NATIONAL RETAIL PROPERTIES, INC.
Form 10-Q
May 05, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended March 31, 2015
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 (State or other jurisdiction of incorporation or organization)	56-1431377 (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.
134,007,840 shares of common stock, $0.01 par value, outstanding as of April 29, 2015.

TABLE OF CONTENTS

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)

	March 31, 2015	December 31, 2014
ASSETS	(unaudited)	
Real estate portfolio:		
Accounted for using the operating method, net of accumulated depreciation and amortization	$4,823,155	$4,716,923
Accounted for using the direct financing method	16,329	16,974
Real estate held for sale	4,731	6,152
Mortgages, notes and accrued interest receivable	11,220	11,075
Commercial mortgage residual interests	11,132	11,626
Cash and cash equivalents	4,456	10,604
Receivables, net of allowance of $1,887 and $1,784, respectively	1,969	3,013
Accrued rental income, net of allowance of $3,086	25,592	25,659
Debt costs, net of accumulated amortization of $13,787 and $14,353, respectively	15,744	16,453
Other assets	106,508	108,235
Total assets	$5,020,836	$4,926,714
LIABILITIES AND EQUITY		
Liabilities:		
Line of credit payable	$41,900	$—
Mortgages payable, including unamortized premium of $839 and $890, respectively	25,878	26,339
Notes payable, net of unamortized discount of $9,968 and $10,285, respectively	1,715,032	1,714,715
Accrued interest payable	29,303	17,396
Other liabilities	84,892	85,172
Total liabilities	1,897,005	1,843,622
Equity:		
Stockholders' equity:		
Preferred stock, $0.01 par value. Authorized 15,000,000 shares		
6.625% Series D, 115,000 shares issued and outstanding, at stated liquidation value of $2,500 per share	287,500	287,500
5.700% Series E, 115,000 shares issued and outstanding, at stated liquidation value of $2,500 per share	287,500	287,500
Common stock, $0.01 par value. Authorized 375,000,000 shares; 133,446,857 and 132,010,104 shares issued and outstanding, respectively	1,336	1,322
Capital in excess of par value	2,762,461	2,711,678
Retained earnings (loss)	(207,022)	(196,827)
Accumulated other comprehensive income (loss)	(8,517)	(8,658)
Total stockholders' equity of NNN	3,123,258	3,082,515
Noncontrolling interests	573	577
Total equity	3,123,831	3,083,092
Total liabilities and equity	$5,020,836	$4,926,714

See accompanying notes to condensed consolidated financial statements.

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

	Quarter Ended March 31,	
	2015	2014
Revenues:		
Rental income from operating leases	$111,474	$99,055
Earned income from direct financing leases	405	443
Percentage rent	185	90
Real estate expense reimbursement from tenants	3,515	3,232
Interest and other income from real estate transactions	163	792
Interest income on commercial mortgage residual interests	445	452
	116,187	104,064
Operating expenses:		
General and administrative	8,605	8,706
Real estate	4,759	4,340
Depreciation and amortization	32,141	28,012
Impairment – commercial mortgage residual interests valuation	—	158
Impairment losses	1,028	396
	46,533	41,612
Earnings from operations	69,654	62,452
Other expenses (revenues):		
Interest and other income	(11)	(63)
Interest expense	21,786	20,278
Real estate acquisition costs	599	209
	22,374	20,424
Earnings from continuing operations before income tax benefit (expense)	47,280	42,028
Income tax benefit (expense)	(442)	93
Earnings from continuing operations	46,838	42,121
Loss from discontinued operations, net of income tax expense	—	(36)
Earnings before gain on disposition of real estate, net of income tax expense	46,838	42,085
Gain on disposition of real estate, net of income tax expense	7,200	1,756
Earnings including noncontrolling interests	54,038	43,841
Earnings attributable to noncontrolling interests:		
Continuing operations	(60)	(508)
Net earnings attributable to NNN	$53,978	$43,333

See accompanying notes to condensed consolidated financial statements.

