STAG Industrial, Inc.
Form 10-Q
November 08, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2012

OR

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

For the transition period from to .

Commission file number 1-34907

STAG INDUSTRIAL, INC.

(Exact name of registrant as specified in its charter)

Maryland	**27-3099608**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
99 High Street, 28th Floor Boston, Massachusetts	**02110**
(Address of principal executive offices)	(Zip Code)

(617) 574-4777

(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. Check one:

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common and preferred shares as of the latest practicable date.

Class	Outstanding at November 7, 2012
Common Stock ($0.01 par value)	34,873,975
9.0 % Series A Cumulative Redeemable Preferred Stock ($0.01 par value)	2,760,000

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Part I. Financial Information

Item 1. Financial Statements

STAG Industrial, Inc.

Consolidated Balance Sheets

(unaudited, in thousands, except share data)

	September 30, 2012	December 31, 2011
Assets		
Rental Property:		
Land	$ 90,337	$ 70,870
Buildings	517,030	394,822
Tenant improvements	31,586	25,056
Building and land improvements	16,836	11,510
Less: accumulated depreciation	(41,881)	(30,004)
Total rental property, net	613,908	472,254
Cash and cash equivalents	10,684	16,498
Restricted cash	5,768	6,611
Tenant accounts receivable, net	7,100	5,592
Prepaid expenses and other assets	5,706	1,355
Deferred financing fees, net	3,646	2,634
Leasing commissions, net	1,335	954
Goodwill	4,923	4,923
Due from related parties	375	400
Deferred leasing intangibles, net	150,466	113,293
Total assets	**$ 803,911**	**$ 624,514**
Liabilities and Stockholders Equity		
Liabilities:		
Mortgage notes payable	$ 161,894	$ 296,779
Credit facility		
Unsecured credit facility	12,000	
Unsecured term loan	100,000	
Accounts payable, accrued expenses and other liabilities	8,179	6,044
Interest rate swaps	577	215
Tenant prepaid rent and security deposits	3,970	3,478
Dividends and distributions payable	12,772	6,160
Deferred leasing intangibles, net	5,513	1,929
Total liabilities	**$ 304,905**	**$ 314,605**
Commitments and contingencies		
Stockholders Equity:		
Preferred stock, par value $0.01 per share, 10,000,000 shares authorized, 2,760,000 shares (liquidation preference of $25.00 per share) issued and outstanding at September 30, 2012 and December 31, 2011	69,000	69,000
Common stock $0.01 par value, 100,000,000 shares authorized, 34,871,099 and 15,901,560 shares outstanding at September 30, 2012 and December 31, 2011, respectively	349	159
Additional paid-in capital	408,834	179,919
Common stock dividends in excess of earnings	(47,916)	(18,385)
Accumulated other comprehensive loss	(427)	

Total stockholders equity		429,840		230,693
Noncontrolling interest		69,166		79,216
Total equity		499,006		309,909
Total liabilities and equity	**$**	**803,911**	**$**	**624,514**

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

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STAG Industrial, Inc. and STAG Predecessor Group

Consolidated and Combined Statements of Operations

(unaudited, in thousands, except per share data)

	STAG Industrial, Inc. Three months Ended September 30, 2012	STAG Industrial, Inc. Three months Ended September 30, 2011	STAG Industrial, Inc. Nine months Ended September 30, 2012	STAG Industrial, Inc. Period from April 20 to September 30, 2011	STAG Predecessor Group Period from January 1 to April 19, 2011
Revenue					
Rental income	$ 19,261	$ 13,394	$ 52,448	$ 23,018	$ 6,866
Tenant recoveries	2,135	1,438	6,283	2,511	1,218
Other income	331	321	982	588	
Total revenue	21,727	15,153	59,713	26,117	8,084
Expenses					
Property	1,345	1,315	4,439	2,110	1,193
General and administrative	3,656	2,453	9,962	4,513	322
Real estate taxes and insurance	1,677	1,284	4,816	2,184	879
Asset management fees					170
Property acquisition costs	1,067	368	2,509	695	
Depreciation and amortization	10,354	7,765	28,465	14,157	2,405
Loss on impairment	3,941		4,563		
Other expenses	87		146		
Total expenses	22,127	13,185	54,900	23,659	4,969
Other income (expense)					
Interest income	9	6	17	15	1
Interest expense	(3,578)	(4,330)	(11,888)	(7,446)	(3,954)
Gain on interest rate swaps		770	215	1,270	762
Formation transaction costs		(61)		(3,789)	
Offering costs		(78)	(68)	(78)	
Loss on extinguishment of debt	(947)		(929)		
Total other income (expense)	(4,516)	(3,693)	(12,653)	(10,028)	(3,191)
Net loss from continuing operations	$ (4,916)	$ (1,725)	$ (7,840)	$ (7,570)	$ (76)
Discontinued operations					
Income (loss) attributable to discontinued operations		1,153	(184)	1,099	(153)
Gain on sale of real estate			219		
Total income (loss) attributable to discontinued operations		1,153	35	1,099	(153)
Net loss	$ (4,916)	$ (572)	$ (7,805)	$ (6,471)	$ (229)
Less: loss attributable to noncontrolling interest	(1,248)	(188)	(3,244)	(2,155)	
Net loss attributable to STAG Industrial, Inc.	**$ (3,668)**	**$ (384)**	**$ (4,561)**	**$ (4,316)**	
Less: preferred stock dividends	1,553		4,659		
	41		81		

