

SPIRIT REALTY CAPITAL, INC.

Form 10-K

March 05, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10-K**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the fiscal year ended December 31, 2012

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from                      to

Commission file number 001-11290

**SPIRIT REALTY CAPITAL, INC.**

(Exact name of registrant as specified in its charter)

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**Maryland**  
 (State or other jurisdiction of  
 incorporation or organization)

**20-0175773**  
 (I.R.S. Employer  
 Identification No.)

**16767 North Perimeter Dr., Suite 210**  
**Scottsdale, Arizona 85260**

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (480) 606-0820

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

Title of each class:	Name of exchange on which registered:
Common Stock, \$0.01 par value	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None.	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

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As of June 30, 2012 (the last business day of the registrant's most recently completed second fiscal quarter), the registrant's common stock was not listed on any exchange or over-the-counter market. The registrant's common stock began trading on the New York Stock Exchange on September 20, 2012. As of December 31, 2012, the aggregate market value of the registrant's voting stock held by non-affiliates was approximately \$1.4 billion based on the number of shares held by non-affiliates as of December 31, 2012, and the last reported sale price of the registrant's common stock on December 31, 2012.

As of March 1, 2013, the number of shares of the registrant's common stock outstanding was 84,851,515.

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**PART I**

**Item 1. Business**  
**The Company**

Spirit Realty Capital, Inc. (which may be referred to in this Annual Report on Form 10-K as the Company, we, us, Spirit and Spirit Realty Capital ) is a Maryland corporation incorporated on August 14, 2003 and organized to operate as a self-administered and self-managed real estate investment trust ( REIT ). We became a public company in December 2004 and were subsequently taken private in August 2007 by a consortium of private investors. On September 25, 2012, we completed an initial public offering (the IPO ) of 33.4 million shares of common stock (including shares issued on October 1, 2012 pursuant to the underwriters option to purchase additional shares). Unless otherwise noted herein, all statements herein are not reflective of the impact of the proposed transaction with Cole Credit Property Trust II, Inc. discussed herein.

Our operations are carried out through Spirit Realty, L.P. (the Operating Partnership ), which is a Delaware limited partnership. Spirit General OP Holdings, LLC, one of our wholly-owned subsidiaries, is the sole general partner and owns 1.0% of the Operating Partnership. We are the sole limited partner and own the remaining 99.0% of the Operating Partnership. Although the Operating Partnership is wholly-owned directly and indirectly by us, in the future, we could agree to issue equity interests in the Operating Partnership to third parties in exchange for property owned by such third parties. In general, any equity interests of the Operating Partnership issued to third parties would be exchangeable for cash or, at our election, shares of our common stock at specified ratios set when equity interests in the Operating Partnership are issued.

Our objective is to maximize stockholder value by seeking superior risk-adjusted returns, with an emphasis on stable rental revenue. We generate our revenue primarily by leasing our properties to our tenants. We invest in single-tenant, operationally essential real estate throughout the United States that is leased on a long-term, triple-net basis primarily to tenants engaged in retail, service and distribution industries. Single-tenant, operationally essential real estate consists of properties that are generally free-standing, commercial real estate facilities where our tenants conduct retail, service or distribution activities that are essential to the generation of their sales and profits. Under a triple-net lease, the tenant is typically responsible for all improvements and is contractually obligated to pay all property operating expenses, such as real estate taxes, insurance premiums and repair and maintenance costs. In support of our primary business of owning and leasing real estate, we have also strategically originated or acquired long-term, commercial mortgage and equipment loans. We view our operations as one segment consisting of triple-net leases.

As of December 31, 2012, our undepreciated gross investment in real estate and loans totaled approximately \$3.65 billion, representing investments in 1,207 properties, including properties securing our mortgage loans. Of this amount, 98.6% consisted of our gross investment in real estate, representing ownership of 1,122 properties, and the remaining 1.4% consisted of commercial mortgage and equipment loans receivable secured by the remaining 85 properties or other related assets. As of December 31, 2012, our owned properties were approximately 98.8% occupied (based on number of properties), and our leases had a weighted average non-cancelable remaining lease term (based on annual rent) of approximately 11.1 years. Our leases are generally long-term, typically with non-cancelable initial terms of 15 to 20 years and tenant renewal options for additional terms. As of December 31, 2012, approximately 96% of our leases (based on annual rent) provided for increases in future annual base rent.

Our portfolio of 1,122 owned properties were leased to approximately 165 tenants as of December 31, 2012. In February 2012, two of our general merchandising tenants, Shopko Stores Operating Co., LLC ( Shopko ), and Pamida Stores Operating Co. LLC ( Pamida ) completed a merger. As a result, the combined company ( Shopko/Pamida ) contributed 29.4% of our annual rent as of December 31, 2012. We lease 181 properties to

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Shopko/Pamida, 179 of which are leased pursuant to three master leases that, as of December 31, 2012, had a weighted average non-cancelable remaining lease term of approximately 12.8 years.

Our tenants operate in 18 different industries, which are as follows:

## **Competitive Strengths**

We believe the following competitive strengths contribute to the stability of our rental revenues and distinguish us from our competitors:

***Large Scale and Diversified Portfolio.*** As of December 31, 2012, our portfolio consisted of 1,122 owned properties, with approximately 165 tenants operating across 18 different industries, including: general, specialty and discount retail; restaurants; movie theaters; automotive dealers; educational and recreational facilities; and supermarkets. Our properties are geographically diversified across 47 states, with only 4 states contributing more than 5% of our annual rent. We believe it would be difficult for a new competitor to replicate such a diversified portfolio on a comparable scale. The diversity of our portfolio reduces the risks associated with adverse events affecting a particular tenant or an economic decline in any particular state or industry. Additionally, the scale of our portfolio allows us to make acquisitions without introducing additional concentration risks. In addition, our operating platform is scalable and will allow us to make new investments without the need for significant additional administrative or management costs.

***Long-Term Triple-Net Leases.*** As of December 31, 2012, our owned properties were approximately 98.8% occupied (based on number of properties), with a weighted average non-cancelable remaining lease term (based on annual rent) of approximately 11.1 years. Due to the triple-net structure of approximately 95% of our leases (based on annual rent) as of December 31, 2012, we do not expect to incur significant capital expenditures, and the potential impact of inflation on our operating expenses is minimal. Additionally, as of December 31, 2012, approximately 96% of our leases (based on annual rent) provided for increases in future annual base rent.

***Established Company with Proven Performance.*** Our Company has been actively investing in triple-net leased real estate since 2003, is well-known within the industry and benefits from an established infrastructure supporting our underwriting, leasing, asset management and reporting functions. From

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our inception in 2003 through December 31, 2012, we have made gross investments of approximately \$4.22 billion in properties and loans receivable. Since our inception, our occupancy has never been below 96.1% (based on number of properties), despite the economic downturn of 2008 through 2010.

***Disciplined Underwriting and Risk Management Expertise.*** Our developed underwriting and risk management expertise enhances our ability to identify and structure investments that provide superior risk-adjusted returns, due to specific investment risks that we believe can be identified and mitigated through intensive credit and real estate analysis, tailored lease structures (such as master leases) and ongoing tenant monitoring. When underwriting new acquisitions we generally target property-level rent coverage ratios in excess of 2.0x.

***Experienced Management Team.*** Our senior management has significant experience in the real estate industry and in managing public companies. Our Chairman and Chief Executive Officer, Thomas H. Nolan, Jr., has been active in the real estate industry for over 25 years, holding numerous leadership positions in private and public real estate companies. Our President and Chief Operating Officer, Peter M. Mavroides, has been active in the single-tenant, net lease industry for over 14 years, holding leadership positions for the past 9 years. Our Chief Financial Officer, Michael A. Bender, has held leadership positions for over 30 years in finance and real estate. Our Senior Vice President, Gregg A. Seibert, who has been with us since our inception, has over 20 years of experience in real estate finance, including over 15 years of leadership responsibilities in credit, acquisitions and portfolio management in the sale-leaseback sector. Our Senior Vice President, Mark L. Manheimer, has over 14 years of experience in real estate finance, including leadership positions in the areas of asset management, underwriting and acquisitions.

***Attractive In-Place Long-Term Indebtedness.*** We have approximately \$1.95 billion principal balance of non-recourse mortgage indebtedness outstanding, which had a weighted average maturity of 5.8 years as of December 31, 2012 and an average annual interest rate of approximately 6.12% for the year ended December 31, 2012 (excluding non-cash interest expense attributable to the amortization of deferred financing costs and debt discounts). Prior to January 1, 2016, we only have \$126.3 million of balloon payments due at maturity. Approximately \$1.7 billion principal balance of our indebtedness is fully or partially amortizing, providing for an ongoing reduction in principal prior to maturity. In addition, we have a \$100.0 million secured revolving credit facility (the Credit Facility ) to help fund future acquisitions and for general corporate purposes. As of December 31, 2012, no amounts were drawn on the Credit Facility and \$100.0 million was available.

**Business and Growth Strategies**

Our objective is to seek superior risk-adjusted returns, with an emphasis on stable rental revenue, by investing primarily in single-tenant, operationally essential real estate leased on a long-term, triple-net basis. We intend to pursue our objective through the following business and growth strategies:

***Focus on Small and Middle Market Companies.*** We primarily focus on investing in properties that we net lease to unrated small and middle market companies that we determine have attractive credit characteristics and stable operating histories. Properties leased to small and middle market companies may offer us the opportunity to achieve superior risk-adjusted returns, as a result of our intensive credit and real estate analysis, lease structuring and portfolio construction. Small and middle market companies are often willing to enter into leases with structures and terms that we consider attractive (such as master leases and leases that require ongoing tenant financial reporting) and that we believe increase the security of rental payments. In addition to small and middle market companies, we selectively acquire properties leased to large companies where we believe that we can achieve superior risk-adjusted returns.

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The following chart highlights the tenants that we target based on company size and corporate credit equivalent:

***Use Our Developed Underwriting and Risk Management Processes to Structure and Manage Our Portfolio.*** We seek to maintain the stability of our rental revenue and the long-term return on our investments by using our developed underwriting and risk management processes to structure and manage our portfolio. In particular, our underwriting and risk management processes emphasize the following:

*Leases for Operationally Essential Real Estate with Relatively Long Terms.* We seek to own properties that are operationally essential to our tenants, thereby reducing the risk that the tenant would choose not to renew an expiring lease or reject a lease in bankruptcy. In addition, we seek to enter into leases with relatively long terms, typically with non-cancelable initial terms of 15 to 20 years and tenant renewal options for additional terms with attractive rent escalation provisions.

*Use of the Master Lease Structure.* Where appropriate, we seek to enter into master leases, pursuant to which we lease multiple properties to a single tenant on an all or none basis. In a master lease structure, a tenant is responsible for a single lease payment relating to the entire portfolio of leased properties, as opposed to multiple lease payments relating to individually leased properties. The master lease structure prevents a tenant from cherry picking locations, where it unilaterally gives up underperforming properties while maintaining its leasehold interest in well-performing properties. As of December 31, 2012, we had 56 master leases that had a weighted average non-cancelable remaining lease term (based on annual rent) of 12.6 years and contributed approximately 63.8% of our annual rent. Our largest master lease, consisting of 112 properties, contributed 25.6% of our annual rent, and our smallest master lease, consisting of two properties, contributed less than 1% of our annual rent. The average number of properties included under our master leases as of December 31, 2012 was 12.0.

*Active Management and Monitoring of Risks Related to Our Investments.* When monitoring existing investments or evaluating new investments, we typically consider two broad categories of risk: (1) tenant financial distress risk; and (2) lease renewal risk. We seek to measure these risks through various processes, including the use of a credit modeling product that we license from Moody's Analytics that estimates the performance of the leased properties relative to rental payments due under the leases, and a review of current market data and our historical recovery rates on re-leased properties and property dispositions. Our underwriting and risk management processes are designed to structure new investments and manage existing investments to address and mitigate each of the above risks and preserve the long-term return on our invested capital.

*Portfolio Diversification.* We monitor and manage the diversification of our real estate investment portfolio in order to reduce the risks associated with adverse developments affecting a particular tenant, property, industry or region. Our strategy emphasizes a portfolio that (1) derives no more



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than 10% of its annual rent from any single tenant or more than 2.5% of its annual rent from any single property, (2) is leased to tenants operating in various industries and (3) is located across the United States without significant geographic concentration. While we consider the foregoing when making investments, we have opportunistically made investments in the past that do not meet one or more of these criteria, and we may make additional investments that do not meet one or more of these criteria if we believe the opportunity is sufficiently attractive. As of December 31, 2012, Shopko/Pamida contributed 29.4% of our annual rent. No other tenant contributed more than 10% of our annual rent, and no one single property contributed more than 2.1% of our annual rent.

***Enhance Our Portfolio through Contractual Growth.*** Approximately 96% of our leases (based on annual rent) contain contractual provisions that increase the rental revenue over the term of the lease. Of these leases, approximately 25% contain fixed contractual rental increases, and the remaining 75% contain increases based on the lesser of a fixed contractual percentage increase or the increase in the consumer price index ( CPI ).

***Selectively Grow Our Portfolio through Acquisitions.*** We plan to selectively make acquisitions that contribute to our portfolio s tenant, industry and geographic diversification. We believe there will be ample acquisition opportunities in the single-tenant market fitting our acquisition criteria.

***Continue to Deleverage Our Portfolio.*** Most of our debt is partially amortizing, and its principal amount will be reduced prior to the balloon payments due at maturity. Contractual amortization payments are scheduled to reduce our outstanding principal amount of indebtedness by \$137.0 million prior to January 1, 2016. We also may use any cash from operations in excess of the distributions that we expect to pay to selectively reduce our indebtedness.

We believe contractual rent growth, selective growth through acquisitions and the ongoing deleveraging of our portfolio will contribute to our cash available for distributions.

## **Financing Strategy**

Our long-term financing strategy is to maintain a leverage profile that creates operational flexibility and generates superior risk-adjusted returns for our stockholders. We intend to employ prudent amounts of debt financing as a means of providing additional funds for the acquisition of assets, to refinance existing debt or for general corporate purposes.

We finance our assets using a variety of methods and determine the amount of equity and debt financing to be used when acquiring an asset by evaluating terms available in the credit markets (such as interest rate, repayment provisions and maturity), our cost of equity capital and our assessment of the particular asset s risk. Historically, a significant portion of our debt has been long-term borrowings secured by specific real estate assets or, more typically, pools of real estate assets. We anticipate using a number of different sources to finance our acquisitions and operations going forward, including cash from operations, issuance of debt securities, funds available from the Credit Facility, private financings (such as bank credit facilities, which may or may not be secured by our assets), property-level mortgage debt, common or preferred equity issuances or any combination of these sources, to the extent available to us, or other sources that may become available from time to time. To the extent practicable, we expect to maintain a debt profile with manageable near-term maturities.

