INDEPENDENT BANK CORP
Form 10-Q
May 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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FORM 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015
Commission File Number: 1-9047

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Independent Bank Corp.
(Exact name of registrant as specified in its charter)

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| | |
|---|---|
| Massachusetts | 04-2870273 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

Office Address: 2036 Washington Street, Hanover Massachusetts 02339
Mailing Address: 288 Union Street, Rockland, Massachusetts 02370
(Address of principal executive offices, including zip code)
(781) 878-6100
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large Accelerated Filer | x | Accelerated Filer | o |
| Non-accelerated Filer | o | Smaller Reporting Company | o |

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

As of May 1, 2015, there were 26,148,263 shares of the issuer's common stock outstanding, par value $0.01 per share.

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PART 1. FINANCIAL INFORMATION
Item 1. Financial Statements
INDEPENDENT BANK CORP.
CONSOLIDATED BALANCE SHEETS
(Unaudited—Dollars in thousands, except share data)

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $108,804 | $143,342 |
| Interest-earning deposits with banks | 47,470 | 34,912 |
| Securities | | |
| Securities - trading | 494 | — |
| Securities - available for sale | 387,038 | 348,554 |
| Securities - held to maturity (fair value $402,322 and $379,699) | 394,745 | 375,453 |
| Total securities | 782,277 | 724,007 |
| Loans held for sale (at fair value) | 9,507 | 6,888 |
| Loans | | |
| Commercial and industrial | 829,380 | 860,839 |
| Commercial real estate | 2,606,444 | 2,347,323 |
| Commercial construction | 291,666 | 265,994 |
| Small business | 87,709 | 85,247 |
| Residential real estate | 681,379 | 530,259 |
| Home equity - first position | 519,978 | 513,518 |
| Home equity - subordinate positions | 356,938 | 350,345 |
| Other consumer | 19,624 | 17,208 |
| Total loans | 5,393,118 | 4,970,733 |
| Less: allowance for loan losses | (54,515) | (55,100) |
| Net loans | 5,338,603 | 4,915,633 |
| Federal Home Loan Bank stock | 37,485 | 33,233 |
| Bank premises and equipment, net | 73,315 | 64,074 |
| Goodwill | 201,083 | 170,421 |
| Identifiable intangible assets | 13,975 | 9,885 |
| Cash surrender value of life insurance policies | 131,643 | 109,854 |
| Other real estate owned and other foreclosed assets | 6,285 | 7,743 |
| Other assets | 160,638 | 144,920 |
| Total assets | $6,911,085 | $6,364,912 |
| Liabilities and Stockholders' Equity | | |
| Deposits | | |
| Demand deposits | 1,603,124 | 1,462,200 |
| Savings and interest checking accounts | 2,232,832 | 2,108,486 |
| Money market | 1,088,223 | 990,160 |
| Time certificates of deposit of $100,000 and over | 304,952 | 254,718 |
| Other time certificates of deposits | 441,581 | 394,902 |
| Total deposits | 5,670,712 | 5,210,466 |
| Borrowings | | |
| Federal Home Loan Bank borrowings | 108,246 | 70,080 |
| Customer repurchase agreements and other short-term borrowings | 128,138 | 147,890 |

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| | | |
|---|---|---|
| Wholesale repurchase agreements | 50,000 | 50,000 |
| Junior subordinated debentures | 73,631 | 73,685 |
| Subordinated debentures | 35,000 | 65,000 |
| Total borrowings | 395,015 | 406,655 |
| Other liabilities | 112,472 | 107,264 |
| Total liabilities | 6,178,199 | 5,724,385 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Preferred stock, $.01 par value. authorized: 1,000,000 shares, outstanding: none | — | — |
| Common stock, $.01 par value. authorized: 75,000,000 shares, issued and outstanding: 26,123,576 shares at March 31, 2015 and 23,998,738 shares at December 31, 2014 (includes 241,660 and 254,500 shares of unvested participating restricted stock awards, respectively) | 259 | 237 |
| Shares held in rabbi trust at cost: 169,262 shares at March 31, 2015 and 176,849 shares at December 31, 2014 | (3,700) | (3,666) |
| Deferred compensation and other retirement benefit obligations | 3,700 | 3,666 |
| Additional paid in capital | 399,936 | 311,978 |
| Retained earnings | 333,104 | 330,444 |
| Accumulated other comprehensive loss, net of tax | (413) | (2,132) |
| Total stockholders’ equity | 732,886 | 640,527 |
| Total liabilities and stockholders' equity | $6,911,085 | $6,364,912 |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

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INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited—Dollars in thousands, except per share data)

| | Three Months Ended March 31 | |
|---|---|---|
| | 2015 | 2014 |
| Interest income | | |
| Interest and fees on loans | $51,687 | $48,204 |
| Taxable interest and dividends on securities | 4,627 | 4,650 |
| Nontaxable interest and dividends on securities | 34 | 37 |
| Interest on loans held for sale | 51 | 51 |
| Interest on federal funds sold and short-term investments | 30 | 38 |
| Total interest and dividend income | 56,429 | 52,980 |
| Interest expense | | |
| Interest on deposits | 2,763 | 2,791 |
| Interest on borrowings | 2,417 | 2,583 |
| Total interest expense | 5,180 | 5,374 |
| Net interest income | 51,249 | 47,606 |
| Provision (benefit) for loan losses | (500) | 4,502 |
| Net interest income after provision for loan losses | 51,749 | 43,104 |
| Noninterest income | | |
| Deposit account fees | 4,166 | 4,359 |
| Interchange and ATM fees | 3,100 | 2,975 |
| Investment management | 5,107 | 4,603 |
| Mortgage banking income | 1,126 | 487 |
| Gain on life insurance benefits | — | 1,627 |
| Increase in cash surrender value of life insurance policies | 778 | 722 |
| Loan level derivative income | 418 | 746 |
| Net gain on sale of equity securities | — | 91 |
| Other noninterest income | 1,862 | 1,906 |
| Total noninterest income | 16,557 | 17,516 |
| Noninterest expenses | | |
| Salaries and employee benefits | 25,288 | 23,080 |
| Occupancy and equipment expenses | 6,394 | 6,146 |
| Data processing and facilities management | 1,122 | 1,253 |
| FDIC assessment | 956 | 905 |
| Advertising expense | 834 | 824 |
| Consulting expense | 755 | 559 |
| Merger and acquisition expense | 10,230 | 77 |
| Software maintenance | 625 | 662 |
| Other noninterest expenses | 8,773 | 8,381 |
| Total noninterest expenses | 54,977 | 41,887 |
| Income before income taxes | 13,329 | 18,733 |
| Provision for income taxes | 3,869 | 5,350 |
| Net income | $9,460 | $13,383 |
| Basic earnings per share | $0.38 | $0.56 |
| Diluted earnings per share | $0.38 | $0.56 |
| Weighted average common shares (basic) | 24,959,865 | 23,819,065 |
| Common shares equivalents | 80,215 | 100,173 |

| | | |
|---|---|---|
| Weighted average common shares (diluted) | 25,040,080 | 23,919,238 |
| Cash dividends declared per common share | $0.26 | $0.24 |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

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INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited—Dollars in thousands)

| | Three Months Ended March 31 | |
|---|---|---|
| | 2015 | 2014 |
| Net income | $9,460 | $13,383 |
| Other comprehensive income, net of tax | | |
| Net change in fair value of securities available for sale | 1,561 | 1,917 |
| Net change in fair value of cash flow hedges | 82 | 502 |
| Net change in other comprehensive income for defined benefit postretirement plans | 76 | (39) |
| Total other comprehensive income | 1,719 | 2,380 |
| Total comprehensive income | $11,179 | $15,763 |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

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INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited—Dollars in thousands, except per share data)

| | Common Stock Outstanding | Common Stock | Value of Shares Held in Rabbi Trust at Cost | Deferred Compensation and Other Retirement Benefit Obligations | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|---|---|
| Balance December 31, 2014 | 23,998,738 | $237 | $ (3,666 ) | $ 3,666 | $311,978 | $330,444 | $ (2,132 ) | $640,527 |
| Net income | — | — | — | — | — | 9,460 | — | 9,460 |
| Other comprehensive income | — | — | — | — | — | — | 1,719 | 1,719 |
| Common dividend declared ($0.26 per share) | — | — | — | — | — | (6,800 ) | — | (6,800 ) |
| Common stock issued for acquisition | 2,052,137 | 21 | — | — | 86,394 | — | — | 86,415 |
| Proceeds from exercise of stock options, net of cash paid | 23,436 | — | — | — | 321 | — | — | 321 |
| Tax benefit related to equity award activity | — | — | — | — | 337 | — | — | 337 |
| Stock based compensation | — | — | — | — | 739 | — | — | 739 |
| Restricted stock awards issued, net of awards surrendered | 33,491 | 1 | — | — | (636 ) | — | — | (635 ) |
| Shares issued under direct stock purchase plan | 15,774 | — | — | — | 638 | — | — | 638 |
| Deferred compensation and other retirement benefit obligations | — | — | (34 ) | 34 | — | — | — | — |
| Tax benefit related to deferred compensation distributions | — | $— | $ — | $— | 165 | — | — | 165 |
| Balance March 31, 2015 | 26,123,576 | $259 | $ (3,700 ) | $ 3,700 | $399,936 | $333,104 | $ (413 ) | $732,886 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2013 | 23,805,984 | $235 | $ (3,404 ) | $ 3,404 | $305,179 | $293,560 | $ (7,434 ) | $591,540 |
| Net income | — | — | — | — | — | 13,383 | — | 13,383 |
| Other comprehensive income | — | — | — | — | — | — | 2,380 | 2,380 |
| Common dividend declared ($0.24 per share) | — | — | — | — | — | (5,725 ) | — | (5,725 ) |
| Proceeds from exercise of stock options, net of cash paid | 7,911 | — | — | — | 133 | — | — | 133 |
| Tax benefit related to equity award activity | — | — | — | — | 193 | — | — | 193 |
| Stock based compensation | — | — | — | — | 677 | — | — | 677 |
| Restricted stock awards issued, net of awards surrendered | 55,761 | 1 | — | — | (473 ) | — | — | (472 ) |
| Shares issued under direct stock purchase plan | 8,400 | — | — | — | 319 | — | — | 319 |
| Deferred compensation and other retirement benefit obligations | — | — | (52 ) | 52 | — | — | — | — |
| Tax benefit related to deferred compensation distributions | — | $— | $ — | $ — | $128 | $— | $ — | $128 |
| Balance March 31, 2014 | 23,878,056 | 236 | (3,456 ) | 3,456 | 306,156 | 301,218 | (5,054 ) | 602,556 |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

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INDEPENDENT BANK CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited—Dollars in thousands)

| | Three Months Ended March 31 | |
|---|---|---|
| | 2015 | 2014 |
| Cash flow from operating activities | | |
| Net income | $9,460 | $13,383 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 3,145 | 2,757 |
| Provision (benefit) for loan losses | (500) | 4,502 |
| Deferred income tax expense | 639 | 471 |
| Net gain on sale of securities | — | (91) |
| Net (gain) loss on fixed assets | (2) | 353 |
| Net loss on other real estate owned and foreclosed assets | 666 | 184 |
| Realized gain on sale leaseback transaction | (258) | (258) |
| Stock based compensation | 739 | 677 |
| Excess tax benefit related to equity award activity | (337) | (193) |
| Increase in cash surrender value of life insurance policies | (778) | (722) |
| Gain on life insurance benefits | — | (1,627) |
| Change in fair value on loans held for sale | (27) | (51) |
| Net change in: | | |
| Trading assets | (494) | — |
| Loans held for sale | (2,592) | 2,145 |
| Other assets | 3,056 | 1,904 |
| Other liabilities | (5,292) | (8,721) |
| Total adjustments | (2,035) | 1,330 |
| Net cash provided by operating activities | 7,425 | 14,713 |
| Cash flows provided by (used in) investing activities | | |
| Proceeds from sales of securities available for sale | — | 673 |
| Proceeds from maturities and principal repayments of securities available for sale | 13,108 | 11,705 |
| Purchases of securities available for sale | (5,846) | (766) |
| Proceeds from maturities and principal repayments of securities held to maturity | 12,616 | 9,083 |
| Purchases of securities held to maturity | (31,890) | (34,017) |
| Investments in low income housing projects | (5,002) | (2,561) |
| Purchases of life insurance policies | (92) | (93) |
| Proceeds from life insurance policies | — | 478 |
| Net decrease (increase) in loans | 41,330 | (93,858) |
| Cash used in business combinations, net of cash acquired | (13,448) | — |
| Purchases of bank premises and equipment | (1,481) | (2,455) |
| Proceeds from the sale of bank premises and equipment | 14 | 756 |
| Proceeds from the sale of other real estate owned and foreclosed assets | 1,641 | 642 |
| Net capital improvements to other real estate owned | (665) | (444) |
| Net cash provided by (used in) investing activities | 10,285 | (110,857) |
| Cash flows provided by (used in) financing activities | | |
| Net decrease in time deposits | (19,023) | (18,342) |

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| | | |
|---|---|---|
| Net increase in other deposits | 47,019 | 146,183 |
| Net repayments of short-term Federal Home Loan Bank borrowings | (10,000) | — |
| Repayments of long-term Federal Home Loan Bank borrowings | (3,000) | — |
| Net decrease in customer repurchase agreements | (29,752) | (20,803) |
| Net increase (decrease) in other short term borrowings | 10,000 | (5,000) |
| Repayments of subordinated debentures | (30,000) | — |
| Proceeds from exercise of stock options, net of cash paid | 321 | 133 |
| Restricted stock awards issued, net of awards surrendered | (635) | (472) |
| Excess tax benefit from stock based compensation | 337 | 193 |
| Tax benefit from deferred compensation distribution | 165 | 128 |
| Proceeds from shares issued under direct stock purchase plan | 638 | 319 |
| Common dividends paid | (5,760) | (5,237) |
| Net cash provided by (used in) financing activities | (39,690) | 97,102 |
| Net increase (decrease) in cash and cash equivalents | (21,980) | 958 |
| Cash and cash equivalents at beginning of year | 178,254 | 216,325 |
| Cash and cash equivalents at end of period | 156,274 | 217,283 |
| Supplemental schedule of noncash investing and financing activities | | |
| Transfer of loans to other real estate owned & foreclosed assets | $354 | $746 |
| Capital commitment relating to low income housing project investments | $— | $25,839 |
| In conjunction with the purchase acquisition detailed in note 2 to the consolidated financial statements, assets were acquired and liabilities were assumed as follows | | |
| Common stock issued for acquisition | $86,415 | $— |
| Fair value of assets acquired, net of cash acquired | $598,376 | $— |
| Fair value of liabilities assumed | $498,513 | $— |

The accompanying condensed notes are an integral part of these unaudited consolidated financial statements.

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CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

Independent Bank Corp. (the “Company”) is a state chartered, federally registered bank holding company, incorporated in 1985. The Company is the sole stockholder of Rockland Trust Company (“Rockland Trust” or the “Bank”), a Massachusetts trust company chartered in 1907.

All material intercompany balances and transactions have been eliminated in consolidation. Certain previously reported amounts may have been reclassified to conform to the current year’s presentation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation of the financial statements, primarily consisting of normal recurring adjustments, have been included. Operating results for the quarter ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or any other interim period.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission.

NOTE 2 - RECENT ACCOUNTING STANDARDS UPDATES

FASB ASC Subtopic 835-30 "Interest - Imputation of Interest" Update No. 2015-03. Update No. 2015-03 was issued in April 2015 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 recognition and measurement guidance for debt issuances costs are not affected by the amendments in this Update. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Topic 810 "Consolidation" Update No. 2015-02. Update No. 2015-02 was issued in February 2015 to respond to stakeholders' concerns about the current accounting for consolidation of certain legal entities. 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. Specifically, the amendments: (1) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, (2) eliminate the presumption that a general partner should consolidate a limited partnership, (3) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, and (4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

FASB ASC Subtopic 225-20 "Income Statement - Extraordinary and Unusual Items" Update No. 2015-01. Update No. 2015-01 was issued in January 2015 to simplify the income statement presentation requirements in Subtopic 225-20 by eliminating the concept of extraordinary items. Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position.

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NOTE 3 - ACQUISITIONS

Peoples Federal Bancshares, Inc.

On February 20, 2015, the Company completed its acquisition of Peoples Federal Bancshares, Inc. ("Peoples"), the parent of Peoples Federal Saving Bank. The transaction qualified as a tax-free reorganization for federal income tax purposes and Peoples shareholders received, for each share of Peoples common stock, the right to receive either $21.00 in cash per share or 0.5523 shares of the Company's stock (valued at $23.26 per share, based upon the highest trading value of the Company's stock on February 20, 2015 of $42.11). The total deal consideration was $141.8 million and was comprised of 40% cash and 60% stock consideration. The cash consideration was $55.4 million in the aggregate, inclusive of cash paid in lieu of fractional shares. The total stock consideration was $86.4 million and resulted in an increase to the Company's outstanding shares of 2,052,137 shares.

The Company accounted for the acquisition using the acquisition method pursuant to the Business Combinations Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). Accordingly, the Company recorded merger and acquisition expenses of $10.2 million during the three months ended March 31, 2015. Additionally, the acquisition method requires the acquirer to recognize the assets acquired and the liabilities assumed at their fair values as of the acquisition date. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed as of the date of the acquisition:

| | Net Assets Acquired at Fair Value (Dollars in thousands) |
|---|---|
| Assets | |
| Cash | $ 41,957 |
| Investments | 43,585 |
| Loans | 463,927 |
| Premises and equipment | 9,346 |
| Goodwill | 30,662 |
| Core deposit and other intangibles | 3,936 |
| Other assets | 46,920 |
| Total assets acquired | 640,333 |
| Liabilities | |
| Deposits | 432,250 |
| Borrowings | 51,209 |
| Other liabilities | 15,054 |
| Total liabilities assumed | 498,513 |
| Purchase price | $ 141,820 |

Fair value adjustments to assets acquired and liabilities assumed are generally amortized using either an effective yield or straight-line basis over periods consistent with the average life, useful life and/or contractual term of the related assets and liabilities.

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

Cash and Cash Equivalents

The fair values of cash and cash equivalents approximate the respective carrying amounts because the instruments are payable on demand or have short-term maturities.

Investments

The fair values of securities were based on quoted market prices for identical securities received from an independent, nationally-recognized, third-party pricing service. Prices provided by the independent pricing service were based on recent trading activity and other observable information including, but not limited to, market interest rate curves, referenced credit spreads and estimated prepayment rates where applicable.

