaudited)

available to pay, or otherwise satisfy obligations to, the creditors of any owner or affiliate of the special purpose entity. At both March 31, 2014 and December 31, 2013, assets totaling $6.1 billion were held, and liabilities totaling $3.8 billion 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 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.

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements - (continued)
March 31, 2014
(Unaudited)

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 $5.1 million and $4.6 million at March 31, 2014 and December 31, 2013, respectively, against accounts receivable balances of $15.9 million and $14.3 million, respectively; receivables are recorded within deferred cost and other assets, net in the accompanying condensed consolidated balance sheets. For accrued 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 March 31, 2014 and December 31, 2013, respectively, against accrued rental revenue receivables of $39.8 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 March 31, 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 March 31, 2014 and December 31, 2013, there were no mortgages or notes on nonaccrual status.
Restricted Cash and Escrow Deposits

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

	March 31, 2014	December 31, 2013
Collateral deposits [1]	$21,865	$21,816
Tenant improvements, repairs, and leasing commissions [2]	11,455	10,297
Master trust release / title company escrow [3]	7,456	21,893
Loan impounds [4]	2,410	2,018
Other [5]	1,917	2,667
	$45,103	$58,691

[1] 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.
[2] 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.

(3) Reflects net sales proceeds from property dispositions held as collateral that can be released upon qualified re-investment.
(4) Funds held in lender controlled accounts generally used to meet future debt service or certain property cost requirements.
(5) Funds held in lender controlled accounts released within the following month after debt service requirements are met.

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements - (continued)
March 31, 2014
(Unaudited)

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, 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.

Note 3. Investments

Real Estate Investments

At March 31, 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 $7.38 billion and $7.24 billion, respectively. These investments are comprised of 2,287 and 2,186, respectively, owned or financed properties that are geographically dispersed throughout 48 states. Only one state, Texas, with a 13.1% investment, accounted for more than 10% of the total dollar amount of the Company’s investment portfolio. At March 31, 2014 and December 31, 2013, respectively, the Company’s gross investment portfolio was comprised of 2,142 and 2,041 owned properties. The Company also held 145 properties securing mortgage loans receivable with aggregate carrying amounts of $115.4 million and $117.3 million as of March 31, 2014 and December 31, 2013, respectively. Other loans receivable with aggregate carrying amounts of $0.4 million were also held as of March 31, 2014 and December 31, 2013.

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements - (continued)
March 31, 2014
(Unaudited)

During the three months ended March 31, 2014, the Company had the following gross real estate and loan activity:

	Number of Properties Owned or Financed	Dollar Amount of Investments (a)
		(In Thousands)
Balance, December 31, 2013	2,186	$7,235,732
Acquisitions/improvements	104	157,972
Dispositions of real estate (b) (Note 11)	(3)	(6,219)
Principal payments and payoffs	—	(1,243)
Impairments	—	(1,707)
Loan premium amortization and other	—	(1,060)
Balance, March 31, 2014	2,287	$7,383,475

(a) The dollar amount of investments includes the gross investment in land, buildings and lease intangibles, as adjusted for any impairment, related to properties owned and the carrying amount of loans receivable and real estate assets held under direct financing leases.

(b) The total accumulated depreciation and amortization associated with dispositions of real estate was $1.7 million for the three months ended March 31, 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 March 31, 2014, 24 of the Company’s properties were vacant, not subject to a lease and in the Company’s possession; five of these properties were held for sale. At December 31, 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 March 31, 2014 (in thousands):

Scheduled Future Rental Payments	March 31, 2014
Remainder of 2014	$407,977
2015	535,137
2016	520,326
2017	505,289
2018	489,417
Thereafter	3,377,651
Total future minimum rentals	$5,835,797

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.