## **Recent Developments**

### ***Proposed Merger with Cole***

On January 22, 2013, Spirit Realty Capital, the Operating Partnership, Cole Credit Property Trust II, Inc., a Maryland corporation ( Cole ) and Cole Operating Partnership II, LP, a Delaware limited partnership (the Cole Partnership ), entered into an Agreement and Plan of Merger (the Merger Agreement ). The Merger Agreement provides for the merger of Spirit Realty Capital with and into Cole (the Company Merger ) with Cole

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continuing as the surviving corporation (the **Surviving Corporation** ) and the merger of the Cole Partnership with and into the Operating Partnership (the **Partnership Merger** and together with the Company Merger, the **Merger** ) with the Operating Partnership continuing as the surviving limited partnership (the **Surviving Partnership** ). The board of directors of Spirit Realty Capital has unanimously approved the Merger Agreement, the Merger and the other transactions contemplated by the Merger Agreement.

Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, at the effective time of the Company Merger (the **Company Merger Effective Time** ), each outstanding share of our common stock, par value \$0.01 per share ( **Company Common Stock** ), will be converted into the right to receive 1.9048 (the **Exchange Ratio** ) shares of common stock, par value \$0.01 per share, of the Surviving Corporation ( **Surviving Corporation Common Stock** ). At and after the Company Merger Effective Time, each share of common stock, par value \$0.01 per share, of Cole ( **Cole Common Stock** ) issued and outstanding immediately prior to the Company Merger Effective Time shall remain outstanding. At the effective time of the Partnership Merger, (i) each outstanding partnership unit in the Cole Partnership (other than partnership units held by Cole, which shall cease to exist) shall automatically be converted into one validly issued share of Surviving Corporation Common Stock, (ii) each outstanding partnership unit in the Operating Partnership shall remain outstanding and (iii) the general partner interest of the Operating Partnership shall constitute the only general partner interests in the Surviving Partnership.

Under the terms of the Merger Agreement, at the Company Merger Effective Time, the Surviving Corporation shall assume our 2012 Incentive Award Plan (the **Plan** ) and the number and kind of shares available for issuance under the Plan shall be converted into shares of Surviving Corporation Common Stock, after giving effect to the Exchange Ratio, in accordance with the provisions of the Plan. Similarly, all outstanding shares of Company Common Stock that are subject to vesting and other restrictions will convert into restricted shares of Surviving Corporation Common Stock, after giving effect to the Exchange Ratio, with the same terms and conditions as were applicable to such shares of Company Common Stock immediately prior to the Company Merger Effective Time.

The completion of the Company Merger is subject to customary conditions, including, among others: (i) approval by the holders of a majority of the outstanding shares of Company Common Stock; (ii) approval by the holders of a majority of the outstanding shares of Cole Common Stock; (iii) the authorization of the listing on the New York Stock Exchange (the **NYSE** ) of the Surviving Corporation Common Stock, including the Surviving Corporation Common Stock to be issued in connection with the Merger; (iv) the registration statement on Form S-4 registering the applicable Surviving Corporation Common Stock to be issued as consideration for the Merger having been declared effective by the Securities and Exchange Commission (the **SEC** ); and (v) the obtaining of certain third-party consents. The transaction is expected to close in the third quarter of 2013.

At the Company Merger Effective Time, the size of the board of directors of the Surviving Corporation will be set at nine, and all seven of our directors immediately prior to the consummation of the Company Merger and up to two individuals designated by Cole and reasonably satisfactory to us, will comprise the board of directors of the Surviving Corporation. In addition, at the Company Merger Effective Time, the charter and bylaws of the Surviving Corporation will be amended and restated to be substantially identical to our charter and bylaws, as in effect immediately prior to the Company Merger Effective Time. The name of the Surviving Corporation will be **Spirit Realty Capital, Inc.**

We and Cole have made certain customary representations, warranties and covenants in the Merger Agreement. Each of us and Cole is required, among other things: (i) subject to certain exceptions, to conduct its business in the ordinary course consistent with past practice during the interim period between the execution of the Merger Agreement and the consummation of the Merger; and (ii) not to solicit alternative transactions, and, subject to certain exceptions, not to enter into discussions concerning, or provide confidential information in connection with, any alternative transaction. Each party has also agreed to use its reasonable best efforts to cause the Merger to be consummated. In addition, subject to certain exceptions, the Merger Agreement requires each

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party to call and hold a special meeting of its stockholders and for the respective board of directors of each party to recommend that its stockholders approve the Company Merger and the transactions contemplated by the Merger Agreement.

The Merger Agreement contains certain termination rights for both us and Cole, including, among other bases for termination, if the Company Merger is not consummated on or before July 22, 2013 (subject to a two-month extension under certain circumstances) and if the requisite approvals of either the stockholders of us or Cole are not obtained. In addition, either party may choose to terminate the Merger Agreement under certain circumstances, including among others, if: (i) prior to its stockholder vote, the party receives a Superior Proposal (as defined in the Merger Agreement) and after providing the other party with adequate notice and paying the termination fee (as described below), the party enters into a definitive agreement in connection with such Superior Proposal; or (ii) the party's board of directors changes its recommendation to its stockholders to vote in favor of the Company Merger as a result of an Intervening Event (as defined in the Merger Agreement) and contemporaneously such party pays the other party the termination fee. If no alternative acquisition proposal has been publicly announced prior to a party's meeting of its stockholders and such party fails to obtain the approval of its stockholders, such party may be required to reimburse the other party's transaction expenses (as described below). The Merger Agreement provides that, in connection with the termination of the Merger Agreement under specified circumstances, one party may be required to pay to the other a termination fee of \$55.0 million and/or reimburse the other party's transaction expenses up to an amount equal to \$10.0 million.

### ***Voting Agreements***

Concurrently with the execution of the Merger Agreement, Macquarie Group (US) Holdings No. 1 Pty Ltd. ( Macquarie ), TPG-Axon Partners, LP ( TPG-AXON Partners ) and TPG-Axon Spirit Holdings Ltd. ( TPG-AXON Spirit ) have each entered into a voting agreement with Cole and the Cole Partnership (each, a Voting Agreement and together, the Voting Agreements ) pursuant to which each of Macquarie, TPG-AXON Partners and TPG-AXON Spirit, who together own approximately 15% of the currently outstanding shares of Company Common Stock, has agreed to vote its shares of Company Common Stock in favor of the Company Merger and the other transactions contemplated by the Merger Agreement, upon the terms and subject to the conditions set forth in such agreements. Each Voting Agreement terminates upon the earliest of: (i) the termination of the Merger Agreement; (ii) a change in recommendation by the board of directors of either us or Cole; (iii) the acquisition of any shares of Company Common Stock by Cole or the Cole Partnership prior to the completion of the Merger; and (iv) September 25, 2013.

### ***First Amendment to Change of Control Severance Plan***

On January 22, 2013, we executed a First Amendment to the Change of Control Severance Plan for Certain Covered Participants of Spirit Finance Corporation (the Severance Plan ). The Severance Plan was amended to provide that the Merger Agreement, the Merger and the other transactions contemplated by the Merger Agreement will not constitute a change of control as defined in, and for purposes of, the Severance Plan.

### ***Waiver Agreements***

In connection with the Merger, Thomas H. Nolan, Jr., Chief Executive Officer, Peter M. Mavroides, President and Chief Operating Officer, Michael A. Bender, Senior Vice President and Chief Financial Officer, Mark L. Manheimer, Senior Vice President, and Gregg A. Seibert, Senior Vice President (collectively, the Executives ) each entered into waiver agreements, dated January 22, 2013 (each, a Waiver and together, the Waivers ), which provide that (i) the Merger will not constitute a change in control for purposes of the Executive's employment agreement and related restricted stock agreement(s) and (ii) any change in position that occurs in connection with the Merger will not constitute good reason or a termination without cause (each, as defined in the Executive's applicable employment agreement) for purposes of the Executive's employment agreement and related restricted stock agreement(s). In addition, under the Waivers executed by Messrs. Nolan,

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Mavoides and Bender, each waived his entitlement to a tax gross-up payment under Section 280G of the Internal Revenue Code of 1986, as amended (the Code), as a result of any payments made to the individual in connection with the Merger.

### **Competition**

We face competition for acquisitions of real property from investors, including traded and non-traded public REITs, private equity investors and institutional investment funds, some of which have greater financial resources than we do, a greater ability to borrow funds to acquire properties and the ability to accept more risk than we can prudently manage. This competition may increase the demand for the types of properties in which we typically invest and, therefore, reduce the number of suitable acquisition opportunities available to us and increase the prices paid for such acquisition properties. This competition will increase if investments in real estate become more attractive relative to other forms of investment.

As a landlord, we compete in the multi-billion dollar commercial real estate market with numerous developers and owners of properties, many of which own properties similar to ours in the same markets in which our properties are located. Some of our competitors have greater economies of scale, have access to more resources and have greater name recognition than we do. If our competitors offer space at rental rates below current market rates or below the rental rates we currently charge our tenants, we may lose our tenants or prospective tenants and we may be pressured to reduce our rental rates or to offer substantial rent abatements, tenant improvement allowances, early termination rights or below-market renewal options in order to retain tenants when our leases expire.

### **Employees**

As of December 31, 2012, we had 38 employees. None of these employees are represented by a labor union.

### **Legal Proceedings**

From time to time, we are party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. We are not currently a party, as plaintiff or defendant, to any legal proceedings that we believe to be material or which, individually or in the aggregate, would be expected to have a material effect on our business, financial condition or results of operation if determined adversely to us.

### **Significant Tenants**

In February 2012, two of our general merchandising tenants, Shopko and Pamida, completed a merger. As a result, the combined company, Shopko/Pamida, contributed 29.4% of our annual rent as of December 31, 2012. We lease 181 properties to Shopko/Pamida, 179 of which are leased pursuant to three master leases that, as of December 31, 2012, had a weighted average non-cancelable remaining lease term of approximately 12.8 years.

For further information on our ten largest tenants and the composition of our tenant base, see Item 2. Properties Our Real Estate Investment Portfolio Diversification by Tenant.

### **Regulation**

#### ***General***

Our properties are subject to various covenants, laws, ordinances and regulations, including regulations relating to common areas and fire and safety requirements. We believe that each of our properties has the necessary permits and approvals.

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### ***Americans With Disabilities Act***

Pursuant to the Americans with Disabilities Act (the "ADA"), our properties are required to meet federal requirements related to access and use by persons with disabilities. Compliance with the ADA, as well as a number of additional federal, state and local laws, may require modifications to properties we currently own and any properties we purchase, or may restrict renovations of those properties. Noncompliance with these laws or regulations could result in the imposition of fines or an award of damages to private litigants, as well as the incurrence of the costs of making modifications to attain compliance, and future legislation could impose additional financial obligations or restrictions on our properties. Although our tenants are generally responsible for all maintenance and repairs of the property pursuant to triple-net leases, including compliance with the ADA and other similar laws or regulations, we could be held liable as the owner of the property for a failure of one of our tenants to comply with such laws or regulations.

### ***Environmental Matters***

Federal, state and local environmental laws and regulations regulate, and impose liability for, releases of hazardous or toxic substances into the environment. Under various of these laws and regulations, a current or previous owner, operator or tenant of real estate may be required to investigate and clean up hazardous or toxic substances, hazardous wastes or petroleum product releases or threats of releases at the property, and may be held liable to a government entity or to third parties for property damage and for investigation, clean-up and monitoring costs incurred by those parties in connection with the actual or threatened contamination. These laws typically impose clean-up responsibility and liability without regard to fault, or whether or not the owner, operator or tenant knew of or caused the presence of the contamination. The liability under these laws may be joint and several for the full amount of the investigation, clean-up and monitoring costs incurred or to be incurred or actions to be undertaken, although a party held jointly and severally liable may seek to obtain contributions from other identified, solvent, responsible parties of their fair share toward these costs. These costs may be substantial, and can exceed the value of the property. The presence of contamination, or the failure to properly remediate contamination, on a property may adversely affect the ability of the owner, operator or tenant to sell or rent that property or to borrow using the property as collateral, and may adversely impact our investment in that property.

Some of our properties contain, have contained, or are adjacent to or near other properties that have contained or currently contain storage tanks for the storage of petroleum products or other hazardous or toxic substances. Similarly, some of our properties were used in the past for commercial or industrial purposes, or are currently used for commercial purposes, that involve or involved the use of petroleum products or other hazardous or toxic substances, or are adjacent to or near properties that have been or are used for similar commercial or industrial purposes. These operations create a potential for the release of petroleum products or other hazardous or toxic substances, and we could potentially be required to pay to clean up any contamination. In addition, strict environmental laws regulate a variety of activities that can occur on a property, including the storage of petroleum products or other hazardous or toxic substances, air emissions and water discharges. Such laws may impose fines or penalties for violations. As a result of the foregoing, we could be materially and adversely affected.

Environmental laws also govern the presence, maintenance and removal of asbestos-containing materials ("ACM"). Federal regulations require building owners and those exercising control over a building's management to identify and warn, through signs and labels, of potential hazards posed by workplace exposure to installed ACM in their building. The regulations also have employee training, record keeping and due diligence requirements pertaining to ACM. Significant fines can be assessed for violation of these regulations. As a result of these regulations, building owners and those exercising control over a building's management may be subject to an increased risk of personal injury lawsuits by workers and others exposed to ACM. The regulations may affect the value of a building containing ACM in which we have invested. Federal, state and local laws and regulations also govern the removal, encapsulation, disturbance, handling and/or disposal of ACM when those materials are in poor condition or in the event of construction, remodeling, renovation or demolition of a

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building. These laws may impose liability for improper handling or a release into the environment of ACM and may provide for fines to, and for third parties to seek recovery from, owners or operators of real properties for personal injury or improper work exposure associated with ACM.

When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. Indoor air quality issues can also stem from inadequate ventilation, chemical contamination from indoor or outdoor sources, and other biological contaminants such as pollen, viruses and bacteria. Indoor exposure to airborne toxins or irritants above certain levels can be alleged to cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, the presence of significant mold or other airborne contaminants at any of our properties could require us to undertake a costly remediation program to contain or remove the mold or other airborne contaminants from the affected property or increase indoor ventilation. In addition, the presence of significant mold or other airborne contaminants could expose us to liability from our tenants, employees of our tenants or others if property damage or personal injury occurs. We are not presently aware of any material adverse indoor air quality issues at our properties that have not been previously addressed or remediated by us.