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

	Quarter Ended March 31,	
	2015	2014
Net earnings attributable to NNN	$53,978	$43,333
Series D preferred stock dividends	(4,762)	(4,762)
Series E preferred stock dividends	(4,097)	(4,097)
Net earnings attributable to common stockholders	$45,119	$34,474
Net earnings per share of common stock:		
Basic:		
Continuing operations	$0.34	$0.28
Discontinued operations	—	—
Net earnings	$0.34	$0.28
Diluted:		
Continuing operations	$0.34	$0.28
Discontinued operations	—	—
Net earnings	$0.34	$0.28
Weighted average number of common shares outstanding:		
Basic	131,665,258	121,575,983
Diluted	132,109,965	121,866,951
Other comprehensive income:		
Net earnings attributable to NNN	$53,978	$43,333
Amortization of interest rate hedges	414	135
Fair value forward starting swaps	—	(3,373)
Net gain (loss) – commercial mortgage residual interests	(346)	684
Net gain – available-for-sale securities	73	115
Comprehensive income attributable to NNN	$54,119	$40,894

See accompanying notes to condensed consolidated financial statements.

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

	Quarter Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Earnings including noncontrolling interests	$54,038	$43,841
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	32,141	28,012
Impairment charges	1,028	459
Impairment – commercial mortgage residual interests valuation	—	158
Amortization of notes payable discount	317	302
Amortization of debt costs	709	656
Amortization of mortgages payable premium	(52)	(15)
Amortization of deferred interest rate hedges	414	135
Gain on disposition of real estate	(7,230)	(1,963)
Performance incentive plan expense	2,575	2,338
Performance incentive plan payment	(676)	(2,808)
Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Decrease in real estate leased to others using the direct financing method	334	328
Decrease (increase) in mortgages, notes and accrued interest receivable	59	(137)
Decrease in receivables	1,044	417
Increase in accrued rental income	(205)	(601)
Decrease in other assets	4,539	742
Increase in accrued interest payable	11,907	10,854
Decrease in other liabilities	(4,311)	(3,205)
Other	507	299
Net cash provided by operating activities	97,138	79,812
Cash flows from investing activities:		
Proceeds from the disposition of real estate	22,697	12,301
Additions to real estate:		
Accounted for using the operating method	(151,319)	(89,862)
Increase in mortgages and notes receivable	—	(3,245)
Principal payments on mortgages and notes receivable	296	214
Other	(593)	(1,100)
Net cash used in investing activities	(128,919)	(81,692)

See accompanying notes to condensed consolidated financial statements.

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

	Quarter Ended March 31, 2015	2014
Cash flows from financing activities:		
Proceeds from line of credit payable	$227,100	$251,000
Repayment of line of credit payable	(185,200)	(205,900)
Repayment of mortgages payable	(409)	(279)
Proceeds from issuance of common stock	49,370	21,144
Payment of Series D Preferred Stock dividends	(4,762)	(4,762)
Payment of Series E Preferred Stock dividends	(4,097)	(4,097)
Stock issuance costs	(991)	(304)
Payment of common stock dividends	(55,314)	(49,273)
Noncontrolling interest distributions	(64)	(1,208)
Net cash provided by financing activities	25,633	6,321
Net increase (decrease) in cash and cash equivalents	(6,148)	4,441
Cash and cash equivalents at beginning of period	10,604	1,485
Cash and cash equivalents at end of period	$4,456	$5,926
Supplemental disclosure of cash flow information:		
Interest paid, net of amount capitalized	$8,881	$8,781
Taxes paid	$116	$27
Supplemental disclosure of noncash investing and financing activities:		
Issued 267,133 and 371,134 shares of restricted and unrestricted common stock in 2015 and 2014, respectively, pursuant to NNN's performance incentive plan	$8,285	$10,345
Issued 3,602 and 3,985 shares of common stock in 2015 and 2014, respectively, to directors pursuant to NNN's performance incentive plan	$154	$132
Issued 3,435 and 4,162 shares of common stock in 2015 and 2014, respectively, pursuant to NNN's Deferred Director Fee Plan	$66	$66
Change in other comprehensive income	$141	$2,439
Mortgage receivable accepted in connection with real estate transactions	$500	$—
Note receivable accepted in connection with real estate transactions	$—	$70
Change in lease classification (direct financing lease to operating lease)	$311	$—

See accompanying notes to condensed consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2015
(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", "Property Portfolio", or individually a "Property").