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Loans

The loans acquired were recorded at fair value without a carryover of the allowance for loan losses. Fair value of the loans is determined using market participant assumptions in estimating the amount and timing of both principal and interest cash flows expected to be collected, as adjusted for an estimate of future credit losses and prepayments, and then applying a market-based discount rate to those cash flows. The overall discount on the loans acquired in this transaction was due to anticipated credit loss, as well as considerations for liquidity and market interest rates.

A portion of the loans acquired showed evidence of deterioration of credit quality at the purchase date and it was deemed unlikely that the Bank will be able to collect all contractually required payments. As such, these loans were deemed to be purchased credit impaired ("PCI") and the carrying value and prospective income recognition are predicated upon future cash flows expected to be collected. The following is a summary of these PCI loans associated with the acquisition as of the date acquired:

| | (Dollars in thousands) |
|---|---|
| Contractually required principal and interest at acquisition | $4,358 |
| Contractual cash flows not expected to be collected | (1,596) |
| Expected cash flows at acquisition | 2,762 |
| Interest component of expected cash flows | (319) |
| Basis in PCI loans at acquisition - estimated fair value | $2,443 |

Premises and Equipment

The fair value of the premises, including land, buildings and improvements, was determined based upon appraisals by licensed real estate appraisers or pending agreed upon sale prices. The appraisals were based upon the best and highest use of the property with final values determined based upon an analysis of the cost, sales comparison and income capitalization approaches for each property appraised.

Core Deposit Intangible

The fair value of the core deposit intangible is derived by comparing the interest rate and servicing costs that the financial institution pays on the core deposit liability versus the current market rate for alternative sources of financing, while factoring in estimates over the remaining life and attrition rate of the deposit accounts. The intangible asset represents the stable and relatively low cost source of funds that the deposits and accompanying relationships provide the Company, when compared to alternative funding sources.

Deposits

The fair value of acquired savings and transaction deposit accounts was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. The fair value of time deposits were determined based on the present value of the contractual cash flows over the remaining period to maturity using a market interest rate.

Borrowings

The fair values of Federal Home Loan Bank ("FHLB") advances were derived based upon the present value of the principal and interest payments using a current market discount rate.

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Selected Pro Forma Results

The following summarizes the unaudited pro forma results of operations as if the Company acquired Peoples on January 1, 2015 (2014 amounts represent combined results for the Company and Peoples). The selected pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the financial results of the combined companies had the acquisition actually been completed at the beginning of the periods presented, nor does it indicate future results for any other interim or full-year period.

| | March 31, | |
|---|---|---|
| | 2015 | 2014 |
| | (Dollars in thousands) | |
| Net interest income after provision for loan losses | $54,407 | $47,516 |
| Net income | 14,161 | 13,897 |

Excluded from the pro forma results of operations for the three months ended March 31, 2015 are merger-related costs of $16.6 million recognized by both the Company and Peoples in the aggregate. These costs were primarily made up of contract terminations arising due to the change in control, the acceleration of certain compensation and benefit costs, and other merger expenses.

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NOTE 4 - SECURITIES

Trading Securities

As of March 31, 2015, the Company had trading securities of $494,000. These securities are held in a rabbi trust and will be used for future payments associated with the Company's non-qualified 401(k) Restoration Plan and non-qualified deferred compensation plan.

Available for Sale and Held to Maturity Securities

The following table presents a summary of the amortized cost, gross unrealized holding gains and losses, other-than-temporary impairment recorded in other comprehensive income and fair value of securities available for sale and securities held to maturity for the periods below:

| | March 31, 2015 | | | | December 31, 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (Dollars in thousands) | | | | | | | |
| Available for sale securities | | | | | | | | |
| U.S. government agency securities | $45,848 | $ 656 | $ — | $46,504 | $41,369 | $ 139 | $ (22 ) | $41,486 |
| Agency mortgage-backed securities | 246,148 | 8,098 | (157 ) | 254,089 | 211,168 | 7,203 | (693 ) | 217,678 |
| Agency collateralized mortgage obligations | 59,896 | 836 | (444 ) | 60,288 | 63,059 | 599 | (623 ) | 63,035 |
| State, county, and municipal securities | 4,837 | 140 | — | 4,977 | 5,106 | 117 | — | 5,223 |
| Single issuer trust preferred securities issued by banks | 2,901 | 19 | (10 ) | 2,910 | 2,913 | 12 | (16 ) | 2,909 |
| Pooled trust preferred securities issued by banks and insurers (1) | 7,862 | 179 | (1,769 ) | 6,272 | 7,906 | 195 | (1,780 ) | 6,321 |
| Equity securities | 11,544 | 674 | (220 ) | 11,998 | 11,572 | 567 | (237 ) | 11,902 |
| Total available for sale securities | $379,036 | $ 10,602 | $ (2,600 ) | $387,038 | $343,093 | $ 8,832 | $ (3,371 ) | $348,554 |
| Held to maturity securities | | | | | | | | |
| U.S. Treasury securities | $1,010 | $ 79 | $ — | $1,089 | $1,010 | $ 63 | $ — | $1,073 |
| Agency mortgage-backed securities | 164,830 | 6,049 | — | 170,879 | 159,522 | 5,422 | — | 164,944 |
| Agency collateralized mortgage obligations | 221,979 | 3,125 | (1,787 ) | 223,317 | 207,995 | 2,141 | (3,478 ) | 206,658 |
| State, county, and municipal securities | 424 | 5 | — | 429 | 424 | 4 | — | 428 |
| Single issuer trust preferred securities issued by banks | 1,500 | 8 | — | 1,508 | 1,500 | — | (23 ) | 1,477 |
| Corporate debt securities | 5,002 | 98 | — | 5,100 | 5,002 | 117 | — | 5,119 |
| Total held to maturity securities | $394,745 | $ 9,364 | $ (1,787 ) | $402,322 | $375,453 | $ 7,747 | $ (3,501 ) | $379,699 |
| Total | $773,781 | $ 19,966 | $ (4,387 ) | $789,360 | $718,546 | $ 16,579 | $ (6,872 ) | $728,253 |

(1) Gross unrealized gains and gross unrealized losses include $146,000 and $230,000 of net non-credit related OTTI at March 31, 2015 and December 31, 2014, respectively.

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on the sale. The Company had no realized gains or losses during the three month period ending March 31, 2015 and realized a net gain of $91,000 during the three month period ending March 31, 2014 on equity securities classified as available for sale. There were no gains on sale on the Company's fixed income securities during the periods ending March 31, 2015 and 2014.

The actual maturities of certain securities may differ from the contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. A schedule of the contractual maturities of securities available for sale and securities held to maturity as of March 31, 2015 is presented below:

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| | Available for Sale | | Held to Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (Dollars in thousands) | | | |
| Due in one year or less | $— | $— | $5,202 | $5,300 |
| Due after one year to five years | 54,992 | 55,912 | 408 | 423 |
| Due after five to ten years | 95,080 | 96,837 | 30,927 | 31,804 |
| Due after ten years | 217,420 | 222,291 | 358,208 | 364,795 |
| Total debt securities | $367,492 | $375,040 | $394,745 | $402,322 |
| Equity securities | $11,544 | $11,998 | $— | $— |
| Total | $379,036 | $387,038 | $394,745 | $402,322 |

Inclusive in the table above is $39.1 million of callable securities in the Company’s investment portfolio at March 31, 2015.

The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law, was $327.4 million and $340.0 million at March 31, 2015 and December 31, 2014, respectively.

At March 31, 2015 and December 31, 2014, the Company had no investments in obligations of individual states, counties, or municipalities which exceeded 10% of stockholders’ equity.

Other-Than-Temporary Impairment ("OTTI")

The Company continually reviews investment securities for the existence of OTTI, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, the credit worthiness of the obligor of the security, volatility of earnings, current analysts’ evaluations, the Company’s intent to sell the security, or whether it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery, as well as other qualitative factors. The term “other-than-temporary” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment.

The following tables show the gross unrealized losses and fair value of the Company’s investments in an unrealized loss position, which the Company has not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

Three months ended September 30, 2018

3,253,347

15

194,543

Nine months ended September 30, 2018

7,071,377

36

$
458,664

(1) As defined by CoStar Realty Information Inc.

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The following table summarizes the allocation of the consideration paid at the date of acquisition during the nine months ended September 30, 2018 for the acquired assets and liabilities in connection with the acquisitions identified in the table above.

| Acquired Assets and Liabilities | Purchase Price (in thousands) | Weighted Average Amortization Period (years) of Intangibles at Acquisition |
|---|---|---|
| Land | $ 39,340 | N/A |
| Buildings | 317,293 | N/A |
| Tenant improvements | 4,849 | N/A |
| Building and land improvements | 21,731 | N/A |
| Deferred leasing intangibles - In-place leases | 52,276 | 8.7 |
| Deferred leasing intangibles - Tenant relationships | 21,861 | 11.8 |
| Deferred leasing intangibles - Above market leases | 4,062 | 8.2 |
| Deferred leasing intangibles - Below market leases | (3,122 ) | 6.7 |
| Deferred leasing intangibles - Above market ground leases | (178 ) | 48.1 |
| Other assets | 794 | N/A |
| Other liabilities | (242 ) | N/A |
| Total purchase price | $ 458,664 | |

The table below sets forth the results of operations for the three and nine months ended September 30, 2018 for the buildings acquired during the nine months ended September 30, 2018 included in the Company's Consolidated Statements of Operations from the date of acquisition.

| Results of Operations (in thousands) | Three months ended September 30, 2018 | Nine months ended September 30, 2018 |
|---|---|---|
| Total revenue | $ 7,122 | $ 11,156 |
| Net income | $ 1,556 | $ 1,642 |

Dispositions

During the nine months ended September 30, 2018, the Company sold 11 buildings comprised of approximately 2.0 million square feet with a net book value of approximately $57.1 million to third parties. These buildings contributed approximately $0.1 million, $2.7 million, $2.6 million and $7.7 million to revenue for the three and nine months ended September 30, 2018 and 2017, respectively. These buildings contributed approximately $5,000, $0.1 million, $0.5 million and $1.4 million to net income (exclusive of loss on involuntary conversion, loss on impairments, and gain on the sales of rental property, net) for the three and nine months ended September 30, 2018 and 2017, respectively. Net proceeds from the sales of rental property were approximately $89.4 million and the Company recognized the full gain on the sales of rental property, net of approximately $32.3 million for the nine months ended September 30, 2018.

Loss on Impairments

The following table summarizes the Company's loss on impairments for assets held and used during the nine months ended September 30, 2018.

| Market [1] | Buildings | Event or Change in Circumstance Leading to Impairment Evaluation[2] | | Valuation technique utilized to estimate fair value | | Fair Value[3] | Loss on Impairments |
|---|---|---|---|---|---|---|---|
| | | | | | | (in thousands) | |
| Buena Vista, VA[4] | 1 | Change in estimated hold period | (5) | Discounted cash flows | (6) | | |
| Sergeant Bluff, IA[4] | 1 | Change in estimated hold period | (5) | Discounted cash flows | (6) | | |
| Three months ended March 31, 2018 | | | | | | $3,176 | $ 2,934 |
| Nine months ended September 30, 2018 | | | | | | $3,176 | $ 2,934 |

(1) As defined by CoStar Realty Information Inc.

(2) The Company tested the asset group for impairment utilizing a probability weighted recovery analysis of certain scenarios, and it was determined that the carrying value of the property and intangibles were not recoverable from the estimated future undiscounted cash flows.

(3) The estimated fair value of the assets held and used is based on Level 3 inputs and is a non-recurring fair value measurement. Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

(4) These buildings do not have markets as defined by CoStar Realty Information Inc.

(5) This property was sold during the nine months ended September 30, 2018.

(6) Level 3 inputs used to determine fair value for the impaired assets held and used for the three months ended March 31, 2018: discount rates ranged from 11.0% to 14.5% and exit capitalization rates ranged from 11.0% to 13.0%.

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Deferred Leasing Intangibles

The following table sets forth the deferred leasing intangibles on the accompanying Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017.

| | September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| Deferred Leasing Intangibles (in thousands) | Gross | Accumulated Amortization | Net | Gross | Accumulated Amortization | Net |
| Above market leases | $70,454 | $ (31,663) | $38,791 | $78,558 | $ (36,810) | $41,748 |
| Other intangible lease assets | 495,172 | (206,229) | 288,943 | 515,337 | (243,832) | 271,505 |
| Total deferred leasing intangible assets | $565,626 | $ (237,892) | $327,734 | $593,895 | $ (280,642) | $313,253 |
| | | | | | | |
| Below market leases | $33,751 | $ (13,043) | $20,708 | $34,776 | $ (13,555) | $21,221 |
| Total deferred leasing intangible liabilities | $33,751 | $ (13,043) | $20,708 | $34,776 | $ (13,555) | $21,221 |

The following table sets forth the amortization expense and the net decrease to rental income for the amortization of deferred leasing intangibles during the three and nine months ended September 30, 2018 and 2017.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Deferred Leasing Intangibles Amortization (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Net decrease to rental income related to above and below market lease amortization | $1,150 | $1,318 | $3,206 | $3,873 |
| Amortization expense related to other intangible lease assets | $20,361 | $17,934 | $56,698 | $53,747 |

The following table sets forth the amortization of deferred leasing intangibles over the next five calendar years beginning with 2018 as of September 30, 2018.

| Year | Amortization Expense Related to Other Intangible Lease Assets (in thousands) | Net Decrease to Rental Income Related to Above and Below Market Lease Amortization (in thousands) |
|---|---|---|
| Remainder of 2018 | $ 17,263 | $ 927 |
| 2019 | $ 57,841 | $ 3,926 |
| 2020 | $ 47,750 | $ 3,546 |
| 2021 | $ 37,229 | $ 2,163 |
| 2022 | $ 29,690 | $ 1,154 |

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4. Debt

The following table sets forth a summary of the Company's outstanding indebtedness, including borrowings under the Company's unsecured credit facility, unsecured term loans, unsecured notes, and mortgage notes as of September 30, 2018 and December 31, 2017.

| Loan | Principal Outstanding as of September 30, 2018 (in thousands) | Principal Outstanding as of December 31, 2017 (in thousands) | Interest Rate (1) | | Maturity Date | Prepayment Terms (2) |
|---|---|---|---|---|---|---|
| Unsecured credit facility: | | | | | | |
| Unsecured Credit Facility (3) | $ 95,000 | $ 271,000 | L + 1.05% | | Jan-15-2023 | i |
| Total unsecured credit facility | 95,000 | 271,000 | | | | |
| Unsecured term loans: | | | | | | |
| Unsecured Term Loan C | 150,000 | 150,000 | L + 1.30% | | Sep-29-2020 | i |
| Unsecured Term Loan B | 150,000 | 150,000 | L + 1.30% | | Mar-21-2021 | i |
| Unsecured Term Loan A | 150,000 | 150,000 | L + 1.30% | | Mar-31-2022 | i |
| Unsecured Term Loan D | 150,000 | — | L + 1.30% | | Jan-04-2023 | i |
| Unsecured Term Loan E (4) | — | — | L + 1.20% | | Jan-15-2024 | i |
| Total unsecured term loans | 600,000 | 450,000 | | | | |
| Less: Total unamortized deferred financing fees and debt issuance costs | (3,915 ) | (3,735 ) | | | | |
| Total carrying value unsecured term loans, net | 596,085 | 446,265 | | | | |
| Unsecured notes: | | | | | | |
| Series F Unsecured Notes | 100,000 | 100,000 | 3.98 | % | Jan-05-2023 | ii |
| Series A Unsecured Notes | 50,000 | 50,000 | 4.98 | % | Oct-1-2024 | ii |
| Series D Unsecured Notes | 100,000 | 100,000 | 4.32 | % | Feb-20-2025 | ii |
| Series G Unsecured Notes | 75,000 | — | 4.10 | % | Jun-13-2025 | ii |
| Series B Unsecured Notes | 50,000 | 50,000 | 4.98 | % | Jul-1-2026 | ii |
| Series C Unsecured Notes | 80,000 | 80,000 | 4.42 | % | Dec-30-2026 | ii |
| Series E Unsecured Notes | 20,000 | 20,000 | 4.42 | % | Feb-20-2027 | ii |
| Series H Unsecured Notes | 100,000 | — | 4.27 | % | Jun-13-2028 | ii |
| Total unsecured notes | 575,000 | 400,000 | | | | |
| Less: Total unamortized deferred financing fees and debt issuance costs | (2,611 ) | (1,766 ) | | | | |
| Total carrying value unsecured notes, net | 572,389 | 398,234 | | | | |
| Mortgage notes (secured debt): | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Wells Fargo Bank, National Association CMBS Loan | 53,652 | 54,949 | 4.31 | % | Dec-1-2022 | iii |
| Thrivent Financial for Lutherans | 3,824 | 3,906 | 4.78 | % | Dec-15-2023 | iv |
| Total mortgage notes | 57,476 | 58,855 | | | | |
| Add: Total unamortized fair market value premiums | 52 | 61 | | | | |
| Less: Total unamortized deferred financing fees and debt issuance costs | (535) | (634) | | | | |
| Total carrying value mortgage notes, net | 56,993 | 58,282 | | | | |
| Total / weighted average interest rate (5) | $ 1,320,467 | $ 1,173,781 | 3.69 | % | | |

(1) Interest rate as of September 30, 2018. At September 30, 2018, the one-month LIBOR ("L") was 2.26056%. The interest rate is not adjusted to include the amortization of deferred financing fees or debt issuance costs incurred in obtaining debt or any unamortized fair market value premiums. The spread over the applicable rate for the Company's unsecured credit facility and unsecured term loans is based on the Company's consolidated leverage ratio, as defined in the respective loan agreements.

(2) Prepayment terms consist of (i) pre-payable with no penalty; (ii) pre-payable with penalty; (iii) pre-payable without penalty three months prior to the maturity date, however can be defeased beginning January 1, 2016; and (iv) pre-payable without penalty three months prior to the maturity date.

(3) The capacity of the unsecured credit facility is $500.0 million. Deferred financing fees and debt issuance costs, net of accumulated amortization related to the unsecured credit facility of approximately $3.4 million and $1.5 million is included in prepaid expenses and other assets on the accompanying Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017, respectively.

(4) Capacity of $175.0 million, which the Company has until July 25, 2019 to draw.

(5) The weighted average interest rate was calculated using the fixed interest rate swapped on the notional amount of $600.0 million of debt that was in effect as of September 30, 2018, and is not adjusted to include the amortization of deferred financing fees or debt issuance costs incurred in obtaining debt or any unamortized fair market value premiums.