Before completing any property acquisition, we obtain environmental assessments in order to identify potential environmental concerns at the property. These assessments are carried out in accordance with the Standard Practice for Environmental Site Assessments (ASTM Practice E 1527-05) as set by ASTM International, formerly known as the American Society for Testing and Materials, and generally include a physical site inspection, a review of relevant federal, state and local environmental and health agency database records, one or more interviews with appropriate site-related personnel, review of the property's chain of title and review of historical aerial photographs and other information on past uses of the property. These assessments are limited in scope, however, if recommended in the initial assessments, we may undertake additional assessments such as soil and/or groundwater samplings or other limited subsurface investigations and ACM or mold surveys to test for substances of concern. A prior owner or operator of a property or historic operations at our properties may have created a material environmental condition that is not known to us or the independent consultants preparing the site assessments. Material environmental conditions may have arisen after the review was completed or may arise in the future, and future laws, ordinances or regulations may impose material additional environmental liability. If environmental concerns are not satisfactorily resolved in any initial or additional assessments, we may obtain environment insurance policies to insure against potential environmental risk or loss depending on the type of property, the availability and cost of the insurance and various other factors we deem relevant (i.e., an environmental occurrence affects one of our properties where our lessee may not have the financial capability to honor its indemnification obligations to us).

Generally, our leases provide that the lessee will indemnify us for any loss or expense we incur as a result of the presence, use or release of hazardous materials on our property. Our ultimate liability for environmental conditions may exceed the policy limits on any environmental insurance policies we obtain, if any. If we are unable to enforce the indemnification obligations of our lessees or if the amount of environmental insurance we carry is inadequate, our results of operations would be adversely affected.

## **Insurance**

Our tenants are required to maintain liability and property insurance coverage for the properties they lease from us pursuant to triple-net leases. Pursuant to such leases, our tenants are required to name us (and any of our lenders that have a mortgage on the property leased by the tenant) as additional insureds on their liability policies and additional named insured and/or loss payee (or mortgagee, in the case of our lenders) on their property policies. All tenants are required to maintain casualty coverage and most carry limits at 100% of replacement cost. Depending on the location of the property, losses of a catastrophic nature, such as those caused by earthquakes and floods, may be covered by insurance policies that are held by our tenant with limitations such as large deductibles or co-payments that a tenant may not be able to meet. In addition, losses of a catastrophic nature, such as those caused by wind/hail, hurricanes, terrorism or acts of war, may be uninsurable or not

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economically insurable. In the event there is damage to our properties that is not covered by insurance and such properties are subject to recourse indebtedness, we will continue to be liable for the indebtedness, even if these properties are irreparably damaged. See Risk Factors Risks Related to Our Business and Properties Insurance on our properties may not adequately cover all losses and uninsured losses could materially and adversely affect us.

In addition to being a named insured on our tenants liability policies, we separately maintain commercial general liability coverage with an aggregate limit of \$52.0 million. We also maintain full property coverage on all untenanted properties and other property coverage as may be required by our lenders which are not required to be carried by our tenants under our leases.

## **Available Information**

Our principal executive offices are located at 16767 North Perimeter Dr., Suite 210, Scottsdale, Arizona 85260. Our telephone number at that location is (480) 606-0820. We maintain an Internet Web site at [www.spiritrealty.com](http://www.spiritrealty.com). On the Investor Relations page on our Web site, we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act ). All such filings on our Investor Relations Web site are available to be viewed on this page free of charge. Also available on our Web site, free of charge, are our corporate governance guidelines, the charters of the nominating and corporate governance, audit and compensation committees of our board of directors and our code of business conduct and ethics (which applies to all directors and employees, including our principal executive officer, principal financial officer and principal accounting officer). Information contained on or hyperlinked from our website is not incorporated by reference into and should not be considered part of this Annual Report on Form 10-K or our other filings with the SEC. A copy of this Annual Report on Form 10-K is available without charge upon written request to: Investor Relations, Spirit Realty Capital, Inc., 16767 North Perimeter Dr., Suite 210, Scottsdale, Arizona 85260. All reports we will file with the SEC will be available free of charge via EDGAR through the SEC Web site at [www.sec.gov](http://www.sec.gov). In addition, the public may read and copy materials we file with the SEC at the SEC's public reference room located at 100 F Street, N.E., Washington, D.C. 20549. Shares of our common stock are traded on the NYSE under the ticker symbol SRC.

## **Item 1A. Risk Factors**

### **Special Note Regarding Forward-Looking Statements**

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws. In particular, statements pertaining to our business and growth strategies, investment and leasing activities and trends in our business, including trends in the market for long-term, triple-net leases of freestanding, single-tenant properties, contain forward-looking statements. When used in this Annual Report on Form 10-K, the words estimate, anticipate, expect, believe, intend, may, will, should, seek, approximately or plan these words and phrases or similar words or phrases which are predictions of or indicate future events or trends and which do not relate solely to historical matters are intended to identify forward-looking statements. You can also identify forward-looking statements by discussions of strategy, plans or intentions of management.

Forward-looking statements involve numerous risks and uncertainties and you should not rely on them as predictions of future events. Forward-looking statements depend on assumptions, data or methods which may be incorrect or imprecise and we may not be able to realize them. We do not guarantee that the transactions and events described will happen as described (or that they will happen at all). The following factors, among others, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements:

general business and economic conditions;

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continued volatility and uncertainty in the credit markets and broader financial markets, including potential fluctuations in the CPI;

other risks inherent in the real estate business, including tenant defaults, potential liability relating to environmental matters, illiquidity of real estate investments, and potential damages from natural disasters;

availability of suitable properties to acquire and our ability to acquire and lease those properties on favorable terms;

ability to renew leases, lease vacant space or re-lease space as existing leases expire;

the degree and nature of our competition;

our failure to generate sufficient cash flows to service our outstanding indebtedness;

access to debt and equity capital markets;

fluctuating interest rates;

availability of qualified personnel and our ability to retain our key management personnel;

the outcome of any legal proceedings to which we are a party;

risks related to our proposed merger with Cole;

changes in, or the failure or inability to comply with, government regulation, including Maryland laws;

failure to maintain our status as a REIT for federal income tax purposes;

changes in the U.S. tax law and other U.S. laws, whether or not specific to REITs; and

additional factors discussed in Item 7. entitled Management's Discussion and Analysis of Financial Condition and Results of Operations and in our other filings with the SEC.

You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. We disclaim any obligation to publicly update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, of new information, data or methods, future events or other changes, except as required by law.

Set forth below are some (but not all) of the factors that could adversely affect our business and financial performance. Moreover, we operate in a highly competitive and rapidly changing environment. New risk factors emerge from time to time, and it is not possible for management to



predict all such risk factors, nor can it assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

**Risks Related to Our Proposed Merger with Cole**

*We will be subject to various uncertainties and contractual restrictions while the Merger is pending that could adversely affect our financial results.*

Uncertainty about the effect of the Merger on tenants may have an adverse effect on us. These uncertainties could cause tenants and others who deal with us to seek to change existing business relationships.

The pursuit of the Merger and the preparation for the integration may place a significant burden on management and internal resources. Any significant diversion of management attention away from ongoing business and any difficulties encountered in the transition and integration process could materially and adversely affect us.

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In addition, the Merger Agreement restricts us, without Cole's consent, from making certain acquisitions and dispositions, from engaging in certain capital raising transactions and taking other specified actions while the Merger is pending. These restrictions may prevent us from pursuing attractive business opportunities and making other changes to our business prior to completion of the Merger or termination of the Merger Agreement.

*We may be unable to obtain in the anticipated timeframe, or at all, satisfaction of all conditions to complete the Merger or, in order to do so, we may be required to comply with material restrictions or conditions that may negatively affect the combined company after the Merger is completed or cause us to abandon the Merger. Failure to complete the Merger may materially and adversely affect us.*

Completion of the Merger is contingent upon, among other things, receipt of certain regulatory approvals and the absence of any injunction prohibiting the Merger. All required regulatory authorizations, approvals or consents may not be obtained or may contain terms, conditions or restrictions that will be detrimental to the combined company after completion of the Merger.

Our stockholders, as well as Cole's stockholders, must approve the Merger at special stockholder meetings to be held after our joint proxy and registration statement is effective. If the stockholders of either company do not approve the Merger, the Merger will not be consummated.

In addition, satisfying the conditions to, and completion of, the Merger may take longer than, and could cost more than, we expect. Any delay in completing or any additional conditions imposed in order to complete the Merger may materially adversely affect the synergies and other benefits that we and Cole expect to achieve from the Merger and the integration of our businesses.

We may be unable to satisfy all the conditions to the Merger or succeed in any litigation brought in connection with the Merger. If the Merger is not completed, our financial results may be adversely affected and we will be subject to several risks, including but not limited to:

payment to Cole of a termination fee of \$55.0 million plus certain expenses, as specified in the Merger Agreement, depending on the nature of the termination;

payment of costs relating to the Merger, whether or not the Merger is completed; and

being subject to litigation related to any failure to complete the Merger.

Any delay or inability to satisfy all conditions to complete the Merger, or failure to complete the Merger, may materially and adversely affect us.

***If completed, the Merger may not achieve the intended results, and we and Cole may be unable to successfully integrate our operations.***

We and Cole entered into the Merger Agreement with the expectation that the Merger will result in various benefits, including, among other things, cost savings and operating efficiencies. Achieving the anticipated benefits of the Merger is subject to a number of uncertainties, including whether our business and that of Cole can be integrated in an efficient and effective manner.

If the Merger is completed, it is possible that the integration process could take longer than anticipated, the disruption of each company's ongoing businesses, processes and systems or inconsistencies in standards, controls, procedures, practices and policies, any of which could adversely affect the combined company's ability to achieve the anticipated benefits of the Merger. The combined company's results of operations could also be adversely affected by any issues attributable to either company's operations that arise or are based on events or actions that occur prior to the closing of the Merger. The integration process is subject to a number of uncertainties, and no assurance can be given that the anticipated benefits will be realized or, if realized, the timing of their realization. Failure to achieve these anticipated benefits could result in increased costs or decreases in the amount of expected revenues and could materially and adversely affect the combined company.

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### **Risks Related to Our Business and Properties**

*We are subject to risks related to commercial real estate ownership that could reduce the value of our properties.*

Our core business is the ownership of real estate that is leased to retail, service and distribution companies on a triple-net basis. Accordingly, our performance is subject to risks incident to the ownership of commercial real estate, including:

inability to collect rents from tenants due to financial hardship, including bankruptcy;

changes in local real estate conditions in the markets in which we operate, including the availability and demand for single-tenant retail space;

changes in consumer trends and preferences that affect the demand for products and services offered by our tenants;

inability to lease or sell properties upon expiration or termination of existing leases;

environmental risks related to the presence of hazardous or toxic substances or materials on our properties;

the subjectivity of real estate valuations and changes in such valuations over time;

the illiquid nature of real estate compared to most other financial assets;

changes in laws and governmental regulations, including those governing real estate usage and zoning;

changes in interest rates and the availability of financing; and

changes in the general economic and business climate.

The occurrence of any of the risks described above may cause the value of our real estate to decline, which could materially and adversely affect us.

*Global market and economic conditions may materially and adversely affect us and our tenants.*

In the United States, market and economic conditions continue to be challenging as a result of the recent economic crisis, which resulted in increased unemployment, large-scale business failures and tight credit markets. Our results of operations are sensitive to changes in the overall economic conditions that impact our tenants' financial condition and leasing practices. Adverse economic conditions such as high unemployment levels, interest rates, tax rates and fuel and energy costs may have an impact on the results of operations and financial conditions of our tenants. During periods of economic slowdown, rising interest rates and declining demand for real estate may result in a general decline in rents or an increased incidence of defaults under existing leases. Rental rates and valuations for retail space, which have decreased over the past few years, have not fully recovered to pre-recession levels and we are unable to predict when they may do so. Continued volatility in the United States and global markets makes it difficult to determine the breadth and duration of the impact of the recent economic and financial market crises and the ways in which our tenants and our business may be affected. A continuation of the recent lack of demand for rental space could adversely affect our ability to maintain our current tenants and gain new tenants, which may affect our growth and profitability. Accordingly, the prolonged

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continuation or further worsening of recent financial conditions could materially and adversely affect us.

***Our business is dependent upon our tenants successfully operating their businesses and their failure to do so could materially and adversely affect us.***

Generally, each of our properties is operated and occupied by a single tenant. Therefore, the success of our investments is materially dependent on the financial stability of our tenants. The success of any one of our tenants is dependent on its individual business and its industry, which could be adversely affected by economic conditions in general, changes in consumer trends and preferences and other factors over which neither they nor we have control. Our portfolio consists primarily of properties leased to single tenants that operate in multiple

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locations, which means we own numerous properties operated by the same tenant. To the extent we finance numerous properties operated by one company, the general failure of that single tenant or a loss or significant decline in its business could materially and adversely affect us.

At any given time, any tenant may experience a downturn in its business that may weaken its operating results or the overall financial condition of individual properties or its business as whole. As a result, a tenant may delay lease commencement, fail to make rental payments when due, decline to extend a lease upon its expiration, become insolvent or declare bankruptcy. We depend on our tenants to operate the properties we own in a manner which generates revenues sufficient to allow them to meet their obligations to us, including their obligations to pay rent, maintain certain insurance coverage, pay real estate taxes and maintain the properties in a manner so as not to jeopardize their operating licenses or regulatory status. The ability of our tenants to fulfill their obligations under our leases may depend, in part, upon the overall profitability of their operations. Cash flow generated by certain tenant businesses may not be sufficient for a tenant to meet its obligations to us. Although our occupied properties are operationally essential to our tenants, meaning the property is essential to the tenant's generation of sales and profits, this does not guarantee that a tenant's operations at a particular property will be successful or that the tenant will meet all of its obligations to us. We could be materially and adversely affected if a number of our tenants were unable to meet their obligations to us.

### ***Single-tenant leases involve significant risks of tenant default.***

Our strategy focuses primarily on investing in single-tenant triple-net leased properties throughout the United States. The financial failure of, or default in payment by, a single tenant under its lease is likely to cause a significant or complete reduction in our rental revenue from that property and a reduction in the value of the property. We may also experience difficulty or a significant delay in re-leasing or selling such property. This risk is magnified in situations where we lease multiple properties to a single tenant under a master lease. A tenant failure or default under a master lease could reduce or eliminate rental revenue from multiple properties and reduce the value of such properties. Although the master lease structure may be beneficial to us because it restricts the ability of tenants to remove individual underperforming assets, there is no guarantee that a tenant will not default in its obligations to us or decline to renew its master lease upon expiration. The default of a tenant that leases multiple properties from us could materially and adversely affect us.

### ***A substantial number of our properties are leased to one tenant, which may result in increased risk due to tenant and industry concentrations.***

In February 2012, two of our general merchandising tenants, Shopko and Pamida, completed a merger. Prior to Shopko's merger with Pamida, we leased 114 properties to Shopko (which would have contributed 25.7% of our annual rent as of December 31, 2012) and 67 properties to Pamida (which would have contributed 3.7% of our annual rent as of December 31, 2012). Currently, we lease 181 properties to Shopko/Pamida, 179 of which are leased pursuant to three master leases. The Shopko/Pamida leases are guaranteed by Specialty Retail Shops Holding Corp., the parent company of Shopko/Pamida (the Shopko Guarantor).