Less: amount allocated to unvested restricted stockholders								
Net loss attributable to common stockholders	**$**	**(5,262)**	**$**	**(384)**	**$**	**(9,301)**	**$**	**(4,316)**
Weighted average common shares outstanding basic and diluted		29,752,057		15,815,282		21,716,590		15,524,807
Income (loss) per share basic and diluted								
Loss from continuing operations attributable to common stockholders	$	(0.18)	$	(0.07)	$	(0.43)	$	(0.33)
Income from discontinued operations attributable to common stockholders	$		$	0.05	$	0.00	$	0.05
Loss per share basic and diluted	$	(0.18)	$	(0.02)	$	(0.43)	$	(0.28)
Dividends declared per common share	**$**	**0.27**	**$**	**0.26**	**$**	**0.80**	**$**	**0.4657**

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

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STAG Industrial, Inc. and STAG Predecessor Group

Consolidated Statements of Comprehensive Income

(unaudited, in thousands, except per share data)

	STAG Industrial, Inc. Three months Ended September 30, 2012	STAG Industrial, Inc. Three months Ended September 30, 2011	STAG Industrial, Inc. Nine months Ended September 30, 2012	STAG Industrial, Inc. Period from April 20 to September 30, 2011	STAG Predecessor Group Period from January 1 to April 19, 2011
Net loss	$ (4,916)	$ (572)	$ (7,805)	$ (6,471)	$ (229)
Other comprehensive loss:					
Unrealized loss on interest rate swaps	(577)		(577)		
Other comprehensive loss	(577)		(577)		
Comprehensive loss	(5,493)	(572)	(8,382)	(6,471)	(229)
Net loss attributable to noncontrolling interest	1,248	188	3,244	2,155	
Other comprehensive loss attributable to noncontrolling interest	111		150		
Comprehensive loss attributable to STAG Industrial, Inc.	$ (4,134)	$ (384)	$ (4,988)	$ (4,316)	

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

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STAG Industrial, Inc. and STAG Predecessor Group

Consolidated and Combined Statements of Stockholders Equity

(unaudited, in thousands, except share data)

	Preferred Stock	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Common Stock Dividends in Excess of Earnings	Predecessor Owner s Deficit	Accumulated Other Comprehensive Loss	Total Stockholder s Equity	Noncontrolling Interest Unit Holders in Operating Partnership	Total Equity
Nine months Ended September 30, 2012										
Balance, December 31, 2011	$ 69,000	15,901,560	$ 159	$ 179,919	$ (18,385)	$	$	**$ 230,693**	$ 79,216	**$ 309,909**
Proceeds from sale of common stock		17,537,500	176	237,392				**237,568**		**237,568**
Offering costs				(10,863)				**(10,863)**		**(10,863)**
Issuance of restricted stock		87,025	1	(1)						
Issuance of common stock, net		9,790								
Dividends and distributions, net	(4,659)				(20,311)			**(24,970)**	(5,938)	**(30,908)**
Stock-based compensation				746				**746**	711	**1,457**
Issuance of units for acquisition fee									225	**225**
Conversion of operating partnership units to common stock		1,335,224	13	13,148				**13,161**	(13,161)	
Rebalancing of noncontrolling interest				(11,507)				**(11,507)**	11,507	
Comprehensive loss							(427)	**(427)**	(150)	**(577)**
Net income (loss)	4,659				(9,220)			**(4,561)**	(3,244)	**(7,805)**
Balance, September 30, 2012	$ 69,000	34,871,099	$ 349	$ 408,834	$ (47,916)	$	$ (427)	**$ 429,840**	$ 69,166	**$ 499,006**
Period from January 1 to April 19, 2011 (STAG Predecessor Group)										
Balance, December 31, 2010	**$**		$	$	$	$ (8,336)	$	**$ (8,336)**	$	**$ (8,336)**
Contributions						4,420		**4,420**		**4,420**
Distributions						(9,900)		**(9,900)**		**(9,900)**
Net loss						(229)		**(229)**		**(229)**
Balance, April 19, 2011	**$**		**$**	**$**	**$**	$ (14,045)	$	**$ (14,045)**	$	**$ (14,045)**
Period from April 20 to September 30, 2011 (STAG Industrial, Inc.)										
Balance, April 20, 2011	$	110	$	$ 2	$	$ (14,045)	$	**$ (14,043)**	$	**$ (14,043)**
		15,812,500	158	205,405				**205,563**		**205,563**