The aggregate undrawn nominal commitment on the unsecured credit facility and unsecured term loans as of September 30, 2018 was approximately $574.4 million, including issued letters of credit. The Company's actual borrowing capacity at any given point in time may be less and is restricted to a maximum amount based on the Company's debt covenant compliance. Total accrued interest for the Company's indebtedness was approximately $7.7 million and $5.6 million as of September 30, 2018 and December 31, 2017, respectively, and is included in accounts payable, accrued expenses and other liabilities on the accompanying Consolidated Balance Sheets.

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The table below sets forth the costs included in interest expense related to the Company's debt arrangements on the accompanying Consolidated Statement of Operations for the three and nine months ended September 30, 2018 and 2017.

| Costs Included in Interest Expense (in thousands) | Three months ended September 30, 2018 | 2017 | Nine months ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Amortization of deferred financing fees and debt issuance costs and fair market value premiums | $617 | $546 | $1,698 | $1,553 |
| Facility fees and unused fees | $275 | $286 | $928 | $839 |

On July 26, 2018, the Company closed on the refinancing of its unsecured credit facility. The refinancing transaction included extending the maturity date to January 15, 2023, increasing the capacity to $500.0 million, and reducing the annual interest rate. As of September 30, 2018, the interest rate on the unsecured credit facility was LIBOR plus a spread of 1.05% based on the Company’s consolidated leverage ratio, as defined in the credit agreement. The Company recognized a loss of approximately $13,000 as a result of the acceleration of unamortized deferred financing fees, which is included in loss on extinguishment of debt in the accompanying Consolidated Statements of Operations. The remaining unamortized deferred financing fees were carried over and will be amortized with any new deferred financing fees through the new maturity date of the unsecured credit facility. As of September 30, 2018, the unsecured credit facility has an annual facility fee of 0.15% based on the Company’s consolidated leverage ratio, as defined in the credit agreement, of total commitments that is due and payable quarterly. The Company also is required to pay an annual fee of $50,000.

On July 26, 2018, the Company entered into a $175.0 million unsecured term loan agreement ("Unsecured Term Loan E"). As of September 30, 2018, the interest rate on the Unsecured Term Loan E was LIBOR plus a spread of 1.20% based on the Company's consolidated leverage ratio, as defined in the loan agreement. Unless otherwise terminated pursuant to the loan agreement, the Unsecured Term Loan E will mature on January 15, 2024. The Unsecured Term Loan E has an accordion feature that allows the Company to increase its borrowing capacity to $350.0 million, subject to the satisfaction of certain conditions and lender consents. The agreement includes a delayed draw feature that allows the Company to draw up to six advances of at least $25.0 million each until July 25, 2019. To the extent that the Company does not request advances of the $175.0 million of aggregate commitments by July 25, 2019, the unadvanced commitments terminate. The Unsecured Term Loan E has an unused commitment fee equal to 0.15% of its unused commitments, which began to accrue on October 24, 2018 and is due and payable monthly until the earlier of (i) the date that commitments of $175.0 million have been fully advanced, (ii) July 26, 2019, and (iii) the date that commitments of $175.0 million have been reduced to zero pursuant to the terms of the agreement. The Company also is required to pay an annual fee of $35,000. The Company and certain wholly owned subsidiaries of the Operating Partnership are guarantors of the Unsecured Term Loan E. The agreement also contains financial and other covenants substantially similar to the covenants in the Company's unsecured credit facility.

On July 26, 2018, the Company entered into amendments to its unsecured term loan agreements to conform certain provisions to the Unsecured Term Loan E agreement and the new unsecured credit facility agreement.

On April 10, 2018, the Company entered into a note purchase agreement (“NPA”) for the private placement by the Operating Partnership of $75.0 million senior unsecured notes (“Series G Unsecured Notes”) maturing June 13, 2025 with a fixed annual interest rate of 4.10%, and $100.0 million senior unsecured notes (“Series H Unsecured Notes”) maturing June 13, 2028 with a fixed annual interest rate of 4.27%. The NPA contains a number of financial covenants substantially similar to the financial covenants contained in the Company’s unsecured credit facility and other unsecured notes. The Operating Partnership issued the Series G Unsecured Notes and the Series H Unsecured Notes on June 13, 2018. In addition, on April 10, 2018, the Company entered into amendments to the note purchase agreements related to the Company's outstanding unsecured notes to conform certain provisions in the agreements to the provisions in the NPA.

On March 28, 2018, the Company drew $75.0 million of the $150.0 million unsecured term loan that was entered into on July 28, 2017. On July 27, 2018, the Company drew the remaining $75.0 million of the $150.0 million unsecured term loan.

Financial Covenant Considerations

The Company was in compliance with all financial and other covenants as of September 30, 2018 and December 31, 2017 related to its unsecured credit facility, unsecured term loans, unsecured notes, and mortgage notes. The real estate net book value of the properties that are collateral for the Company's debt arrangements was approximately $88.4 million and $90.9 million at September 30, 2018 and December 31, 2017, respectively, and is limited to senior, property-level secured debt financing arrangements.

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Fair Value of Debt

The following table presents the aggregate principal outstanding under the Company's debt arrangements and the corresponding estimate of fair value as of September 30, 2018 and December 31, 2017 (in thousands).

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Principal Outstanding | Fair Value | Principal Outstanding | Fair Value |
| Unsecured credit facility | $95,000 | $95,000 | $271,000 | $271,528 |
| Unsecured term loans | 600,000 | 607,663 | 450,000 | 451,463 |
| Unsecured notes | 575,000 | 569,493 | 400,000 | 415,599 |
| Mortgage notes | 57,476 | 57,608 | 58,855 | 59,769 |
| Total principal amount | 1,327,476 | $1,329,764 | 1,179,855 | $1,198,359 |
| Add: Total unamortized fair market value premiums | 52 | | 61 | |
| Less: Total unamortized deferred financing fees and debt issuance costs | (7,061 ) | | (6,135 ) | |
| Total carrying value | $1,320,467 | | $1,173,781 | |

The applicable fair value guidance establishes a three tier value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The fair value of the Company's debt is based on Level 3 inputs.

5. Use of Derivative Financial Instruments

Risk Management Objective of Using Derivatives

The Company's use of derivative instruments is limited to the utilization of interest rate swaps to manage interest rate risk exposure on existing and future liabilities and not for speculative purposes. The principal objective of such arrangements is to minimize the risks and related costs associated with the Company's operating and financial structure.

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The following table details the Company's outstanding interest rate swaps as of September 30, 2018. All of the Company's interest rate swaps are designated as qualifying cash flow hedges.

| Interest Rate Derivative Counterparty | Trade Date | Effective Date | Notional Amount (in thousands) | Fair Value (in thousands) | Pay Fixed Interest Rate | Receive Variable Interest Rate | Maturity Date |
|---|---|---|---|---|---|---|---|
| Regions Bank | Mar-01-2013 | Mar-01-2013 | $ 25,000 | $ 471 | 1.3300 % | One-month L | Feb-14-2020 |
| Capital One, N.A. | Jun-13-2013 | Jul-01-2013 | $ 50,000 | $ 703 | 1.6810 % | One-month L | Feb-14-2020 |
| Capital One, N.A. | Jun-13-2013 | Aug-01-2013 | $ 25,000 | $ 344 | 1.7030 % | One-month L | Feb-14-2020 |
| Regions Bank | Sep-30-2013 | Feb-03-2014 | $ 25,000 | $ 245 | 1.9925 % | One-month L | Feb-14-2020 |
| The Toronto-Dominion Bank | Oct-14-2015 | Sep-29-2016 | $ 25,000 | $ 700 | 1.3830 % | One-month L | Sep-29-2020 |
| PNC Bank, N.A. | Oct-14-2015 | Sep-29-2016 | $ 50,000 | $ 1,391 | 1.3906 % | One-month L | Sep-29-2020 |
| Regions Bank | Oct-14-2015 | Sep-29-2016 | $ 35,000 | $ 978 | 1.3858 % | One-month L | Sep-29-2020 |
| U.S. Bank, N.A. | Oct-14-2015 | Sep-29-2016 | $ 25,000 | $ 695 | 1.3950 % | One-month L | Sep-29-2020 |
| Capital One, N.A. | Oct-14-2015 | Sep-29-2016 | $ 15,000 | $ 417 | 1.3950 % | One-month L | Sep-29-2020 |
| Royal Bank of Canada | Jan-08-2015 | Mar-20-2015 | $ 25,000 | $ 684 | 1.7090 % | One-month L | Mar-21-2021 |
| The Toronto-Dominion Bank | Jan-08-2015 | Mar-20-2015 | $ 25,000 | $ 682 | 1.7105 % | One-month L | Mar-21-2021 |
| The Toronto-Dominion Bank | Jan-08-2015 | Sep-10-2017 | $ 100,000 | $ 1,488 | 2.2255 % | One-month L | Mar-21-2021 |
| Wells Fargo, N.A. | Jan-08-2015 | Mar-20-2015 | $ 25,000 | $ 886 | 1.8280 % | One-month L | Mar-31-2022 |
| The Toronto-Dominion Bank | Jan-08-2015 | Feb-14-2020 | $ 25,000 | $ 271 | 2.4535 % | One-month L | Mar-31-2022 |
| Regions Bank | Jan-08-2015 | Feb-14-2020 | $ 50,000 | $ 520 | 2.4750 % | One-month L | Mar-31-2022 |
| Capital One, N.A. | Jan-08-2015 | Feb-14-2020 | $ 50,000 | $ 467 | 2.5300 % | One-month L | Mar-31-2022 |
| The Toronto-Dominion Bank | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,054 | 1.8485 % | One-month L | Jan-04-2023 |
| Royal Bank of Canada | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,054 | 1.8505 % | One-month L | Jan-04-2023 |
| Wells Fargo, N.A. | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,055 | 1.8505 % | One-month L | Jan-04-2023 |
| PNC Bank, N.A. | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,052 | 1.8485 % | One-month L | Jan-04-2023 |
| PNC Bank, N.A. | Jul-20-2017 | Oct-30-2017 | $ 50,000 | $ 2,105 | 1.8475 % | One-month L | Jan-04-2023 |
| The Toronto-Dominion Bank | Jul-24-2018 | Jul-26-2019 | $ 50,000 | $ 111 | 2.9180 % | One-month L | Jan-12-2024 |
| PNC Bank, N.A. | Jul-24-2018 | Jul-26-2019 | $ 50,000 | $ 106 | 2.9190 % | One-month L | Jan-12-2024 |
| Bank of Montreal | Jul-24-2018 | Jul-26-2019 | $ 50,000 | $ 113 | 2.9190 % | One-month L | Jan-12-2024 |
| U.S. Bank, N.A. | Jul-24-2018 | Jul-26-2019 | $ 25,000 | $ 57 | 2.9190 % | One-month L | Jan-12-2024 |

The fair value of the interest rate swaps outstanding as of September 30, 2018 and December 31, 2017 was as follows.

| Balance Sheet Line Item (in thousands) | Notional Amount September 30, 2018 | Fair Value September 30, 2018 | Notional Amount December 31, 2017 | Fair Value December 31, 2017 |
|---|---|---|---|---|
| Interest rate swaps-Asset | $ 900,000 | $ 17,649 | $ 475,000 | $ 6,079 |
| Interest rate swaps-Liability | $ — | $ — | $ 250,000 | $ (1,217 ) |

Cash Flow Hedges of Interest Rate Risk

The Company’s objectives in using interest rate swaps are to add stability to interest expense and to manage its exposure to interest rate movements.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in accumulated other comprehensive income and subsequently reclassified into interest expense in the same periods during which the hedged transaction affects earnings.

Amounts reported in accumulated other comprehensive income related to derivatives designated as qualifying cash flow hedges will be reclassified to interest expense as interest payments are made on the Company's variable rate debt. The Company estimates that approximately $5.1 million will be reclassified from accumulated other comprehensive income as a decrease to interest expense over the next 12 months.

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The table below presents the effect of cash flow hedge accounting and the location in the consolidated financial statements for the three and nine months ended September 30, 2018 and 2017.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Effect of Cash Flow Hedge Accounting (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Income (loss) recognized in accumulated other comprehensive income on interest rate swaps | $2,572 | $316 | $13,349 | $(1,126 ) |
| Income (loss) reclassified from accumulated other comprehensive income into income (loss) as interest expense | $512 | $(282 ) | $538 | $(1,426 ) |
| Total interest expense presented in the Consolidated Statements of Operations in which the effects of cash flow hedges are recorded | $12,698 | $10,446 | $35,602 | $31,557 |

Credit-risk-related Contingent Features

The Company has agreements with each of its derivative counterparties that contain a provision where the Company could be declared in default on its derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to the Company's default on the indebtedness.

As of September 30, 2018, the Company had no derivatives that were in a net liability position by counterparty.

Fair Value of Interest Rate Swaps

The Company’s valuation of the interest rate swaps is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs including interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty’s nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2018 and December 31, 2017, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The following sets forth the Company’s financial instruments that are accounted for at fair value on a recurring basis as of September 30, 2018 and December 31, 2017.

| | | Fair Value Measurements as of September 30, 2018 Using | | |
|---|---|---|---|---|
| Balance Sheet Line Item (in thousands) | Fair Value September 30, | Level 1 | Level 2 | Level 3 |

| | 2018 | | | |
|---|---|---|---|---|
| Interest rate swaps-Asset | $ 17,649 | $ — | $ 17,649 | $ — |
| Interest rate swaps-Liability | $ — | $ — | $ — | $ — |

| | | Fair Value Measurements as of December 31, 2017 Using | | |
|---|---|---|---|---|
| Balance Sheet Line Item (in thousands) | Fair Value December 31, 2017 | Level 1 | Level 2 | Level 3 |
| Interest rate swaps-Asset | $ 6,079 | $ — | $ 6,079 | $ — |
| Interest rate swaps-Liability | $ (1,217 ) | $ — | $ (1,217 ) | $ — |

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## 6. Equity

### Preferred Stock

On June 11, 2018, the Company gave notice to redeem all 2,800,000 issued and outstanding shares of the 6.625% Series B Cumulative Redeemable Preferred Stock (“Series B Preferred Stock”). The Company recognized a deemed dividend to the holders of the Series B Preferred Stock of approximately $2.7 million on the accompanying Consolidated Statements of Operations for the nine months ended September 30, 2018 related to redemption costs and the original issuance costs of the Series B Preferred Stock. On July 11, 2018, the Company redeemed all of the Series B Preferred Stock.

The table below sets forth the Company’s outstanding preferred stock issuances as of September 30, 2018.

| Preferred Stock Issuances | Issuance Date | Number of Shares | Liquidation Value Per Share | Interest Rate |
|---|---|---|---|---|
| 6.875% Series C Cumulative Redeemable Preferred Stock (“Series C Preferred Stock”) | March 17, 2016 | 3,000,000 | $ 25.00 | 6.875 % |

The tables below set forth the dividends attributable to the Company's outstanding preferred stock issuances during the nine months ended September 30, 2018 and the year ended December 31, 2017.

| Quarter Ended 2018 | Declaration Date | Series B Preferred Stock Per Share | | Series C Preferred Stock Per Share | Payment Date |
|---|---|---|---|---|---|
| September 30 | July 11, 2018 | $ 0.0460069 | (1) | $ 0.4296875 | October 1, 2018 |
| June 30 | April 10, 2018 | 0.4140625 | | 0.4296875 | July 2, 2018 |
| March 31 | February 14, 2018 | 0.4140625 | | 0.4296875 | April 2, 2018 |
| Total | | $ 0.8741319 | | $ 1.2890625 | |

(1) On June 11, 2018, the Company gave notice to redeem all 2,800,000 issued and outstanding shares of the Series B Preferred Stock. On July 11, 2018, the Company redeemed all of the Series B Preferred Stock at a cash redemption price of $25.00 per share, plus accrued and unpaid dividends to but excluding the redemption date, without interest.

| Quarter Ended 2017 | Declaration Date | Series B Preferred Stock Per Share | Series C Preferred Stock Per Share | Payment Date |
|---|---|---|---|---|
| December 31 | November 2, 2017 | $0.4140625 | $0.4296875 | December 29, 2017 |
| September 30 | July 31, 2017 | 0.4140625 | 0.4296875 | September 29, 2017 |
| June 30 | May 1, 2017 | 0.4140625 | 0.4296875 | June 30, 2017 |
| March 31 | February 15, 2017 | 0.4140625 | 0.4296875 | March 31, 2017 |
| Total | | $1.6562500 | $1.7187500 | |

On October 10, 2018, the Company’s board of directors declared the Series C Preferred Stock dividends for the quarter ending December 31, 2018 at a quarterly rate of $0.4296875 per share.

### Common Stock

The following table sets forth the terms of the Company's at-the market ("ATM") common stock offering program as of September 30, 2018.

| ATM Common Stock Offering Program | Date | Maximum Aggregate Offering Price (in thousands) | Aggregate Common Stock Available as of September 30, 2018 (in thousands) |
|---|---|---|---|
| 2017 $500 million ATM | November 13, 2017 | $ 500,000 | $ 213,217 |

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The table below set forth the activity under the ATM common stock offering programs during the nine months ended September 30, 2018 and year ended December 31, 2017 (in thousands, except share data).

| | Nine months ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| ATM Common Stock Offering Program | Shares Sold | Weighted Average Price Per Share | Gross Proceeds | Sales Agents' Fee | Net Proceeds |
| 2017 $500 million ATM | 10,387,962 | $ 26.61 | $276,457 | $ 2,888 | $273,569 |
| Total/weighted average | 10,387,962 | $ 26.61 | $276,457 | $ 2,888 | $273,569 |

| | Year ended December 31, 2017 | | | | |
|---|---|---|---|---|---|
| ATM Common Stock Offering Program | Shares Sold | Weighted Average Price Per Share | Gross Proceeds | Sales Agents' Fee | Net Proceeds |
| 2017 $500 million ATM | 363,843 | $ 28.38 | $10,326 | $ 129 | $10,197 |
| 2017 $300 million ATM(1) | 11,098,748 | $ 27.03 | 300,000 | 3,637 | 296,363 |
| 2016 $228 million ATM(1) | 4,799,784 | $ 24.42 | 117,216 | 1,604 | 115,612 |
| Total/weighted average | 16,262,375 | $ 26.29 | $427,542 | $ 5,370 | $422,172 |

(1) These programs ended before December 31, 2017.

