NATIONAL RETAIL PROPERTIES, INC.
Form 10-Q
November 05, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended September 30, 2013
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
NATIONAL RETAIL PROPERTIES, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Maryland<br>(State or other jurisdiction of incorporation or organization) | 56-1431377<br>(I.R.S. Employer Identification No.) |

450 South Orange Avenue, Suite 900
Orlando, Florida 32801
(Address of principal executive offices, including zip code)
Registrant's telephone number, including area code: (407) 265-7348

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 x No ¨

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

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. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer x | 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 x

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.
121,857,587 shares of common stock, $0.01 par value, outstanding as of October 30, 2013.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)

| | September 30, 2013 (unaudited) | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| Real estate portfolio: | | |
| Accounted for using the operating method, net of accumulated depreciation and amortization | $4,221,892 | $3,793,416 |
| Accounted for using the direct financing method | 21,523 | 22,692 |
| Real estate held for sale | 16,792 | 18,699 |
| Mortgages, notes and accrued interest receivable | 16,693 | 27,770 |
| Commercial mortgage residual interests | 14,755 | 13,096 |
| Cash and cash equivalents | 6,530 | 2,076 |
| Receivables, net of allowance of $2,936 and $855, respectively | 2,736 | 3,112 |
| Accrued rental income, net of allowance of $3,086 and $3,270, respectively | 25,411 | 25,458 |
| Debt costs, net of accumulated amortization of $19,556 and $17,965, respectively | 13,535 | 12,781 |
| Other assets | 96,993 | 68,926 |
| Total assets | $4,436,860 | $3,988,026 |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Line of credit payable | $— | $174,200 |
| Mortgages payable, including unamortized premium of $144 and $187, respectively | 9,764 | 10,602 |
| Notes payable – convertible, net of unamortized discount of $0 and $2,072, respectively | — | 236,500 |
| Notes payable, net of unamortized discount of $11,116 and $9,338, respectively | 1,513,884 | 1,165,662 |
| Accrued interest payable | 27,913 | 17,527 |
| Other liabilities | 97,369 | 85,950 |
| Total liabilities | 1,648,930 | 1,690,441 |
| Equity: | | |
| Stockholders' equity: | | |
| Preferred stock, $0.01 par value. Authorized 15,000,000 shares | | |
| Series D, 11,500,000 depositary shares issued and outstanding, at stated liquidation value of $25 per share | 287,500 | 287,500 |
| Series E, 11,500,000 depositary shares issued and outstanding, at stated liquidation value of $25 per share | 287,500 | — |
| Common stock, $0.01 par value. Authorized 375,000,000 shares; 121,856,503 and 111,554,997 shares issued and outstanding, respectively | 1,220 | 1,117 |
| Excess stock, $0.01 par value. Authorized 390,000,000 shares; none issued or outstanding | — | — |
| Capital in excess of par value | 2,347,014 | 2,101,002 |
| Retained earnings (deficit) | (134,003) | (90,952) |
| Accumulated other comprehensive income (loss) | (2,548) | (2,382) |

| | | |
|---|---|---|
| Total stockholders’ equity of NNN | 2,786,683 | 2,296,285 |
| Noncontrolling interests | 1,247 | 1,300 |
| Total equity | 2,787,930 | 2,297,585 |
| Total liabilities and equity | $4,436,860 | $3,988,026 |

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands, except per share data)
(Unaudited)

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues: | | | | |
| Rental income from operating leases | $95,772 | $79,815 | $274,583 | $228,690 |
| Earned income from direct financing leases | 534 | 571 | 1,630 | 1,739 |
| Percentage rent | 267 | 242 | 800 | 574 |
| Real estate expense reimbursement from tenants | 3,113 | 2,658 | 9,203 | 8,024 |
| Interest and other income from real estate transactions | 341 | 512 | 1,095 | 1,982 |
| Interest income on commercial mortgage residual interests | 594 | 593 | 1,789 | 2,064 |
| | 100,621 | 84,391 | 289,100 | 243,073 |
| Retail operations: | | | | |
| Revenues | — | — | — | 19,008 |
| Operating expenses | — | — | — | (18,543) |
| Net | — | — | — | 465 |
| Operating expenses: | | | | |
| General and administrative | 7,534 | 8,653 | 25,209 | 23,282 |
| Real estate | 4,420 | 3,842 | 12,580 | 12,376 |
| Depreciation and amortization | 25,856 | 17,242 | 72,126 | 53,574 |
| Impairment – commercial mortgage residual interests valuation | 16 | — | 16 | 2,718 |
| Impairment losses and other charges, net of recoveries | — | 3,223 | 1,972 | 3,258 |
| | 37,826 | 32,960 | 111,903 | 95,208 |
| Earnings from operations | 62,795 | 51,431 | 177,197 | 148,330 |
| Other expenses (revenues): | | | | |
| Interest and other income | (722) | (1,194) | (1,433) | (1,913) |
| Interest expense | 19,989 | 23,039 | 65,210 | 62,425 |
| | 19,267 | 21,845 | 63,777 | 60,512 |
| Earnings from continuing operations before income tax benefit (expense) and equity in earnings of unconsolidated affiliate | 43,528 | 29,586 | 113,420 | 87,818 |
| Income tax benefit (expense) | (365) | 7,438 | (363) | 7,167 |
| Equity in earnings of unconsolidated affiliate | — | 3,769 | — | 4,074 |
| Earnings from continuing operations | 43,163 | 40,793 | 113,057 | 99,059 |
| Earnings (loss) from discontinued operations, net of income tax expense | 1,179 | (2,803) | 2,794 | 2,231 |
| Earnings including noncontrolling interests | 44,342 | 37,990 | 115,851 | 101,290 |
| Loss (earnings) attributable to noncontrolling interests: | | | | |
| Continuing operations | 17 | 27 | 276 | 73 |
| Discontinued operations | (7) | (2) | (223) | (10) |

| | | | | |
|---|---|---|---|---|
| | 10 | 25 | 53 | 63 |
| Net earnings attributable to NNN | $44,352 | $38,015 | $115,904 | $101,353 |

See accompanying notes to condensed consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands, except per share data)
(Unaudited)