Proceeds from sale of common stock									
Redemption of initial capitalization of STAG Industrial, Inc.	(110)		(2)				**(2)**		**(2)**
Issuance of units for acquisition of properties								95,670	**95,670**
Exchange of owners equity for units					14,045		**14,045**	(14,045)	
Offering costs			(17,042)				**(17,042)**		**(17,042)**
Issuance of restricted stock	80,809	1	(1)						
Issuance of common stock	3,281								
Dividends and distributions				(7,402)			**(7,402)**	(3,628)	**(11,030)**
Stock-based compensation			142				**142**	234	**376**
Rebalancing of noncontrolling interest			(7,140)				**(7,140)**	7,140	
Net loss				(4,316)			**(4,316)**	(2,155)	**(6,471)**
Balance, September 30, 2011	$ 15,896,590	$ 159	$ 181,364	$ (11,718)	$	$	**$ 169,805**	$ 83,216	**$ 253,021**

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

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STAG Industrial, Inc. and STAG Predecessor Group

Consolidated and Combined Statements of Cash Flows

(unaudited, in thousands)

	STAG Industrial, Inc. Nine months Ended September 30, 2012	STAG Industrial, Inc. Period from April 20 to September 30, 2011	STAG Predecessor Group Period from January 1 to April 19, 2011
Cash flows from operating activities:			
Net loss	**$ (7,805)**	**$ (6,471)**	**$ (229)**
Adjustment to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	28,486	14,778	2,459
Loss on impairment	4,563		
Non-cash portion of interest expense	755	538	31
Intangible amortization in rental income, net	3,481	1,714	(2)
Straight line adjustment, net	(1,733)	(821)	(16)
Gain on interest rate swaps	(215)	(1,270)	(762)
Loss on extinguishment of debt	929		
Gain on sale of real estate	(219)		
Stock-based compensation expense	1,457	376	
Issuance of units for acquisition fee	225		
Change in assets and liabilities:			
Tenant accounts receivable, net	(317)	(126)	88
Leasing commissions, net	(567)	(819)	(24)
Restricted cash	(943)	(551)	
Prepaid expenses and other assets	(716)	(56)	(87)
Accounts payable, accrued expenses and other liabilities	2,308	1,902	106
Tenant prepaid rent and security deposits	492	1,217	169
Due from related parties	25	55	767
Due to related parties		91	(141)
Total adjustments	38,011	17,028	2,588
Net cash provided by operating activities	**30,206**	**10,557**	**2,359**
Cash flows from investing activities:			
Additions of land and building improvements	(159,951)	(49,340)	(39)
Proceeds from sale of rental property, net	3,216		
Restricted cash	3,339	(1,834)	(542)
Cash paid for contributed assets, net		(425)	
Cash paid for deal deposits, net	(3,675)	(2,159)	
Additions to lease intangibles	(54,239)	(18,266)	
Net cash used in investing activities	**(211,310)**	**(72,024)**	**(581)**
Cash flows from financing activities:			
Proceeds from issuance of common stock at initial public offering		205,563	
Offering costs related to issuance of common stock		(17,042)	
Redemption of initial capitalization of STAG Industrial, Inc. shares		(2)	
Proceeds from notes payable to related parties			789
Repayment of notes payable to related parties		(10,366)	