	March 31, 2015
Property Portfolio:	
Total properties	2,104
Gross leasable area (square feet)	23,146,000
States	47
Weighted average remaining lease term (years)	11.5

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 ended March 31, 2015, may not be indicative of the results that may be expected for the year ending December 31, 2015. Amounts as of December 31, 2014, 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, 2014.
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 quarters ended March 31, 2015 and 2014, NNN recorded $390,000 and $434,000, respectively, in capitalized interest during development.
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 and the value of in-place leases, based on their respective 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 their fair values.

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 will renew the option whereby the Company amortizes 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 (dollars in thousands):

	March 31, 2015	December 31, 2014
Intangible lease assets (included in Other assets):		
Value of above market in-place leases, net	$11,937	$11,751
Value of in-place leases, net	68,118	65,770
Intangible lease liabilities (included in Other liabilities):		
Value of below market in-place leases, net	28,522	29,162

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 or may be held in accounts without any federal insurance or any other insurance or guarantee. 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, tenant 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 March 31, 2015	2014
Basic and Diluted Earnings:		
Net earnings attributable to NNN	$53,978	$43,333
Less: Series D preferred stock dividends	(4,762)	(4,762)
Less: Series E preferred stock dividends	(4,097)	(4,097)
Net earnings available to NNN's common stockholders	45,119	34,474
Less: Earnings allocated to unvested restricted shares	(163)	(163)
Net earnings used in basic and diluted earnings per share	$44,956	$34,311
Basic and Diluted Weighted Average Shares Outstanding:		
Weighted average number of shares outstanding	132,453,638	122,412,739
Less: Unvested restricted stock	(388,331)	(403,309)
Less: Unvested contingent shares	(400,049)	(433,447)
Weighted average number of shares outstanding used in basic earnings per share	131,665,258	121,575,983
Other dilutive securities	444,707	290,968
Weighted average number of shares outstanding used in diluted earnings per share	132,109,965	121,866,951

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.

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

	Gains or Losses on Cash Flow Hedges [1]	Gains and Losses on Commercial Mortgage Residual Interests [2]	Gains and Losses on Available-for-Sale Securities	Total
Beginning balance, December 31, 2014	$(13,579)	$4,793	$ 128	$(8,658)
Other comprehensive income (loss)	—	(346)	73	(273)
Reclassifications from accumulated other comprehensive income to net earnings	414 [3]	—	—	414

Net current period other comprehensive income (loss)	414	(346)	73	141
Ending balance, March 31, 2015	$(13,165)	$4,447	$ 201	$(8,517)

[1] Additional disclosure is included in Note 7 – Derivatives.

(2) Additional disclosure is included in Note 8 – Fair Value Measurements.
(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 May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. The core principle of ASU 2014-09, is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Certain contracts are excluded from ASU 2014-09, including lease contracts within the scope of the FASB guidance included in Leases. NNN is currently evaluating to determine the potential impact, if any, the adoption of ASU 2014-09 will have on its financial position and results of operations.

In June 2014, the FASB issued ASU 2014-12, "Compensation – Stock Compensation (Topic 718)," effective for annual periods and interim periods within those periods beginning after December 15, 2015. The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. NNN is currently evaluating to determine the potential impact, if any, the adoption of ASU 2014-12 will have on its financial position and results of operations.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205-40)," effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The amendments in this update provide guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. NNN is currently evaluating to determine the potential disclosure impact, if any, the adoption of ASU 2014-15 will have on footnote disclosures.