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Net earnings attributable to NNN | $44,352 | $38,015 | $115,904 | $101,353 |
| Series C preferred stock dividends | — | — | — | (1,979) |
| Series D preferred stock dividends | (4,762) | (4,762) | (14,285) | (10,688) |
| Series E preferred stock dividends | (4,780) | — | (4,780) | — |
| Excess of redemption value over carrying value of Series C preferred shares redeemed | — | — | — | (3,098) |
| Net earnings attributable to common stockholders | $34,810 | $33,253 | $96,839 | $85,588 |
| Net earnings per share of common stock: | | | | |
| Basic: | | | | |
| Continuing operations | $0.28 | $0.33 | $0.80 | $0.78 |
| Discontinued operations | 0.01 | (0.02) | 0.02 | 0.02 |
| Net earnings | $0.29 | $0.31 | $0.82 | $0.80 |
| Diluted: | | | | |
| Continuing operations | $0.28 | $0.32 | $0.79 | $0.77 |
| Discontinued operations | 0.01 | (0.02) | 0.02 | 0.02 |
| Net earnings | $0.29 | $0.30 | $0.81 | $0.79 |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 120,287,890 | 107,487,935 | 117,222,163 | 106,140,002 |
| Diluted | 121,230,232 | 110,339,705 | 119,356,194 | 108,091,909 |
| Other comprehensive income: | | | | |
| Net earnings attributable to NNN | $44,352 | $38,015 | $115,904 | $101,353 |
| Amortization of interest rate hedges | 128 | 57 | 306 | 171 |
| Fair value forward starting swaps | — | — | (3,141) | — |
| Unrealized gain – commercial mortgage residual interests | 376 | — | 1,595 | 213 |
| Stock value adjustments | 36 | (1) | 125 | (2) |
| Reclassification of noncontrolling interests | — | — | 949 | — |
| Comprehensive income attributable to NNN | $44,892 | $38,071 | $115,738 | $101,735 |

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

| | Nine Months Ended September 30, 2013 | 2012 |
|---|---|---|
| Cash flows from operating activities: | | |
| Earnings including noncontrolling interests | $115,851 | $101,290 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 72,423 | 54,926 |
| Impairment losses and other charges, net of recoveries | 4,003 | 9,043 |
| Impairment – commercial mortgage residual interests valuation | 16 | 2,718 |
| Amortization of notes payable discount | 2,888 | 3,641 |
| Amortization of debt costs | 2,460 | 2,506 |
| Amortization of mortgages payable premium | (43) | (14) |
| Amortization of deferred interest rate hedges | 306 | 171 |
| Equity in earnings of unconsolidated affiliate | — | (4,074) |
| Distributions received from unconsolidated affiliate | — | 7,019 |
| Gain on disposition of real estate | (4,402) | (4,446) |
| Gain on note receivable and property foreclosure | — | (198) |
| Performance incentive plan expense | 6,531 | 7,010 |
| Performance incentive plan payment | (2,139) | — |
| Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations: | | |
| Additions to held for sale real estate | (1,029) | (4,941) |
| Decrease in real estate leased to others using the direct financing method | 1,230 | 1,222 |
| Decrease in mortgages, notes and accrued interest receivable | 688 | 37 |
| Decrease in receivables | 1,433 | 1,014 |
| Increase in commercial mortgage residual interests | (80) | — |
| Increase in accrued rental income | (166) | (695) |
| Decrease in other assets | 82 | 1,365 |
| Increase in accrued interest payable | 10,386 | 7,004 |
| Increase (decrease) in other liabilities | 4,061 | (4,893) |
| Increase (decrease) in current tax liability | 580 | (7,192) |
| Net cash provided by operating activities | 215,079 | 172,513 |
| Cash flows from investing activities: | | |
| Proceeds from the disposition of real estate | 52,092 | 32,371 |
| Additions to real estate: | | |
| Accounted for using the operating method | (569,770) | (416,068) |
| Increase in mortgages and notes receivable | (3,086) | (8,768) |
| Principal payments on mortgages and notes receivable | 14,225 | 10,668 |
| Cash received from commercial mortgage residual interests | — | 286 |
| Payment of lease costs | (969) | (1,583) |
| Return of investment from unconsolidated affiliate | — | 1,220 |
| Other | (781) | (313) |
| Net cash used in investing activities | (508,289) | (382,187) |

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

| | Nine Months Ended September 30, 2013 | 2012 |
|---|---|---|
| Cash flows from financing activities: | | |
| Proceeds from line of credit payable | $445,000 | $685,900 |
| Repayment of line of credit payable | (619,200) | (751,500) |
| Payment of interest rate hedge | (3,141) | — |
| Repayment of mortgages payable | (795) | (19,134) |
| Proceeds from notes payable | 347,406 | 320,011 |
| Repayment of notes payable | — | (50,000) |
| Repayment of notes payable – convertible | (246,797) | — |
| Payment of debt costs | (3,265) | (2,992) |
| Proceeds from issuance of common stock | 263,366 | 119,259 |
| Proceeds from issuance of Series D preferred stock | — | 287,500 |
| Proceeds from issuance of Series E preferred stock | 287,500 | — |
| Stock issuance costs | (13,455) | (11,200) |
| Redemption of Series C preferred stock | — | (92,000) |
| Payment of Series C preferred stock dividends | — | (1,979) |
| Payment of Series D preferred stock dividends | (14,285) | (10,688) |
| Payment of Series E preferred stock dividends | (4,780) | — |
| Payment of common stock dividends | (139,890) | (124,139) |
| Net cash provided by financing activities | 297,664 | 349,038 |
| Net increase in cash and cash equivalents | 4,454 | 139,364 |
| Cash and cash equivalents at beginning of year | 2,076 | 2,082 |
| Cash and cash equivalents at end of year | $6,530 | $141,446 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid, net of amount capitalized | $50,667 | $50,872 |
| Taxes paid | $212 | $125 |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Issued 298,896 and 396,577 shares of restricted and unrestricted common stock in 2013 and 2012, respectively, pursuant to NNN's performance incentive plan | $8,218 | $8,576 |
| Issued 12,186 and 12,373 shares of common stock in 2013 and 2012, respectively, to directors pursuant to NNN's performance incentive plan | $428 | $346 |
| Issued 9,044 and 14,836 shares of common stock in 2013 and 2012, respectively, pursuant to NNN's Deferred Director Fee Plan | $118 | $223 |
| Surrender of 241 and of 4,712 shares of restricted common stock in 2013 and 2012, respectively | $7 | $113 |
| Change in other comprehensive income | $166 | $(382) |
| Change in lease classification (direct financing lease to operating lease) | $— | $757 |
| Mortgages payable assumed in connection with real estate transactions | $— | $6,634 |
| Mortgage receivable accepted in connection with real estate transactions | $750 | $— |
| Real estate acquired in connection with mortgage receivable foreclosure | $— | $490 |
| Real estate received in note receivable foreclosure | $— | $1,595 |

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013
(Unaudited)

Note 1 – Organization and Summary of Significant Accounting Policies:
Organization and Nature of Business – National Retail Properties, Inc., a Maryland corporation, is a fully integrated real estate investment trust ("REIT") formed in 1984. The terms "NNN" and the "Company" refer to National Retail Properties, Inc. and all of its consolidated subsidiaries. NNN has elected to treat certain subsidiaries as taxable REIT subsidiaries. These taxable subsidiaries and their majority owned and controlled subsidiaries are collectively referred to as the "TRS."
NNN's assets include: real estate, mortgages and notes receivable, and commercial mortgage residual interests. NNN acquires, owns, invests in and develops properties that are leased primarily to retail tenants under long-term net leases and primarily held for investment ("Properties" or "Property Portfolio").