Proceeds from credit facility	124,300	28,500	
Repayment of credit facility	(124,300)	(11,000)	
Proceeds from unsecured credit facility	12,000		
Proceeds from unsecured term loan	100,000		
Proceeds from mortgage notes payable	9,252	40,438	
Repayment of mortgage notes payable	(143,985)	(154,119)	(1,180)
Termination of swap contracts		(894)	
Payment of loan fees and costs	(2,833)	(3,029)	
Dividends and distributions	(24,296)	(4,871)	(2,679)
Proceeds from sale of common stock	237,568		
Offering costs	(10,863)		
Restricted cash - escrow for dividends	(1,553)		
Net cash provided by (used in) financing activities	**175,290**	**73,178**	**(3,070)**
Increase (decrease) in cash and cash equivalents	(5,814)	11,711	(1,292)
Cash and cash equivalents beginning of period	16,498	277	1,567
Cash and cash equivalents end of period	**$ 10,684**	**$ 11,988**	**$ 275**

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

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STAG Industrial, Inc. and STAG Predecessor Group

Notes to Consolidated and Combined Financial Statements

(unaudited)

1. Organization and Description of Business

STAG Industrial, Inc. (the Company) is a fully-integrated, self-administered and self-managed real estate company focused on the acquisition, ownership and management of single-tenant industrial properties throughout the United States. The Company was formed as a Maryland corporation on July 21, 2010 and has elected to be treated as a real estate investment trust (REIT) under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code). The Company is structured as an umbrella partnership REIT, commonly called an UPREIT, and owns substantially all of its assets and conducts substantially all of its business through its operating partnership, STAG Industrial Operating Partnership, L.P., a Delaware limited partnership (the Operating Partnership). As of September 30, 2012 and December 31, 2011, the Company owned an 83.92% and 67.12%, respectively, limited partnership interest in the Operating Partnership. As used herein, the Company refers to STAG Industrial, Inc. and its consolidated subsidiaries and partnerships except where context otherwise requires.

As of September 30, 2012, the Company owned 134 properties in 31 states with approximately 23.5 million rentable square feet, consisting of 82 warehouse/distribution properties, 32 manufacturing properties and 20 flex/office properties. The Company s properties were 96.3% leased to 116 tenants as of September 30, 2012.

The Company s predecessor for accounting purposes is STAG Predecessor Group (or Predecessor), which is not a legal entity, but a collection of the real estate entities that were owned by STAG Investments III, LLC prior to the Company s initial public offering in April 2011 (the IPO). Prior to the IPO, STAG Predecessor Group also was engaged in the business of owning, leasing and operating real estate consisting primarily of industrial properties located throughout the United States. The financial information contained in this report that relates to the time periods on or prior to April 19, 2011 is the Predecessor s financial information; the financial information contained in this report for any time period on or after April 20, 2011 is the Company s financial information. **The Company did not have any operating activity before April 20, 2011 and, as a result of the Company s IPO and related formation transactions, is substantially different from STAG Predecessor Group.**

2. Summary of Significant Accounting Policies

Interim Financial Information

The accompanying interim financial statements have been presented in conformity with accounting principles generally accepted in the United States of America (GAAP) and with the instructions to Form 10-Q of Regulation S-X for interim financial information. Accordingly, these statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying interim financial statements include all adjustments, consisting of normal recurring items, necessary for their fair presentation in conformity with GAAP. Interim results are not necessarily indicative of results for a full year. The year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company s financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

Basis of Presentation

The Company s consolidated financial statements include the accounts of the Company, the Operating Partnership and their subsidiaries. The equity interests of other limited partners in the Operating Partnership are reflected as noncontrolling interest. The combined financial statements of STAG Predecessor Group include the accounts of STAG Predecessor Group and all entities in which STAG Predecessor Group had a controlling interest. All significant intercompany balances and transactions have been eliminated in the combination of entities. The financial statements of the Company are presented on a consolidated basis, for all periods presented and comprise the consolidated historical financial statements of the transferred collection of real estate entities and holdings, upon the IPO. The combined financial information presented for periods on or prior to April 19, 2011 relate solely to STAG Predecessor Group. The financial statements for the periods after April 19, 2011 include the financial information of the Company, the Operating Partnership and their subsidiaries. **Where the Company is referenced in comparisons of financial results for any date prior to and including April 19, 2011, the financial information for such period relates solely to STAG Predecessor Group, notwithstanding Company being the reference.**

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Adoption of New Accounting Pronouncements

The Company adopted Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* issued by the Financial Accounting Standards Board (FASB) effective January 1, 2012 that amends measurement and disclosure requirements related to fair value measurements to improve consistency with International Financial Reporting Standards. The adoption of this guidance did not affect the Company s financial position, results of operations or cash flows but did result in additional disclosure pertaining to fair value measurements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present components of other comprehensive income as part of the statement of equity. In December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05*, which deferred the new requirement to present components of reclassifications of other comprehensive income on the face of the income statement. Both ASU 2011-05 and ASU 2011-12 became effective for the Company on January 1, 2012. The Company s adoption of this authoritative guidance did not have a material impact on its operating results or financial position.