The table below sets forth the dividends attributable to the Company's outstanding shares of common stock that were declared during the nine months ended September 30, 2018 and the year ended December 31, 2017.

| Month Ended 2018 | Declaration Date | Record Date | Per Share | Payment Date |
|---|---|---|---|---|
| September 30 | July 11, 2018 | September 28, 2018 | $0.118333 | October 15, 2018 |
| August 31 | July 11, 2018 | August 31, 2018 | 0.118333 | September 17, 2018 |
| July 31 | July 11, 2018 | July 31, 2018 | 0.118333 | August 15, 2018 |
| June 30 | April 10, 2018 | June 29, 2018 | 0.118333 | July 16, 2018 |
| May 31 | April 10, 2018 | May 31, 2018 | 0.118333 | June 15, 2018 |
| April 30 | April 10, 2018 | April 30, 2018 | 0.118333 | May 15, 2018 |
| March 31 | November 2, 2017 | March 29, 2018 | 0.118333 | April 16, 2018 |
| February 28 | November 2, 2017 | February 28, 2018 | 0.118333 | March 15, 2018 |
| January 31 | November 2, 2017 | January 31, 2018 | 0.118333 | February 15, 2018 |
| Total | | | $1.064997 | |

| Month Ended 2017 | Declaration Date | Record Date | Per Share | Payment Date |
|---|---|---|---|---|
| December 31 | July 31, 2017 | December 29, 2017 | $0.117500 | January 16, 2018 |
| November 30 | July 31, 2017 | November 30, 2017 | 0.117500 | December 15, 2017 |
| October 31 | July 31, 2017 | October 31, 2017 | 0.117500 | November 15, 2017 |
| September 30 | May 1, 2017 | September 29, 2017 | 0.117500 | October 16, 2017 |
| August 31 | May 1, 2017 | August 31, 2017 | 0.117500 | September 15, 2017 |
| July 31 | May 1, 2017 | July 31, 2017 | 0.117500 | August 15, 2017 |
| June 30 | February 15, 2017 | June 30, 2017 | 0.116667 | July 17, 2017 |
| May 31 | February 15, 2017 | May 31, 2017 | 0.116667 | June 15, 2017 |
| April 30 | February 15, 2017 | April 28, 2017 | 0.116667 | May 15, 2017 |
| March 31 | November 2, 2016 | March 31, 2017 | 0.116667 | April 17, 2017 |
| February 28 | November 2, 2016 | February 28, 2017 | 0.116667 | March 15, 2017 |
| January 31 | November 2, 2016 | January 31, 2017 | 0.116667 | February 15, 2017 |
| Total | | | $1.405002 | |

On October 10, 2018, the Company’s board of directors declared the common stock dividends for the months ending October 31, 2018, November 30, 2018 and December 31, 2018 at a monthly rate of $0.118333 per share of common stock.

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Restricted Stock-Based Compensation

Restricted shares of common stock granted on January 5, 2018 to certain employees of the Company, subject to the recipient's continued employment, will vest in four equal installments on January 1 of each year beginning in 2019. The following table summarizes activity related to the Company's unvested restricted shares of common stock for the nine months ended September 30, 2018 and the year ended December 31, 2017.

| Unvested Restricted Shares of Common Stock | Shares | |
|---|---|---|
| Balance at December 31, 2016 | 272,337 | |
| Granted | 75,001 | (1) |
| Vested | (109,209) | (2) |
| Forfeited | (922) | |
| Balance at December 31, 2017 | 237,207 | |
| Granted | 76,659 | (1) |
| Vested | (112,405) | (2) |
| Forfeited | (10,630) | |
| Balance at September 30, 2018 | 190,831 | |

(1) The fair value per share on the grant date of January 5, 2018 and January 6, 2017 was $26.40 and $24.41, respectively.

(2) The Company repurchased and retired 41,975 and 40,836 restricted shares of common stock that vested during the nine months ended September 30, 2018 and the year ended December 31, 2017, respectively.

The unrecognized compensation expense associated with the Company's restricted shares of common stock at September 30, 2018 was approximately $3.1 million and is expected to be recognized over a weighted average period of approximately 2.5 years.

The following table summarizes the fair value at vesting for the restricted shares of common stock that vested during the three and nine months ended September 30, 2018 and 2017.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Vested restricted shares of common stock | — | — | 112,405 | 109,209 |
| Fair value of vested restricted shares of common stock (in thousands) | $ — | $ — | $ 3,002 | $ 2,591 |

7. Noncontrolling Interest

The table below summarizes the activity for noncontrolling interest in the Company for the nine months ended September 30, 2018 and the year ended December 31, 2017.

| | LTIP Units | Other Common Units | Total Noncontrolling Common Units | Noncontrolling Interest |
|---|---|---|---|---|
| Balance at December 31, 2016 | 1,576,516 | 2,057,365 | 3,633,881 | 4.3 % |
| Granted/Issued | 126,239 | 687,827 | 814,066 | N/A |
| Forfeited | — | — | — | N/A |

| | | | | | |
|---|---|---|---|---|---|
| Conversions from LTIP units to Other Common Units | (245,685 ) | 245,685 | — | N/A | |
| Redemptions from Other Common Units to common stock | — | (351,260 ) | (351,260 ) | N/A | |
| Balance at December 31, 2017 | 1,457,070 | 2,639,617 | 4,096,687 | 4.1 | % |
| Granted/Issued | 324,802 | — | 324,802 | N/A | |
| Forfeited | — | — | — | N/A | |
| Conversions from LTIP units to Other Common Units | (165,672 ) | 165,672 | — | N/A | |
| Redemptions from Other Common Units to common stock | — | (352,055 ) | (352,055 ) | N/A | |
| Balance at September 30, 2018 | 1,616,200 | 2,453,234 | 4,069,434 | 3.6 | % |

LTIP Units

On March 12, 2018, the Company's board of directors appointed Michelle Dilley to serve as director of the Company. On March 12, 2018, Ms. Dilley was granted 3,930 LTIP units which, subject to Ms. Dilley's continued service, will vest on January 1, 2019.

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LTIP units granted on January 5, 2018 to non-employee, independent directors, subject to the recipient's continued service, will vest on January 1, 2019. LTIP units granted on January 5, 2018 to certain senior executive officers and senior employees, subject to the recipient's continued employment, will vest quarterly over four years, with the first vesting date having been March 31, 2018. Refer to Note 8 for a discussion of vested LTIP units granted on January 5, 2018 pursuant to the 2015 Outperformance Program (the "2015 OPP").

The fair value of the LTIP units at the date of grant was determined by a lattice-binomial option-pricing model based on a Monte Carlo simulation. The fair value of the LTIP units are based on Level 3 inputs and are non-recurring fair value measurements. The table below sets forth the assumptions used in valuing such LTIP units granted during the nine months ended September 30, 2018 (excluding those vested LTIP units granted pursuant to the 2015 OPP; refer to Note 8 for details).

| LTIP Units | Assumptions | |
|---|---|---|
| Grant date | March 12, 2018 | January 5, 2018 |
| Expected term (years) | 10 | 10 |
| Expected volatility | 22.0 % | 22.0 % |
| Expected dividend yield | 6.0 % | 6.0 % |
| Risk-free interest rate | 2.46 % | 2.09 % |
| Fair value of LTIP units at issuance (in thousands) | $90 | $ 3,447 |
| LTIP units at issuance | 3,930 | 137,616 |
| Fair value unit price per LTIP unit at issuance | $22.90 | $ 25.05 |

The following table summarizes activity related to the Company's unvested LTIP units for the nine months ended September 30, 2018 and the year ended December 31, 2017.

| Unvested LTIP Units | LTIP Units |
|---|---|
| Balance at December 31, 2016 | 403,423 |
| Granted | 126,239 |
| Vested | (229,355) |
| Forfeited | — |
| Balance at December 31, 2017 | 300,307 |
| Granted | 324,802 |
| Vested | (342,940) |
| Forfeited | — |
| Balance at September 30, 2018 | 282,169 |

The unrecognized compensation expense associated with the Company's LTIP units at September 30, 2018 was approximately $5.7 million and is expected to be recognized over a weighted average period of approximately 2.5 years.

The following table summarizes the fair value at vesting for the LTIP units that vested during the three and nine months ended September 30, 2018 and 2017.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Vested LTIP units | 30,949 | 44,942 | 342,940 | 157,816 |

| | | | | |
|---|---|---|---|---|
| Fair value of vested LTIP units (in thousands) | $851 | $1,235 | $9,002 | $4,146 |

8. Equity Incentive Plan

At the Company's annual meeting of stockholders held on April 30, 2018, the Company's stockholders approved an amendment and restatement of the 2011 Plan, under which the Company may issue equity-based awards, including stock options, stock appreciation rights, restricted stock, restricted stock units, unrestricted stock awards and other awards based on shares of the Company's common stock, such as LTIP units, to executive officers, directors, employees and other individuals providing bona fide services to or for the Company or its affiliates. The amendment increased the total number of shares of common stock authorized and reserved for issuance under the 2011 Plan by 3,000,000 shares to an aggregate of 6,642,461 shares, subject to certain adjustments as described in the 2011 Plan. Awards previously granted under the 2011 Plan will remain in effect pursuant to their terms.

On January 5, 2018, the Company granted performance units approved by the compensation committee of the board of directors, under the 2011 Plan to certain key employees of the Company. The terms of the performance units granted on January 5, 2018 are substantially the same as the terms of the performance units granted on January 6, 2017 and March 8, 2016, except that the measuring period commences on January 1, 2018 and ends on December 31, 2020.

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The fair value of the performance units at the date of grant was determined by a lattice-binomial option-pricing model based on a Monte Carlo simulation. The fair value of the performance units are based on Level 3 inputs and are non-recurring fair value measurements. The performance unit equity compensation expense is recognized into earnings ratably from the grant date over the respective vesting periods. The table below sets forth the assumptions used in valuing the performance units granted during the nine months ended September 30, 2018.

| Performance Units | Assumptions | |
|---|---|---|
| Grant date | January 5, 2018 | |
| Expected volatility | 22.0 | % |
| Expected dividend yield | 6.0 | % |
| Risk-free interest rate | 2.09 | % |
| Fair value of performance units grant (in thousands) | $ 5,456 | |

On January 1, 2018, the Company’s three year measurement period pursuant to the 2015 OPP concluded. It was determined that the Company's total stockholder return exceeded the threshold percentage and return hurdle and a pool of approximately $6.2 million was awarded to the participants. The compensation committee of the board of directors approved the issuance of 183,256 vested LTIP units and 53,722 vested shares of common stock (of which 15,183 shares of common stock were repurchased and retired) to the participants, all of which were issued on January 5, 2018.

The unrecognized compensation expense associated with the Company's performance units at September 30, 2018 was approximately $6.1 million and is expected to be recognized over a weighted average period of approximately 2.3 years.

Non-cash Compensation Expense

The following table summarizes the amount recorded in general and administrative expenses in the accompanying Consolidated Statements of Operations for the amortization of restricted shares of common stock, LTIP units, performance units, the 2015 OPP (performance units and the 2015 OPP, collectively the “Performance-based Compensation Plans”), and the Company’s director compensation for the three and nine months ended September 30, 2018 and 2017.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Non-Cash Compensation Expense (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Restricted shares of common stock | $406 | $594 | $1,269 | $1,776 |
| LTIP units | 893 | 1,167 | 2,654 | 3,508 |
| Performance-based Compensation Plans | 838 | 536 | 2,463 | 1,610 |
| Director compensation [(1)] | 99 | 87 | 285 | 265 |
| Total non-cash compensation expense | $2,236 | $2,384 | $6,671 | $7,159 |

(1) All of the Company’s independent directors elected to receive shares of common stock in lieu of cash for their service during the three and nine months ended September 30, 2018 and 2017. The number of shares of common stock granted is calculated based on the trailing 10 days average common stock price ending on the third business day preceding the grant date.

9. Earnings Per Share

During the three and nine months ended September 30, 2018 and 2017, there were 193,117, 196,871, 237,207 and 238,129, respectively, of unvested restricted shares of common stock on a weighted average basis that were considered participating securities.

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The following table sets forth the computation of basic and diluted earnings per common share for the three and nine months ended September 30, 2018 and 2017.

| Earnings Per Share (in thousands, except per share data) | Three months ended September 30, 2018 | 2017 | Nine months ended September 30, 2018 | 2017 |
|---|---|---|---|---|
| Numerator | | | | |
| Net income | $8,876 | $21,839 | $48,989 | $23,276 |
| Less: preferred stock dividends | 1,289 | 2,449 | 6,315 | 7,345 |
| Less: redemption of preferred stock | — | — | 2,661 | — |
| Less: amount allocated to participating securities | 69 | 84 | 209 | 250 |
| Less: income attributable to noncontrolling interest after preferred stock dividends | 281 | 828 | 1,589 | 673 |
| Net income attributable to common stockholders | $7,237 | $18,478 | $38,215 | $15,008 |
| Denominator | | | | |
| Weighted average common shares outstanding — basic | 105,783 | 92,787 | 101,095 | 87,632 |
| Effect of dilutive securities[(1)] | | | | |
| Share-based compensation | 550 | 648 | 400 | 606 |
| Weighted average common shares outstanding — diluted | 106,333 | 93,435 | 101,495 | 88,238 |
| Net income per share — basic and diluted | | | | |
| Net income per share attributable to common stockholders — basic | $0.07 | $0.20 | $0.38 | $0.17 |
| Net income per share attributable to common stockholders — diluted | $0.07 | $0.20 | $0.38 | $0.17 |

(1) During the three and nine months ended September 30, 2018 and 2017, there were approximately 193, 197, 237 and 238, respectively, unvested restricted shares of common stock on a weighted average basis that were not included in the computation of diluted earnings per share because to do so would have been antidilutive for the period.

## 10. Commitments and Contingencies

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance subject to deductible requirements. Management believes that the ultimate settlement of these actions will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

The Company has letters of credit of approximately $5.6 million as of September 30, 2018 related to construction projects and certain other agreements.

## 11. Subsequent Events

There were no recognized or non-recognized subsequent events.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion with the financial statements and related notes included elsewhere in Item 1 of this report and the audited financial statements and related notes thereto included in our most recent Annual Report on Form 10-K.

As used herein, except where the context otherwise requires, “Company,” “we,” “our” and “us,” refer to STAG Industrial, Inc. and our consolidated subsidiaries and partnerships, including our operating partnership, STAG Industrial Operating Partnership, L.P. (“Operating Partnership”).

Forward-Looking Statements

This report contains “forward-looking statements” within the meaning of the safe harbor from civil liability provided for such statements by the Private Securities Litigation Reform Act of 1995 (set forth in Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)). You can identify forward-looking statements by the use of words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “seeks,” “should,” “will,” and variations of such words or simila expressions. Forward-looking statements in this report include, among others, statements about our future financial condition, results of operations, capitalization rates on future acquisitions, our business strategy and objectives, including our acquisition strategy, occupancy and leasing rates and trends, and expected liquidity needs and sources (including capital expenditures and the ability to obtain financing or raise capital). Our forward-looking statements reflect our current views about our plans, intentions, expectations, strategies and prospects, which are based on the information currently available to us and on assumptions we have made. Although we believe that our plans, intentions, expectations, strategies and prospects as reflected in or suggested by our forward-looking statements are reasonable, we can give no assurance that our plans, intentions, expectations, strategies or prospects will be attained or achieved and you should not place undue reliance on these forward looking statements. Furthermore, actual results may differ materially from those described in the forward looking statements and may be affected by a variety of risks and factors including, without limitation:

- the factors included in our Annual Report on Form 10-K for the year ended December 31, 2017, as updated elsewhere in this report, including those set forth under the headings “Business,” “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations;”
- our ability to raise equity capital on attractive terms;
- the competitive environment in which we operate;
- real estate risks, including fluctuations in real estate values and the general economic climate in local markets and competition for tenants in such markets;
- decreased rental rates or increased vacancy rates;
- potential defaults (including bankruptcies or insolvency) on or non-renewal of leases by tenants;
- acquisition risks, including our ability to identify and complete accretive acquisitions and/or failure of such acquisitions to perform in accordance with projections;
- the timing of acquisitions and dispositions;
- potential natural disasters and other potentially catastrophic events such as acts of war and/or terrorism;

- international, national, regional and local economic conditions;
- the general level of interest rates and currencies;
- potential changes in the law or governmental regulations and interpretations of those laws and regulations, including changes in real estate and zoning laws or real estate investment trust (“REIT”) or corporate income tax laws, and potential increases in real property tax rates;

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- financing risks, including the risks that our cash flows from operations may be insufficient to meet required payments of principal and interest and we may be unable to refinance our existing debt upon maturity or obtain new financing on attractive terms or at all;
- credit risk in the event of non-performance by the counterparties to the interest rate swaps and revolving and unfunded debt;
- lack of or insufficient amounts of insurance;
- our ability to maintain our qualification as a REIT;
- our ability to retain key personnel;
- litigation, including costs associated with prosecuting or defending claims and any adverse outcomes; and
- possible environmental liabilities, including costs, fines or penalties that may be incurred due to necessary remediation of contamination of properties presently owned or previously owned by us.

Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise over time, and it is not possible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We are a REIT focused on the acquisition and operation of single-tenant, industrial properties throughout the United States. We are a Maryland corporation and our common stock is publicly traded on the New York Stock Exchange under the symbol “STAG.”

We are organized and conduct our operations to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and generally are not subject to federal income tax to the extent we currently distribute our income to our stockholders and maintain our qualification as a REIT. We remain subject to state and local taxes on our income and property and to U.S. federal income and excise taxes on our undistributed income.

Factors That May Influence Future Results of Operations

Our ability to increase revenues or cash flow will depend in part on our (i) external growth, specifically acquisition activity, and (ii) internal growth, specifically occupancy and rental rates on our portfolio. A variety of other factors, including those noted below, also affect our future results of operations.

As used herein “total annualized base rental revenue” refers to the contractual monthly base rent as of September 30, 2018 (which differs from rent calculated in accordance with generally accepted accounting principles in the United States of America (“GAAP”)) multiplied by 12. If a tenant is in a free rent period as of September 30, 2018, the annualized rent is calculated based on the first contractual monthly base rent amount multiplied by 12.

Outlook

The outlook for our business remains positive, albeit on a moderated basis in light of over eight years of economic growth, some uncertainty regarding U.S. policy initiatives, and continued asset appreciation. In September 2018, the federal funds target rate was raised 25 basis points to a target range of 2.00% to 2.25%. This announcement combined with the unwinding of its balance sheet by selling Treasury securities and anticipation of one more rate increase in 2018 are signs of the Central Bank's confidence in the economy. The current trajectory of the federal funds target rate aligns with the Central Bank's consistent commentary that future rate increases would be gradual. If interest rates rise further as a result of Federal Reserve policy action (short-term interest rates) or changes in market expectations and capital flows (long-term interest rates), we believe strengthening economic conditions are likely to accompany these changes. This strengthening of economic conditions combined with the currently favorable industrial supply demand environment should translate to a net positive result for our business. Specifically, our existing portfolio should benefit from rising rental rates and our acquisition activity should benefit from higher yields. Furthermore, we believe certain characteristics of our business should position us well in a rising interest rate environment, including the fact that we have minimal floating rate debt exposure (taking into account our hedging activities) and that many of our competitors for the assets we purchase tend to be smaller local and regional investors who are likely to be more heavily impacted by interest rate increases.