Shopko/Pamida's future financial condition and results of operations will depend, in part, upon the successful integration of Shopko and Pamida, which operated as separate companies prior to their merger in February 2012. Shopko/Pamida has indicated that it intends to convert Pamida locations to the Shopko store concept and brand. In connection with this conversion, Shopko/Pamida will likely incur additional costs, including costs associated with liquidating Pamida merchandise, restocking Pamida locations and converting Pamida locations to the Shopko brand. We expect that these expenses will initially reduce the property-level rent coverage ratio and the ratio of corporate-level earnings before interest, taxes, depreciation, amortization and rent (EBITDAR) to net interest and rent expense of the Shopko Guarantor. Though we believe that expenses of the merged Shopko/Pamida entity will normalize over time, it is also possible that the expected benefits of the Shopko/Pamida merger ultimately will not be realized, will only partially be realized or may take longer to realize than anticipated. If the Shopko/Pamida integration costs are more than expected or if expected benefits do not materialize over the intermediate term, Shopko/Pamida's creditworthiness may deteriorate, and it may seek rent discounts or deferrals from us or default in its lease obligations to us.

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Because a significant portion of our revenues are derived from rental revenues received from Shopko/Pamida, defaults, breaches or delay in payment of rent by it may materially and adversely affect us. Effective January 2009, we began deferring collection and recognition of a portion of Shopko's rent for a two-year period totaling \$3.0 million in the aggregate and postponed scheduled contingent rent increases during this time. In September 2010, Shopko repaid, and we recognized, the total accumulated deferred amount (\$2.6 million) plus interest before its contractual due dates. As agreed, the scheduled contingent rent increase from Shopko was postponed from its originally scheduled date of June 2009 to June 2011, at which time Shopko began to pay and we began to recognize the increased rent amount.

As a result of the significant number of properties leased to Shopko/Pamida, our results of operations and financial condition will be closely tied to the performance of its stores and the retail industry in which it operates. Shopko/Pamida operates as a multi-department general merchandise retailer and retail health services provider primarily in mid-size and larger communities in the Midwest, Pacific Northwest, North Central and Western Mountain states. Shopko/Pamida is subject to the following risks, as well as other risks that we are not currently aware of, that could adversely affect its ability to pay rent to us:

The retail industry in which it operates is highly competitive, which could limit growth opportunities and reduce profitability. Shopko/Pamida competes with other discount retail merchants as well as mass merchants, catalog merchants, internet retailers and other general merchandise, apparel and household merchandise retailers. It faces strong competition from large national discount retailers, such as Walmart, Kmart and Target, and mid-tier merchants such as Kohl's and JCPenney.

Shopko/Pamida stores are geographically located in a limited number of regions, particularly in the Midwest, Pacific Northwest, North Central and Western Mountain states. Adverse economic conditions in these regions may materially and adversely affect its results of operations, retail sales and ability to make payments to us under the leases.

Fluctuations in quarterly performance and seasonality in retail operations may cause Shopko/Pamida's results of operations to vary considerably from quarter to quarter and could adversely affect its cash flows.

Shopko/Pamida stores are dependent on the efficient functioning of its distribution networks. Problems that cause delays or interruptions in the distribution networks could materially and adversely affect its results of operations.

Shopko/Pamida stores depend on attracting and retaining quality employees. Many employees are entry level or part-time employees with historically high rates of turnover.

If Shopko/Pamida experiences declines in its business, financial condition or results of operations, it may request discounts or deferrals on the rents it pays to us, seek to terminate its master leases with us or close certain of its stores, all of which could decrease the amount of revenue we receive from it. Decreases in the amount of revenue received from Shopko/Pamida could materially and adversely affect us.

***One tenant, operating in the building materials industry, leases a substantial number of our properties that contribute 6.5% of our annual rent and has been adversely affected by the current economic environment, which may result in increased risk of tenant default.***

Approximately \$6.9 million of net annual cash flow, representing \$18.4 million (6.5% of our annual rent) less non-cash revenue and non-recourse commercial mortgage-backed security (CMBS) debt service, was generated by 109 properties that we master lease to 84 Properties, LLC and its affiliates. 84 Properties, LLC and its affiliates (collectively, 84 Lumber), are privately held building materials and services suppliers to professional contractors and build-it-yourselfers that operate more than 280 stores, component plants, door shops, installation centers and engineered wood product shops in 35 states. Because a significant portion of our revenues is derived from rental revenues received from 84 Lumber, defaults, breaches or delay in payment of rent by 84 Lumber may materially and adversely affect us.

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84 Lumber is currently meeting its rent payment obligations to us and based upon financial information supplied to us (which we cannot independently verify), the properties subject to the master lease generate sufficient EBITDAR to cover the rental payments due to us. There can be no assurance that 84 Lumber will have the ability to continue to do this or that shareholders will continue to provide loans.

During 2011, there was a triggering event under the 84 Lumber CMBS loan agreement, which required the tenant to deposit (in addition to rental payments due under the master lease) escrow reserves for property taxes and insurance. This triggering event has since been cured. However, no assurance can be given that a triggering event will not occur in the future. If a monetary event of default were to occur under the 84 Lumber master lease or an event of default under the loan relating to the CMBS debt, then all funds, including those in excess of monthly tax and insurance costs, would be withheld by the lender. This would limit the amount of cash available for us to use in our business and could limit or eliminate our ability to make distributions to our common stockholders.

As a result of the significant number of properties leased to 84 Lumber, our results of operations and financial condition will be impacted by the performance of the 84 Lumber stores and the building materials supply industry in which they operate. 84 Lumber is subject to the following risks, as well as other risks that we are not currently aware of, that could adversely affect its ability to pay rent to us:

84 Lumber's financial performance depends significantly on the stability of the housing, residential construction and home improvement markets, as well as general economic conditions, including changes in gross domestic product. Adverse conditions in or sustained uncertainty about these markets or the economy could adversely impact consumer confidence, causing 84 Lumber's customers to delay purchasing or determine not to purchase home improvement products and services. Other factors (e.g., high levels of unemployment and foreclosures, interest rate fluctuations, fuel and other energy costs, labor and healthcare costs, the availability of financing, the state of the credit markets, including mortgages, home equity loans and consumer credit, weather, natural disasters and other conditions beyond our control) could further adversely affect demand for 84 Lumber's products and services, its costs of doing business and its ability to pay rent to us.

84 Lumber operates in markets that are highly competitive. In each market it serves, there are a number of other home improvement stores, electrical, plumbing and building materials supply houses and lumber yards. With respect to some products and services, 84 Lumber also competes with specialty design stores, showrooms, discount stores, local, regional and national hardware stores, mail order firms, warehouse clubs, independent building supply stores and other retailers, as well as with installers of home improvement products. Intense competitive pressures from one or more competitors could affect prices or demand for 84 Lumber's products and services and could adversely affect 84 Lumber and its ability to pay rent to us.

***The vast majority of our properties are leased to unrated tenants, and the tools we use to measure credit quality may not be accurate.***

The vast majority of our properties are leased to unrated tenants whom we determine, through our internal underwriting and credit analysis, to be creditworthy. Substantially all of our tenants are required to provide corporate-level financial information, which includes balance sheet, income statement and cash flow statement data on an annual basis, and the vast majority of our lease investment portfolio require the tenant to provide property-level performance information, which includes income statement data on an annual basis. To assist in our determination of a tenant's credit quality, we license a product from Moody's Analytics that provides an estimated default frequency (EDF) and a shadow rating, and we evaluate a lease's property-level rent coverage ratio. An EDF is only an estimate of default probability based, in part, on assumptions incorporated into the product. A shadow rating does not constitute a published credit rating and lacks the extensive company participation that is typically involved when a rating agency publishes a rating; accordingly, a shadow rating may not be as indicative of creditworthiness as a rating published by Moody's Investment Services, Inc. (Moody's), Standard & Poor's (S&P) or another nationally recognized statistical rating organization. Our calculations of EDFs, shadow ratings and rent coverage ratios are based on financial information provided to us by our tenants and prospective tenants

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without independent verification on our part, and we must assume the appropriateness of estimates and judgments that were made by the party preparing the financial information. If our assessment of credit quality proves to be inaccurate, we may be subject to defaults, and investors may view our cash flows as less stable. The ability of an unrated tenant to meet its obligations to us may not be considered as well assured as that of rated tenant.

### ***The decrease in demand for retail and restaurant space may materially and adversely affect us.***

As of December 31, 2012, leases representing approximately 38.4% and 17.9% of our annual rent were with tenants in the retail and restaurant industries, respectively. In the future we may acquire additional retail and restaurant properties. Accordingly, decreases in the demand for retail and/or restaurant spaces may have a greater adverse effect on us than if we had fewer investments in these industries. The market for retail and restaurant space has been, and could continue to be, adversely affected by weakness in the national, regional and local economies, the adverse financial condition of some large retail and restaurant companies, the ongoing consolidation in the retail and restaurant industries, the excess amount of retail and restaurant space in a number of markets and, in the case of the retail industry, increasing consumer purchases through catalogues or the internet. To the extent that these conditions continue, they are likely to negatively affect market rents for retail and restaurant space and could materially and adversely affect us.

### ***We may be unable to renew leases, lease vacant space or re-lease space as leases expire on favorable terms or at all.***

Our results of operations depend on our ability to continue to strategically lease space in our properties, including renewing expiring leases, leasing vacant space and re-leasing space in properties where leases are expiring, optimizing our tenant mix or leasing properties on more economically favorable terms. As of December 31, 2012, leases representing approximately 0.8% of our annual rent will expire during 2013. As of December 31, 2012, 14 of our properties, representing approximately 1.2% of our total number of owned properties, were vacant. Current tenants may decline, or may not have the financial resources available, to renew current leases and we cannot assure you that leases that are renewed will have terms that are as economically favorable to us as the expiring lease terms. If tenants do not renew the leases as they expire, we will have to find new tenants to lease our properties and there is no guarantee that we will be able to find new tenants or that our properties will be re-leased at rental rates equal to or above the current average rental rates or that substantial rent abatements, tenant improvement allowances, early termination rights or below-market renewal options will not be offered to attract new tenants. We may experience significant costs in connection with re-leasing a significant number of our properties, which could materially and adversely affect us.

### ***Our ability to realize future rent increases will vary depending on changes in the CPI.***

Most of our leases contain rent escalators, or provisions that periodically increase the base rent payable by the tenant under the lease. Although some of our rent escalators increase rent at a fixed amount on fixed dates, most of our rent escalators increase rent by the lesser of (a) 1 to 1.25 times any increase in the CPI over a specified period or (b) a fixed percentage. If the product of any increase in the CPI multiplied by the applicable factor is less than the fixed percentage, the increased rent we are entitled to receive will be less than what we otherwise would have been entitled to receive if the rent escalator was based solely on a fixed percentage. Therefore, during periods of low inflation or deflation, small increases or decreases in the CPI will subject us to the risk of receiving lower rental revenue than we otherwise would have been entitled to receive if our rent escalators were based solely on fixed percentages or amounts. Conversely, if the product of any increase in the CPI multiplied by the applicable factor is more than the fixed percentage, the increased rent we are entitled to receive will be less than what we otherwise would have been entitled to receive if the rent escalator was based solely on an increase in CPI. Therefore, periods of high inflation will subject us to the risk of receiving lower rental revenue than we otherwise would have been entitled to receive if our rent escalators were based solely on CPI increases.



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### ***The bankruptcy or insolvency of any of our tenants could result in the termination of such tenant's lease and material losses to us.***

The occurrence of a tenant bankruptcy or insolvency could diminish the income we receive from that tenant's lease or leases. If a tenant becomes bankrupt or insolvent, federal law may prohibit us from evicting such tenant based solely upon such bankruptcy or insolvency. In addition, a bankrupt or insolvent tenant may be authorized to reject and terminate its lease or leases with us. Any claims against such bankrupt tenant for unpaid future rent would be subject to statutory limitations that would likely result in our receipt of rental revenues that are substantially less than the contractually specified rent we are owed under the lease or leases. In addition, any claim we have for unpaid past rent, if any, may not be paid in full. We may also be unable to re-lease a terminated or rejected space or to re-lease it on comparable or more favorable terms. As a result, tenant bankruptcies may materially and adversely affect us.

Tenants who are considering filing for bankruptcy protection may request that we agree to amendments of their master leases to remove certain of the properties they lease from us under such master leases. In 2010, two of the tenants with whom we have master leases filed for protection under federal bankruptcy law. During such bankruptcy filings, we entered into amendments to the master leases with both tenants, pursuant to which one tenant was permitted to remove from its master lease 15 of the 22 properties it leased from us in exchange for \$6.25 million in termination fees and the other tenant was permitted to remove from its master lease three of the nine properties it leased from us for \$6.0 million in termination fees. Although, as of December 31, 2012, we have sold or re-leased 17 of the 18 properties that were vacated in connection with these amendments, we cannot guarantee that we will be able to sell or re-lease the remaining property on terms that are favorable to us, or at all. This proceeding is ongoing and we cannot predict its outcome with certainty. We cannot guarantee that we will be able to sell or re-lease properties that we agree to release from tenants' leases in the future or that lease termination fees, if any, will be sufficient to make up for the rental revenues lost as a result of lease amendments.

### ***Property vacancies could result in significant capital expenditures.***

The loss of a tenant, either through lease expiration or tenant bankruptcy or insolvency, may require us to spend significant amounts of capital to renovate the property before it is suitable for a new tenant and cause us to incur significant costs. Many of the leases we enter into or acquire are for properties that are especially suited to the particular business of our tenants. Because these properties have been designed or physically modified for a particular tenant, if the current lease is terminated or not renewed, we may be required to renovate the property at substantial costs, decrease the rent we charge or provide other concessions in order to lease the property to another tenant. In addition, in the event we are required to sell the property, we may have difficulty selling it to a party other than the tenant due to the special purpose for which the property may have been designed or modified. This potential illiquidity may limit our ability to quickly modify our portfolio in response to changes in economic or other conditions, including tenant demand. These limitations may materially and adversely affect us.