Consolidated and Combined Statements of Cash Flows Supplemental Disclosures

The following table provides supplemental disclosures related to the Consolidated and Combined Statements of Cash Flows (in thousands):

	STAG Industrial, Inc. (Nine months Ended September 30, 2012)	STAG Industrial, Inc. (Period from April 20 to September 30, 2011)	STAG Predecessor Group (Period from January 1 to April 19, 2011)
Supplemental cash flow information			
Cash paid for interest	$ 11,132	$ 7,026	$ 2,433
Supplemental schedule of noncash investing and financing activities			
Acquisition of tangible assets	$	$ (211,501)	$
Acquisition of goodwill upon formation transactions	$	$ (4,923)	$
Acquisition of intangible assets upon formation transactions	$	$ (83,442)	$
Assumption of mortgage notes payable	$	$ (197,723)	$
Fair market value adjustment to mortgage notes payable acquired	$	$ (350)	$
Assumption of related party notes payable upon formation transactions	$	$ 4,466	$
Acquisition of intangible liabilities upon formation transactions	$	$ 1,066	$
Acquisition of interest rate swaps upon formation transactions included in the purchase price allocation	$	$ 420	$
Acquisition of other liabilities upon formation transactions	$	$ 171	$
	$	$ 95,670	$

Issuance of units for acquisition of net assets upon formation transactions						
Disposition of accrued lender fees upon formation transactions	$		$		$	4,420
Assumption of bridge loan for Option Properties upon formation transactions	$		$		$	(4,750)
Assumption of note payable to related party for Option Properties upon formation transactions	$		$		$	(727)
Assumption of interest rate swaps to related party for Option Properties upon formation transactions	$		$		$	(352)
Noncash investing activities included in additions of land and building improvements	$	(377)	$	(420)	$	
Dividends and distributions declared but not paid	$	12,772	$	6,159	$	
Accrued distribution upon formation transactions	$		$		$	(1,392)

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Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Restricted Cash

Restricted cash may include security deposits and cash held in escrow for real estate taxes and capital improvements as required in various mortgage loan agreements. As of September 30, 2012, restricted cash included $1.6 million, which amount was held by the Company s transfer agent for preferred stock dividends and distributed subsequent to September 30, 2012. As of December 31, 2011, the preferred stock dividends for the three months ended December 31, 2011 were distributed; therefore, the transfer agent did not hold any restricted cash.

Tenant Accounts Receivable, net

Tenant accounts receivable, net on the Consolidated Balance Sheets, includes both tenant accounts receivable, net and accrued rental income, net. The Company provides an allowance for doubtful accounts against the portion of tenant accounts receivable that is estimated to be uncollectible. As of September 30, 2012 and December 31, 2011, the Company had an allowance for doubtful accounts of $0.7 million and $0.5 million, respectively.

The Company accrues rental revenue earned, but not yet receivable, in accordance with GAAP. As of September 30, 2012 and December 31, 2011, the Company had accrued rental revenue of $5.4 million and $4.5 million, respectively, which is reflected in tenant accounts receivable, net on the accompanying Consolidated Balance Sheets. The Company maintains an allowance for estimated losses that may result from those revenues. If a tenant fails to make contractual payments beyond any allowance, the Company may recognize additional bad debt expense in future periods equal to the amount of unpaid rent and accrued rental revenue. As of September 30, 2012 and December 31, 2011, the Company had an allowance on accrued rental revenue of $0.1 million and $0.4 million, respectively.

As of September 30, 2012 and December 31, 2011, the Company had a total of approximately $3.3 million and $3.6 million, respectively, of total lease security deposits available in existing letters of credit; and $1.7 million and $1.2 million, respectively, of lease security deposits available in cash.

Deferred Costs

Deferred financing fees include costs incurred in obtaining debt that are capitalized. The deferred financing fees are amortized to interest expense over the life of the respective loans. Any unamortized amounts upon early repayment of mortgage notes payable are written off in the period of repayment. During the three and nine months ended September 30, 2012, the three months ended September 30, 2011, the period from April 20, 2011 to September 30, 2011 and the period from January 1, 2011 to April 19, 2011 amortization of deferred financing fees included in interest expense was \$0.3 million, \$0.9 million, \$0.3 million, \$0.5 million, and \$31 thousand, respectively. Fully amortized deferred charges are removed upon maturity of the underlying debt.