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Several industrial specific trends contribute to the expected strong demand, including:

- the rise of e-commerce (as compared to the traditional retail store distribution model) and the concomitant demand by e-commerce industry participants for well-located, functional distribution space;
- the increasing attractiveness of the U.S. as a manufacturing and distribution location because of the size of the U.S. consumer market, an increase in overseas labor costs and the overall cost of supplying and shipping goods (i.e. the shortening and fattening of the supply chain); and
- the overall quality of the transportation infrastructure in the U.S.

Furthermore, the lack of material speculative development and the broader failure of supply to keep pace with demand in many of our markets has improved and may continue to modestly improve occupancy levels and rental rates in our portfolio. We believe, however, that industrial supply, more so than other real estate property types, has historically had a short lead time and can appear quickly. We have started to see a notable pick-up in development activity in a growing number of the primary industrial markets. On the demand side, we note that the quality and availability of labor remains a key focus of tenants making occupancy decisions. We will continue to monitor the supply and demand fundamentals for industrial real estate and assess its impact on our business.

Conditions in Our Markets

The buildings in our portfolio are located in markets throughout the United States. Positive or negative changes in economic or other conditions, new supply, adverse weather conditions and natural disasters, and other factors in these markets may affect our overall performance.

Rental Income

We receive income primarily in the form of rental income from the tenants who occupy our buildings. The amount of rental income generated by the buildings in our portfolio depends principally on occupancy and rental rates. As of September 30, 2018, our Operating Portfolio was approximately 96.0% leased and our straight-line (“SL”) rent change (as defined below) on new and renewal leases together grew approximately 10.6% and 14.7% during the three and nine months ended September 30, 2018, respectively. We define the Operating Portfolio as all warehouse and light manufacturing assets that were acquired stabilized or have achieved Stabilization. The Operating Portfolio excludes non-core flex/office assets and assets contained in the Value Add Portfolio. We define Stabilization for assets under redevelopment to occur upon the earlier of achieving 90% occupancy or 12 months after completion. Stabilization for assets that were acquired and immediately added to the Value Add Portfolio occurs under the following: (i) if acquired with less than 75% occupancy as of the acquisition date, Stabilization will occur upon the earlier of achieving 90% occupancy or 12 months from the acquisition date; or (ii) if acquired and will be less than 75% occupied due to known move-outs within two years of the acquisition date, Stabilization will occur upon the earlier of achieving 90% occupancy after the known move-outs have occurred or 12 months after the known move-outs have occurred. We define the Value Add Portfolio as properties that meet any of the following criteria: (i) less than 75% occupied as of the acquisition date; (ii) will be less than 75% occupied due to known move-outs within two years of the acquisition date; or (iii) out of service with significant physical renovation of the asset.

Future economic downturns or regional downturns affecting our submarkets that impair our ability to renew or re-lease space and the ability of our tenants to fulfill their lease commitments, as in the case of tenant bankruptcies, could adversely affect our ability to maintain or increase rental rates at our buildings. Our ability to lease our properties and the attendant rental rate is dependent upon, among other things, (i) the overall economy, (ii) the supply/demand dynamic in our markets, (iii) the quality of our properties, including age, clear height, and configuration, and (iv) our tenants’ ability to meet their contractual obligations to us.

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The following table provides a summary of our Operating Portfolio leases executed during the three and nine months ended September 30, 2018. Certain leases contain rental concessions; any such rental concessions are accounted for on a straight-line basis over the term of the lease.

| Operating Portfolio | Square Feet | Cash Basis Rent Per Square Foot | SL Rent Per Square Foot | Total Costs Per Square Foot[(1)] | Cash Rent Change[(2)] | SL Rent Change[(3)] | Weighted Average Lease Term[(4)] (years) | Rental Concessions per Square Foot[(5)] |
|---|---|---|---|---|---|---|---|---|
| Three months ended September 30, 2018 | | | | | | | | |
| New Leases[(6)] | 544,253 | $ 4.26 | $ 4.41 | $ 2.61 | (4.1 )% | (0.4 )% | 5.6 | $ 0.54 |
| Renewal Leases[(7)] | 523,306 | 4.37 | 4.52 | 0.56 | 13.9 % | 19.5 % | 3.6 | — |
| Total/weighted average | 1,067,559 | $ 4.31 | $ 4.46 | $ 1.60 | 5.9 % | 10.6 % | 4.6 | $ 0.27 |
| Nine months ended September 30, 2018 | | | | | | | | |
| New Leases[(6)] | 1,756,935 | $ 3.73 | $ 3.87 | $ 2.33 | 9.9 % | 17.7 % | 6.8 | $ 0.75 |
| Renewal Leases[(7)] | 5,254,633 | 3.98 | 4.11 | 0.62 | 7.4 % | 14.1 % | 4.6 | 0.07 |
| Total/weighted average | 7,011,568 | $ 3.91 | $ 4.05 | $ 1.05 | 7.9 % | 14.7 % | 5.1 | $ 0.24 |

(1) We define Total Costs as the costs for improvements of vacant and renewal spaces, as well as the legal fees and commissions for leasing transactions. Total Costs per square foot represent the total costs expected to be incurred on the leases signed during the period and do not reflect actual expenditures for the period.

(2) We define Cash Rent Change as the percentage change in the base rent of the lease executed during the period compared to the base rent of the Comparable Lease for assets included in the Operating Portfolio. The calculation compares the first base rent payment due after the lease commencement date compared to the base rent of the last monthly payment due prior to the termination of the lease, excluding holdover rent. Rent under gross or similar type leases are converted to a net rent based on an estimate of the applicable recoverable expenses. We define a Comparable Lease as a lease in the same space with a similar lease structure as compared to the previous in-place lease, excluding new leases for space that was not occupied under our ownership. This resulted in 192,707 and 1,532,343 square feet to be deemed non-comparable for three and nine months ended September 30, 2018, respectively.

(3) We define SL Rent Change as the percentage change in the average monthly base rent over the term of the lease, calculated on a straight-line basis, of the lease executed during the period compared to the Comparable Lease for assets included in the Operating Portfolio. Rent under gross or similar type leases are converted to a net rent based on an estimate of the applicable recoverable expenses, and this calculation excludes the impact of any holdover rent.

(4) We define Weighted Average Lease Term as the contractual lease term in years as of the lease start date weighted by square footage.

(5) Represents the total rental concessions for the entire lease term.

(6) We define a New Lease as any lease that is signed for an initial term equal to or greater than twelve months for any vacant space; this includes a new tenant or an existing tenant that is expanding into new (additional) space.

(7) We define a Renewal Lease as a lease signed by an existing tenant to extend the term for twelve months or more, including (i) a renewal of the same space as the current lease at lease expiration, (ii) a renewal of only a portion of the current space at lease expiration and (iii) an early renewal or workout, which ultimately does extend the original term for twelve months or more.

Property Operating Expenses

Our property operating expenses generally consist of utilities, real estate taxes, management fees, insurance, and site repair and maintenance costs. For the majority of our tenants, our property operating expenses are controlled, in part, by the triple net provisions in tenant leases. In our triple net leases, the tenant is responsible for all aspects of and costs related to the building and its operation during the lease term, including utilities, taxes, insurance and maintenance costs. However, we also have modified gross leases and gross leases in our building portfolio. The terms of those leases vary and on some occasions we may absorb certain building related expenses of our tenants. In our modified gross leases, we are responsible for some building related expenses during the lease term, but the cost of most of the expenses is passed through to the tenant for reimbursement to us. In our gross leases, we are responsible for all costs related to the building and its operation during the lease term. Our overall performance will be affected by the extent to which we are able to pass-through property operating expenses to our tenants.

Scheduled Lease Expirations

Our ability to re-lease space subject to expiring leases will impact our results of operations and is affected by economic and competitive conditions in our markets and by the desirability of our individual buildings. Leases that comprise approximately 9.7% of our annualized base rental revenue will expire during the period from October 1, 2018 to September 30, 2019, excluding month to month leases. We assume, based upon internal renewal probability estimates that some of our tenants will renew and others will vacate and the associated space will be re-let subject to downtime assumptions. Using the aforementioned assumptions, we expect that the rental rates on the respective new leases will generally be higher than the rates under existing leases expiring during the period October 1, 2018 to September 30, 2019, thereby resulting in higher revenue from the same space.

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The following table sets forth a summary of lease expirations for leases in place as of September 30, 2018, plus available space, for each of the ten calendar years beginning with 2018 and thereafter in our portfolio. The information in the table assumes that tenants exercise no renewal options and no early termination rights.

| Lease Expiration Year | Number of Leases Expiring | Total Rentable Square Feet | % of Total Occupied Square Feet | | Total Annualized Base Rental Revenue (in thousands) | % of Total Annualized Base Rental Revenue | |
|---|---|---|---|---|---|---|---|
| Available | — | 3,466,010 | — | | — | — | |
| Month-to-month leases | 5 | 205,043 | 0.3 | % | $ 828 | 0.3 | % |
| Remainder of 2018 | 4 | 798,875 | 1.1 | % | 3,489 | 1.2 | % |
| 2019 | 53 | 8,413,096 | 11.7 | % | 35,622 | 11.8 | % |
| 2020 | 50 | 9,814,812 | 13.6 | % | 42,116 | 14.0 | % |
| 2021 | 69 | 10,940,764 | 15.2 | % | 47,063 | 15.6 | % |
| 2022 | 51 | 6,532,253 | 9.1 | % | 28,129 | 9.3 | % |
| 2023 | 46 | 8,755,494 | 12.2 | % | 32,648 | 10.9 | % |
| 2024 | 28 | 5,320,625 | 7.4 | % | 21,716 | 7.2 | % |
| 2025 | 23 | 3,991,385 | 5.5 | % | 17,349 | 5.8 | % |
| 2026 | 23 | 5,069,584 | 7.0 | % | 19,818 | 6.6 | % |
| 2027 | 12 | 1,916,418 | 2.7 | % | 9,059 | 3.0 | % |
| Thereafter | 45 | 10,161,454 | 14.2 | % | 43,022 | 14.3 | % |
| Total | 409 | 75,385,813 | 100.0 | % | $ 300,859 | 100.0 | % |

Portfolio Summary

The following table sets forth information relating to diversification by building type in our portfolio as of September 30, 2018.

| Building Type | Number of Buildings | Square Footage Amount | % | | Occupancy Rate(1) | | Annualized Base Rental Revenue Amount (in thousands) | % | |
|---|---|---|---|---|---|---|---|---|---|
| Warehouse/Distribution | 309 | 67,433,301 | 89.5 | % | 95.7 | % | $264,832 | 88.1 | % |
| Light Manufacturing | 59 | 6,614,487 | 8.8 | % | 100.0 | % | 29,615 | 9.8 | % |
| Total Operating Portfolio/weighted average | 368 | 74,047,788 | 98.3 | % | 96.0 | % | $294,447 | 97.9 | % |
| | | | | | | | | | |
| Value Add | 4 | 773,345 | 1.0 | % | 53.7 | % | 1,792 | 0.6 | % |
| Flex/Office | 9 | 564,680 | 0.7 | % | 67.9 | % | 4,620 | 1.5 | % |
| Total portfolio/weighted average | 381 | 75,385,813 | 100.0 | % | 95.4 | % | $300,859 | 100.0 | % |

(1) We define Occupancy Rate as the percentage of total leasable square footage for which either revenue recognition has commenced in accordance with GAAP or the lease term has commenced as of the close of the reporting period, whichever occurs earlier.

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Portfolio Acquisitions

The following table summarizes our acquisitions during the nine months ended September 30, 2018.

| Market [1] | Date Acquired | Square Feet | Buildings | Purchase Price (in thousands) |
|---|---|---|---|---|
| Greenville/Spartanburg, SC | January 11, 2018 | 203,000 | 1 | $ 10,755 |
| Minneapolis/St Paul, MN | January 26, 2018 | 145,351 | 1 | 13,538 |
| Philadelphia, PA | February 1, 2018 | 278,582 | 1 | 18,277 |
| Houston, TX | February 22, 2018 | 242,225 | 2 | 22,478 |
| Greenville/Spartanburg, SC | March 30, 2018 | 222,710 | 1 | 13,773 |
| Three months ended March 31, 2018 | | 1,091,868 | 6 | 78,821 |
| Chicago, IL | April 23, 2018 | 169,311 | 2 | 10,975 |
| Milwaukee/Madison, WI | April 26, 2018 | 53,680 | 1 | 4,316 |
| Pittsburgh, PA | April 30, 2018 | 175,000 | 1 | 15,380 |
| Detroit, MI | May 9, 2018 | 274,500 | 1 | 19,328 |
| Minneapolis/St Paul, MN | May 15, 2018 | 509,910 | 2 | 26,983 |
| Cincinnati/Dayton, OH | May 23, 2018 | 158,500 | 1 | 7,317 |
| Baton Rouge, LA | May 31, 2018 | 279,236 | 1 | 21,379 |
| Las Vegas, NV | June 12, 2018 | 122,472 | 1 | 17,920 |
| Greenville/Spartanburg, SC | June 15, 2018 | 131,805 | 1 | 5,621 |
| Denver, CO | June 18, 2018 | 64,750 | 1 | 7,044 |
| Cincinnati/Dayton, OH | June 25, 2018 | 465,136 | 1 | 16,421 |
| Charlotte, NC | June 29, 2018 | 69,200 | 1 | 5,446 |
| Houston, TX | June 29, 2018 | 252,662 | 1 | 27,170 |
| Three months ended June 30, 2018 | | 2,726,162 | 15 | 185,300 |
| Knoxville, TN | July 10, 2018 | 106,000 | 1 | 6,477 |
| Pittsburgh, PA | August 2, 2018 | 265,568 | 1 | 19,186 |
| Raleigh/Durham, NC | August 2, 2018 | 365,000 | 1 | 21,067 |
| Detroit, MI | August 6, 2018 | 439,150 | 1 | 21,077 |
| Des Moines, IA | August 8, 2018 | 121,922 | 1 | 6,053 |
| McAllen/Edinburg/Pharr, TX | August 9, 2018 | 270,084 | 1 | 18,523 |
| Pittsburgh, PA | August 15, 2018 | 200,500 | 1 | 11,327 |
| Minneapolis/St Paul, MN | August 24, 2018 | 120,606 | 1 | 8,422 |
| Milwaukee/Madison, WI | September 28, 2018 | 100,800 | 1 | 7,484 |
| Milwaukee/Madison, WI | September 28, 2018 | 174,633 | 2 | 13,288 |
| Chicago, IL | September 28, 2018 | 105,637 | 1 | 6,368 |
| Indianapolis, IN | September 28, 2018 | 478,721 | 1 | 29,085 |
| Augusta/Richmond County, GA | September 28, 2018 | 203,726 | 1 | 9,379 |
| Charlotte, NC | September 28, 2018 | 301,000 | 1 | 16,807 |
| Three months ended September 30, 2018 | | 3,253,347 | 15 | 194,543 |
| Nine months ended September 30, 2018 | | 7,071,377 | 36 | $ 458,664 |

(1) As defined by CoStar Realty Information Inc.

Portfolio Dispositions

During the nine months ended September 30, 2018, we sold 11 buildings comprised of approximately 2.0 million square feet with a net book value of approximately $57.1 million to third parties. Net proceeds from the sales of rental property were approximately $89.4 million and we recognized the full gain on the sales of rental property, net of approximately $32.3 million for the nine months ended September 30, 2018.

We may dispose of additional properties from time to time and, among other individual properties, are currently marketing for sale a portfolio of seven assets in six states. The seven assets contain a total of approximately 1.8 million rentable square feet. We make no assurance that the sale will occur or, if it does, that the portfolio sold will not differ substantially from the portfolio now on the market.

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Geographic Diversification

The following table sets forth information about the ten largest markets in our portfolio based on total annualized base rental revenue as of September 30, 2018.

| Top Ten Markets [1] | % of Total Annualized Base Rental Revenue | |
|---|---|---|
| Philadelphia, PA | 9.5 | % |
| Chicago, IL | 8.6 | % |
| Greenville/Spartanburg, SC | 4.8 | % |
| Milwaukee/Madison, WI | 4.1 | % |
| Detroit, MI | 3.9 | % |
| Cincinnati/Dayton, OH | 3.3 | % |
| Charlotte, NC | 3.2 | % |
| Houston, TX | 3.2 | % |
| Minneapolis/St Paul, MN | 3.0 | % |
| Pittsburgh, PA | 2.8 | % |
| Total | 46.4 | % |

(1) As defined by CoStar Realty Information Inc.

Industry Diversification

The following table sets forth information about the ten largest tenant industries in our portfolio based on total annualized base rental revenue as of September 30, 2018.

| Top Ten Tenant Industries [1] | % of Total Annualized Base Rental Revenue | |
|---|---|---|
| Capital Goods | 14.8 | % |
| Automobiles & Components | 12.8 | % |
| Materials | 11.7 | % |
| Transportation | 8.9 | % |
| Consumer Durables & Apparel | 8.9 | % |
| Food, Beverage & Tobacco | 7.9 | % |
| Commercial & Prof Services | 7.6 | % |
| Retailing | 5.0 | % |
| Household & Personal Products | 4.7 | % |
| Food & Staples Retailing | 4.3 | % |
| Total | 86.6 | % |

(1) Industry classification based on GICS methodology.

Top Tenants

The following table sets forth information about the ten largest tenants in our portfolio based on total annualized base rental revenue as of September 30, 2018.

| Top Ten Tenants [1] | Number of Leases | % of Total Annualized Base Rental |
|---|---|---|

| | | Revenue | |
|---|---|---|---|
| General Service Administration | 1 | 2.3 | % |
| XPO Logistics | 4 | 1.9 | % |
| Deckers Outdoor | 2 | 1.4 | % |
| Yanfeng US Automotive Interior | 3 | 1.3 | % |
| Solo Cup | 1 | 1.3 | % |
| TriMas Corporation | 4 | 1.2 | % |
| DHL | 4 | 1.0 | % |
| Generation Brands | 1 | 0.9 | % |
| Schneider Electric USA, Inc. | 4 | 0.9 | % |
| Carolina Beverage Group | 2 | 0.9 | % |
| Total | 26 | 13.1 | % |

(1) Includes tenants, guarantors, and/or non-guarantor parents.

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Critical Accounting Policies

See “Critical Accounting Policies” in “Management's Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the year ended December 31, 2017, for a discussion of our critical accounting policies and estimates.