### ***We may be unable to identify and complete acquisitions of suitable properties, which may impede our growth, and our future acquisitions may not yield the returns we expect.***

Our ability to expand through acquisitions requires us to identify and complete acquisitions or investment opportunities that are compatible with our growth strategy and to successfully integrate newly acquired properties into our portfolio. We continually evaluate investment opportunities and may acquire properties when strategic opportunities exist. Our ability to acquire properties on favorable terms and successfully operate them may be constrained by the following significant risks:

we face competition from other real estate investors with significant capital, including REITs and institutional investment funds, which may be able to accept more risk than we can prudently manage, including risks associated with paying higher acquisition prices;

we face competition from other potential acquirers which may significantly increase the purchase price for a property we acquire, which could reduce our growth prospects;

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we may incur significant costs and divert management attention in connection with evaluating and negotiating potential acquisitions, including ones that we are subsequently unable to complete;

we may acquire properties that are not accretive to our results upon acquisition, and we may be unsuccessful in managing and leasing such properties in accordance with our expectations;

our cash flow from an acquired property may be insufficient to meet our required principal and interest payments with respect to debt used to finance the acquisition of such property;

we may discover unexpected items, such as unknown liabilities, during our due diligence investigation of a potential acquisition or other customary closing conditions may not be satisfied, causing us to abandon an acquisition opportunity after incurring expenses related thereto;

we may fail to obtain financing for an acquisition on favorable terms or at all;

we may spend more than budgeted amounts to make necessary improvements or renovations to acquired properties;

market conditions may result in higher than expected vacancy rates and lower than expected rental rates; or

we may acquire properties subject to liabilities and without any recourse, or with only limited recourse, with respect to unknown liabilities such as liabilities for clean-up of undisclosed environmental contamination, claims by tenants, vendors or other persons dealing with the former owners of the properties, liabilities incurred in the ordinary course of business and claims for indemnification by general partners, directors, officers and others indemnified by the former owners of the properties.

If any of these risks are realized, we may be materially and adversely affected.

***Illiquidity of real estate investments could significantly impede our ability to respond to adverse changes in the performance of our properties and harm our financial condition.***

The real estate investments made, and expected to be made, by us are relatively difficult to sell quickly. As a result, our ability to promptly sell one or more properties in our portfolio in response to changing economic, financial or investment conditions is limited. Return of capital and realization of gains, if any, from an investment generally will occur upon disposition or refinancing of the underlying property. We may be unable to realize our investment objective by sale, other disposition or refinancing at attractive prices within any given period of time or may otherwise be unable to complete any exit strategy. In particular, these risks could arise from weakness in or even the lack of an established market for a property, changes in the financial condition or prospects of prospective purchasers, changes in national or international economic conditions, such as the economic downturn of 2008 through 2010, and changes in laws, regulations or fiscal policies of the jurisdiction in which the property is located.

In addition, the Code imposes restrictions on a REIT's ability to dispose of properties that are not applicable to other types of real estate companies. In particular, the tax laws applicable to REITs effectively require that we hold our properties for investment, rather than primarily for sale in the ordinary course of business, which may cause us to forgo or defer sales of properties that otherwise would be in our best interest. Therefore, we may not be able to vary our portfolio in response to economic or other conditions promptly or on favorable terms, which may materially and adversely affect us.

***We face significant competition for tenants, which may decrease or prevent increases of the occupancy and rental rates of our properties, and competition for acquisitions may reduce the number of acquisitions we are able to complete and increase the costs of these acquisitions.***

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We compete with numerous developers, owners and operators of properties, many of which own properties similar to ours in the same markets in which our properties are located. If our competitors offer space at rental rates below current market rates or below the rental rates we currently charge our tenants, we may lose existing or potential tenants and we may be pressured to reduce our rental rates or to offer more substantial rent

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abatements, tenant improvements, early termination rights or below-market renewal options in order to retain tenants when our leases expire. Competition for tenants could decrease or prevent increases of the occupancy and rental rates of our properties, which could materially and adversely affect us.

We also face competition for acquisitions of real property from investors, including traded and non-traded public REITs, private equity investors and institutional investment funds, some of which have greater financial resources than we do, a greater ability to borrow funds to acquire properties and the ability to accept more risk than we can prudently manage. This competition may increase the demand for the types of properties in which we typically invest and, therefore, reduce the number of suitable acquisition opportunities available to us and increase the prices paid for such acquisition properties. This competition will increase if investments in real estate become more attractive relative to other types of investment. Accordingly, competition for the acquisition of real property could materially and adversely affect us.

***The loss of a borrower or the failure of a borrower to make loan payments on a timely basis will reduce our revenues, which could lead to losses on our investments and reduced returns to our stockholders.***

We have originated or acquired long-term, commercial mortgage and equipment loans. The success of our loan investments is materially dependent on the financial stability of our borrowers. The success of our borrowers is dependent on each of their individual businesses and their industries, which could be affected by economic conditions in general, changes in consumer trends and preferences and other factors over which neither they nor we have control. A default of a borrower on its loan payments to us that would prevent us from earning interest or receiving a return of the principal of our loan could materially and adversely affect us. In the event of a default, we may also experience delays in enforcing our rights as lender and may incur substantial costs in collecting the amounts owed to us and in liquidating any collateral.

Foreclosure and other similar proceedings used to enforce payment of real estate loans are generally subject to principles of equity, which are designed to relieve the indebted party from the legal effect of that party's default. Foreclosure and other similar laws may limit our right to obtain a deficiency judgment against the defaulting party after a foreclosure or sale. The application of any of these principles may lead to a loss or delay in the payment on loans we hold, which in turn could reduce the amounts we have available to make distributions. Further, in the event we have to foreclose on a property, the amount we receive from the foreclosure sale of the property may be inadequate to fully pay the amounts owed to us by the borrower and our costs incurred to foreclose, repossess and sell the property which could materially and adversely affect us.

***If we invest in mortgage loans, these investments may be affected by unfavorable real estate market conditions, including interest rate fluctuations, which could decrease the value of those loans.***

If we invest in mortgage loans, we will be at risk of defaults by the borrowers and, in addition, will be subject to interest rate risks. To the extent we incur delays in liquidating defaulted mortgage loans, we may not be able to obtain all amounts due to us under such loans. Further, we will not know whether the values of the properties securing the mortgage loans will remain at the levels existing on the dates of origination of those mortgage loans or the dates of our investment in the loans. If the values of the underlying properties decline, the value of the collateral securing our mortgage loans will also decline and if we were to foreclose on any of the properties securing the mortgage loans, we may not be able to sell or lease them for an amount equal to the unpaid amounts due to us under the mortgage loans. As a result, defaults on mortgage loans in which we invest may materially and adversely affect us.

***Inflation may materially and adversely affect us and our tenants.***

Increased inflation could have a negative impact on variable-rate debt we currently have or that we may incur in the future. During times when inflation is greater than the increases in rent provided by many of our leases, rent increases will not keep up with the rate of inflation. Increased costs may have an adverse impact on our tenants if increases in their operating expenses exceed increases in revenue, which may adversely affect the tenants' ability to pay rent owed to us.

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*Our growth depends on external sources of capital that are outside of our control and may not be available to us on commercially reasonable terms or at all.*

In order to maintain our qualification as a REIT, we are required under the Code, among other things, to distribute annually at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gain. In addition, we will be subject to income tax at regular corporate rates to the extent that we distribute less than 100% of our REIT taxable income, determined without regard to the dividends paid deduction and including any net capital gain. Because of these distribution requirements, we may not be able to fund future capital needs, including any necessary acquisition financing, from operating cash flow. Consequently, we may rely on third-party sources to fund our capital needs. We may not be able to obtain the financing on favorable terms or at all. Any additional debt we incur will increase our leverage and likelihood of default. Our access to third-party sources of capital depends, in part, on:

general market conditions;

the market's perception of our growth potential;

our current debt levels;

our current and expected future earnings;

our cash flow and cash distributions; and

the market price per share of our common stock.

Recently, the credit markets have been subject to significant disruptions. If we cannot obtain capital from third-party sources, we may not be able to acquire properties when strategic opportunities exist, meet the capital and operating needs of our existing properties, satisfy our debt service obligations or make the cash distributions to our stockholders necessary to maintain our qualification as a REIT.

Historically, we have raised a significant amount of debt capital through our master trust facility and the CMBS market. We have generally used the proceeds from these financings to repay debt and fund real estate acquisitions. As of December 31, 2012, we had issued notes under our master trust facility in three separate issuances with an aggregate outstanding principal balance of \$937.4 million. These notes mature in July 2020, March 2021 and March 2022, respectively. As of December 31, 2012, we also had CMBS loans with an aggregate outstanding principal balance of \$1.01 billion and an average maturity of 3.5 years. Our obligations under these loans are generally secured by liens on certain of our properties. In the case of our master trust facility, subject to certain conditions, we may substitute real estate collateral from time to time. No assurance can be given that the CMBS market will be available to us in the future, whether to refinance existing debt or to raise additional debt capital. Moreover, we view our ability to substitute collateral under our master trust facility favorably, and no assurance can be given that financing facilities offering similar flexibility will be available to us in the future.

*Failure to hedge effectively against interest rate changes may materially and adversely affect us.*

We attempt to mitigate our exposure to interest rate volatility by using interest rate hedging arrangements. However, these arrangements involve risks and may not be effective in reducing our exposure to interest rate changes. In addition, the counterparties to our hedging arrangements may not honor their obligations. Failure to hedge effectively against changes in interest rates relating to the interest expense of our future borrowings may materially and adversely affect us.

*Loss of our key personnel with long-standing business relationships could materially impair our ability to operate successfully.*

Our continued success and our ability to manage anticipated future growth depend, in large part, upon the efforts of key personnel, particularly our Chief Executive Officer and Chairman of our board of directors, Thomas H. Nolan, Jr., and our President and Chief Operating Officer,

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Peter M. Mavoides, who have extensive market knowledge and relationships and exercise substantial influence over our operational, financing,

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acquisition and disposition activity. Among the reasons that they are important to our success is that each has a national or regional industry reputation that attracts business and investment opportunities and assists us in negotiations with lenders, existing and potential tenants and industry personnel.

Many of our other key executive personnel, particularly our senior managers, also have extensive experience and strong reputations in the real estate industry and have been instrumental in setting our strategic direction, operating our business, identifying, recruiting and training key personnel and arranging necessary financing. In particular, the extent and nature of the relationships that these individuals have developed with financial institutions and existing and prospective tenants is critically important to the success of our business. The loss of services of one or more members of our senior management team, or our inability to attract and retain highly qualified personnel, could adversely affect our business, diminish our investment opportunities and weaken our relationships with lenders, business partners, existing and prospective tenants and industry personnel, which could materially and adversely affect us.

***We have a limited operating history as a public company and our past experience may not be sufficient to allow us to successfully operate as a public company going forward.***

We have a limited operating history as a publicly traded company. Prior to our public offering in September 2012, we had not been publicly traded since 2007. We cannot assure you that our past experience will be sufficient to successfully operate our company as a publicly traded company, including the requirements to timely meet disclosure requirements of the SEC, and comply with the Sarbanes-Oxley Act of 2002. We are required to develop and implement control systems and procedures in order to satisfy our periodic and current reporting requirements under applicable SEC regulations and comply with the NYSE, listing standards, and this transition could place a significant strain on our management systems, infrastructure and other resources. Failure to operate successfully as a public company could materially and adversely affect us.

***We may become subject to litigation, which could materially and adversely affect us.***

In the future we may become subject to litigation, including claims relating to our operations, security offerings and otherwise in the ordinary course of business. Some of these claims may result in significant defense costs and potentially significant judgments against us, some of which are not, or cannot be, insured against. We generally intend to vigorously defend ourselves. However, we cannot be certain of the ultimate outcomes of any claims that may arise in the future. Resolution of these types of matters against us may result in our having to pay significant fines, judgments, or settlements, which, if uninsured, or if the fines, judgments, and settlements exceed insured levels, could adversely impact our earnings and cash flows, thereby materially and adversely affecting us. Certain litigation or the resolution of certain litigation may affect the availability or cost of some of our insurance coverage, which could materially and adversely impact us, expose us to increased risks that would be uninsured, and materially and adversely impact our ability to attract directors and officers.

Further, in connection with the Merger, we may face litigation alleging, among other things, that our board of directors conducted an unfair sales process resulting in unfair consideration to our stockholders in the Merger and seeking to enjoin the Merger and seek unspecified monetary damages. If such litigation occurs, it could prevent or delay the completion of the Merger, divert the attention of our management and that of Cole from operating our respective businesses, and result in substantial costs to us, including any costs associated with any applicable indemnification obligations. The defense or settlement of any lawsuit or claim that remains unresolved at the time of the Merger may materially and adversely affect us.

***If we fail to maintain an effective system of internal control over financial reporting and disclosure controls, we may not be able to accurately and timely report our financial results.***

Effective internal control over financial reporting and disclosure controls are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. Beginning with our 2013 Annual Report on Form 10-K to be filed in 2014, we will be required to perform system

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and process evaluation and testing of our internal control over financial reporting to allow management to report on, and our independent registered public accounting firm to attest to, the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002. To date, the audit of our consolidated financial statements by our independent registered public accounting firm has included a consideration of internal control over financial reporting as a basis of designing their audit procedures but not for the purpose of expressing an opinion (as will be required pursuant to Section 404 of the Sarbanes-Oxley Act of 2002) on the effectiveness of our internal control over financial reporting. As a result of material weaknesses or significant deficiencies that may be identified in our internal control over financial reporting, we may also identify certain deficiencies in some of our disclosure controls and procedures that we believe require remediation. If we or our independent registered public accounting firm discover weaknesses, we will make efforts to improve our internal control over financial reporting and disclosure controls. However, there is no assurance that we will be successful. Any failure to maintain effective controls or timely effect any necessary improvement of our internal control over financial reporting and disclosure controls could harm operating results or cause us to fail to meet our reporting obligations, which could affect the listing of our common stock on the NYSE. Ineffective internal control over financial reporting and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the per share trading price of our common stock.

***The costs of compliance with or liabilities related to environmental laws may materially and adversely affect us.***

The properties we own or have owned in the past may subject us to known and unknown environmental liabilities. Under various federal, state and local laws and regulations relating to the environment, as a current or former owner or operator of real property, we may be liable for costs and damages resulting from the presence or discharge of hazardous or toxic substances, waste or petroleum products at, on, in, under or migrating from such property, including costs to investigate, clean up such contamination and liability for harm to natural resources. We may face liability regardless of:

our knowledge of the contamination;

the timing of the contamination;

the cause of the contamination; or

the party responsible for the contamination of the property.

There may be environmental liabilities associated with our properties of which we are unaware. We obtain Phase I environmental site assessments on all properties we finance or acquire. The Phase I environmental site assessments are limited in scope and therefore may not reveal all environmental conditions affecting a property. Therefore, there could be undiscovered environmental liabilities on the properties we own. Some of our properties use, or may have used in the past, underground tanks for the storage of petroleum-based products or waste products that could create a potential for release of hazardous substances or penalties if tanks do not comply with legal standards. If environmental contamination exists on our properties, we could be subject to strict, joint and/or several liability for the contamination by virtue of our ownership interest. Some of our properties may contain ACM. Strict environmental laws govern the presence, maintenance and removal of ACM and such laws may impose fines and penalties for failure to comply with these requirements or expose us to third-party liability (e.g., liability for personal injury associated with exposure to asbestos). Strict environmental laws also apply to other activities that can occur on a property, such as air emissions and water discharges, and such laws may impose fines and penalties for violations.

The presence of hazardous substances on a property may adversely affect our ability to sell, lease or improve the property or to borrow using the property as collateral. In addition, environmental laws may create liens on contaminated properties in favor of the government for damages and costs it incurs to address such contamination. Moreover, if contamination is discovered on our properties, environmental laws may impose restrictions on the manner in which they may be used or businesses may be operated, and these restrictions may require substantial expenditures.