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements - (continued)
March 31, 2014
(Unaudited)

Loans Receivable

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

	March 31, 2014	December 31, 2013
Mortgage - principal	$101,083	$102,315
Mortgage - premium	14,345	14,976
Mortgages, net	115,428	117,291
Other notes - principal	418	430
Total Loans receivable, net	$115,846	$117,721

Real Estate Assets Under Direct Financing Leases

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

	March 31, 2014	December 31, 2013
Minimum lease payments receivable	$18,633	$19,555
Estimated residual value of leased assets	55,858	57,739
Unearned income	(17,688)	(18,534)
Total	$56,803	$58,760

Real Estate Assets Held for Sale

The following table shows the activity in real estate assets held for sale for the three months ended March 31, 2014:

	Number of Properties	Carrying Value (In Thousands)
Balance, December 31, 2013	11	$19,611
Transfers from real estate investments	1	8,611
Sales (Note 11)	(2)	(3,135)
Balance, March 31, 2014 [a]	10	$25,087

[a] Includes a single property with a net carrying amount of $8.6 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 sheet as of March 31, 2014 and December 31, 2013 (in thousands):

SPIRIT REALTY CAPITAL, INC.
Notes to Condensed Consolidated Financial Statements - (continued)
March 31, 2014
(Unaudited)

	March 31, 2014	December 31, 2013
Assets		
Land and improvements	$8,878	$10,003
Buildings and improvements	11,135	14,178
Total real estate investments	20,013	24,181
Less: Accumulated depreciation	(3,656)	(4,819)
Intangible lease assets, net	567	697
Total assets	$16,924	$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 months ended March 31, 2014 and 2013 (in thousands):

	Three Months Ended March 31,	
	2014	2013
Real estate and intangible asset impairment	$1,637	$2,103
Write-off of lease intangibles due to lease terminations	70	—
Total impairment loss continuing and discontinued operations	$1,707	$2,103

Note 4. Lease Intangibles, net

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

	March 31, 2014	December 31, 2013
In-place leases	$670,789	$663,027
Above-market leases	97,571	95,118
Less: accumulated amortization	(155,198)	(140,024)
Intangible lease assets, net	$613,162	$618,121
Below-market leases	$246,452	$243,237
Less: accumulated amortization	(26,575)	(23,123)
Intangible lease liabilities, net	$219,877	$220,114

The amounts amortized as a net increase to rental revenue for capitalized above- and below-market leases was $1.3 million and $0.3 million for the three months ended March 31, 2014 and 2013, respectively. Above- and below-market lease amortization from properties acquired in connection with the Merger contributed $0.9 million of the increase during 2014. The value of in-place leases amortized and included in depreciation and amortization expense was $13.4

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million and $4.4 million for the three months ended March 31, 2014 and 2013, respectively. Lease-in-place amortization from properties acquired in connection with the Merger contributed $8.0 million of the increase in 2014.

Note 5. Debt
The Company's debt is summarized below:

	2014 Weighted Average Effective Interest Rates (a)		March 31, 2014	December 31, 2013
			(In Thousands)	
Revolving credit facilities [b]	7.89	%	$135,606	$35,120
Master trust notes	6.27	%	1,233,724	1,241,437
CMBS - fixed-rate	5.60	%	2,391,246	2,387,532
CMBS - variable-rate [c]	3.30	%	110,935	111,018
Unsecured fixed rate promissory note	9.74	%	1,408	1,442
			3,872,919	3,776,549
Unamortized net debt premium			740	1,669
Total debt, net			$3,873,659	$3,778,218

(a) The effective interest rates include amortization of debt discount, amortization of deferred financing costs, and related debt insurer premiums, where applicable, calculated as of March 31, 2014.
(b) The effective interest rate on the revolving credit facilities, excluding the impact of non-cash amortization of deferred financing costs and non-utilization fee, was 2.97% as of March 31, 2014.
(c) Variable-rate notes are predominately hedged with interest rate swaps (see Note 6).

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 for the three months ended March 31, 2014.
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 March 31, 2014, $3.5 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 8.09% for the three months ended March 31, 2014. The interest rate, excluding the impact of non-cash amortization of deferred financing costs and non-utilization fee, was 2.68% as of March 31, 2014. As of March 31, 2014, $120.0 million was outstanding on the Credit Facility under three separate advances, secured by 231 properties.

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.

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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 March 31, 2014, the Operating Partnership was in compliance with these financial covenants.

Line of Credit - As of March 31, 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 March 31, 2014, $15.6 million was outstanding on the Line of Credit under three separate advances, secured by 3 properties, at a weighted average effective interest rate of 4.26%. 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 March 31, 2014, the Company and special purpose entity were in compliance with these financial covenants.