Use of Derivative Financial Instruments

The Company follows authoritative guidance for disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company s objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

The Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm

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commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

In accordance with the FASB s fair value measurement guidance, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Fair Value of Financial Instruments

Financial instruments include cash and cash equivalents, tenant accounts receivable, interest rate swaps, accounts payable, other accrued expenses, credit facility, unsecured credit facility, unsecured term loan and mortgage notes payable. The fair values of the cash and cash equivalents, tenant accounts receivable, accounts payable and other accrued expenses approximate their carrying or contract values because of the short term maturity of these instruments. See Note 5 for the fair values of the Company s debt. See Note 6 for the fair values of the Company s interest rate swaps.

Revenue Recognition

By the terms of their leases, certain tenants are obligated to pay directly the costs of their properties insurance, real estate taxes and certain other expenses and these costs are not reflected in the Company s consolidated financial statements. To the extent any tenant responsible for these costs under its respective lease defaults on its lease or it is deemed probable that the tenant will fail to pay for such costs, the Company would record a liability for such obligation. The Company estimates that real estate taxes, which are the responsibility of these certain tenants, were approximately \$1.9 million and \$4.9 million for the three and nine months ended September 30, 2012, \$1.4 million for the three months ended September 30, 2011, \$2.4 million for the period from April 20, 2011 to September 30, 2011, and \$0.5 million for the period from January 1, 2011 to April 19, 2011, and this would have been the maximum liability of the Company had the tenants not met their contractual obligations. The Company does not recognize recovery revenue related to leases where the tenant has assumed the cost for real estate taxes, insurance and certain other expenses.

Income Taxes

Prior to the IPO, STAG Predecessor Group was comprised primarily of limited partnerships and limited liability companies. Under applicable federal and state income tax rules, the allocated share of net income or loss from the limited partnerships and limited liability companies was reportable in the income tax returns of the respective partners and members.

The Company elected to qualify as a REIT under the Code commencing with the taxable year ended December 31, 2011. To continue to qualify as a REIT, the Company is required to distribute at least 90% of its REIT taxable income to its stockholders and meet the various other requirements imposed by the Code relating to such matters as operating results, asset holdings, distribution levels and diversity of stock ownership. Provided the Company qualifies for taxation as a REIT, the Company is generally not subject to corporate level income tax on the earnings distributed currently to its stockholders that it derives from its REIT qualifying activities. If the Company fails to qualify as a REIT in any taxable year, and is unable to avail itself of certain savings provisions set forth in the Code, all of the Company s taxable income would be subject to federal income tax at regular corporate rates, including any applicable alternative minimum tax.

The Company will not be required to make distributions with respect to income derived from the activities conducted through subsidiaries that the Company elects to treat as taxable REIT subsidiaries (TRS) for federal income tax purposes. Certain activities that the Company undertakes must be conducted by a TRS, such as performing non-customary services for its tenants and holding assets that it cannot hold directly. A TRS is subject to federal and state income taxes. The Company s TRS did not have any activity during the nine months ended September 30, 2012 and period from April 20, 2011 to December 31, 2011.

The Company and certain of its subsidiaries are subject to certain state and local income, excise and franchise taxes. Taxes in the amount of $0.1 million and $0.1 million have been recorded in other expenses in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2012, respectively.

The Company currently has no liabilities for uncertain tax positions.

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3. Real Estate

As part of the IPO and the related formation transactions, STAG Investments IV, LLC and STAG GI Investments, LLC contributed 100% of their real estate entities and operations in exchange for 7,320,610 common limited partnership units in the Operating Partnership (common units) valued at $13.00 per common unit. The members of STAG Capital Partners, LLC and STAG Capital Partners III, LLC (referred to, together, as the Management Company in this report), contributed 100% of those entities assets and liabilities in exchange for 38,621 common units valued at $13.00 per common unit. The contribution of interests in the Management Company was accounted for as an acquisition under the acquisition method of accounting and recognized at the estimated fair value of acquired assets and assumed liabilities on the date of such contribution. STAG Predecessor Group, which includes the entity that is considered the Company s accounting acquirer, is part of the Company s predecessor business and therefore the assets and liabilities of STAG Predecessor Group were accounted for at carryover basis.

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