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In addition, although our leases generally require our tenants to operate in compliance with all applicable laws and to indemnify us against any environmental liabilities arising from a tenant's activities on the property, we could be subject to strict liability by virtue of our ownership interest. We cannot be sure that our tenants will, or will be able to, satisfy their indemnification obligations, if any, under our leases. Furthermore, the discovery of environmental liabilities on any of our properties could lead to significant remediation costs or to other liabilities or obligations attributable to the tenant of that property, which may affect such tenant's ability to make payments to us, including rental payments and, where applicable, indemnification payments.

Our environmental liabilities may include property damage, personal injury, investigation and clean-up costs. These costs could be substantial. Although we may obtain insurance for environmental liability for certain properties that are deemed to warrant coverage, our insurance may be insufficient to address any particular environmental situation and we may be unable to continue to obtain insurance for environmental matters, at a reasonable cost or at all, in the future. If our environmental liability insurance is inadequate, we may become subject to material losses for environmental liabilities. Our ability to receive the benefits of any environmental liability insurance policy will depend on the financial stability of our insurance company and the position it takes with respect to our insurance policies. If we were to become subject to significant environmental liabilities, we could be materially and adversely affected.

Most of the environmental risks discussed above refer to properties that we own or may acquire in the future. However, each of the risks identified also applies to the owners (and potentially, the lessees) of the properties that secure each of the loans we have made and any loans we may acquire or make in the future. Therefore, the existence of environmental conditions could diminish the value of each of the loans and the abilities of the borrowers to repay the loans and could materially and adversely affect us.

### ***Our properties may contain or develop harmful mold, which could lead to liability for adverse health effects and costs of remediation.***

When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. Concern about indoor exposure to mold has been increasing, as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, should our tenants or their employees or customers be exposed to mold at any of our properties we could be required to undertake a costly remediation program to contain or remove the mold from the affected property. In addition, exposure to mold by our tenants or others could subject us to liability if property damage or health concerns arise. If we were to become subject to significant mold-related liabilities, we could be materially and adversely affected.

### ***Insurance on our properties may not adequately cover all losses and uninsured losses could materially and adversely affect us.***

Our tenants are required to maintain liability and property insurance coverage for the properties they lease from us pursuant to triple-net leases. Pursuant to such leases, our tenants are required to name us (and any of our lenders that have a mortgage on the property leased by the tenant) as additional insureds on their liability policies and additional named insured and/or loss payee (or mortgagee, in the case of our lenders) on their property policies. All tenants are required to maintain casualty coverage and most carry limits at 100% of replacement cost. Depending on the location of the property, losses of a catastrophic nature, such as those caused by earthquakes and floods, may be covered by insurance policies that are held by our tenant with limitations such as large deductibles or co-payments that a tenant may not be able to meet. In addition, losses of a catastrophic nature, such as those caused by wind/hail, hurricanes, terrorism or acts of war, may be uninsurable or not economically insurable. In the event there is damage to our properties that is not covered by insurance and such properties are subject to recourse indebtedness, we will continue to be liable for the indebtedness, even if these properties are irreparably damaged.

Inflation, changes in building codes and ordinances, environmental considerations, and other factors, including terrorism or acts of war, may make any insurance proceeds we receive insufficient to repair or replace

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a property if it is damaged or destroyed. In that situation, the insurance proceeds received may not be adequate to restore our economic position with respect to the affected real property. Furthermore, in the event we experience a substantial or comprehensive loss of one of our properties, we may not be able to rebuild such property to its existing specifications without significant capital expenditures which may exceed any amounts received pursuant to insurance policies, as reconstruction or improvement of such a property would likely require significant upgrades to meet zoning and building code requirements. The loss of our capital investment in or anticipated future returns from our properties due to material uninsured losses could materially and adversely affect us.

***Compliance with the ADA and fire, safety and other regulations may require us to make unanticipated expenditures that materially and adversely affect us.***

Our properties are subject to the ADA. Under the ADA, all public accommodations must meet federal requirements related to access and use by disabled persons. Compliance with the ADA requirements could require removal of access barriers and non-compliance could result in imposition of fines by the U.S. government or an award of damages to private litigants, or both. While our tenants are obligated by law to comply with the ADA and typically obligated under our leases and financing agreements to cover costs associated with compliance, if required changes involve greater expenditures than anticipated or if the changes must be made on a more accelerated basis than anticipated, the ability of our tenants to cover costs could be adversely affected. We could be required to expend our own funds to comply with the provisions of the ADA, which could materially and adversely affect us.

In addition, we are required to operate our properties in compliance with fire and safety regulations, building codes and other land use regulations, as they may be adopted by governmental agencies and bodies and become applicable to our properties. We may be required to make substantial capital expenditures to comply with those requirements and may be required to obtain approvals from various authorities with respect to our properties, including prior to acquiring a property or when undertaking renovations of any of our existing properties. There can be no assurance that existing laws and regulatory policies will not adversely affect us or the timing or cost of any future acquisitions or renovations, or that additional regulations will not be adopted that increase such delays or result in additional costs. Additionally, failure to comply with any of these requirements could result in the imposition of fines by governmental authorities or awards of damages to private litigants. While we intend to only acquire properties that we believe are currently in substantial compliance with all regulatory requirements, these requirements may change and new requirements may be imposed which would require significant unanticipated expenditures by us and could materially and adversely affect us.

***As a result of acquiring C corporations in carry-over basis transactions, we may inherit material tax liabilities and other tax attributes from such acquired corporations, and we may be required to distribute earnings and profits.***

From time to time, we have and may continue to acquire C corporations in transactions in which the basis of the corporations' assets in our hands is determined by reference to the basis of the assets in the hands of the acquired corporations, or carry-over basis transactions. In June 2005, we acquired Camelback Ski Corporation in a cash merger treated as a stock purchase followed by a liquidation of such corporation for federal income tax purposes. In May 2006, we acquired Shopko Stores, Inc. in a stock purchase and immediately thereafter dissolved such corporation. In December 2008, we revoked the election to treat Spirit Management Company, our former taxable REIT subsidiary, as a taxable REIT subsidiary for federal income tax purposes. In each such transaction, we acquired the assets of such corporations in a carry-over basis transaction for federal income tax purposes.

In connection with the IPO, Redford Australian Investment Trust ( RAIT ), an Australian investment trust through which our non-U.S. investors indirectly owned shares of our common stock prior to the IPO, transferred substantially all of its assets (including shares of our common stock) to our company in exchange for newly issued shares of our common stock, and RAIT liquidated and distributed such shares to its owners. Such exchange of shares of our common stock held by RAIT for newly issued shares of our common stock was on a

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one-for-one basis. RAIT was treated as a C corporation for federal income tax purposes, and such transactions were intended to qualify as a tax-free reorganization for federal income tax purposes. We did not acquire any earnings and profits of RAIT as a result of such transactions.

If we acquire any asset from a corporation that is or has been a C corporation in a transaction in which the basis of the asset in our hands is less than the fair market value of the asset, in each case determined at the time we acquired the asset, and we subsequently recognize gain on the disposition of the asset during the ten-year period (or the five-year period in the case of dispositions in 2012 and 2013) beginning on the date on which we acquired the asset, then we will be required to pay tax at the highest regular corporate tax rate on this gain to the extent of the excess of (1) the fair market value of the asset over (2) our adjusted basis in the asset, in each case determined as of the date on which we acquired the asset. Any taxes we pay as a result of such gain would reduce the amount available for distribution to our stockholders. The imposition of such tax may require us to forgo an otherwise attractive disposition of any assets we acquire from a C corporation in a carry-over basis transaction, and as a result may reduce the liquidity of our portfolio of investments. In addition, in such a carry-over basis transaction, we will succeed to any tax liabilities and earnings and profits of the acquired C corporation. To qualify as a REIT, we must distribute any non-REIT earnings and profits by the close of the taxable year in which such transaction occurs. Any adjustments to the acquired corporation's income for taxable years ending on or before the date of the transaction, including as a result of an examination of the corporation's tax returns by the Internal Revenue Service (the IRS), could affect the calculation of the corporation's earnings and profits. If the IRS were to determine that we acquired non-REIT earnings and profits from a corporation that we failed to distribute prior to the end of the taxable year in which the carry-over basis transaction occurred, we could avoid disqualification as a REIT by paying a deficiency dividend. Under these procedures, we generally would be required to distribute any such non-REIT earnings and profits to our stockholders within 90 days of the determination and pay a statutory interest charge at a specified rate to the IRS. Such a distribution would be in addition to the distribution of REIT taxable income necessary to satisfy the REIT distribution requirement and may require that we borrow funds to make the distribution even if the then-prevailing market conditions are not favorable for borrowings. In addition, payment of the statutory interest charge could materially and adversely affect us.

***Changes in accounting standards may materially and adversely affect us.***

From time to time the Financial Accounting Standards Board (FASB), and the SEC, who create and interpret appropriate accounting standards, may change the financial accounting and reporting standards or their interpretation and application of these standards that will govern the preparation of our financial statements. These changes could materially and adversely affect our reported financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in restating prior period financial statements. Similarly, these changes could materially and adversely affect our tenants' reported financial condition or results of operations and affect their preferences regarding leasing real estate.

The SEC is currently considering whether issuers in the United States should be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) instead of U.S. generally accepted accounting principles (GAAP). IFRS is a comprehensive set of accounting standards promulgated by the International Accounting Standards Board (IASB), which are rapidly gaining worldwide acceptance. If the SEC decides to require IFRS, it expects that U.S. issuers would first report under the new standards beginning as early as 2015 or 2016, although the timeframe has not been finalized. If IFRS is adopted, the potential issues associated with lease accounting, along with other potential changes associated with the adoption or convergence with IFRS, may materially and adversely affect us.

Additionally, the FASB is considering various changes to GAAP, some of which may be significant, as part of a joint effort with the IASB to converge accounting standards. In particular, FASB has proposed accounting rules that would require companies to capitalize all leases on their balance sheets by recognizing a lessee's rights and obligations. If the proposal is adopted in its current form, many companies that account for certain leases on an off-balance sheet basis would be required to account for such leases on balance sheet. This change would

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remove many of the differences in the way companies account for owned property and leased property, and could have a material effect on various aspects of our tenants' businesses, including their credit quality and the factors they consider in deciding whether to own or lease properties. If the proposal is adopted in its current form, it could cause companies that lease properties to prefer shorter lease terms in an effort to reduce the leasing liability required to be recorded on the balance sheet. The proposal could also make lease renewal options less attractive, because, under certain circumstances, the rule would require a tenant to assume that a renewal right will be exercised and accrue a liability relating to the longer lease term.

***In the future, we may choose to acquire properties or portfolios of properties through tax deferred contribution transactions, which could result in stockholder dilution and limit our ability to sell such assets.***

In the future we may acquire properties or portfolios of properties through tax deferred contribution transactions in exchange for partnership interests in the Operating Partnership, which may result in stockholder dilution. This acquisition structure may have the effect of, among other things, reducing the amount of tax depreciation we could deduct over the tax life of the acquired properties, and may require that we agree to protect the contributors' ability to defer recognition of taxable gain through restrictions on our ability to dispose of the acquired properties and/or the allocation of partnership debt to the contributors to maintain their tax bases. These restrictions could limit our ability to sell an asset at a time, or on terms, that would be favorable absent such restrictions.

## **Risks Related to Our Indebtedness**

***We have approximately \$1.95 billion principal balance of indebtedness outstanding, which may expose us to the risk of default under our debt obligations.***

As of December 31, 2012, our total outstanding consolidated indebtedness was approximately \$1.95 billion principal balance, of which \$49.5 million (or approximately 2.5%) is variable-rate debt (we have entered into four amortizing interest rate swaps that effectively fixed the interest rates on a significant portion of this variable-rate debt at approximately 4.84%), and we may incur significant additional debt to finance future investment activities. In addition, we have a \$100.0 million secured revolving Credit Facility, under which, no amounts were drawn as of December 31, 2012. Payments of principal and interest on borrowings may leave us with insufficient cash resources to meet our cash needs or make the distributions to our common stockholders necessary to maintain our REIT qualification. Our level of debt and the limitations imposed on us by our debt agreements could have significant adverse consequences, including the following:

our cash flow may be insufficient to meet our required principal and interest payments;

cash interest expense and financial covenants relating to our indebtedness may limit or eliminate our ability to make distributions to our common stockholders;

we may be unable to borrow additional funds as needed or on favorable terms, which could, among other things, adversely affect our ability to capitalize upon acquisition opportunities or meet operational needs;

we may be unable to refinance our indebtedness at maturity or the refinancing terms may be less favorable than the terms of our original indebtedness;

because a portion of our debt bears interest at variable rates, increases in interest rates could increase our interest expense;

we may be unable to hedge floating rate debt, counterparties may fail to honor their obligations under any hedge agreements we enter into, such agreements may not effectively hedge interest rate fluctuation risk, and, upon the expiration of any hedge agreements we enter into, we would be exposed to then-existing market rates of interest and future interest rate volatility;

we may be forced to dispose of properties, possibly on unfavorable terms or in violation of certain covenants to which we may be subject;

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we may default on our obligations and the lenders or mortgagees may foreclose on our properties or our interests in the entities that own the properties that secure their loans and receive an assignment of rents and leases;

we may be restricted from accessing some of our excess cash flow after debt service if certain of our tenants fail to meet certain financial performance metric thresholds;

we may violate restrictive covenants in our loan documents, which would entitle the lenders to accelerate our debt obligations; and

our default under any loan with cross-default provisions could result in a default on other indebtedness.

The occurrence of any of these events could materially and adversely affect us. Furthermore, foreclosures could create taxable income without accompanying cash proceeds, which could hinder our ability to meet the REIT distribution requirements imposed by the Code.

***Current market conditions could adversely affect our ability to refinance existing indebtedness or obtain additional financing for growth on acceptable terms or at all, which could materially and adversely affect us.***

Over the last few years, the credit markets have experienced significant price volatility, displacement and liquidity disruptions, including the bankruptcy, insolvency or restructuring of certain financial institutions. These circumstances have materially impacted liquidity in the financial markets, making financing terms for borrowers less attractive, and in certain cases, have resulted in the unavailability of various types of debt financing. As a result, we may be unable to obtain debt financing on favorable terms or at all or fully refinance maturing indebtedness with new indebtedness. Reductions in our available borrowing capacity or inability to obtain credit when required or when business conditions warrant could materially and adversely affect us.

Furthermore, if prevailing interest rates or other factors at the time of refinancing result in higher interest rates upon refinancing, then the interest expense relating to that refinanced indebtedness would increase. Higher interest rates on newly incurred debt may negatively impact us as well. If interest rates increase, our interest costs and overall costs of capital will increase, which could materially and adversely affect us.