Results of Operations

The following discussion of our results of our same store (as defined below) net operating income (“NOI”) should be read in conjunction with our Consolidated Financial Statements. For a detailed discussion of NOI, including the reasons management believes NOI is useful to investors, see “Non-GAAP Financial Measures” below. Same store results are considered to be useful to investors in evaluating our performance because they provide information relating to changes in building-level operating performance without taking into account the effects of acquisitions or dispositions. We encourage the reader to not only look at our same store results, but also our total portfolio results, due to historic and future growth.

Comparison of the three months ended September 30, 2018 to the three months ended September 30, 2017

We define same store properties as properties that were in the Operating Portfolio for the entirety of the comparative periods presented. Same store properties exclude Operating Portfolio properties with expansions placed into service after June 30, 2017. On September 30, 2018, we owned 309 industrial buildings consisting of approximately 61.8 million square feet, which represents approximately 82.0% of our total portfolio, that are considered our same store portfolio in the analysis below. Same store occupancy decreased approximately 0.3% to 96.1% as of September 30, 2018 compared to 96.4% as of September 30, 2017.

The following table summarizes selected operating information for our same store portfolio and our total portfolio for the three months ended September 30, 2018 and 2017 (dollars in thousands). This table includes a reconciliation from our same store portfolio to our total portfolio by also providing information for the three months ended September 30, 2018 and 2017 with respect to the buildings acquired and disposed of and Operating Portfolio buildings with expansions placed into service or transferred from the Value Add Portfolio to the Operating Portfolio after June 30, 2017 and our flex/office buildings and Value Add Portfolio.

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| | Same Store Portfolio | | | | Acquisitions/Dispositions | | Other | | Total Portfolio | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Three months ended September 30, | | Change | | Three months ended September 30, | | Three months ended September 30, | | Three months ended September 30, | | Change | |
| | 2018 | 2017 | $ | % | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | $ | % |
| Revenue | | | | | | | | | | | | |
| Operating revenue | | | | | | | | | | | | |
| Rental income | $61,926 | $60,611 | $1,315 | 2.2 % | $9,977 | $3,030 | $3,256 | $2,032 | $75,159 | $65,673 | $9,486 | 14.4 % |
| Tenant recoveries | 10,760 | 11,239 | (479) | (4.3)% | 1,865 | 620 | 893 | 507 | 13,518 | 12,366 | 1,152 | 9.3 % |
| Other income | 254 | 44 | 210 | 477.3 % | 15 | 50 | — | 11 | 269 | 105 | 164 | 156.2 % |
| Total operating revenue | 72,940 | 71,894 | 1,046 | 1.5 % | 11,857 | 3,700 | 4,149 | 2,550 | 88,946 | 78,144 | 10,802 | 13.8 % |
| Expenses | | | | | | | | | | | | |
| Property | 13,572 | 13,388 | 184 | 1.4 % | 2,049 | 993 | 1,491 | 1,020 | 17,112 | 15,401 | 1,711 | 11.1 % |
| Net operating income (1) | $59,368 | $58,506 | $862 | 1.5 % | $9,808 | $2,707 | $2,658 | $1,530 | 71,834 | 62,743 | 9,091 | 14.5 % |
| Other expenses | | | | | | | | | | | | |
| General and administrative | | | | | | | | | 8,911 | 8,380 | 531 | 6.3 % |
| Property acquisition costs | | | | | | | | | — | 1,386 | (1,386) | (100.0)% |
| Depreciation and amortization | | | | | | | | | 44,355 | 38,186 | 6,169 | 16.2 % |
| Other expenses | | | | | | | | | 223 | 58 | 165 | 284.5 % |
| Total other expenses | | | | | | | | | 53,489 | 48,010 | 5,479 | 11.4 % |
| Total expenses | | | | | | | | | 70,601 | 63,411 | 7,190 | 11.3 % |
| Other income (expense) | | | | | | | | | | | | |
| Interest and other income | | | | | | | | | 3 | 2 | 1 | 50.0 % |
| Interest expense | | | | | | | | | (12,698) | (10,446) | (2,252) | 21.6 % |
| Loss on extinguishment of debt | | | | | | | | | (13) | (13) | — | — % |
| Gain on the sales of rental property, net | | | | | | | | | 3,239 | 17,563 | (14,324) | (81.6)% |
| Total other income (expense) | | | | | | | | | (9,469) | 7,106 | (16,575) | (233.3)% |
| Net income (1) | | | | | | | | | $8,876 | $21,839 | $(12,963) | (59.4)% |

For a detailed discussion of NOI, including the reasons management believes NOI is useful to investors, see "Non-GAAP Financial Measures" below.

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Net Income

Net income for our total portfolio decreased by $13.0 million or 59.4% to $8.9 million for the three months ended September 30, 2018, compared to $21.8 million for the three months ended September 30, 2017.

Same Store Total Operating Revenue

Same store total operating revenue consists primarily of (i) rental income consisting of base rent, straight-line rent and above and below market lease amortization from our properties, and (ii) tenant reimbursements for insurance, real estate taxes and certain other expenses (“tenant recoveries”).

For a detailed reconciliation of our same store total operating revenue to net income, see the table above.

Same store rental income increased by $1.3 million or 2.2% to $61.9 million for the three months ended September 30, 2018 compared to $60.6 million for the three months ended September 30, 2017. Approximately $2.4 million of the increase was attributable to rental increases due to new leases and renewals of existing tenants. This increase was partially offset by an approximately $1.1 million decrease due to a reduction of base rent due to tenants downsizing their spaces and vacancies.

Same store tenant recoveries decreased by $0.5 million or 4.3% to $10.8 million for the three months ended September 30, 2018 compared to $11.2 million for the three months ended September 30, 2017. The decrease was primarily attributable to one of our properties where it was determined, during the three months ended September 30, 2017, that the tenant will not be able to meet its requirements set forth by the taxing authority to be entitled to an abatement of real estate taxes. The abatement was applicable to prior periods, and therefore the expense and related recovery recorded for the three months ended September 30, 2017 includes 36 months of real estate taxes, which attributed to approximately $0.6 million of the decrease in same store tenant recoveries as it did not recur for the three months ended September 30, 2018. Additionally, approximately $0.3 million of the decrease related to the vacancy of previously occupied buildings and decreases in real estate taxes levied by the taxing authority. These decreases were partially offset by an increase of approximately $0.4 million related to increases in occupancy and real estate taxes levied by the taxing authority.

Same Store Operating Expenses

Same store operating expenses consist primarily of property operating expenses and real estate taxes and insurance.

For a detailed reconciliation of our same store operating expenses to net income, see the table above.

Total same store operating expenses increased by $0.2 million or 1.4% to $13.6 million for the three months ended September 30, 2018 compared to $13.4 million for the three months ended September 30, 2017. This increase was primarily related to increases in general repairs and maintenance and utilities expense of approximately $0.4 million and an increase in real estate taxes levied by the related taxing authority of approximately $0.1 million. Additionally during the three months ended September 30, 2017 approximately $0.3 million of previously recorded bad debt reserve was reversed, which did not recur during the three months ended September 30, 2018. These increases were partially offset by a decrease in real estate taxes attributable to one of our properties where it was determined, during the three months ended September 30, 2017, that the tenant will not be able to meet its requirements set forth by the taxing authority to be entitled to an abatement of real estate taxes. The abatement was applicable to prior periods, and therefore the expense and related recovery recorded for the three months ended September 30, 2017 includes 36 months of real estate taxes, which attributed to approximately $0.6 million of the decrease in same store operating expenses as it did not recur for the three months ended September 30, 2018.

Acquisitions and Dispositions Net Operating Income

For a detailed reconciliation of our acquisitions and dispositions NOI to net income, see the table above.

Subsequent to June 30, 2017, we acquired 53 buildings consisting of approximately 10.5 million square feet (excluding four buildings that were included in the Value Add Portfolio at September 30, 2018 or transferred from the Value Add Portfolio to the Operating Portfolio after June 30, 2017), and sold 18 buildings consisting of approximately 3.7 million square feet. For the three months ended September 30, 2018 and 2017, the buildings acquired after June 30, 2017 contributed approximately $9.8 million and $0.2 million to NOI, respectively. For the three months ended September 30, 2018 and 2017, the buildings sold after June 30, 2017 contributed approximately $(8,000) and $2.5 million to NOI, respectively. Refer to Note 3 in the accompanying Notes to Consolidated Financial Statements for additional discussion regarding buildings acquired or sold.

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Other Net Operating Income

Our other assets include our flex/office buildings, Value Add Portfolio, and Operating Portfolio buildings with expansions placed in service or transferred from the Value Add Portfolio to the Operating Portfolio after June 30, 2017. Other NOI also includes termination income from buildings in our same store portfolio.

For a detailed reconciliation of our other NOI to net income, see the table above.

At September 30, 2018, we owned nine flex/office buildings consisting of approximately 0.6 million square feet, four buildings in our Value Add Portfolio consisting of approximately 0.8 million square feet, and six buildings consisting of approximately 1.8 million square feet that were Operating Portfolio buildings with expansions placed in service or transferred from the Value Add Portfolio to the Operating Portfolio after June 30, 2017. These buildings contributed approximately $2.5 million and $1.3 million to NOI for the three months ended September 30, 2018 and 2017, respectively. Additionally, there was $0.2 million and $0.2 million of termination fee income from certain buildings in our same store portfolio for the three months ended September 30, 2018 and 2017, respectively.

Total Other Expenses

Total other expenses consist of general and administrative expenses, property acquisition costs, depreciation and amortization, and other expenses.

Total other expenses increased $5.5 million or 11.4% for the three months ended September 30, 2018 to $53.5 million compared to $48.0 million for the three months ended September 30, 2017. This is primarily a result of an increase in depreciation and amortization of approximately $6.2 million as a result of acquisitions increased the depreciable asset base. General and administrative expenses increased by approximately $0.5 million due to increases in compensation and other payroll costs. Additionally, other expenses increased by approximately $0.2 million primarily due to a gain on incentive fee of approximately $0.2 million during the three months ended September 30, 2017 due to the finalization of a one-time incentive fee payable to Columbus Nova Real Estate Acquisition Group, LLC, which did not recur during the three months ended September 30, 2018. These increases were partially offset by a decrease in property acquisition costs of approximately $1.4 million due to the adoption of Accounting Standards Update 2017-01, as discussed in Note 2 of the accompanying Notes to Consolidated Financial Statements.

Total Other Income (Expense)

Total other income (expense) consists of interest and other income, interest expense, loss on extinguishment of debt, and gain on the sales of rental property, net. Interest expense includes interest incurred during the period as well as adjustments related to amortization of financing fees and debt issuance costs, and amortization of fair market value adjustments associated with the assumption of debt.

Total net other income decreased $16.6 million or 233.3% to a net other expense position of $9.5 million for the three months ended September 30, 2018 compared a net other income of $7.1 million for the three months ended September 30, 2017. This decrease is primarily the result of a decrease in the gain on the sales of rental property, net of approximately $14.3 million. This decrease is also attributable to an increase in interest expense of approximately $2.3 million which was primarily attributable to the issuance of new unsecured term loans and unsecured notes as discussed in Note 4 of the accompanying Notes to Consolidated Financial Statements.

Comparison of the nine months ended September 30, 2018 to the nine months ended September 30, 2017

We define same store properties as properties that were in the Operating Portfolio for the entirety of the comparative periods presented. Same store properties exclude Operating Portfolio properties with expansions placed into service after December 31, 2016. On September 30, 2018, we owned 278 industrial buildings consisting of approximately 55.1 million square feet, which represents approximately 73.1% of our total portfolio, that are considered our same store portfolio in the analysis below. Same store occupancy decreased approximately 0.4% to 95.6% as of September 30, 2018 compared to 96.0% as of September 30, 2017.

The following table summarizes selected operating information for our same store portfolio and our total portfolio for the nine months ended September 30, 2018 and 2017 (dollars in thousands). This table includes a reconciliation from our same store portfolio to our total portfolio by also providing information for the nine months ended September 30, 2018 and 2017 with respect to the buildings acquired and disposed of and Operating Portfolio buildings with expansions placed into service or transferred from the Value Add Portfolio to the Operating Portfolio after December 31, 2016 and our flex/office buildings and Value Add Portfolio.

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| | Same Store Portfolio | | | | Acquisitions/Dispositions | | Other | | Total Portfolio | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Nine months ended September 30, | | Change | | Nine months ended September 30, | | Nine months ended September 30, | | Nine months ended September 30, | | Change | |
| | 2018 | 2017 | $ | % | 2018 | 2017 | 2018 | 2017 | 2018 | 2017 | $ | % |
| Revenue | | | | | | | | | | | | |
| Operating revenue | | | | | | | | | | | | |
| Rental income | $162,063 | $158,798 | $3,265 | 2.1 % | $44,984 | $21,629 | $10,180 | $6,194 | $217,227 | $186,621 | $30,606 | 16.4 |
| Tenant recoveries | 28,341 | 27,519 | 822 | 3.0 % | 8,693 | 4,004 | 2,409 | 1,429 | 39,443 | 32,952 | 6,491 | 19.7 |
| Other income | 725 | 118 | 607 | 514.4% | 216 | 70 | 92 | 56 | 1,033 | 244 | 789 | 323.4 |
| Total operating revenue | 191,129 | 186,435 | 4,694 | 2.5 % | 53,893 | 25,703 | 12,681 | 7,679 | 257,703 | 219,817 | 37,886 | 17.2 |
| Expenses | | | | | | | | | | | | |
| Property | 35,947 | 33,839 | 2,108 | 6.2 % | 10,337 | 5,317 | 4,451 | 3,156 | 50,735 | 42,312 | 8,423 | 19.9 |
| Net operating income [(1)] | $155,182 | $152,596 | $2,586 | 1.7 % | $43,556 | $20,386 | $8,230 | $4,523 | 206,968 | 177,505 | 29,463 | 16.6 |
| Other expenses | | | | | | | | | | | | |
| General and administrative | | | | | | | | | 25,637 | 25,090 | 547 | 2.2 |
| Property acquisition costs | | | | | | | | | — | 4,684 | (4,684) | (100.0) |
| Depreciation and amortization | | | | | | | | | 125,221 | 110,286 | 14,935 | 13.5 |
| Loss on impairments | | | | | | | | | 2,934 | — | 2,934 | 100.0 |
| Loss on involuntary conversion | | | | | | | | | — | 330 | (330) | (100.0) |
| Other expenses | | | | | | | | | 864 | 1,502 | (638) | (42.5) |
| Total other expenses | | | | | | | | | 154,656 | 141,892 | 12,764 | 9.0 |
| Total expenses | | | | | | | | | 205,391 | 184,204 | 21,187 | 11.5 |
| Other income (expense) | | | | | | | | | | | | |
| Interest and other income | | | | | | | | | 16 | 10 | 6 | 60.0 |
| Interest expense | | | | | | | | | (35,602) | (31,557) | (4,045) | 12.8 |
| Loss on extinguishment of debt | | | | | | | | | (13) | (15) | 2 | (13.3) |
| Gain on the sales of rental property, net | | | | | | | | | 32,276 | 19,225 | 13,051 | 67.9 |
| Total other income (expense) | | | | | | | | | (3,323) | (12,337) | 9,014 | 73.1 |

| | | | | |
|---|---|---|---|---|
| Net income | $48,989 | $23,276 | $25,713 | 110.5 |

(1) For a detailed discussion of NOI, including the reasons management believes NOI is useful to investors, see “Non-GAAP Financial Measures” below.

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Net Income

Net income for our total portfolio increased by $25.7 million or 110.5% to $49.0 million for the nine months ended September 30, 2018 compared to $23.3 million for the nine months ended September 30, 2017.

Same Store Total Operating Revenue

Same store total operating revenue consists primarily of (i) rental income consisting of base rent, straight-line rent and above and below market lease amortization from our properties, and (ii) tenant recoveries.

For a detailed reconciliation of our same store total operating revenue to net income, see the table above.

Same store rental income increased by $3.3 million or 2.1% to $162.1 million for the nine months ended September 30, 2018 compared to $158.8 million for the nine months ended September 30, 2017. Approximately $5.9 million of the increase was attributable to rental increases due to new leases and renewals of existing tenants. Same store rental income also increased by approximately $0.5 million due to a net decrease in the amortization of net above market leases. These increases were partially offset by an approximately $3.1 million decrease due to a reduction of base rent due to tenants downsizing their spaces and vacancies.

Same store tenant recoveries increased by $0.8 million or 3.0% to $28.3 million for the nine months ended September 30, 2018 compared to $27.5 million for the nine months ended September 30, 2017. Approximately $2.7 million of the increase was primarily due to increases in occupancy and real estate taxes levied by the taxing authority, as well as changes to lease terms where we began paying the real estate taxes and operating expenses on behalf of tenants that had previously paid its taxes and operating expenses directly to respective vendors. This increase was partially offset by a decrease of approximately $1.3 million related to vacancy of previously occupied buildings and decreases in real estate taxes levied by the taxing authority. These increases were also partially offset by one of our properties where it was determined, during the nine months ended September 30, 2017, that the tenant will not be able to meet its requirements set forth by the taxing authority to be entitled to an abatement of real estate taxes. The abatement was applicable to prior periods, and therefore the expense and related recovery recorded for the nine months ended September 30, 2017 includes 36 months of real estate taxes, which attributed to approximately $0.6 million of the decrease in same store tenant recoveries as it did not recur for the nine months ended September 30, 2018.

Same Store Operating Expenses

Same store operating expenses consist primarily of property operating expenses and real estate taxes and insurance.

For a detailed reconciliation of our same store operating expenses to net income, see the table above.

Total same store operating expenses increased by $2.1 million or 6.2% to $35.9 million for the nine months ended September 30, 2018 compared to $33.8 million for the nine months ended September 30, 2017. This increase was primarily related to increases in general repairs and maintenance expense of approximately $0.4 million, an increase in real estate taxes levied by the related taxing authority of approximately $0.8 million, an increase of approximately $0.6 million in snow removal and utilities expenses, and an increase of approximately $0.6 million of bad debt expense. Additionally during the nine months ended September 30, 2017 approximately $0.3 million of previously recorded bad debt reserve was reversed, which did not recur during the nine months ended September 30, 2018. These increases were partially offset by a decrease in real estate taxes attributable to one of our properties where it was determined, during the nine months ended September 30, 2017, that the tenant will not be able to meet its requirements set forth by the taxing authority to be entitled to an abatement of real estate taxes. The abatement was applicable to prior periods, and therefore the expense and related recovery recorded for the nine months ended September 30, 2017 includes 36 months of real estate taxes, which attributed to approximately $0.6 million of the decrease in same store operating expenses as it did not recur for the three months ended September 30, 2018.