Master Trust Notes

Spirit Master Funding, LLC, Spirit Master Funding II, LLC, and Spirit Master Funding III, LLC, all of which are indirect wholly-owned subsidiaries, have issued three series of net-lease mortgage notes payable (collectively referred to as the "Notes") that are secured by substantially all of the assets owned by these entities.

The Series 2005-1 notes are comprised of two separate tranches; tranche A-1 is an amortizing note with a stated rate of 5.05% and tranche A-2 consists of an interest-only note with a stated rate of 5.37%; both are due in 2020, with outstanding balances as of March 31, 2014 of $96.4 million and $258.3 million, respectively. The Series 2006-1 notes are amortizing with a stated rate of 5.76%, due in 2021, with an outstanding balance of $236.0 million as of March 31, 2014. The Series 2007-1 notes are amortizing with a stated rate of 5.74%, due in 2022, with an outstanding balance of $314.0 million as of March 31, 2014. The Notes also require debt insurer premiums of 0.30% to 0.32% of the outstanding principal amount, which are reflected in interest expense. As of March 31, 2014, these notes are secured by 722 properties in total, including 76 properties securing mortgage loans. The obligations under the four series net-lease mortgage notes are cross collateralized.

In December 2013, Spirit Master Funding VII ("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 March 31, 2014, the Series 2013-1 and Series 2013-2 notes have outstanding balances of $125.0 million and $204.0 million, respectively, and are secured by 318 properties, including 79 properties securing mortgage loans.

CMBS

The Company has 232 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 March 31, 2014 for the fixed rate notes ranged from 3.90% to 8.39% with a weighted average stated rate of 5.87%. The variable rate notes ranged from 2.67% to 3.67% with a weighted average stated rate of 3.28%. As of March 31, 2014, the fixed and variable rate loans have balances outstanding of $2.4 billion and $110.9 million, respectively, and are secured by 854 and 123 properties, respectively.

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Debt Maturities

As of March 31, 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	$42,720	$29,761	$72,481
2015	58,123	245,794	303,917
2016	51,888	889,330	941,218
2017	45,745	925,164	970,909
2018	45,445	248,851	294,296
Thereafter	134,285	1,155,813	1,290,098
	$378,206	$3,494,713	$3,872,919

Balloon payments subsequent to 2018 are as follows: $49.5 million due in 2019, $294.5 million due in 2020, $167.5 million due in 2021, $292.2 million due in 2022, $352.1 million due in 2023. As of March 31, 2014, the remaining weighted average maturity of the Company's outstanding indebtedness was 4.7 years.

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

	Three Months Ended March 31,	
	2014	2013
Interest expense – revolving credit facilities	$720	$105
Interest expense – mortgages and notes payable	53,596	29,472
Interest expense – other	39	—
Amortization of deferred financing costs [(a)]	973	3,901
Amortization of debt (premium)/discount	(929)	2,961
Total interest expense	$54,399	$36,439

(a) Includes $3.6 million arising from financing commitments related to the Merger for the three months ended March 31, 2013.

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 $23.4 million and $23.8 million at March 31, 2014 and December 31, 2013, respectively, and are included in deferred costs and other assets, net on the accompanying condensed consolidated balance sheets.

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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	March 31, 2014	December 31, 2013
Interest Rate Swap	Accounts payable, accrued expenses and other liabilities	$10,968	4.62 %	06/28/12	07/06/17	$(43)	$(42)
Interest Rate Swap	Accounts payable, accrued expenses and other liabilities	$6,783	5.75 %	07/17/13	03/01/16	(292)	(326)
Interest Rate Swap	Accounts payable, accrued expenses and other liabilities	$32,400	3.15 %	07/17/13	09/05/15	(175)	(178)
Interest Rate Swaps[a]	Accounts payable, accrued expenses and other liabilities	$61,758	5.14 %	01/02/14	12/13/18	(335)	(246)
						$(845)	$(792)

[a]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 months ended ended March 31, 2014 and 2013, respectively (in thousands):

	Amount of Loss Recognized in AOCL on Derivative (Effective Portion) Three Months Ended March 31,	
Derivatives in Cash Flow Hedging Relationships	2014	2013
Interest rate swaps	$ (402)	$ (31)

Amount of Loss Reclassified from AOCL into Operations

Location of Loss Reclassified from AOCL into Operations	(Effective Portion) Three Months Ended March 31, 2014	2013
Interest expense	$ (323)	$ (92)
General and administrative expense	—	(22)

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 March 31, 2014 and December 31, 2013, there were no termination events or events of default related to the interest rate swaps.