| | September 30, 2013 |
|---|---|
| Property Portfolio: | |
| Total properties | 1,850 |
| Gross leasable area (square feet) | 20,292,000 |
| States | 47 |

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by U.S. generally accepted accounting principles ("GAAP"). The unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. Operating results for the quarter and nine months ended September 30, 2013, may not be indicative of the results that may be expected for the year ending December 31, 2013. Amounts as of December 31, 2012, included in the condensed consolidated financial statements have been derived from the audited consolidated financial statements as of that date. The unaudited condensed consolidated financial statements, included herein, should be read in conjunction with the consolidated financial statements and notes thereto as well as Management's Discussion and Analysis of Financial Condition and Results of Operations in NNN's Form 10-K for the year ended December 31, 2012.
Principles of Consolidation – NNN's condensed consolidated financial statements include the accounts of each of the Company's respective majority owned and controlled affiliates, including transactions whereby NNN has been determined to be the primary beneficiary in accordance with the Financial Accounting Standards Board ("FASB") guidance included in Consolidation. All significant intercompany account balances and transactions have been eliminated. NNN applies the equity method of accounting to investments in partnerships and joint ventures that are not subject to control by NNN due to the significance of rights held by other parties.
Real Estate Portfolio – NNN records the acquisition of real estate which is not subject to a lease at cost, including acquisition and closing costs. The cost of properties developed by NNN includes direct and indirect costs of construction, property taxes, interest and other miscellaneous costs incurred during the development period until the project is substantially complete and available for occupancy. During the quarter and nine months ended September 30, 2013, NNN recorded $470,000 and $1,010,000, respectively, in capitalized interest and recorded $336,000 and $1,204,000 in capitalized interest during the same periods in 2012, respectively.
Purchase Accounting for Acquisition of Real Estate Subject to a Lease – In accordance with the FASB guidance on business combinations, the fair value of the real estate acquired with in-place leases is allocated to the acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, value of in-place leases and value of tenant relationships, based in each case on their fair values. Acquisition costs incurred in connection with a business combination are expensed when incurred.

The fair value of the tangible assets of an acquired leased property is determined by valuing the property as if it were vacant, and the "as-if-vacant" value is then allocated to land, building and tenant improvements based on the determination of the fair values of these assets. The as-if-vacant fair value of a property is provided to management by a qualified appraiser.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, above-market and below-market in-place lease values are recorded as other assets or liabilities based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases, and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining term of the lease and the applicable option terms if it is probable that the tenant will exercise the option. The capitalized above-market lease values are amortized as a reduction of rental income over the remaining terms of the respective leases. The capitalized below-market lease values are amortized as an increase to rental income over the initial term unless the Company believes that it is likely that the tenant would renew the option whereby the Company would amortize the value attributable to the renewal over the renewal period.

The aggregate value of other acquired intangible assets, consisting of in-place leases, is measured by the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as-if-vacant, determined as set forth above. The value of in-place leases exclusive of the value of above-market and below-market in-place leases is amortized to expense over the remaining non-cancelable periods of the respective leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off. The value of tenant relationships is reviewed on individual transactions to determine if future value was derived from the acquisition.

Intangible assets and liabilities consisted of the following as of (in thousands):

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Intangible lease assets (included in Other assets): | | |
| Value of above market in-place leases, net | $12,236 | $6,679 |
| Value of in-place leases, net | 59,365 | 37,889 |
| Intangible lease liabilities (included in Other liabilities): | | |
| Value of below market in-place leases, net | 29,678 | 23,708 |

Investment in an Unconsolidated Affiliate – NNN accounts for its investment in an unconsolidated affiliate under the equity method of accounting. In September 2007, NNN entered into a joint venture, NNN Retail Properties Fund I LLC ("NNN Crow JV"), with an affiliate of Crow Holdings Realty Partners IV, L.P., which is accounted for under the equity method of accounting. During the quarter ended September 30, 2012, NNN Crow JV sold all of its assets and paid off its bank term loan. In April 2013, NNN Crow JV was dissolved.

Cash and Cash Equivalents – NNN considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents consist of demand deposits and money market accounts and are stated at cost plus accrued interest, which approximates fair value.

Cash accounts maintained on behalf of NNN in demand deposits at commercial banks and money market funds may exceed federally insured levels. However, NNN has not experienced any losses in such accounts.

Valuation of Receivables – NNN estimates the collectability of its accounts receivable related to rents, expense reimbursements and other revenues. NNN analyzes accounts receivable and historical bad debt levels, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. In addition, tenants in bankruptcy are analyzed and estimates are made in connection with the expected recovery of pre-petition and post-petition claims.

Earnings Per Share – Earnings per share have been computed pursuant to the FASB guidance included in Earnings Per Share. Effective January 1, 2009, the guidance requires classification of the Company's unvested restricted share units, which carry rights to receive nonforfeitable dividends, as participating securities requiring the two-class method of computing earnings per share. Under the two-class method, earnings per common share are computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities based on the weighted average shares outstanding during the period.

The following table is a reconciliation of the numerator and denominator used in the computation of basic and diluted earnings per common share using the two-class method (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Basic and Diluted Earnings: | | | | |
| Net earnings attributable to NNN | $44,352 | $38,015 | $115,904 | $101,353 |
| Less: Series C preferred stock dividends | — | — | — | (1,979) |
| Less: Series D preferred stock dividends | (4,762) | (4,762) | (14,285) | (10,688) |
| Less: Series E preferred stock dividends | (4,780) | — | (4,780) | — |
| Less: Excess of redemption value over carrying value of Series C preferred shares redeemed | — | — | — | (3,098) |
| Net earnings available to NNN’s common stockholders | 34,810 | 33,253 | 96,839 | 85,588 |
| Less: Earnings attributable to unvested restricted shares | (135) | (215) | (366) | (525) |
| Net earnings used in basic earnings per share | 34,675 | 33,038 | 96,473 | 85,063 |
| Reallocated undistributed loss | — | (1) | (3) | (4) |
| Net earnings used in diluted earnings per share | $34,675 | $33,037 | $96,470 | $85,059 |
| | | | | |
| Basic and Diluted Weighted Average Shares Outstanding: | | | | |
| Weighted average number of shares outstanding | 121,096,076 | 108,461,120 | 117,973,443 | 107,039,590 |
| Less: Unvested restricted stock | (469,370) | (696,270) | (441,588) | (652,890) |
| Less: Contingent shares | (338,816) | (276,915) | (309,692) | (246,698) |
| Weighted average number of shares outstanding used in basic earnings per share | 120,287,890 | 107,487,935 | 117,222,163 | 106,140,002 |
| Effects of dilutive securities: | | | | |
| Contingent shares | — | — | — | 8,459 |
| Convertible notes payable | 768,843 | 2,692,153 | 1,963,457 | 1,787,275 |
| Common stock options | — | — | — | 1,287 |
| Directors’ deferred fee plan | 173,499 | 159,617 | 170,574 | 154,886 |
| Weighted average number of shares outstanding used in diluted earnings per share | 121,230,232 | 110,339,705 | 119,356,194 | 108,091,909 |

Fair Value Measurement – NNN’s estimates of fair value of financial and non-financial assets and liabilities are based on the framework established in the fair value accounting guidance. The framework specifies a hierarchy of valuation inputs which was established to increase consistency, clarity and comparability in fair value measurements and related disclosures. The guidance describes a fair value hierarchy based upon three levels of inputs that may be used to measure fair value, two of which are considered observable and one that is considered unobservable. The following describes the three levels:

- Level 1 – Valuation is based upon quoted prices in active markets for identical assets or liabilities.
- Level 2 – Valuation is based upon inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- 

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include option pricing models, discounted cash flow models and similar techniques.