Total debt payments for 2013 and 2014 are \$43.5 million and \$75.9 million, respectively. We expect to meet these repayment requirements primarily through net cash from operating activities.

***Some of our financing arrangements involve balloon payment obligations, which may materially and adversely affect us.***

Some of our financings require us to make a lump-sum or balloon payment at maturity. Our ability to make any balloon payment is uncertain and may depend on our ability to obtain additional financing or our ability to sell our properties. At the time the balloon payment is due, we may or may not be able to refinance the balloon payment on terms as favorable as the original loan or sell our properties at a price sufficient to make the balloon payment, if at all. If the balloon payment is refinanced at a higher rate, it will reduce or eliminate any income from our properties. Our inability to meet a balloon payment obligation, through refinancing or sale proceeds, or refinancing on less attractive terms could materially and adversely affect us. We have balloon maturities of \$580.7 million in 2016. If we are unable to refinance these maturities or otherwise retire the indebtedness by that time, we could be materially adversely affected, and could be forced to relinquish the related collateral, consisting of 206 properties, including 177 properties subject to two master leases and two individual leases with Shopko/Pamida.

***Our debt financing agreements, including the Credit Facility, contain restrictions and covenants which may limit our ability to enter into or obtain funding for certain transactions, operate our business or make distributions to our common stockholders.***

The agreements governing our borrowings, including the Credit Facility, contain financial and other covenants with which we are or will be required to comply and that limit or will limit our ability to operate our

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business. These covenants, as well as any additional covenants to which we may be subject in the future because of additional borrowings, could cause us to have to forego investment opportunities, reduce or eliminate distributions to our common stockholders or obtain financing that is more expensive than financing we could obtain if we were not subject to the covenants. In addition, the agreements governing our borrowing may have cross default provisions, which provide that a default under one of our debt financing agreements would lead to a default on all of our debt financing agreements.

If an event of default occurs under certain of our CMBS loans, if the master tenants at the properties which secure the CMBS loans fail to maintain certain EBITDAR ratios or if an uncured monetary default exists under the master leases, then a portion of or all of the cash which would otherwise be distributed to us may be restricted by the lenders and unavailable to us. This would limit the amount of cash available to us for use in our business and could limit or eliminate our ability to make distributions to our common stockholders. During 2011, there was a triggering event under the 84 Lumber CMBS loan agreement, which required the tenant to deposit (in addition to rental payments due under the master lease) escrow reserves for property taxes and insurance. This triggering event has since been cured. However, no assurance can be given that a triggering event will not occur in the future.

The covenants and other restrictions under our debt agreements affect, among other things, our ability to:

incur indebtedness;

create liens on assets;

sell or substitute assets;

modify certain terms of our leases;

manage our cash flows; and

make distributions to equity holders.

Additionally, these restrictions may adversely affect our operating and financial flexibility and may limit our ability to respond to changes in our business or competitive environment, all of which may materially and adversely affect us.

## **Risks Related to Our Organizational Structure**

*Our charter and bylaws and Maryland law contain provisions that may delay, defer or prevent a change of control transaction, even if such a change in control may be in the interest of our stockholders, and as a result may depress the market price of our common stock.*

*Our charter contains certain restrictions on ownership and transfer of our stock.* Our charter contains various provisions that are intended to preserve our qualification as a REIT and, subject to certain exceptions, authorize our directors to take such actions as are necessary or appropriate to preserve our qualification as a REIT. For example, our charter prohibits the actual, beneficial or constructive ownership by any person of more than 9.8% in value or number of shares, whichever is more restrictive, of the outstanding shares of our common stock or more than 9.8% in value of the aggregate of the outstanding shares of all classes and series of our stock. Our board of directors, in its sole and absolute discretion, may exempt a person, prospectively or retroactively, from these ownership limits if certain conditions are satisfied. The restrictions on ownership and transfer of our stock may:

discourage a tender offer or other transactions or a change in management or of control that might involve a premium price for our common stock or that our stockholders otherwise believe to be in their best interests; or

result in the transfer of shares acquired in excess of the restrictions to a trust for the benefit of a charitable beneficiary and, as a result, the forfeiture by the acquirer of the benefits of owning the additional shares.



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*We could increase the number of authorized shares of stock, classify and reclassify unissued stock and issue stock without stockholder approval.* Our board of directors, without stockholder approval, has the power under our charter to amend our charter to increase the aggregate number of shares of stock or the number of shares of stock of any class or series that we are authorized to issue, to authorize us to issue authorized but unissued shares of our common stock or preferred stock and to classify or reclassify any unissued shares of our common stock or preferred stock into one or more classes or series of stock and to set the terms of such newly classified or reclassified shares. As a result, we may issue one or more series or classes of common stock or preferred stock with preferences, dividends, powers and rights, voting or otherwise, that are senior to, or otherwise conflict with, the rights of our common stockholders. Although our board of directors has no such intention at the present time, it could establish a class or series of common stock or preferred stock that could, depending on the terms of such series, delay, defer or prevent a transaction or a change of control that might involve a premium price for our common stock or otherwise be in the best interest of our stockholders.

*Certain provisions of Maryland law could inhibit changes in control, which may discourage third parties from conducting a tender offer or seeking other change of control transactions that could involve a premium price for our common stock or that our stockholders otherwise believe to be in their best interest.* Certain provisions of the Maryland General Corporation Law (the "MGCL") may have the effect of inhibiting a third party from making a proposal to acquire us or of impeding a change of control under circumstances that otherwise could provide our common stockholders with the opportunity to realize a premium over the then-prevailing market price of such shares, including:

business combination provisions that, subject to certain limitations, prohibit certain business combinations between us and an interested stockholder (defined generally as any person who beneficially owns 10% or more of the voting power of our shares or an affiliate thereof or an affiliate or associate of ours who was the beneficial owner, directly or indirectly, of 10% or more of the voting power of our then outstanding voting stock at any time within a two-year period immediately prior to the date in question) or any affiliate of an interested stockholder for five years after the most recent date on which the stockholder becomes an interested stockholder, and thereafter impose fair price and/or supermajority and stockholder voting requirements on these combinations; and

control share provisions that provide that a holder of control shares of our company (defined as shares that, when aggregated with other shares controlled by the stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a control share acquisition (defined as the direct or indirect acquisition of ownership or control of outstanding control shares) has no voting rights with respect to those shares except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

As permitted by the MGCL, we have elected, by resolution of our board of directors, to opt out of the business combination provisions of the MGCL and, pursuant to a provision in our bylaws, to exempt any acquisition of our stock from the control share provisions of the MGCL. However, our board of directors may by resolution elect to repeal the exemption from the business combination provisions of the MGCL and may by amendment to our bylaws opt into the control share provisions of the MGCL at any time in the future, whether before or after an acquisition of control shares.

Certain provisions of the MGCL permit our board of directors, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to implement certain corporate governance provisions, some of which (for example, a classified board) are not currently applicable to us. These provisions may have the effect of limiting or precluding a third party from making an unsolicited acquisition proposal for us or of delaying, deferring or preventing a change in control of us under circumstances that otherwise could be in the best interests of our stockholders. Our charter contains a provision whereby we elect, at such time as we become eligible to do so, to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of directors.

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***Termination of the employment agreements with certain members of our senior management team could be costly and prevent a change in control of our company.***

The employment agreements with certain members of our senior management team provide that if their employment with us terminates under certain circumstances (including in connection with a change in control of our company), we may be required to pay them significant amounts of severance compensation, thereby making it costly to terminate their employment. Furthermore, these provisions could delay or prevent a transaction or a change in control of our company that might involve a premium paid for shares of our common stock or otherwise be in the best interests of our stockholders.

***Our board of directors may change our investment and financing policies without stockholder approval and we may become more highly leveraged, which may increase our risk of default under our debt obligations.***

Our investment and financing policies are exclusively determined by our board of directors. Accordingly, our stockholders do not control these policies. Further, our organizational documents do not limit the amount or percentage of indebtedness, funded or otherwise, that we may incur. Our board of directors may alter or eliminate our current policy on borrowing at any time without stockholder approval. If this policy changed, we could become more highly leveraged, which could result in an increase in our debt service. Higher leverage also increases the risk of default on our obligations. In addition, a change in our investment policies, including the manner in which we allocate our resources across our portfolio or the types of assets in which we seek to invest, may increase our exposure to interest rate risk, real estate market fluctuations and liquidity risk. Changes to our policies with regards to the foregoing could materially and adversely affect us.

***Our rights and the rights of our stockholders to take action against our directors and officers are limited.***

As permitted by Maryland law, our charter limits the liability of our directors and officers to us and our stockholders for money damages, except for liability resulting from:

actual receipt of an improper benefit or profit in money, property or services; or

active and deliberate dishonesty by the director or officer that was established by a final judgment as being material to the cause of action adjudicated.

As a result, we and our stockholders have rights against our directors and officers that are more limited than might otherwise exist. Accordingly, in the event that actions taken in good faith by any of our directors or officers impede the performance of our company, your and our ability to recover damages from such director or officer will be limited. In addition, our charter authorizes us to obligate our company, and our bylaws require us, to indemnify our directors and officers for actions taken by them in those and certain other capacities to the maximum extent permitted by Maryland law.

***We are a holding company with no direct operations and will rely on funds received from the Operating Partnership to pay liabilities.***

We are a holding company and conduct substantially all of our operations through the Operating Partnership. We do not have, apart from an interest in the Operating Partnership, any independent operations. As a result, we rely on distributions from the Operating Partnership to pay any dividends we might declare on shares of our common stock. We also rely on distributions from the Operating Partnership to meet any of our obligations, including any tax liability on taxable income allocated to us from the Operating Partnership. In addition, because we are a holding company, your claims as stockholders will be structurally subordinated to all existing and future liabilities and obligations (whether or not for borrowed money) of the Operating Partnership and its subsidiaries. Therefore, in the event of our bankruptcy, liquidation or reorganization, our assets and those of the Operating Partnership and its subsidiaries will be able to satisfy the claims of our stockholders only after all of our and the Operating Partnership's and its subsidiaries' liabilities and obligations have been paid in full.

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We own directly or indirectly 100% of the interests in the Operating Partnership. However, in connection with our future acquisition of properties or otherwise, we may issue units of the Operating Partnership to third parties. Such issuances would reduce our ownership in the Operating Partnership. Because you will not directly own units of the Operating Partnership, you will not have any voting rights with respect to any such issuances or other partnership level activities of the Operating Partnership.

***Conflicts of interest could arise in the future between the interests of our stockholders and the interests of holders of units in the Operating Partnership, which may impede business decisions that could benefit our stockholders.***

Conflicts of interest could arise in the future as a result of the relationships between us and our affiliates, on the one hand, and the Operating Partnership or any future partner thereof, on the other. Our directors and officers have duties to our company under applicable Maryland law in connection with the management of our company. At the same time, one of our wholly-owned subsidiaries, Spirit General OP Holdings, LLC, as the general partner of the Operating Partnership, has fiduciary duties and obligations to the Operating Partnership and its future limited partners under Delaware law and the partnership agreement of the Operating Partnership in connection with the management of the Operating Partnership. The fiduciary duties and obligations of Spirit General OP Holdings, LLC, as general partner of the Operating Partnership, and its future partners may come into conflict with the duties of our directors and officers to our company.

Under the terms of the partnership agreement of the Operating Partnership, if there is a conflict between the interests of our stockholders on one hand and any future limited partners on the other, we will endeavor in good faith to resolve the conflict in a manner not adverse to either our stockholders or any future limited partners; provided, however, that for so long as we own a controlling interest in the Operating Partnership, any conflict that cannot be resolved in a manner not adverse to either our stockholders or any future limited partners shall be resolved in favor of our stockholders.

The partnership agreement also provides that the general partner will not be liable to the Operating Partnership, its partners or any other person bound by the partnership agreement for monetary damages for losses sustained, liabilities incurred or benefits not derived by the Operating Partnership or any future limited partner, except for liability for the general partner's intentional harm or gross negligence. Moreover, the partnership agreement provides that the Operating Partnership is required to indemnify the general partner and its members, managers, managing members, officers, employees, agents and designees from and against any and all claims that relate to the operations of the Operating Partnership, except (1) if the act or omission of the person was material to the matter giving rise to the action and either was committed in bad faith or was the result of active or deliberate dishonesty, (2) for any transaction for which the indemnified party received an improper personal benefit, in money, property or services or otherwise in violation or breach of any provision of the partnership agreement or (3) in the case of a criminal proceeding, if the indemnified person had reasonable cause to believe that the act or omission was unlawful.

## **Risks Related to Taxes and Our Status as a REIT**

***Failure to qualify as a REIT would materially and adversely affect us and the value of our common stock.***

We believe that we have been organized and have operated in a manner that has allowed us to qualify as a REIT for federal income tax purposes commencing with our taxable year ended December 31, 2003, and we intend to continue operating in such a manner. We have not requested and do not plan to request a ruling from the IRS that we qualify as a REIT, and the statements in this Annual Report on Form 10-K are not binding on the IRS or any court. Therefore, we cannot assure you that we have qualified as a REIT, or that we will remain qualified as such in the future. If we lose our REIT status, we will face significant tax consequences that would substantially reduce our cash available for distribution to you for each of the years involved because:

we would not be allowed a deduction for distributions to stockholders in computing our taxable income and would be subject to federal income tax at regular corporate rates;

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we also could be subject to the federal alternative minimum tax and increased state and local taxes; and

unless we are entitled to relief under applicable statutory provisions, we could not elect to be taxed as a REIT for four taxable years following the year during which we were disqualified.

Any such corporate tax liability could be substantial and would reduce our cash available for, among other things, our operations and distributions to stockholders. In addition, if we fail to qualify as a REIT, we will not be required to make distributions to our stockholders. As a result of all these factors, our failure to qualify as a REIT also could impair our ability to expand our business and raise capital, and could materially and adversely affect the trading price of our common stock.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which there are only limited judicial and administrative interpretations. The determination of various factual matters and circumstances not entirely within our control may affect our ability to qualify as a REIT. In order to qualify as a REIT, we must satisfy a number of requirements, including requirements regarding the ownership of our stock, requirements regarding the composition of our assets and a requirement that at least 95% of our gross income in any year must be derived from qualifying sources, such as rents from real property. Also, we must make distributions to stockholders aggregating annually at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gains. In addition, legislation, new regulations, administrative interpretations or court decisions may materially and adversely affect our investors, our ability to qualify as a REIT for federal income tax purposes or the desirability of an investment in a REIT relative to other investments.

Even if we qualify as a REIT for federal income tax purposes, we may be subject to some federal, state and local income, property and excise taxes on our income or property and, in certain cases, a 100% penalty tax, in the event we sell property as a dealer. In addition, our taxable REIT subsidiaries will be subject to income tax as regular corporations in the jurisdictions in which they operate.