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Note 7. Stockholders' Equity

During the three months ended March 31, 2014, the Company declared cash dividends equivalent to $0.16625 per share on its common stock, payable on April 15, 2014, to stockholders of record as of March 31, 2014. On January 1, 2014, portions of awards of restricted common stock granted to certain of the Company's officers and other employees vested. As permitted by the terms of the Plan and the award grants, certain executive officers elected to surrender shares to the Company solely to pay some or all of the associated minimum statutory tax withholdings. The surrendered shares are held as treasury stock and included in stockholders' equity.

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 March 31, 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 March 31, 2014, the Company had commitments totaling $16.9 million, of which $14.1 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 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 March 31, 2014 and December 31, 2013 (in thousands):

		Fair Value Hierarchy Level		
	Fair Value	Level 1	Level 2	Level 3
March 31, 2014:				
Derivatives:				
Interest rate swaps financial liabilities	$(845)	$—	$(845)	$—
December 31, 2013:				
Derivatives:				
Interest rate swaps financial liabilities	$(792)	$—	$(792)	$—

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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 March 31, 2014 and December 31, 2013 (in thousands):

			Fair Value Hierarchy Level			Impairment
Description	Fair Value	Dispositions	Level 1	Level 2	Level 3	Charges [1]
March 31, 2014:						
Long-lived assets held and used	$7,488	$—	$—	$—	$7,488	$(795)
Lease intangible assets	—	—	—	—	—	(70)
Long-lived assets held for sale	8,611	—	—	—	8,611	(842)
						$(1,707)
December 31, 2013:						
Lease intangible assets	$—	$—	$—	$—	$—	$(182)
Long-lived assets held for sale	11,198	(26,832)	—	—	38,030	(7,134)
						$(7,316)

[1] Impairment charges are presented for the three months ended March 31, 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.

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 March 31, 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.

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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):

	March 31, 2014		December 31, 2013	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Loans receivable, net	$115,846	$125,493	$117,721	$131,587
Revolving credit facilities, net	135,606	136,441	35,120	34,911
Mortgages and notes payable, net	3,738,053	3,929,117	3,743,098	3,892,621

Note 10. Significant Credit and Revenue Concentration
As of March 31, 2014 and December 31, 2013, the Company’s real estate investments are operated by 387 and 377 tenants, respectively, that engage in retail, service and distribution activities across various industries throughout the United States. Shopko Stores Operating Co., LLC (“Shopko”) and Pamida Stores Operating Co., LLC (“Pamida”), operate in the general and discount retailer industry and represent the Company’s largest tenant. Total revenues from the combined Shopko/Pamida (“Shopko/Pamida”) entity for the three months ended March 31, 2014 and 2013, contributed 14.0% and 29.0% of the Company's total revenues from 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 March 31, 2014 and December 31, 2013, the combined properties that are operated by Shopko/Pamida represent approximately 14.1% and 14.4%, respectively, of the Company’s total investment portfolio.

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.

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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 months ended March 31, 2014 and 2013, are summarized below (dollars in thousands):

	Three Months Ended March 31,	
	2014	2013
Revenues:		
Rent	$308	$2,222
Non-cash rent	(29)	18
Other	2,917	—
Total revenues	3,196	2,240
Expenses:		
General and administrative	3	9
Property costs	139	74
Interest	—	194
Depreciation and amortization	—	1,377
Impairments	—	2,103
Total expenses	142	3,757
Gain (loss) from discontinued operations before other income	3,054	(1,517)
Other income:		
Other	—	23
Total other income	—	23
Income (loss) from discontinued operations	3,054	(1,494)
(Loss) gain on dispositions of assets	(7)	180
Total discontinued operations		