Other Comprehensive Income (Loss) – The following table outlines the changes in accumulated other comprehensive income (dollars in thousands):

| | Gain or Loss on Cash Flow Hedges [1] | Unrealized Gains and Losses on Commercial Mortgage Residual Interests [2] | Unrealized Gains and Losses on Available-for-Sale Securities | Total |
|---|---|---|---|---|
| Beginning balance, December 31, 2012 | $(5,693) | $3,244 | $ 67 | $(2,382) |
| Other comprehensive income (loss) | (3,141) | 2,544 | 125 | (472) |
| Reclassifications from accumulated other comprehensive income to net earnings | 306 | — | — | 306 [3] |
| Net current period other comprehensive income (loss) | (2,835) | 2,544 | 125 | (166) |
| Ending balance, September 30, 2013 | $(8,528) | $5,788 | $ 192 | $(2,548) |

1) Additional disclosure is included in Note 10 - Derivatives.

2) Additional disclosure is included in Note 3 - Commercial Mortgage Residual Interests.

3) Reclassifications out of other comprehensive income are recorded in Interest Expense on the Condensed Consolidated Statements of Comprehensive Income. There is no income tax expense (benefit) resulting from this reclassification.

New Accounting Pronouncements – In December 2011, the FASB issued Accounting Standards Update ("ASU") 2011-11 amending its guidance on offsetting assets and liabilities in financial statements. The objective of this update will require disclosure to facilitate comparison between those entities that prepare their financial statements on the basis of GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards ("IFRS"). The amendments in this update are effective for annual reporting periods beginning on or after January 1, 2013. The adoption of the standard did not have a significant impact on NNN's financial position or results of operations.

In February 2013, the FASB issued ASU 2013-02. The objective of this update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The update requires reporting significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income or cross-reference other required disclosures that provide additional detail about amounts that are not. The amendments in this update are effective prospectively for reporting periods beginning after December 15, 2012. The adoption of the standard in the quarter ended March 31, 2013, did not have a significant impact on NNN's financial position or results of operations.

In February 2013, the FASB issued ASU 2013-04. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. NNN is currently evaluating ASU 2013-04 to determine the potential impact, if any, its adoption will have on NNN's financial position and results of operations.

In July 2013, the FASB issued ASU 2013-10. The amendments in this update permit the Fed Funds Effective Swap Rate (also referred to as Overnight Index Swap Rate) to be used as a United States benchmark interest rate for hedge accounting purposes under Topic 815, in addition to treasury obligations of the United States Government and the London Interbank Offered Rate. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of the standard did not have a significant impact on NNN's financial position or results of operations.

In July 2013, the FASB issued ASU 2013-11. The objective of the amendments in this update is to eliminate the diversity in practice of financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The provisions of the update are that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented, with certain exceptions, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. NNN is currently evaluating ASU 2013-11 to determine the potential impact, if any, its adoption will have on NNN's financial position and results of operations.

Use of Estimates – Management of NNN has made a number of estimates and assumptions relating to the reporting of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these consolidated

financial statements in conformity with GAAP. Significant estimates include provisions for impairment and allowances for certain assets, accruals, useful lives of assets and purchase price allocation. Actual results could differ from those estimates.
Reclassification – Certain items in the prior year's consolidated financial statements and notes to consolidated financial statements have been reclassified to conform to the 2013 presentation.

Note 2 – Real Estate:
Real Estate – Portfolio
Leases – The following outlines key information for NNN's leases:

| | September 30, 2013 |
|---|---|
| Lease classification: | |
| Operating | 1,861 |
| Direct financing | 13 |
| Building portion – direct financing / land portion – operating | 4 |
| Weighted average remaining lease term | 12 Years |

The leases generally provide for periodic increases in rent as a result of fixed increases, increases in the consumer price index, and/or increases in the tenant's sales volume. Generally, the tenant is also required to pay all property taxes and assessments, substantially maintain the interior and exterior of the property and carry property and liability insurance coverage. Certain of NNN's Properties are subject to leases under which NNN retains responsibility for specific costs and expenses of the property. Generally, the leases of the Properties provide the tenant with one or more multi-year renewal options, and the terms and conditions of the lease for the renewal options remain the same as for the initial term, except for increases in rent in the renewal options.
Real Estate Portfolio – Accounted for Using the Operating Method – Real estate subject to operating leases consisted of the following as of (dollars in thousands):

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Land and improvements | $1,637,830 | $1,473,671 |
| Buildings and improvements | 2,904,914 | 2,563,729 |
| Leasehold interests | 1,290 | 1,290 |
| | 4,544,034 | 4,038,690 |
| Less accumulated depreciation and amortization | (393,339) | (331,781) |
| | 4,150,695 | 3,706,909 |
| Work in progress | 71,197 | 86,507 |
| | $4,221,892 | $3,793,416 |

Real Estate – Held For Sale
As of September 30, 2013 and December 31, 2012, NNN categorized 10 of its Properties as held for sale. Real estate held for sale consisted of the following as of (dollars in thousands):

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Property held for sale: | | |
| Land and improvements | $10,591 | $10,445 |
| Building and improvements | 17,935 | 17,773 |
| Accounted for using the direct financing method | 464 | 525 |
| Work in process | — | 72 |
| | 28,990 | 28,815 |
| Less accumulated depreciation and amortization | (2,033) | (1,997) |
| Less impairment | (10,165) | (8,119) |
| | $16,792 | $18,699 |

In March 2013, NNN completed a strategic review of its Properties held for sale and reclassified 15 Properties that were previously held for sale to held for investment, included in Real Estate – Portfolio.

Real Estate – Dispositions

The following table summarizes the number of Properties sold and the corresponding gain recognized on the disposition of Properties included in discontinued operations (dollars in thousands):

| | Quarter Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | | 2012 | | 2013 | | 2012 | |
| | # of Sold Properties | Gain | # of Sold Properties | Gain | # of Sold Properties | Gain | # of Sold Properties | Gain |
| Discontinued operations [(1)] | 22 | $1,228 | 8 | $1,694 | 31 | $4,249 | 18 | $4,446 |
| Noncontrolling interests | | — | | — | | 153 | | — |
| | | $1,228 | | $1,694 | | $4,402 | | $4,446 |

(1) None of the gains from property sales for the period were reported in continuing operations.