***If the Operating Partnership fails to qualify as a disregarded entity or partnership for federal income tax purposes, we would cease to qualify as a REIT and suffer other adverse consequences.***

The Operating Partnership is currently treated as a disregarded entity for federal income tax purposes. If a property contributor or other third party is admitted to the Operating Partnership as a limited partner and, as a result, we cease to be the 100% owner (directly or indirectly) of the interests in the Operating Partnership, the Operating Partnership would cease to be treated as a disregarded entity, and instead would be treated as a partnership, for federal income tax purposes. As a disregarded entity or partnership, the Operating Partnership would not be subject to federal income tax on its income. Instead, for federal income tax purposes, if the Operating Partnership is treated as a disregarded entity, we would be treated as directly earning its income, or if the Operating Partnership is treated as a partnership, each of its partners, including us, would be allocated, and may be required to pay tax with respect to, such partner's share of its income. We cannot assure you that the IRS will not challenge the status of the Operating Partnership or any other subsidiary partnership in which we own an interest as a disregarded entity or partnership for federal income tax purposes, or that a court would not sustain such a challenge. If the IRS were successful in treating the Operating Partnership or any such other subsidiary partnership as an entity taxable as a corporation for federal income tax purposes, we would fail to meet the gross income tests and certain of the asset tests applicable to REITs and, accordingly, we would likely cease to qualify as a REIT. Also, the failure of the Operating Partnership or any subsidiary partnerships to qualify as a disregarded entity or partnership could cause it to become subject to federal and state corporate income tax, which would reduce significantly the amount of cash available for debt service and for distribution to its partners, including us.

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***Our ownership of taxable REIT subsidiaries is subject to certain restrictions, and we will be required to pay a 100% penalty tax on certain income or deductions if our transactions with our taxable REIT subsidiaries are not conducted on arm's length terms.***

We currently own an interest in one taxable REIT subsidiary and may acquire securities in additional taxable REIT subsidiaries in the future. A taxable REIT subsidiary is a corporation, other than a REIT, in which a REIT directly or indirectly holds stock, and that has made a joint election with such REIT to be treated as a taxable REIT subsidiary. If a taxable REIT subsidiary owns more than 35% of the total voting power or value of the outstanding securities of another corporation, such other corporation will also be treated as a taxable REIT subsidiary. Other than some activities relating to lodging and health care facilities, a taxable REIT subsidiary may generally engage in any business, including the provision of customary or non-customary services to tenants of its parent REIT. A taxable REIT subsidiary is subject to federal income tax as a regular C corporation. In addition, a 100% excise tax will be imposed on certain transactions between a taxable REIT subsidiary and its parent REIT that are not conducted on an arm's length basis.

A REIT's ownership of securities of a taxable REIT subsidiary is not subject to the 5% or 10% asset tests applicable to REITs. Not more than 25% of the value of our total assets may be represented by securities (including securities of taxable REIT subsidiaries), other than those securities includable in the 75% asset test. We anticipate that the aggregate value of the stock and securities of any taxable REIT subsidiaries and other nonqualifying assets that we own will be less than 25% of the value of our total assets, and we will monitor the value of these investments to ensure compliance with applicable ownership limitations. In addition, we intend to structure our transactions with any taxable REIT subsidiaries that we own to ensure that they are entered into on arm's length terms to avoid incurring the 100% excise tax described above. There can be no assurance, however, that we will be able to comply with the 25% limitation or to avoid application of the 100% excise tax discussed above.

***To maintain our REIT status, we may be forced to borrow funds during unfavorable market conditions, and the unavailability of such capital on favorable terms at the desired times, or at all, may cause us to curtail our investment activities and/or to dispose of assets at inopportune times, which could materially and adversely affect us.***

To qualify as a REIT, we generally must distribute to our stockholders at least 90% of our REIT taxable income each year, determined without regard to the dividends paid deduction and excluding any net capital gains, and we will be subject to regular corporate income taxes on our undistributed taxable income to the extent that we distribute less than 100% of our REIT taxable income, determined without regard to the dividends paid deduction and including any net capital gains, each year. In addition, we will be subject to a 4% nondeductible excise tax on the amount, if any, by which distributions paid by us in any calendar year are less than the sum of 85% of our ordinary income, 95% of our capital gain net income and 100% of our undistributed income from prior years. In order to maintain our REIT status and avoid the payment of income and excise taxes, we may need to borrow funds to meet the REIT distribution requirements even if the then prevailing market conditions are not favorable for these borrowings. These borrowing needs could result from, among other things, differences in timing between the actual receipt of cash and recognition of income for federal income tax purposes, or the effect of non-deductible capital expenditures, the creation of reserves or required debt or amortization payments. These sources, however, may not be available on favorable terms or at all. Our access to third-party sources of capital depends on a number of factors, including the market's perception of our growth potential, our current debt levels, the market price of our common stock, and our current and potential future earnings. We cannot assure you that we will have access to such capital on favorable terms at the desired times, or at all, which may cause us to curtail our investment activities and/or to dispose of assets at inopportune times, and could materially and adversely affect us.

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***The IRS may treat sale-leaseback transactions as loans, which could jeopardize our REIT status or require us to make an unexpected distribution.***

The IRS may take the position that specific sale-leaseback transactions that we treat as leases are not true leases for federal income tax purposes but are, instead, financing arrangements or loans. If a sale-leaseback transaction were so re-characterized, we might fail to satisfy the REIT asset tests, the income tests or distribution requirements and consequently lose our REIT status effective with the year of re-characterization unless we elect to make an additional distribution to maintain our REIT status. The primary risk relates to our loss of previously incurred depreciation expenses, which could affect the calculation of our REIT taxable income and could cause us to fail the REIT distribution test that requires a REIT to distribute at least 90% of its REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gain. In this circumstance, we may elect to distribute an additional dividend of the increased taxable income so as not to fail the REIT distribution test. This distribution would be paid to all stockholders at the time of declaration rather than the stockholders existing in the taxable year affected by the re-characterization.

***Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.***

Income from qualified dividends payable to U.S. stockholders that are individuals, trusts and estates are generally subject to tax at preferential rates. Dividends payable by REITs, however, generally are not eligible for the preferential tax rates applicable to qualified dividend income. Although these rules do not adversely affect the taxation of REITs or dividends payable by REITs, to the extent that the preferential rates continue to apply to regular corporate qualified dividends, investors who are individuals, trusts and estates may perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could materially and adversely affect the value of the shares of REITs, including the per share trading price of our common stock.

***The tax imposed on REITs engaging in prohibited transactions may limit our ability to engage in transactions which would be treated as sales for federal income tax purposes.***

A REIT's net income from prohibited transactions is subject to a 100% penalty tax. In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property, held primarily for sale to customers in the ordinary course of business. Although we do not intend to hold any properties that would be characterized as held for sale to customers in the ordinary course of our business, unless a sale or disposition qualifies under certain statutory safe harbors, such characterization is a factual determination and no guarantee can be given that the IRS would agree with our characterization of our properties or that we will always be able to make use of the available safe harbors.

***Complying with REIT requirements may affect our profitability and may force us to liquidate or forgo otherwise attractive investments.***

To qualify as a REIT, we must continually satisfy tests concerning, among other things, the nature and diversification of our assets, the sources of our income and the amounts we distribute to our stockholders. We may be required to liquidate or forgo otherwise attractive investments in order to satisfy the asset and income tests or to qualify under certain statutory relief provisions. We also may be required to make distributions to stockholders at disadvantageous times or when we do not have funds readily available for distribution. As a result, having to comply with the distribution requirement could cause us to: (1) sell assets in adverse market conditions; (2) borrow on unfavorable terms; or (3) distribute amounts that would otherwise be invested in future acquisitions, capital expenditures or repayment of debt. Accordingly, satisfying the REIT requirements could materially and adversely affect us. Moreover, if we are compelled to liquidate our investments to meet any of these asset, income or distribution tests, or to repay obligations to our lenders, we may be unable to comply with one or more of the requirements applicable to REITs or may be subject to a 100% tax on any resulting gain if such sales constitute prohibited transactions.

**Table of Contents****Legislative or other actions affecting REITs could have a negative effect on us.**

The rules dealing with federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Department of the Treasury. Changes to the tax laws, with or without retroactive application, could materially and adversely affect our investors or us. We cannot predict how changes in the tax laws might affect our investors or us. New legislation, Treasury Regulations, administrative interpretations or court decisions could significantly and negatively affect our ability to qualify as a REIT or the federal income tax consequences of such qualification.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties  
Our Real Estate Investment Portfolio**

As of December 31, 2012, our gross investment in real estate and loans totaled approximately \$3.65 billion, representing investments in 1,207 properties. Of this amount, 98.6% consisted of our gross investment in real estate, representing ownership of 1,122 properties, and the remaining 1.4% consisted of commercial mortgage and equipment loans receivable secured by 85 properties or related assets. Our owned properties are leased to approximately 165 tenants operating across 18 different industries, including: general, specialty and discount retail; restaurants; movie theaters; automotive dealers; educational and recreational facilities; and supermarkets. Our properties are geographically diversified across 47 states, with only 4 states contributing more than 5.0% of our annual rent. Over 95% of our leases (based on annual rent) as of December 31, 2012 are triple-net, for which the tenant is typically responsible for all improvements and is contractually obligated to pay all property operating expenses, such as real estate taxes, insurance premiums and repair and maintenance costs. Due to the triple-net structure of our leases, we do not expect to incur significant capital expenditures relating to our triple-net leased properties, and the potential impact of inflation on our operating expenses is reduced.

**Diversification By Tenant**

The following table lists the top 10 tenants of our owned real estate properties (based on annual rent) as of December 31, 2012:

	<b>Tenant</b>	<b>Number of Properties</b>	<b>Annual Rent (in thousands)<sup>(1)</sup></b>	<b>Percent of Total Annual Rent</b>
1.	Shopko Stores/Pamida Operating Co., LLC	181	\$ 83,445	29.4%
2.	84 Properties, LLC	109	18,437	6.5
3.	Carmike Cinemas, Inc.	12	8,024	2.8
4.	Universal Pool Co., Inc.	14	6,680	2.4
5.	CBH20, LP (Camelback Ski Resort)	1	5,779	2.0
6.	Casual Male Retail Group Inc <sup>(2)</sup>	1	4,814	1.7
7.	Carmax, Inc.	5	4,726	1.7
8.	United Supermarkets, LLC	14	4,575	1.6
9.	Main Event Entertainment, LP	6	4,477	1.6
10.	NE Opco, Inc.	6	4,378	1.6
	Other	773	138,193	48.7
	<b>Total</b>	<b>1,122</b>	<b>\$ 283,528</b>	<b>100%</b>

(1) We define annual rent as rental revenue for the three months ended December 31, 2012 multiplied by four.

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- (2) Casual Male Retail Group Inc. formally changed its corporate name to Destination XL Group, Inc. effective as of February 25, 2013.



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As shown in the table above, as of December 31, 2012, the merged Shopko/Pamida entity contributed 29.4% of our total annual rent. Shopko/Pamida operates as a multi-department general merchandise retailer and retail health services provider, primarily in mid-size and larger communities in the Midwest, Pacific Northwest, North Central and Western Mountain states. Currently, we lease 181 properties to Shopko/Pamida, 179 of which are leased pursuant to three master leases that, as of December 31, 2012, had a weighted average non-cancelable remaining lease term of approximately 12.8 years.

We believe that, over time, the merger of Shopko and Pamida will be beneficial to our portfolio from a credit perspective, because we expect: (1) properties that previously operated under the Pamida brand will be improved and converted to the Shopko brand; and (2) the operations at the 114 of our properties that historically have operated under the Shopko brand will continue as they have historically at the property level. However, no assurance can be given as to the future performance of the merged Shopko/Pamida entity or its stores.

**Diversification By Industry**

The following table sets forth information regarding the diversification of our owned real estate properties among different industries (based on annual rent) as of December 31, 2012:

Industry	Number of Properties	Percent of Total Annual Rent <sup>(1)</sup>
General and discount retail properties	181	29.4%
Restaurants quick service	392	10.1
Specialty retail properties	48	9.0
Restaurants casual dining	124	7.8
Movie theatres	23	7.7
Building material suppliers	110	6.6
Industrial properties	26	5.4
Automotive dealers, parts and service properties	70	5.3
Educational properties	22	4.7
Recreational properties	8	3.7
Medical/other office properties	11	2.2
Supermarkets	20	1.9
Convenience stores/car washes	32	1.8
Distribution properties	37	1.4
Health clubs/gyms	5	1.1
Interstate travel plazas	3	1.0
Drugstores	9	*
Call centers	1	*
<b>Total</b>	<b>1,122</b>	<b>100%</b>

\* Less than 1%

(1) We define annual rent as rental revenue for the three months ended December 31, 2012 multiplied by four.

**Table of Contents****Diversification By Geography**

The following table sets forth information regarding the geographic diversification of our owned real estate properties as of December 31, 2012:

<b>Location</b>	<b>Number of Properties</b>	<b>Percent of Total Annual Rent<sup>(1)</sup></b>
Wisconsin	57	11.1%
Texas	82	8.5
Illinois	91	6.7
Pennsylvania	50	5.2
Florida	61	4.6
Minnesota	36	4.5
Arizona	26	4.4
Georgia	66	3.9
Indiana	40	3.3
Michigan	34	3.2
Nebraska	17	3.1
Ohio	49	3.0
Massachusetts	6	2.8
California	9	2.6
Utah	14	2.2
North Carolina	25	2.1
Iowa	34	2.1
Idaho	9	2.0
Tennessee	60	1.9
Kentucky	37	1.9
Alabama	43	1.7
Washington	9	1.6
Missouri	30	1.5
Montana	7	1.4
South Dakota	9	1.4
New York	28	1.4
Oregon	6	1.2
Oklahoma	11	1.2
Virginia	29	1.2
West Virginia	26	1.1
Colorado	9	*
Kansas	6	*
South Carolina	12	*
Maryland	18	*
Louisiana	13	*
Maine	20	*
New Jersey	3	*
Arkansas	7	*
Wyoming	8	*
New Mexico	4	*
Nevada	1	*
Delaware	2	*
Vermont	2	*
Mississippi	7	*
North Dakota	2	*
New Hampshire	6	*
Rhode Island	1	*
<b>Total properties owned</b>	<b>1,122</b>	<b>100%</b>

\* Less than 1%

(1) We define annual rent as rental revenue for the three months ended December 31, 2012 multiplied by four.

**Table of Contents****Lease Expirations**

The following table sets forth a summary schedule of lease expirations for leases in place as of December 31, 2012. As of December 31, 2012, the weighted average remaining non-cancelable lease term (based on annual rent) was 11.1 years. The information set forth in the table assumes that tenants exercise no renewal options and all early termination rights:

<b>Leases expiring in</b>	<b>Number of Properties</b>	<b>Expiring Annual Rent (in thousands)<sup>(1)</sup></b>	<b>Percent of Total Annual Rent</b>
2013	11	\$ 2,250	0.8%
2014	53	7,687	2.7
2015	&nbs		