Acquisitions and Dispositions Net Operating Income

For a detailed reconciliation of our acquisitions and dispositions NOI to net income, see the table above.

Subsequent to December 31, 2016, we acquired 83 buildings consisting of approximately 17.0 million square feet (excluding six buildings that were included in the Value Add Portfolio at September 30, 2018 or transferred from the Value Add Portfolio to the Operating Portfolio after December 31, 2016), and sold 22 buildings consisting of approximately 3.9 million square feet. For the nine months ended September 30, 2018 and September 30, 2017, the buildings acquired after December 31, 2016 contributed approximately $42.2 million and $12.1 million to NOI, respectively. For the nine months ended September 30, 2018 and

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September 30, 2017, the buildings sold after December 31, 2016 contributed approximately $1.4 million and $8.3 million to NOI, respectively. Refer to Note 3 in the accompanying Notes to Consolidated Financial Statements for additional discussion regarding buildings acquired or sold.

Other Net Operating Income

Our other assets include our flex/office buildings, Value Add Portfolio, and Operating Portfolio buildings with expansions placed in service or transferred from the Value Add Portfolio to the Operating Portfolio after December 31, 2016. Other NOI also includes termination income from buildings from our same store portfolio.

For a detailed reconciliation of our other NOI to net income, see the table above.

At September 30, 2018 we owned nine flex/office buildings consisting of approximately 0.6 million square feet, four buildings in our Value Add Portfolio consisting of approximately 0.8 million square feet, and seven buildings consisting of approximately 2.0 million square feet that were Operating Portfolio buildings with expansions placed in service or transferred from the Value Add Portfolio to the Operating Portfolio after December 31, 2016. These buildings contributed approximately $7.8 million and $3.8 million to NOI for the nine months ended September 30, 2018 and September 30, 2017, respectively. Additionally, there was $0.4 million and $0.7 million of termination fee income from certain buildings in our same store portfolio for the nine months ended September 30, 2018 and September 30, 2017, respectively.

Total Other Expenses

Total other expenses consist of general and administrative expenses, property acquisition costs, depreciation and amortization, loss on impairments, loss on involuntary conversion, and other expenses.

Total other expenses increased $12.8 million or 9.0% to $154.7 million for the nine months ended September 30, 2018 compared to $141.9 million for the nine months ended September 30, 2017. This is primarily a result of an increase in depreciation and amortization of approximately $14.9 million as a result of acquisitions that increased the depreciable asset base. The increase was also attributable to two buildings that were impaired in the amount of approximately $2.9 million during the nine months ended September 30, 2018, whereas there were no buildings impaired during the nine months ended September 30, 2017. General and administrative expenses increased by approximately $0.5 million due to increases in compensation and other payroll costs. These increases were partially offset by a decrease in property acquisition costs of approximately $4.7 million due to the adoption of Accounting Standards Update 2017-01, as discussed in Note 2 of the accompanying Notes to Consolidated Financial Statements. Additionally, loss on involuntary conversion decreased approximately $0.3 million as there were no involuntary conversion events during the nine months ended September 30, 2018, and other expenses decreased by approximately $0.6 million primarily due to the finalization of a one-time incentive fee during the nine months ended September 30, 2017 payable to Columbus Nova Real Estate Acquisition Group, LLC, which did not recur for the nine months ended September 30, 2018.

Total Other Income (Expense)

Total other income (expense) consists of interest and other income, interest expense, loss on extinguishment of debt, and gain on the sales of rental property, net. Interest expense includes interest incurred during the period as well as adjustments related to amortization of financing fees and debt issuance costs, and amortization of fair market value adjustments associated with the assumption of debt.

Total other expenses decreased $9.0 million or 73.1% to $3.3 million for the nine months ended September 30, 2018 compared to $12.3 million for the nine months ended September 30, 2017. This decrease was primarily the result of an increase in the gain on the sales of rental property of approximately $13.1 million. This was partially offset by an increase in interest expense of approximately $4.0 million which was primarily attributable to a higher unsecured credit facility balance during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017, and the issuance of new unsecured term loans and unsecured notes as discussed in Note 4 of the accompanying Notes to Consolidated Financial Statements. The increase in interest expense was slightly offset by the repayment of several mortgage notes during the year ended December 31, 2017.

Non-GAAP Financial Measures

In this report, we disclose funds from operations ("FFO") and NOI, which meet the definition of "non-GAAP financial measures" as set forth in Item 10(e) of Regulation S-K promulgated by the Securities and Exchange Commission ("SEC"). As a result, we are required to include in this report a statement of why management believes that presentation of these measures provides useful information to investors.

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Funds From Operations

FFO should not be considered as an alternative to net income (determined in accordance with GAAP) as an indication of our performance, and we believe that to understand our performance further, FFO should be compared with our reported net income (loss) in accordance with GAAP, as presented in our consolidated financial statements included in this report.

We calculate FFO in accordance with the standards established by the National Association of Real Estate Investment Trusts (“NAREIT”). FFO represents GAAP net income (loss), excluding gains (or losses) from sales of depreciable operating buildings, impairment write-downs of depreciable real estate, real estate related depreciation and amortization (excluding amortization of deferred financing costs and fair market value of debt adjustment) and after adjustments for unconsolidated partnerships and joint ventures.

Management uses FFO as a supplemental performance measure because it is a widely recognized measure of the performance of REITs. FFO may be used by investors as a basis to compare our operating performance with that of other REITs.

However, because FFO excludes depreciation and amortization and captures neither the changes in the value of our buildings that result from use or market conditions nor the level of capital expenditures and leasing commissions necessary to maintain the operating performance of our buildings, all of which have real economic effects and could materially impact our results from operations, the utility of FFO as a measure of our performance is limited. In addition, other REITs may not calculate FFO in accordance with the NAREIT definition, and, accordingly, our FFO may not be comparable to such other REITs’ FFO. FFO should not be used as a measure of our liquidity, and is not indicative of funds available for our cash needs, including our ability to pay dividends.

The following table sets forth a reconciliation of our FFO attributable to common stockholders and unit holders for the periods presented to net income, the nearest GAAP equivalent.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| Reconciliation of Net Income to FFO (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Net income | $8,876 | $21,839 | $48,989 | $23,276 |
| Rental property depreciation and amortization | 44,281 | 38,114 | 124,999 | 110,069 |
| Loss on impairments | — | — | 2,934 | — |
| Gain on the sales of rental property, net | (3,239) | (17,563) | (32,276) | (19,225) |
| FFO | 49,918 | 42,390 | 144,646 | 114,120 |
| Preferred stock dividends | (1,289) | (2,449) | (6,315) | (7,345) |
| Redemption of preferred stock | — | — | (2,661) | — |
| FFO attributable to common stockholders and unit holders | $48,629 | $39,941 | $135,670 | $106,775 |

Net Operating Income

We consider NOI to be an appropriate supplemental performance measure to net income (loss) because we believe it helps investors and management understand the core operations of our buildings. NOI is defined as rental revenue, including reimbursements and other income, less property expenses and real estate taxes and insurance. NOI should not be viewed as an alternative measure of our financial performance since it excludes expenses which could materially impact our results of operations. Further, our NOI may not be comparable to that of other real estate companies, as they may use different methodologies for calculating NOI.

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The following table sets forth a reconciliation of our NOI for the periods presented to net income, the nearest GAAP equivalent.

| Reconciliation of Net Income to NOI (in thousands) | Three months ended September 30, 2018 | Three months ended September 30, 2017 | Nine months ended September 30, 2018 | Nine months ended September 30, 2017 |
|---|---|---|---|---|
| Net income | $8,876 | $21,839 | $48,989 | $23,276 |
| Asset management fee income | — | (9) | — | (52) |
| General and administrative | 8,911 | 8,380 | 25,637 | 25,090 |
| Property acquisition costs | 94 | 1,386 | 170 | 4,684 |
| Depreciation and amortization | 44,355 | 38,186 | 125,221 | 110,286 |
| Interest and other income | (3) | (2) | (16) | (10) |
| Interest expense | 12,698 | 10,446 | 35,602 | 31,557 |
| Loss on impairments | — | — | 2,934 | — |
| Loss on involuntary conversion | — | — | — | 330 |
| Loss on extinguishment of debt | 13 | 13 | 13 | 15 |
| Other expenses | 129 | 260 | 694 | 813 |
| (Gain) loss on incentive fee | — | (202) | — | 689 |
| Gain on the sales of rental property, net | (3,239) | (17,563) | (32,276) | (19,225) |
| Net operating income | $71,834 | $62,734 | $206,968 | $177,453 |

Cash Flows

Comparison of the nine months ended September 30, 2018 to the nine months ended September 30, 2017

The following table summarizes our cash flows for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

| Cash Flows (dollars in thousands) | Nine months ended September 30, 2018 | Nine months ended September 30, 2017 | Change $ | Change % |
|---|---|---|---|---|
| Net cash provided by operating activities | $148,610 | $120,034 | $28,576 | 23.8 % |
| Net cash used in investing activities | $393,250 | $468,294 | $(75,044) | (16.0)% |
| Net cash provided by financing activities | $227,766 | $341,042 | $(113,276) | (33.2)% |

Net cash provided by operating activities increased $28.6 million to $148.6 million for the nine months ended September 30, 2018 compared to $120.0 million for the nine months ended September 30, 2017. The increase was primarily attributable to incremental operating cash flows from property acquisitions completed after December 31, 2016, and operating performance at existing properties. These increases were partially offset by the loss of cash flows from property dispositions completed after December 31, 2016 and fluctuations in working capital due to timing of payments and rental receipts.

Net cash used in investing activities decreased $75.0 million to $393.3 million for the nine months ended September 30, 2018 compared to $468.3 million for the nine months ended September 30, 2017. The decreased cash outflow was primarily due to the acquisition of 36 buildings for a total cash consideration of approximately $458.4 million for the nine months ended September 30, 2018 compared to the acquisition of 42 buildings for a total cash consideration of approximately $485.8 million for the nine months ended September 30, 2017. The decrease is also attributable to the sale of 11 buildings during the nine months ended September 30, 2018 for net proceeds of approximately $89.4 million, compared to the nine months ended September 30, 2017 where we sold nine buildings for net proceeds of approximately $43.5 million.

Net cash provided by financing activities decreased $113.3 million to $227.8 million for the nine months ended September 30, 2018 compared to $341.0 million for the nine months ended September 30, 2017. The decrease was primarily due to an increase in net cash outflow on our unsecured credit facility of approximately $393.0 million and a decrease in proceeds from sales of common stock of approximately $63.2 million, as well as an approximately $13.5 million increase in dividends paid during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 and the redemption of the 6.625% Series B Cumulative Redeemable Preferred Stock ("Series B Preferred Stock") of $70.0 million on July 11, 2018. These increases in net cash outflow were partially offset by the $150.0 million draw on the unsecured term loan that was entered into on July 28, 2017, the funding of the unsecured notes that were entered into on April 10, 2018 of $175.0 million, as well as a decrease in the repayment of mortgage notes of approximately $103.6 million during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

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Liquidity and Capital Resources

We believe that our liquidity needs will be satisfied through cash flows generated by operations, disposition proceeds, and financing activities. Operating cash flow is primarily rental income, expense recoveries from tenants, and other income from operations and is our principal source of funds that we use to pay operating expenses, debt service, recurring capital expenditures and the distributions required to maintain our REIT qualification. We look to the capital markets (common equity, preferred equity, and debt) to primarily fund our acquisition activity. We seek to increase cash flows from our properties by maintaining quality standards for our buildings that promote high occupancy rates and permit increases in rental rates while reducing tenant turnover and controlling operating expenses. We believe that our revenue, together with proceeds from building sales and debt and equity financings, will continue to provide funds for our short-term and medium-term liquidity needs.

Our short-term liquidity requirements consist primarily of funds to pay for operating expenses and other expenditures directly associated with our buildings, including interest expense, interest rate swap payments, scheduled principal payments on outstanding indebtedness, funding of property acquisitions under contract, general and administrative expenses, and capital expenditures for tenant improvements and leasing commissions.

Our long-term liquidity needs, in addition to recurring short-term liquidity needs as discussed above, consist primarily of funds necessary to pay for acquisitions, non-recurring capital expenditures, and scheduled debt maturities. We intend to satisfy our long-term liquidity needs through cash flow from operations, the issuance of equity or debt securities, other borrowings, property dispositions, or, in connection with acquisitions of certain additional buildings, the issuance of common units in the Operating Partnership.

As of September 30, 2018, we had total immediate liquidity of approximately $580.4 million, comprised of $6.0 million of cash and cash equivalents and $574.4 million of immediate availability on our unsecured credit facility and unsecured term loans.

In addition, we require funds for future dividends to be paid to our common and preferred stockholders and common unit holders in our Operating Partnership. The table below sets forth the dividends attributable to our outstanding common stock that had a record date during the nine months ended September 30, 2018. These distributions on our common stock are voluntary (at the discretion of our board of directors), to the extent we have satisfied distribution requirements in order to maintain our REIT status for federal income tax purposes, and may be reduced or stopped if needed to fund other liquidity requirements or for other reasons.

| Month Ended 2018 | Declaration Date | Record Date | Per Share | Payment Date |
|---|---|---|---|---|
| September 30 | July 11, 2018 | September 28, 2018 | $0.118333 | October 15, 2018 |
| August 31 | July 11, 2018 | August 31, 2018 | 0.118333 | September 17, 2018 |
| July 31 | July 11, 2018 | July 31, 2018 | 0.118333 | August 15, 2018 |
| June 30 | April 10, 2018 | June 29, 2018 | 0.118333 | July 16, 2018 |
| May 31 | April 10, 2018 | May 31, 2018 | 0.118333 | June 15, 2018 |
| April 30 | April 10, 2018 | April 30, 2018 | 0.118333 | May 15, 2018 |
| March 31 | November 2, 2017 | March 29, 2018 | 0.118333 | April 16, 2018 |
| February 28 | November 2, 2017 | February 28, 2018 | 0.118333 | March 15, 2018 |
| January 31 | November 2, 2017 | January 31, 2018 | 0.118333 | February 15, 2018 |
| Total | | | $1.064997 | |

On October 10, 2018, our board of directors declared the common stock dividends for the months ending October 31, 2018, November 30, 2018 and December 31, 2018 at a monthly rate of $0.118333 per share of common stock.

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During the nine months ended September 30, 2018, we paid quarterly cumulative dividends on the Series B Preferred Stock and the 6.875% Series C Cumulative Redeemable Preferred Stock ("Series C Preferred Stock," and together with Series B Preferred Stock, the "Preferred Stock Issuances") at a rate equivalent to the fixed annual rate of $1.65625 and $1.71875 per share, respectively. The table below sets forth the dividends on the Preferred Stock Issuances during the nine months ended September 30, 2018.

| Quarter Ended 2018 | Declaration Date | Series B Preferred Stock Per Share | | Series C Preferred Stock Per Share | Payment Date |
|---|---|---|---|---|---|
| September 30 | July 11, 2018 | $ 0.0460069 | (1) | $ 0.4296875 | October 1, 2018 |
| June 30 | April 10, 2018 | 0.4140625 | | 0.4296875 | July 2, 2018 |
| March 31 | February 14, 2018 | 0.4140625 | | 0.4296875 | April 2, 2018 |
| Total | | $ 0.8741319 | | $ 1.2890625 | |

(1) On June 11, 2018, we gave notice to redeem all 2,800,000 issued and outstanding shares of the Series B Preferred Stock. On July 11, 2018, we redeemed all of the Series B Preferred Stock at a cash redemption price of $25.00 per share, plus accrued and unpaid dividends to but excluding the redemption date, without interest.

On October 10, 2018, our board of directors declared the Series C Preferred Stock dividends for the quarter ending December 31, 2018 at a quarterly rate of $0.4296875 per share.

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Indebtedness Outstanding

The following table sets forth certain information with respect to our indebtedness outstanding as of September 30, 2018.

| Loan | Principal Outstanding (in thousands) | Interest Rate (1) | | Maturity Date | Prepayment Terms (2) |
|---|---|---|---|---|---|
| Unsecured credit facility: | | | | | |
| Unsecured Credit Facility (3) | $95,000 | L + 1.05% | | Jan-15-2023 | i |
| Total unsecured credit facility | 95,000 | | | | |
| Unsecured term loans: | | | | | |
| Unsecured Term Loan C | 150,000 | L + 1.30% | | Sep-29-2020 | i |
| Unsecured Term Loan B | 150,000 | L + 1.30% | | Mar-21-2021 | i |
| Unsecured Term Loan A | 150,000 | L + 1.30% | | Mar-31-2022 | i |
| Unsecured Term Loan D | 150,000 | L + 1.30% | | Jan-04-2023 | i |
| Unsecured Term Loan E (4) | — | L + 1.20% | | Jan-15-2024 | i |
| Total unsecured term loans | 600,000 | | | | |
| Less: Total unamortized deferred financing fees and debt issuance costs | (3,915) | | | | |
| Total carrying value unsecured term loans, net | 596,085 | | | | |
| Unsecured notes: | | | | | |
| Series F Unsecured Notes | 100,000 | 3.98 | % | Jan-05-2023 | ii |
| Series A Unsecured Notes | 50,000 | 4.98 | % | Oct-1-2024 | ii |
| Series D Unsecured Notes | 100,000 | 4.32 | % | Feb-20-2025 | ii |
| Series G Unsecured Notes | 75,000 | 4.10 | % | Jun-13-2025 | ii |
| Series B Unsecured Notes | 50,000 | 4.98 | % | Jul-1-2026 | ii |
| Series C Unsecured Notes | 80,000 | 4.42 | % | Dec-30-2026 | ii |
| Series E Unsecured Notes | 20,000 | 4.42 | % | Feb-20-2027 | ii |
| Series H Unsecured Notes | 100,000 | 4.27 | % | Jun-13-2028 | ii |
| Total unsecured notes | 575,000 | | | | |
| Less: Total unamortized deferred financing fees and debt issuance costs | (2,611) | | | | |
| Total carrying value unsecured notes, net | 572,389 | | | | |
| Mortgage notes (secured debt): | | | | | |
| Wells Fargo Bank, National Association CMBS Loan | 53,652 | 4.31 | % | Dec-1-2022 | iii |
| Thrivent Financial for Lutherans | 3,824 | 4.78 | % | Dec-15-2023 | iv |
| Total mortgage notes | 57,476 | | | | |
| Add: Total unamortized fair market value premiums | 52 | | | | |

| | | | |
|---|---|---|---|
| Less: Total unamortized deferred financing fees and debt issuance costs | (535 | ) | |
| Total carrying value mortgage notes, net | 56,993 | | |
| Total / weighted average interest rate (5) | $ 1,320,467 | 3.69 | % |

(1) Interest rate as of September 30, 2018. At September 30, 2018, the one-month LIBOR ("L") was 2.26056%. The interest rate is not adjusted to include the amortization of deferred financing fees or debt issuance costs incurred in obtaining debt or any unamortized fair market value premiums. The spread over the applicable rate for our unsecured credit facility and unsecured term loans is based on our consolidated leverage ratio, as defined in the respective loan agreements.