Real Estate – Commitments

In connection with improvements to leased Properties, NNN has the following funding commitments (dollars in thousands):

| | September 30, 2013 | | | |
|---|---|---|---|---|
| | # of Properties | Total Commitment[(1)] | Amount Funded | Remaining Commitment |
| Real estate – portfolio | 51 | $147,084 | $109,852 | $37,232 |

(1) Includes land, construction costs and tenant improvements.

Real Estate – Impairments

Management periodically assesses the Company's real estate for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the asset, including accrued rental income, may not be recoverable through operations. Events or circumstances that may occur include significant changes in real estate market conditions and the ability of NNN to re-lease or sell properties that are vacant or become vacant. If an impairment is indicated, it is recognized to the extent the current book value of the respective asset exceeds the fair value of the asset.

As a result of the Company's review of long lived assets, including identifiable intangible assets, NNN recognized the following real estate impairments (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Continuing operations | $— | $3,223 | $1,957 | $3,258 |
| Discontinued operations | 727 | 5,440 | 2,046 | 5,785 |
| Impairment recoveries – discontinued operations | (728) | — | — | — |
| | $(1) | $8,663 | $4,003 | $9,043 |

The valuation of impaired assets is determined using widely accepted valuation techniques including discounted cash flow analysis, income capitalization, analysis of recent comparable sales transactions, actual sales negotiations and bona fide purchase offers received from third parties, which are level 3 inputs. NNN may consider a single valuation technique or multiple valuation techniques, as appropriate, when measuring the fair value of its real estate.

Note 3 – Commercial Mortgage Residual Interests:

NNN holds the residual interests ("Residuals") from seven commercial mortgage securitizations. Each of the Residuals is recorded at fair value based upon an independent valuation. Unrealized gains and losses are reported as other comprehensive income in stockholders' equity and other than temporary losses as a result of a change in the timing, or amount of estimated cash flows are recorded as an other than temporary valuation impairment.

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Due to the expected timing of future cash flows relating to the Residuals, the independent valuation adjusted certain of the valuation assumptions. The following table summarizes the key assumptions used in determining the value of the Residuals as of:

| | September 30, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| Discount rate (1) | 20% or 25% | | 25 | % |
| Average life equivalent CPR(2) speeds range | 0.80% to 19.39% CPR | | 0.80% to 24.31% CPR | |
| Foreclosures: | | | | |
| Frequency curve default model | 0.07% - 3.97% range | | 0.09% - 4.49% range | |
| Loss severity of loans in foreclosure | 20 | % | 20 | % |
| Yield: | | | | |
| LIBOR | Forward 3-month curve | | Forward 3-month curve | |
| Prime | Forward curve | | Forward curve | |

(1) For September 30, 2013, three of the securitizations have a 20% discount rate and four have a 25% discount rate.
(2) Conditional prepayment rate.

The following table summarizes the recognition of unrealized gains and/or losses recorded as other comprehensive income as well as other than temporary valuation impairments recorded in the condensed consolidated statements of earnings (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Unrealized gains | $376 | $— | $1,595 | $213 |
| Other than temporary valuation impairment | $16 | $— | $16 | $2,718 |

Note 4 – Line of Credit Payable:
NNN's $500,000,000 revolving credit facility (the “Credit Facility”) had a weighted average outstanding balance of $49,975,000 and a weighted average interest rate of 1.4% during the nine months ended September 30, 2013. The Credit Facility matures October 2016, unless the Company exercises its option to extend maturity to October 2017. The Credit Facility bears interest at LIBOR plus 117.5 basis points; however, such interest rate may change pursuant to a tiered interest rate structure based on NNN's debt rating. The Credit Facility also includes an accordion feature to increase the facility size up to $1,000,000,000, subject to lender approval. As of September 30, 2013, there was no outstanding balance and $500,000,000 was available for future borrowings under the Credit Facility.

Note 5 – Notes Payable:
In April 2013, NNN filed a prospectus supplement to the prospectus contained in its February 2012 shelf registration statement and issued $350,000,000 aggregate principal amount of 3.300% Notes due April 2023 (the “2023 Notes”). The 2023 Notes were sold at a discount with an aggregate purchase price of $347,406,000 with interest payable semi-annually commencing on October 15, 2013. The discount of $2,594,000 is being amortized to interest expense over the term of the note using the effective interest method. The effective interest rate for the 2023 Notes after accounting for note discount is 3.388%. NNN previously entered into four forward starting swaps with an aggregate notional amount of $240,000,000. Upon issuance of the 2023 Notes, NNN terminated the forward starting swaps resulting in a liability of $3,156,000, of which $3,141,000 was deferred in other comprehensive income. The deferred liability is being amortized to interest expense over the term of the 2023 Notes using the effective interest method. The 2023 Notes are senior unsecured obligations of NNN and are subordinated to all secured indebtedness and to the indebtedness and other liabilities of NNN's subsidiaries. Additionally, the 2023 Notes are redeemable at NNN's option, in whole or part anytime, for an amount equal to (i) the sum of the outstanding principal balance of the notes being redeemed plus accrued interest thereon to the redemption date, and (ii) the make whole amount, if any, as defined in the supplemental indenture dated April 9, 2013, relating to the 2023 Notes.

NNN received approximately $344,266,000 of proceeds in connection with the issuance of the 2023 Notes, net of debt issuance costs totaling $3,140,000 consisting primarily of underwriting discounts and commissions, legal and accounting fees, rating agency fees and printing expenses.

Note 6 – Notes Payable – Convertible:

NNN recorded the following in interest expense relating to the 3.950% convertible senior notes due 2026 (the "2026 Notes") and the 5.125% convertible senior notes due 2028 (the "2028 Notes") (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Contractual interest expense | $26 | $4,227 | $5,400 | $12,682 |
| Noncash interest charges | — | 1,082 | 2,072 | 3,189 |
| Amortization of debt costs | — | 291 | 566 | 851 |
| Total interest expense | $26 | $5,600 | $8,038 | $16,722 |

As of December 31, 2012, $15,537,000 of the principal amount of 2026 Notes were outstanding. In January 2013, the Company paid approximately $20,702,000 in aggregate settlement value for the $15,537,000 of settled notes. The difference between the amount paid and the principal amount of the settled notes of $5,028,000 was recognized as a decrease to additional paid-in capital and $137,000 was recorded as interest expense.

As of December 31, 2012, $223,035,000 of the principal amount of 2028 Notes were outstanding. In June 2013, NNN called all of the outstanding 2028 Notes for redemption on July 11, 2013. On July 11, 2013, $130,000 principal amount of the 2028 Notes was settled at par plus accrued interest. As of September 30, 2013, holders of the remaining balance of $222,905,000 principal amount of 2028 Notes had elected to convert into cash and shares of the Company's common stock in accordance with the conversion formula which is based on the average daily closing price of NNN's common stock price over a period of 20 days commencing after receipt of a note holder's conversion notice. In 2013, the Company issued 2,407,911 shares of common stock and paid approximately $226,427,000 in aggregate settlement value for the $223,035,000 of settled notes. The difference between the amount paid and the principal amount of the settled notes of $3,197,000 was recognized as a decrease to additional paid-in capital and $195,000 was recorded as interest expense.