In November 2014, the FASB issued ASU 2014-16, "Derivatives and Hedging (Topic 815)." Entities commonly raise capital by issuing different classes of shares, including preferred stock, that entitle the holders to certain preferences and rights over the other shareholders. The specific terms of those shares may include conversion rights, redemption rights, voting rights, and liquidation and dividend payment preferences, among other features. One or more of those features may meet the definition of a derivative under GAAP. Shares that include such embedded derivative features are referred to as hybrid financial instruments. The objective of this update is to eliminate the use of different methods in practice and thereby reduce existing diversity under GAAP in the accounting for hybrid financial instruments issued in the form of a share. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. NNN is currently evaluating to determine the potential impact, if any, the adoption of ASU 2014-16 will have on its financial position and results of operations.

In January 2015, the FASB issued ASU 2015-01, "Income Statement - Extraordinary and Unusual Items (Subtopic 225-20)," effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. This update eliminates from GAAP the concept of extraordinary items. NNN is currently evaluating to determine the potential disclosure impact, if any, the adoption of ASU 2015-01 will have on its financial position and results of operations.

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810)," effective for fiscal years, and for interim periods within those years, beginning after December 15, 2015. The amendments in this update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. NNN is currently evaluating to determine the potential impact, if any, the adoption of ASU 2015-02 will have on its financial position and results of operations.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30)". To simplify presentation of debt issuance costs, the amendments in this update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in this update are effective for financial statements issued for fiscal years beginning after December 15, 2015 and interim periods within fiscal years beginning after December 15, 2016. NNN is currently evaluating to determine the potential impact, if any, the adoption of ASU 2015-03 will have on its 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 condensed 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 2015 presentation.

Note 2 – Real Estate:

Real Estate – Portfolio

Leases – The following outlines key information for NNN's leases:

	March 31, 2015
Lease classification:	
Operating	2,140
Direct financing	11
Building portion – direct financing/land portion – operating	1
Weighted average remaining lease term (years)	11.5

The leases generally provide for limited 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 Property and carry property and liability insurance coverage. Certain of the Properties are subject to leases under which NNN retains responsibility for specific costs and expenses of the Property. Generally, the leases provide the tenant with one or more multi-year renewal options subject to generally the same terms and conditions of the base term of the lease, including rent increases.

Real Estate Portfolio – Accounted for Using the Operating Method – Real estate subject to operating leases consisted of the following as of (dollars in thousands):

	March 31, 2015	December 31, 2014
Land and improvements	$1,816,363	$1,783,822
Buildings and improvements	3,515,904	3,414,570
Leasehold interests	1,290	1,290
	5,333,557	5,199,682
Less accumulated depreciation and amortization	(538,435)	(511,667)
	4,795,122	4,688,015
Work in progress	28,033	28,908
	$4,823,155	$4,716,923

Real Estate – Held For Sale

On a quarterly basis, the Company evaluates its Properties for held for sale classification based on specific criteria as outlined in ASC 360, Property, Plant & Equipment, including management's intent to commit to a plan to sell the asset. In January 2014, NNN completed a strategic review of its Properties held for sale and reclassified one Property that was previously held for sale to held for investment, included in Real Estate – Portfolio. As of March 31, 2015, NNN had six Properties categorized as held for sale. NNN anticipates the disposition of these Properties to occur within 12 months. NNN's real estate held for sale at December 31, 2014, includes eight properties, two of which were subsequently sold in 2015. Real estate held for sale consisted of the following as of (dollars in thousands):

	March 31, 2015	December 31, 2014
Land and improvements	$3,592	$3,918
Building and improvements	2,461	4,765
	6,053	8,683
Less accumulated depreciation and amortization	(757)	(1,509)
Less impairment	(565)	(1,022)
	$4,731	$6,152

Real Estate – Dispositions

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

	Quarter Ended March 31,				
	2015		2014		
	# of Sold Properties	Gain	# of Sold Properties	Gain	
Gain on disposition of real estate	6	$7,230	2	$1,954	
Income tax expense		(30)		(198)	
		7,200		1,756	
Gain on disposition of real estate included in discontinued operations	—	—	2	9	(1)
		$7,200		$1,765	

(1) Amount includes deferred gain on previously sold properties.

