Spirit Realty Capital, Inc.
Form 10-Q
August 06, 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 June 30, 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	20-1676382
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
16767 North Perimeter Drive, Suite 210, Scottsdale, Arizona 85260	(480) 606-0820
(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 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 August 1, 2014, there were 398,809,443 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)

	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 June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 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 June 30,		Six Months Ended 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		
	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 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.

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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.

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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 similiar 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 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 [(1)]	$21,945	$21,816
Tenant improvements, repairs, and leasing commissions [(2)]	12,035	10,297
Master trust release / title company escrow [(3)]	14,165	21,893
Loan impounds [(4)]	2,239	2,018
Other [(5)]	1,082	2,667
	$51,466	$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) Includes 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.

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[2] (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

(1) 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.

(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,

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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

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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 [(a)]	12	$40,955

[(a)] 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 continuing and discontinued operations	$27,627	$1,601	$29,334	$3,704

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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%			