Note 7 – Stockholders' Equity:

Dividends – The following table outlines the dividends declared and paid for each issuance of NNN's stock (in thousands, except per share data):

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2013 | 2012 |
| Series C preferred stock [(1)]: | | |
| Dividends | $— | $1,979 |
| Per share | — | 0.5378 |
| | | |
| Series D preferred stock [(3)]: | | |
| Dividends | 14,285 | 10,688 |
| Per share | 1.2422 | 0.9293 |
| | | |
| Series E preferred stock [(2)(3)]: | | |
| Dividends | 4,780 | — |
| Per share | 0.4156 | — |
| | | |
| Common stock: | | |
| Dividends | 139,890 | 124,139 |
| Per share | 1.195 | 1.165 |

1) The Series C preferred stock was redeemed in March 2012. The dividends paid during the nine months ended September 30, 2012 include accumulated and unpaid dividends through the redemption date.

2) The Series E preferred stock dividends paid during the quarter ended September 30, 2013 include

accumulated and unpaid dividends from the issuance date through the declaration date.

3) The Series D and E preferred stock have no maturity date and will remain outstanding unless redeemed.

In October 2013, NNN declared a dividend of $0.405 per share, which is payable in November 2013 to its common stockholders of record as of October 31, 2013.

Preferred Stock Issuances – In February 2012, NNN filed a shelf registration statement with the Securities and Exchange Commission (the "Commission") which permits the issuance by NNN of an indeterminate amount of debt and equity securities.

In February 2012, NNN issued 11,500,000 depositary shares representing interests in our 6.625% Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock") at a price of $25.00 per depositary share generating gross proceeds of $287,500,000. In connection with this offering, NNN incurred stock issuance costs totaling approximately $9,855,000, consisting primarily of underwriters' fees and commissions, rating agency fees, legal and accounting fees and printing expenses.

In March 2012, NNN redeemed all 3,680,000 outstanding depositary shares representing interests in its 7.375% Series C Cumulative Redeemable Preferred Stock (“Series C Preferred Stock”). The Series C Preferred Stock was redeemed at a price of $25.00 per depositary share, plus accumulated and unpaid distributions through the redemption date, for an aggregate redemption price of approximately $25.0768 per depositary share. The excess carrying amount of preferred stock redeemed over the cash paid to redeem the preferred stock was $3,098,000, representing Series C Preferred Stock issuance costs.

In May 2013, NNN issued 11,500,000 depositary shares representing interests in its 5.700% Series E Cumulative Redeemable Preferred Stock ("Series E Preferred Stock") at a price of $25.00 per depositary share generating gross proceeds of $287,500,000. In connection with this offering, NNN incurred stock issuance costs totaling approximately $9,856,000, consisting primarily of underwriters' fees and commissions, rating agency fees, legal and accounting fees and printing expenses.

At The Market Offerings – In May 2012, NNN established an at-the-market equity program ("2012 ATM") which allowed NNN to sell up to an aggregate of 9,000,000 shares of common stock from time to time through May 2015. The following table outlines the common stock issuances pursuant to the 2012 ATM (dollars in thousands, except per share data):

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2013 | 2012 |
| Shares of common stock | 4,676,542 | 2,251,798 |
| Average price per share (net) | $32.60 | $28.97 |
| Net proceeds | 152,435 | 65,245 |
| Stock issuance costs [(1)] | 2,161 | 1,171 |

(1) Stock issuance costs consist primarily of underwriters' fees and commissions, and legal and accounting fees.

In March 2013, NNN established a second ATM equity program ("2013 ATM") which allows NNN to sell up to an aggregate of 9,000,000 shares of common stock from time to time through March 2015. The following table outlines the common stock issuances pursuant to the 2013 ATM (dollars in thousands, except per share data):

| | Nine Months Ended September 30, 2013 |
|---|---|
| Shares of common stock | 2,280,450 |
| Average price per share (net) | $37.82 |
| Net proceeds | 86,237 |
| Stock issuance costs [(1)] | 1,585 |

(1) Stock issuance costs consist primarily of underwriters' fees and commissions, and legal and accounting fees.

Dividend Reinvestment and Stock Repurchase Plan – In February 2012, NNN filed a shelf registration statement with the Commission for its Dividend Reinvestment and Stock Purchase Plan ("DRIP") which permits the issuance by NNN of up to 16,000,000 shares of common stock. The following table outlines the common stock issuances pursuant to NNN's DRIP (dollars in thousands):

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2013 | 2012 |
| Shares of common stock | 634,146 | 1,994,113 |
| Net proceeds | $21,159 | $52,781 |

Note 8 – Income Taxes:
NNN has elected to be taxed as a REIT under the Internal Revenue Code ("Code"), commencing with its taxable year ended December 31, 1984. To qualify as a REIT, NNN must meet a number of organizational and operational requirements, including

a requirement that it currently distribute at least 90% of its REIT taxable income to its stockholders. NNN intends to adhere to these requirements and maintain its REIT status. As a REIT, NNN generally will not be subject to corporate level federal income tax on taxable income that it distributes currently to its stockholders. NNN may be subject to certain state and local taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income, if any. The provision for federal income taxes in NNN's consolidated financial statements relates to its TRS operations and any potential taxable built-in gain. NNN did not have significant tax provisions or deferred income tax items during the periods reported hereunder.

In June 2006, the FASB issued guidance which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB guidance included in Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

NNN, in accordance with FASB guidance included in Income Taxes, has analyzed its various federal and state tax filing positions. NNN believes that its income tax filing positions and deductions are well documented and supported. Additionally, NNN believes that its accruals for tax liabilities are adequate. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to the FASB guidance.

NNN has had no increases or decreases in unrecognized tax benefits for current or prior years. Further, no interest or penalties have been included since no reserves were recorded and no significant increases or decreases are expected to occur within the next 12 months. When applicable, such interest and penalties will be recorded as non-operating expenses. The periods that remain open under federal statute are 2010 through 2013. NNN also files tax returns in many states with varying open years under statute.