Real Estate – Commitments

NNN has agreed to fund construction commitments on leased Properties. The improvements are estimated to be completed within 12 months. These construction commitments, as of March 31, 2015, are outlined in the table below (dollars in thousands):

Number of properties	30
Total commitment[1]	$119,818
Amount funded	$57,027
Remaining commitment	$62,791

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

Real Estate – Impairments

Management periodically assesses its real estate for possible impairment whenever certain 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 in a reasonable period of time. Impairments are measured as the amount by which the current book value of the asset exceeds the estimated 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 March 31,	
	2015	2014
Continuing operations	$1,028	$396
Discontinued operations	—	63
	$1,028	$459

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 estimating the fair value of its real estate.

Note 3 – Line of Credit Payable:
NNN's $650,000,000 revolving credit facility (the “Credit Facility”) had a weighted average outstanding balance of $25,489,000 and a weighted average interest rate of 1.1% during the quarter ended March 31, 2015. The Credit Facility matures January 2019, unless the Company exercises its option to extend maturity to January 2020. The Credit Facility bears interest at LIBOR plus 92.5 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 March 31, 2015, $41,900,000 was outstanding and $608,100,000 was available for future borrowings under the Credit Facility.

Note 4 – Notes Payable:
In May 2014, 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 3.900% notes due June 2024 (the “2024 Notes”). The 2024 Notes were sold at a discount with an aggregate purchase price of $349,293,000 with interest payable semi-annually commencing on December 15, 2014. The discount of $707,000 is being amortized to interest expense over the term of the notes using the effective interest method. The effective interest rate for the 2024 Notes after accounting for the note discount is 3.924%. NNN previously entered into three forward starting swaps with an aggregate notional amount of $225,000,000. Upon issuance of the 2024 Notes, NNN terminated the forward starting swaps resulting in a liability of $6,312,000, which was deferred in other comprehensive income. The deferred liability is being amortized to interest expense over the term of the 2024 Notes using the effective interest method.
The 2024 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 2024 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 May 5, 2014, relating to the 2024 Notes.
NNN received approximately $346,068,000 of net proceeds in connection with the issuance of the 2024 Notes, after incurring debt issuance costs totaling $3,225,000 consisting primarily of underwriting discounts and commissions, legal and accounting fees, rating agency fees and printing expenses.

Note 5 – Stockholders' Equity:
In February 2015, 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 November 2014, NNN filed a prospectus supplement to the prospectus contained in its February 2012 shelf registration statement and issued 5,462,500 shares (including 712,500 shares in connection with the underwriters' over-allotment) of common stock at a price of $38.16 per share and received net proceeds of $199,961,000. In connection with this offering, NNN incurred stock issuance costs totaling approximately $8,488,000, consisting primarily of underwriters' fees and commissions, legal and accounting fees and printing expenses.
Dividend Reinvestment and Stock Repurchase Plan – In February 2015, 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):

	Quarter Ended March 31,	
	2015	2014
Shares of common stock	31,854	184,503
Net proceeds	$1,142	$6,107

14

At The Market Offerings – NNN established an at-the-market equity program ("ATM") which allows NNN to sell shares of common stock from time to time. The following outlines NNN's ATM programs:

	2015 ATM	2013 ATM	2012 ATM
Established date	February 2015	March 2013	May 2012
Termination date	February 2018	February 2015	February 2015
Total allowable shares	10,000,000	9,000,000	9,000,000
Total shares issued as of March 31, 2015	977,973	6,252,812	8,958,840

The following table outlines the common stock issuances pursuant to NNN's ATM equity program (dollars in thousands, except per share data):

	Quarter Ended March 31,		
	2015		2014
	2015 ATM	2013 ATM	2013 ATM
Shares of common stock	977,973	214,000	432,000
Average price per share (net)	$39.91	$39.84	$34.91
Net proceeds	$39,031	$8,525	$15,080
Stock issuance costs[1]	$712	$130	$265

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

No shares were issued under the 2012 ATM during the quarters ended March 31, 2015 and 2014.