(2) Prepayment terms consist of (i) pre-payable with no penalty; (ii) pre-payable with penalty; (iii) pre-payable without penalty three months prior to the maturity date, however can be defeased beginning January 1, 2016; and (iv) pre-payable without penalty three months prior to the maturity date.

(3) The capacity of the unsecured credit facility is $500.0 million.

(4) Capacity of $175.0 million, which we have until July 25, 2019 to draw.

(5) The weighted average interest rate was calculated using the fixed interest rate swapped on the notional amount of $600.0 million of debt that was in effect as of September 30, 2018, and is not adjusted to include the amortization of deferred financing fees or debt issuance costs incurred in obtaining debt or any unamortized fair market value premiums.

The aggregate undrawn nominal commitments on the unsecured credit facility and unsecured term loans as of September 30, 2018 was approximately $574.4 million, including issued letters of credit. Our actual borrowing capacity at any given point in time may be less and is restricted to a maximum amount based on our debt covenant compliance.

Our unsecured credit facility, unsecured term loans, unsecured notes, and mortgage notes are subject to ongoing compliance with a number of financial and other covenants. As of September 30, 2018, we were in compliance with the applicable financial covenants.

On July 26, 2018, we closed on the refinancing of the unsecured credit facility. The refinancing transaction included extending the maturity date to January 15, 2023, increasing the capacity to $500.0 million, and reducing the annual interest rate. As of September 30, 2018, the interest rate on the unsecured credit facility was LIBOR plus a spread of 1.05% based on the Company's consolidated leverage ratio, as defined in the credit agreement.

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On July 26, 2018, we entered into a $175.0 million unsecured term loan agreement. As of September 30, 2018, the interest rate on the new term loan was LIBOR plus a spread of 1.20% based on the Company's consolidated leverage ratio, as defined in the loan agreement. On July 24, 2018, we entered into four interest rate swaps with a total notional amount of $175.0 million to fix LIBOR at 2.9187% on the new unsecured term loan. The interest rate swaps will become effective on July 26, 2019 and expire on January 12, 2024.

On July 26, 2018, we entered into amendments to our unsecured term loan agreements to conform certain provisions to the new unsecured term loan agreement and the new unsecured credit facility agreement.

On April 10, 2018, we entered into a note purchase agreement for the private placement by the Operating Partnership of $75.0 million senior unsecured notes (“Series G Unsecured Notes”) maturing June 13, 2025 with a fixed annual interest rate of 4.10%, and $100.0 million senior unsecured notes (“Series H Unsecured Notes”) maturing June 13, 2028 with a fixed annual interest rate of 4.27%. We issued the Series G Unsecured Notes and the Series H Unsecured Notes on June 13, 2018. In addition, on April 10, 2018, we entered into amendments to the note purchase agreements related to our outstanding unsecured notes to conform certain provisions in the agreements to the provisions in the new note purchase agreement.

On March 28, 2018, we drew $75.0 million of the $150.0 million unsecured term loan that was entered into on July 28, 2017. On July 27, 2018, we drew the remaining $75.0 million of the $150.0 million unsecured term loan.

The chart below details our debt capital structure as of September 30, 2018.

| Debt Capital Structure | September 30, 2018 | |
|---|---|---|
| Total principal outstanding (in thousands) | $1,327,476 | |
| Weighted average duration (years) | 4.9 | |
| % Secured debt | 4 | % |
| % Debt maturing next 12 months | — | % |
| Net Debt to Real Estate Cost Basis [(1)] | 39 | % |

(1) We define Net Debt as our amounts outstanding under our unsecured credit facility, unsecured term loans, unsecured notes, and mortgage notes, less cash and cash equivalents. We define Real Estate Cost Basis as the book value of rental property and deferred leasing intangibles, exclusive of the related accumulated depreciation and amortization.

We regularly pursue new financing opportunities to ensure an appropriate balance sheet position. As a result of these dedicated efforts, we are confident in our ability to meet future debt maturities and building acquisition funding needs. We believe that our current balance sheet is in an adequate position at the date of this filing, despite possible volatility in the credit markets.

Our interest rate exposure as it relates to interest expense payments on our floating rate debt is managed through our use of interest rate swaps, which fix the rate of our long term floating rate debt. For a detailed discussion on our use of interest rate swaps, see “Interest Rate Risk” below.

Equity

Preferred Stock

On June 11, 2018, we gave notice to redeem all 2,800,000 issued and outstanding shares of the Series B Preferred Stock. We recognized a deemed dividend to the holders of the Series B Preferred Stock of approximately $2.7 million on the accompanying Consolidated Statements of Operations for the nine months ended September 30, 2018 related to redemption costs and the original issuance costs of the Series B Preferred Stock. On July 11, 2018, we redeemed all of the Series B Preferred Stock.

The table below sets forth our outstanding preferred stock issuances as of September 30, 2018.

| Preferred Stock Issuances | Issuance Date | Number of Shares | Liquidation Value Per Share | Interest Rate |
|---|---|---|---|---|
| Series C Preferred Stock | March 17, 2016 | 3,000,000 | $ 25.00 | 6.875% |

The Series C Preferred Stock ranks senior to our common stock with respect to dividend rights and rights upon the liquidation, dissolution or winding up of our affairs. The Series C Preferred Stock has no stated maturity date and is not subject to mandatory redemption or any sinking fund. Generally, we are not permitted to redeem the Series C Preferred Stock prior to March 17, 2021, except in limited circumstances relating to our ability to qualify as a REIT and in certain other circumstances related to a change of control.

Common Stock

The following sets forth our at-the-market ("ATM") common stock offering program as of September 30, 2018. We may from time to time sell common stock through sales agents under the program.

| ATM Common Stock Offering Program | Date | Maximum Aggregate Offering Price (in thousands) | Aggregate Common Stock Available as of September 30, 2018 (in thousands) |
|---|---|---|---|
| 2017 $500 million ATM | November 13, 2017 | $ 500,000 | $ 213,217 |

The table below set forth the activity for the ATM common stock offering programs during the three and nine months ended September 30, 2018 (in thousands, except share data).

| | Three months ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| ATM Common Stock Offering Program | Shares Sold | Weighted Average Price Per Share | Gross Proceeds | Sales Agents' Fee | Net Proceeds |
| 2017 $500 million ATM | 3,568,382 | $ 27.94 | $ 99,695 | $ 1,129 | $ 98,566 |
| Total/weighted average | 3,568,382 | $ 27.94 | $ 99,695 | $ 1,129 | $ 98,566 |

| | Nine months ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| ATM Common Stock Offering Program | Shares Sold | Weighted Average Price Per Share | Gross Proceeds | Sales Agents' Fee | Net Proceeds |
| 2017 $500 million ATM | 10,387,962 | $ 26.61 | $ 276,457 | $ 2,888 | $ 273,569 |
| Total/weighted average | 10,387,962 | $ 26.61 | $ 276,457 | $ 2,888 | $ 273,569 |

Noncontrolling Interest

We own our interests in all of our properties and conduct substantially all of our business through our Operating Partnership. We are the sole member of the sole general partner of the Operating Partnership. As of September 30, 2018, we owned approximately 96.4% of the common units of our Operating Partnership, and our current and former executive officers, directors, senior employees and their affiliates, and third parties who contributed properties to us in exchange for common units in our Operating Partnership, owned the remaining 3.6%.

Interest Rate Risk

We use interest rate swaps to fix the rate of our variable rate debt. As of September 30, 2018, all of our outstanding variable rate debt, with the exception of our unsecured credit facility, was fixed with interest rate swaps.

We recognize all derivatives on the balance sheet at fair value. If the derivative is designated as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income (loss), which is a component of equity. Derivatives that are not designated as hedges must be adjusted to fair value and the changes in fair value must be reflected as income or expense.

We have established criteria for suitable counterparties in relation to various specific types of risk. We only use counterparties that have a credit rating of no lower than investment grade at swap inception from Moody's Investor Services, Standard & Poor's, or Fitch Ratings or other nationally recognized rating agencies.

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The following table details our outstanding interest rate swaps as of September 30, 2018.

| Interest Rate Derivative Counterparty | Trade Date | Effective Date | Notional Amount (in thousands) | Fair Value (in thousands) | Pay Fixed Interest Rate | Receive Variable Interest Rate | Maturity Date |
|---|---|---|---|---|---|---|---|
| Regions Bank | Mar-01-2013 | Mar-01-2013 | $ 25,000 | $ 471 | 1.3300 % | One-month L | Feb-14-2020 |
| Capital One, N.A. | Jun-13-2013 | Jul-01-2013 | $ 50,000 | $ 703 | 1.6810 % | One-month L | Feb-14-2020 |
| Capital One, N.A. | Jun-13-2013 | Aug-01-2013 | $ 25,000 | $ 344 | 1.7030 % | One-month L | Feb-14-2020 |
| Regions Bank | Sep-30-2013 | Feb-03-2014 | $ 25,000 | $ 245 | 1.9925 % | One-month L | Feb-14-2020 |
| The Toronto-Dominion Bank | Oct-14-2015 | Sep-29-2016 | $ 25,000 | $ 700 | 1.3830 % | One-month L | Sep-29-2020 |
| PNC Bank, N.A. | Oct-14-2015 | Sep-29-2016 | $ 50,000 | $ 1,391 | 1.3906 % | One-month L | Sep-29-2020 |
| Regions Bank | Oct-14-2015 | Sep-29-2016 | $ 35,000 | $ 978 | 1.3858 % | One-month L | Sep-29-2020 |
| U.S. Bank, N.A. | Oct-14-2015 | Sep-29-2016 | $ 25,000 | $ 695 | 1.3950 % | One-month L | Sep-29-2020 |
| Capital One, N.A. | Oct-14-2015 | Sep-29-2016 | $ 15,000 | $ 417 | 1.3950 % | One-month L | Sep-29-2020 |
| Royal Bank of Canada | Jan-08-2015 | Mar-20-2015 | $ 25,000 | $ 684 | 1.7090 % | One-month L | Mar-21-2021 |
| The Toronto-Dominion Bank | Jan-08-2015 | Mar-20-2015 | $ 25,000 | $ 682 | 1.7105 % | One-month L | Mar-21-2021 |
| The Toronto-Dominion Bank | Jan-08-2015 | Sep-10-2017 | $ 100,000 | $ 1,488 | 2.2255 % | One-month L | Mar-21-2021 |
| Wells Fargo, N.A. | Jan-08-2015 | Mar-20-2015 | $ 25,000 | $ 886 | 1.8280 % | One-month L | Mar-31-2022 |
| The Toronto-Dominion Bank | Jan-08-2015 | Feb-14-2020 | $ 25,000 | $ 271 | 2.4535 % | One-month L | Mar-31-2022 |
| Regions Bank | Jan-08-2015 | Feb-14-2020 | $ 50,000 | $ 520 | 2.4750 % | One-month L | Mar-31-2022 |
| Capital One, N.A. | Jan-08-2015 | Feb-14-2020 | $ 50,000 | $ 467 | 2.5300 % | One-month L | Mar-31-2022 |
| The Toronto-Dominion Bank | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,054 | 1.8485 % | One-month L | Jan-04-2023 |
| Royal Bank of Canada | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,054 | 1.8505 % | One-month L | Jan-04-2023 |
| Wells Fargo, N.A. | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,055 | 1.8505 % | One-month L | Jan-04-2023 |
| PNC Bank, N.A. | Jul-20-2017 | Oct-30-2017 | $ 25,000 | $ 1,052 | 1.8485 % | One-month L | Jan-04-2023 |
| PNC Bank, N.A. | Jul-20-2017 | Oct-30-2017 | $ 50,000 | $ 2,105 | 1.8475 % | One-month L | Jan-04-2023 |
| The Toronto-Dominion Bank | Jul-24-2018 | Jul-26-2019 | $ 50,000 | $ 111 | 2.9180 % | One-month L | Jan-12-2024 |
| PNC Bank, N.A. | Jul-24-2018 | Jul-26-2019 | $ 50,000 | $ 106 | 2.9190 % | One-month L | Jan-12-2024 |
| Bank of Montreal | Jul-24-2018 | Jul-26-2019 | $ 50,000 | $ 113 | 2.9190 % | One-month L | Jan-12-2024 |
| U.S. Bank, N.A. | Jul-24-2018 | Jul-26-2019 | $ 25,000 | $ 57 | 2.9190 % | One-month L | Jan-12-2024 |

The swaps outlined in the above table were all designated as cash flow hedges of interest rate risk, and all are valued as Level 2 financial instruments. Level 2 financial instruments are defined as significant other observable inputs. As of September 30, 2018, the fair value of all of our 25 interest rate swaps were in an asset position of approximately $17.6 million, including any adjustment for nonperformance risk related to these agreements.

As of September 30, 2018, we had $695.0 million of variable rate debt. As of September 30, 2018, all of our outstanding variable rate debt, with the exception of our unsecured credit facility, was fixed with interest rate swaps. To the extent interest rates increase, interest costs on our floating rate debt not fixed with interest rate swaps will increase, which could adversely affect our cash flow and our ability to pay principal and interest on our debt and our ability to make distributions to our security holders. From time to time, we may enter into interest rate swap agreements and other interest rate hedging contracts, including swaps, caps and floors. In addition, an increase in interest rates could decrease the amounts third parties are willing to pay for our assets, thereby limiting our ability to change our portfolio promptly in response to changes in economic or other conditions.

Off-balance Sheet Arrangements

As of September 30, 2018, we had letters of credit related to development projects and certain other agreements of approximately $5.6 million. As of September 30, 2018, we had no other material off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. The primary market risk we are exposed to is interest rate risk. We have used derivative financial instruments to manage, or hedge, interest rate risks related to our borrowings, primarily through interest rate swaps.

As of September 30, 2018, we had $695.0 million of variable rate debt outstanding. As of September 30, 2018, all of our outstanding variable rate debt, with the exception of $95.0 million outstanding under our unsecured credit facility, was fixed with interest rate swaps. To the extent we undertake additional variable rate indebtedness, if interest rates increase, then so will the interest costs on our unhedged variable rate debt, which could adversely affect our cash flow and our ability to pay principal and interest on our debt and our ability to make distributions to our security holders. Further, rising interest rates could limit our ability to refinance

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existing debt when it matures or significantly increase our future interest expense. From time to time, we enter into interest rate swap agreements and other interest rate hedging contracts, including swaps, caps and floors. While these agreements are intended to lessen the impact of rising interest rates on us, they also expose us to the risk that the other parties to the agreements will not perform, we could incur significant costs associated with the settlement of the agreements, the agreements will be unenforceable and the underlying transactions will fail to qualify as highly-effective cash flow hedges under GAAP. In addition, an increase in interest rates could decrease the amounts third parties are willing to pay for our assets, thereby limiting our ability to change our portfolio promptly in response to changes in economic or other conditions. If interest rates increased by 100 basis points and assuming we had an outstanding balance of $95.0 million on our unsecured credit facility (the portion outstanding at September 30, 2018 not fixed by interest rate swaps) for the nine months ended September 30, 2018, our interest expense would have increased by approximately $0.7 million for the nine months ended September 30, 2018.

## Item 4. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

As required by SEC Rule 13a-15(b), we have evaluated, under the supervision of and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act, as of September 30, 2018. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures for the periods covered by this report were effective to provide reasonable assurance that information required to be disclosed by our Company in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### Changes in Internal Controls

There was no change to our internal control over financial reporting during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. Other Information

### Item 1. Legal Proceedings
From time to time, we are a party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. We are not currently a party, as plaintiff or defendant, to any legal proceedings which, individually or in the aggregate, would be expected to have a material effect on our business, financial condition or results of operations if determined adversely to our company.

### Item 1A. Risk Factors
There have been no material changes from the risk factors disclosed in the Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 15, 2018.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures
Not applicable.

### Item 5. Other Information

None.

Item 6. Exhibits

| Exhibit Number | Description of Document |
|---|---|
| 10.1 | Credit Agreement, dated as of July 26, 2018, by and among STAG Industrial Operating Partnership, L.P., as Borrower, STAG Industrial, Inc., as a Guarantor, Wells Fargo Bank, National Association, as Administrative Agent, and the other lenders party thereto (1) |
| 10.2 | Term Loan Agreement, dated as of July 26, 2018, by and among STAG Industrial Operating Partnership, L.P., as Borrower, STAG Industrial, Inc., as a Guarantor, Wells Fargo Bank, National Association, as Administrative Agent, and the other lenders party thereto (1) |
| 10.3 | Second Amendment to Amended and Restated Term Loan Agreement, dated as of July 26, 2018, by and among STAG Industrial Operating Partnership, L.P., as Borrower, STAG Industrial, Inc., as a Guarantor, Wells Fargo Bank, National Association, as Administrative Agent, and the other lenders party thereto (1) |
| 10.4 | Second Amendment to Second Amended and Restated Term Loan Agreement, dated as of July 26, 2018, by and among STAG Industrial Operating Partnership, L.P., as Borrower, STAG Industrial, Inc., as a Guarantor, Wells Fargo Bank, National Association, as Administrative Agent, and the other lenders party thereto (1) |
| 10.5 | Third Amendment to Term Loan Agreement, dated as of July 26, 2018, by and among STAG Industrial Operating Partnership, L.P., as Borrower, STAG Industrial, Inc., as a Guarantor, Wells Fargo Bank, National Association, as Administrative Agent, and the other lenders party thereto (1) |
| 10.6 | First Amendment to Term Loan Agreement, dated as of July 26, 2018, by and among STAG Industrial Operating Partnership, L.P., as Borrower, STAG Industrial, Inc., as a Guarantor, Bank of America, N.A., as Administrative Agent, and the other lenders party thereto (1) |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101 * | The following materials from STAG Industrial, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Equity, (v) the Consolidated Statements of Cash Flows, and (vi) related notes to Consolidated Financial Statements |

* Filed herewith.

(1) Incorporated by reference to STAG Industrial, Inc.'s Current Report on Form 8-K filed with the SEC on July 31, 2018.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | | |
|---|---|---|
| | | STAG INDUSTRIAL, INC. |
| Date: November 1, 2018 | BY: | /s/ WILLIAM R. CROOKER |
| | | William R. Crooker<br>Chief Financial Officer, Executive Vice President and Treasurer (Principal Financial Officer and Principal Accounting Officer) |