Note 9 – Earnings from Discontinued Operations:

NNN classified the revenues and expenses related to Properties which were sold or were held for sale as of September 30, 2013, as discontinued operations. The following is a summary of the earnings (loss) from discontinued operations (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Revenues: | | | | |
| Rental income from operating leases | $791 | $1,606 | $1,999 | $5,796 |
| Earned income from direct financing leases | 12 | 37 | 38 | 121 |
| Real estate expense reimbursement from tenants | 63 | 124 | 231 | 323 |
| Interest and other income from real estate transactions | 1 | 4 | 37 | 38 |
| | 867 | 1,771 | 2,305 | 6,278 |
| Operating expenses: | | | | |
| General and administrative | 3 | 2 | 218 | 7 |
| Real estate | 219 | 305 | 479 | 846 |
| Depreciation and amortization | 148 | 301 | 297 | 1,204 |
| Impairment losses and other charges, net of recoveries | (1) | 5,440 | 2,046 | 5,785 |
| | 369 | 6,048 | 3,040 | 7,842 |
| Other expenses: | | | | |
| Interest expense | 136 | 183 | 444 | 552 |
| | 136 | 183 | 444 | 552 |
| Earnings (loss) before gain on disposition of real estate and income tax expense | 362 | (4,460) | (1,179) | (2,116) |
| Gain on disposition of real estate | 1,228 | 1,694 | 4,402 | 4,446 |
| Income tax expense | (411) | (37) | (429) | (99) |
| Earnings (loss) from discontinued operations attributable to NNN including noncontrolling interests | 1,179 | (2,803) | 2,794 | 2,231 |
| Earnings attributable to noncontrolling interests | (7) | (2) | (223) | (10) |
| Earnings (loss) from discontinued operations attributable to NNN | $1,172 | $(2,805) | $2,571 | $2,221 |

Note 10 – Derivatives:

In accordance with the guidance on derivatives and hedging, NNN records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

NNN’s objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, NNN primarily uses treasury locks, forward swaps and interest rate swaps as part of its cash flow hedging strategy. Treasury locks and forward starting swaps are used to hedge forecasted debt issuances. Treasury locks designated as cash flow hedges lock in the yield/price of a treasury security. Forward swaps also lock the associated swap spread. Interest rate swaps designated as cash flow hedges hedging the variable cash flows associated with floating rate debt involve the receipt of variable rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount.

For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings.

NNN discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is re-designated as a hedging instrument or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

When hedge accounting is discontinued, NNN continues to carry the derivative at its fair value on the balance sheet, and recognizes any changes in its fair value in earnings or may choose to cash settle the derivative at that time.

In April 2013, NNN terminated four forward starting swaps with an aggregate notional amount of $240,000,000 that were hedging the risk of changes in forecasted interest payments on a forecasted issuance of long-term debt. When terminated, the fair value of the forward starting swaps, designated as cash flow hedges, was a liability of $3,156,000, of which $3,141,000 was deferred in other comprehensive income. The amount reported in accumulated other comprehensive income will be reclassified to interest expense as interest payments are made on the 2023 Notes.

As of September 30, 2013, $8,528,000 remained in other comprehensive income related to the effective portion of NNN's 2013 and previous interest rate hedges. During the nine months ended September 30, 2013 and 2012, NNN reclassified out of comprehensive income $306,000 and $171,000, respectively, as an increase to interest expense. Over the next 12 months, NNN estimates that an additional $703,000 will be reclassified as an increase in interest expense. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on NNN's long-term debt.

NNN does not use derivatives for trading or speculative purposes or currently have any derivatives that are not designated as hedges. NNN had no derivative financial instruments outstanding at September 30, 2013.

Note 11 – Fair Value Measurements:

NNN currently values its Residuals based upon an independent valuation which provides a discounted cash flow analysis based upon prepayment speeds, expected loan losses and yield curves. These valuation inputs are generally considered unobservable; therefore, the Residuals are considered Level 3 financial assets. The table below presents a roll forward of the Residuals (dollars in thousands):

| | Nine Months Ended September 30, 2013 |
|---|---|
| Balance at beginning of period | $13,096 |
| Total gains (losses) – realized/unrealized: | |
| Included in earnings | (16) |
| Included in other comprehensive income | 1,595 |
| Interest income on Residuals | 1,789 |
| Cash received from Residuals | (1,709) |
| Purchases, sales, issuances and settlements, net | — |
| Transfers in and/or out of Level 3 | — |
| Balance at end of period | $14,755 |
| Changes in gains (losses) included in earnings attributable to a change in unrealized gains (losses) relating to assets still held at the end of period | $(328) |

Note 12 – Fair Value of Financial Instruments:

NNN believes the carrying value of its Credit Facility approximates fair value based upon its nature, terms and variable interest rate. NNN believes that the carrying value of its cash and cash equivalents, mortgages, notes and other receivables, mortgages payable and other liabilities at September 30, 2013 and December 31, 2012, approximate fair value based upon current market prices of similar issues. At September 30, 2013 and December 31, 2012, the fair value of NNN's notes payable was $1,559,656,000 and $1,585,756,000, respectively, based upon quoted market prices, which is a level one valuation since NNN's debt is publicly traded.

Note 13 – Subsequent Events:

NNN reviewed its subsequent events and transactions that have occurred after September 30, 2013, the date of the condensed consolidated balance sheet. There were no reportable subsequent events or transactions.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K of National Retail Properties, Inc. for the year ended December 31, 2012. The terms “NNN” and the “Company” refer to National Retail Properties, Inc. and all of its consolidated subsidiaries. NNN has elected to treat certain subsidiaries as taxable real estate investment trust subsidiaries. These subsidiaries and their majority owned and controlled subsidiaries are collectively referred to as the “TRS.”

Forward-Looking Statements

The information herein contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934 (the “Exchange Act”). These statements generally are characterized by the use of terms such as “believe,” “expect,” “intend,” “may,” or similar words or expressions. Forward-looking statements are not historical facts or guarantees of future performance and are subject to known and unknown risks. Certain factors that could cause actual results or events to differ materially from those NNN anticipates or projects include, but are not limited to, the following:

- Financial and economic conditions may have an adverse impact on NNN, its tenants, and commercial real estate in general;
- NNN may be unable to obtain debt or equity capital on favorable terms, if at all;
- Loss of revenues from tenants would reduce NNN's cash flow;
- A significant portion of the source of NNN's Property Portfolio annual base rent is heavily concentrated in specific industry classifications, tenants and in specific geographic locations;
- Owning real estate and indirect interests in real estate carries inherent risk;
- NNN's real estate investments are illiquid;
- Costs of complying with changes in governmental laws and regulations may adversely affect NNN's results of operations;
- NNN may be subject to known or unknown environmental liabilities and hazardous materials on properties owned by NNN;
- NNN may not be able to successfully execute its acquisition or development strategies;
- NNN may not be able to dispose of properties consistent with its operating strategy;
- A change in the assumptions used to determine the value of commercial mortgage residual interests could adversely affect NNN's financial position;
- NNN may suffer a loss in the event of a default or bankruptcy of a borrower or a tenant;
- Certain provisions of NNN's leases or loan agreements may be unenforceable;
- Property ownership through joint ventures and partnerships could limit NNN's control of those investments;
- Competition from numerous other REITs, commercial developers, real estate limited partnerships and other investors may impede NNN's ability to grow;
- NNN's loss of key management personnel could adversely affect performance and the value of its common stock;
- Uninsured losses may adversely affect NNN's operating results and asset values;
- Acts of violence, terrorist attacks or war may adversely affect the markets in which NNN operates and NNN's results of operations;
- Vacant properties or bankrupt tenants could adversely affect NNN's business or financial condition;
- The amount of debt NNN has and the restrictions imposed by that debt could adversely affect NNN's business and financial condition;
- NNN is obligated to comply with financial and other covenants in its debt instruments that could restrict its operating activities, and the failure to comply with such covenants could result in defaults that accelerate the payment of such debt;
-