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

	Quarter Ended March 31,	
	2015	2014
Series D preferred stock[1]:		
Dividends	$4,762	$4,762
Per depositary share	0.414063	0.414063
Series E preferred stock[1]:		
Dividends	4,097	4,097
Per depositary share	0.356250	0.356250
Common stock:		
Dividends	55,314	49,273
Per share	0.420	0.405

[1] The Series D and E preferred stock have no maturity date and will remain outstanding unless redeemed.

In April 2015, NNN declared a dividend of $0.420 per share, which is payable in May 2015 to its common stockholders of record as of April 30, 2015.

Note 6 – 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.

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 2011 through 2015. NNN also files tax returns in many states with varying open years under statute.

Note 7 – 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 ("forward hedges") 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.
The following table outlines NNN's derivatives which were hedging the risk of changes in forecasted interest payments on forecasted issuance of long-term debt (dollars in thousands):

Terminated	Description	Aggregate Notional Amount	Fair Value When Terminated [(1)]	Fair Value Deferred In Other Comprehensive Income [(2)]
April 2013	Four forward starting swaps	$240,000	$3,156	$ 3,141
May 2014	Three forward starting swaps	225,000	6,312	6,312

(1) Liability
(2) The amount reported in accumulated other comprehensive income will be reclassified to interest expense as interest payments are made on the related notes payable.
As of March 31, 2015, $13,165,000 remained in other comprehensive income related to the effective portion of NNN's previous interest rate hedges. During the quarters ended March 31, 2015 and 2014, NNN reclassified out of

comprehensive income $414,000 and $135,000, respectively, as an increase to interest expense. Over the next 12 months, NNN estimates that an additional $1,707,000 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 March 31, 2015.

Note 8 – Fair Value Measurements:

NNN holds the commercial mortgage residual interests ("Residuals") from seven securitizations. Each of the Residuals is recorded at fair value. 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.

NNN currently values its Residuals based upon a valuation which provides a discounted cash flow analysis based upon estimated 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):

	Quarter Ended March 31, 2015
Balance at beginning of period	$11,626
Total gains (losses) – realized/unrealized:	
Included in earnings	—
Included in other comprehensive income	(346)
Interest income on Residuals	445
Cash received from Residuals	(593)
Purchases, sales, issuances and settlements, net	—
Transfers in and/or out of Level 3	—
Balance at end of period	$11,132
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	$—

Note 9 – 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 March 31, 2015 and December 31, 2014, approximate fair value based upon current market prices of similar instruments. At March 31, 2015 and December 31, 2014, the fair value of NNN's notes payable was $1,819,996,000 and $1,813,439,000, respectively, based upon quoted market prices, which is a Level 1 valuation since NNN's debt is publicly traded.

Note 10 – Subsequent Events:

NNN reviewed its subsequent events and transactions that have occurred after March 31, 2015, 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, 2014. 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 REIT for federal income tax purposes could result in significant tax liability;
- Even if NNN remains qualified as a REIT, NNN faces 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 expose NNN to liabilities to tenants, employees, capital providers, and other third parties; 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, 2014, 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", or individually a "Property").

As of March 31, 2015, NNN owned 2,104 Properties, with an aggregate gross leasable area of approximately 23,146,000 square feet, located in 47 states, with a weighted average remaining lease term of 11.5 years. Approximately 99 percent of the Properties were leased as of March 31, 2015.

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 evaluates the creditworthiness of its current and prospective tenants. This evaluation includes reviewing available financial statements, press releases, public credit ratings from major credit rating agencies, industry news publications, financial market data (debt and equity pricing), and developing a thorough understanding of the tenant's business and operations, including periodically meeting with senior management of certain tenants and evaluating property level financial performance.

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. The 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 the Property Portfolio:

	March 31, 2015	December 31, 2014	March 31, 2014
Properties Owned:			
Number	2,104	2,054	1,903
Total gross leasable area (square feet)	23,146,000		