The market value of NNN's equity and debt securities is subject to various factors that may cause significant fluctuations or volatility;

- NNN's failure to qualify as a real estate investment trust for federal income tax purposes could result in significant tax liability;
- Even if NNN remains qualified as a REIT, NNN may face other tax liabilities that reduce operating results and cash flow;
- Adverse legislative or regulatory tax changes could reduce NNN's earnings, cash flow and market price of NNN's common stock;
- Compliance with REIT requirements, including distribution requirements, may limit NNN's flexibility and negatively affect NNN's operating decisions;

- Changes in accounting pronouncements could adversely impact NNN's or NNN's tenants' reported financial performance;
- NNN's failure to maintain effective internal control over financial reporting could have a material adverse effect on its business, operating results and share price;
- NNN's ability to pay dividends in the future is subject to many factors;
- Cybersecurity risks and cyber incidents could adversely affect NNN's business and disrupt operations; and
- Future investments in international markets could subject NNN to additional risks.

Additional information related to these risks and uncertainties are included in Item 1A. Risk Factors of NNN's Annual Report on Form 10-K for the year ended December 31, 2012, and may cause NNN's actual future results to differ materially from expected results. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. NNN undertakes no obligation to update or revise such forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

NNN, a Maryland corporation, is a fully integrated real estate investment trust ("REIT") formed in 1984. NNN's assets include: real estate, mortgages and notes receivable, and commercial mortgage residual interests (the "Residuals"). NNN acquires, owns, invests in and develops properties that are leased primarily to retail tenants under long-term net leases and primarily held for investment ("Properties" or "Property Portfolio").

As of September 30, 2013, NNN owned 1,850 Properties, with an aggregate gross leasable area of approximately 20,292,000 square feet, located in 47 states. Approximately 98 percent of the Properties in the Property Portfolio were leased as of September 30, 2013.

NNN's management team focuses on certain key indicators to evaluate the financial condition and operating performance of NNN. The key indicators for NNN include items such as: the composition of the Property Portfolio (such as tenant, geographic and line of trade diversification), the occupancy rate of the Property Portfolio, certain financial performance ratios and profitability measures, and industry trends and performance compared to that of NNN.

NNN continues to maintain its diversification by tenant, geography and tenant's line of trade. NNN's highest lines of trade concentrations are the convenience store and restaurant (including full and limited service) sectors. These sectors represent a large part of the freestanding retail property marketplace and NNN's management believes these sectors present attractive investment opportunities. NNN's Property Portfolio is geographically concentrated in the south and southeast United States, which are regions of historically above-average population growth. Given these concentrations, any financial hardship within these sectors or geographic locations, respectively, could have a material adverse effect on the financial condition and operating performance of NNN.

Results of Operations
Property Analysis
General. The following table summarizes NNN's Property Portfolio:

| | September 30, 2013 | December 31, 2012 | September 30, 2012 |
|---|---|---|---|
| Properties Owned: | | | |
| Number | 1,850 | 1,622 | 1,530 |
| Total gross leasable area (square feet) | 20,292,000 | 19,168,000 | 18,331,000 |
| Properties: | | | |
| Leased and unimproved land | 1,814 | 1,588 | 1,497 |
| Percent of Properties – leased and unimproved land | 98 % | 98 % | 98 % |
| Weighted average remaining lease term (years) | 12 | 12 | 12 |
| Total gross leasable area (square feet) – leased | 19,728,000 | 18,524,000 | 17,755,000 |

The following table summarizes the diversification of NNN's Property Portfolio based on the top 10 lines of trade:

| | | % of Annual Base Rent [(1)] | | |
|---|---|---|---|---|
| | Lines of Trade | September 30, 2013 | December 31, 2012 | September 30, 2012 |
| 1. | Convenience stores | 19.9 % | 19.8 % | 21.6 % |
| 2. | Restaurants - full service | 9.8 % | 10.7 % | 11.3 % |
| 3. | Automotive service | 7.6 % | 7.6 % | 6.4 % |
| 4. | Restaurants - limited service | 5.4 % | 5.2 % | 3.5 % |
| 5. | Automotive parts | 5.1 % | 5.6 % | 5.8 % |
| 6. | Theaters | 4.4 % | 4.7 % | 4.5 % |
| 7. | Banks | 4.1 % | 0.2 % | 0.2 % |
| 8. | Health and fitness | 4.0 % | 3.7 % | 2.8 % |
| 9. | Sporting goods | 3.7 % | 4.0 % | 4.5 % |
| 10. | Wholesale clubs | 3.1 % | 3.4 % | 3.6 % |
| | Other | 32.9 % | 35.1 % | 35.8 % |
| | | 100.0 % | 100.0 % | 100.0 % |

(1) Based on annualized base rent for all leases in place for each respective period.

Property Acquisitions. The following table summarizes the Property acquisitions (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Acquisitions: | | | | |
| Number of Properties | 35 | 30 | 261 | 124 |
| Gross leasable area (square feet) | 243,000 | 575,000 | 1,468,000 | 2,048,000 |
| Total dollars invested[(1)] | $90,070 | $139,600 | $570,334 | $452,558 |

(1) Includes dollars invested in projects under construction or tenant improvements for each respective year.

NNN typically funds property acquisitions either through available cash, borrowings under its unsecured revolving Credit Facility (see "Debt – Line of Credit Payable") or by issuing its debt or equity securities in the capital markets.

Property Dispositions. The following table summarizes the Properties sold by NNN (dollars in thousands):

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Number of properties | 22 | 8 | 31 | 18 |
| Gross leasable area (square feet) | 169,000 | 40,000 | 301,000 | 141,000 |
| Net sales proceeds | $35,971 | $20,347 | $52,585 | $32,088 |
| Net gain, net of non-controlling interest | $1,228 | $1,694 | $4,402 | $4,446 |

NNN typically uses the proceeds from property sales either to pay down the Credit Facility or reinvest in real estate.

Analysis of Revenue From Continuing Operations

General. During the quarter and nine months ended September 30, 2013, rental income increased primarily due to an increase in rental income from property acquisitions (See “Results of Operations - Property Analysis - Property Acquisitions”). NNN anticipates increases in rental income will continue to come from additional property acquisitions and increases in rents pursuant to lease terms.

The following summarizes NNN’s revenues from continuing operations (dollars in thousands):

| | Quarter Ended September 30, | | | | | Nine Months Ended September 30, | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 | Percent Increase (Decrease) | 2013 | 2012 | 2013 | 2012 | Percent Increase (Decrease) |
| | | | Percent of Total | | | | | Percent of Total | | |