REALTY INCOME CORP
Form 10-Q
October 26, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2016, or

o **Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File Number 1-13374

REALTY INCOME CORPORATION

(Exact name of registrant as specified in its charter)

Maryland	**33-0580106**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

11995 El Camino Real, San Diego, California 92130

(Address of Principal Executive Offices)

Registrant s telephone number, including area code: **(858) 284-5000**

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

There were 258,599,202 shares of common stock outstanding as of October 20, 2016.

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REALTY INCOME CORPORATION

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September 30, 2016

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

September 30, 2016 and December 31, 2015

(dollars in thousands, except per share data)

	2016 (unaudited)	2015
ASSETS		
Real estate, at cost:		
Land	$ 3,527,734	$ 3,286,004
Buildings and improvements	9,624,689	9,010,778
Total real estate, at cost	13,152,423	12,296,782
Less accumulated depreciation and amortization	(1,913,580)	(1,687,665)
Net real estate held for investment	11,238,843	10,609,117
Real estate held for sale, net	24,815	9,767
Net real estate	11,263,658	10,618,884
Cash and cash equivalents	29,801	40,294
Accounts receivable, net	94,498	81,678
Acquired lease intangible assets, net	1,087,648	1,034,417
Goodwill	15,165	15,321
Other assets, net	45,683	54,785
Total assets	$ 12,536,453	$ 11,845,379
LIABILITIES AND EQUITY		
Distributions payable	$ 54,768	$ 50,344
Accounts payable and accrued expenses	97,541	115,826
Acquired lease intangible liabilities, net	265,045	250,916
Other liabilities	97,905	53,965
Line of credit payable	1,082,000	238,000
Term loans, net	319,054	318,835
Mortgages payable, net	503,201	646,187
Notes payable, net	3,346,442	3,617,973
Total liabilities	5,765,956	5,292,046
Commitments and contingencies		
Stockholders equity:		
Preferred stock and paid in capital, par value $0.01 per share, 69,900,000 shares authorized, 16,350,000 shares issued and outstanding as of September 30, 2016 and December 31, 2015, liquidation preference $25.00 per share	395,378	395,378
Common stock and paid in capital, par value $0.01 per share, 370,100,000 shares authorized, 258,592,608 shares issued and outstanding as of September 30, 2016 and 250,416,757 shares issued and outstanding as of December 31, 2015	8,144,983	7,666,428
Distributions in excess of net income	(1,785,630)	(1,530,210)
Total stockholders equity	6,754,731	6,531,596
Noncontrolling interests	15,766	21,737

Total equity	6,770,497	6,553,333
Total liabilities and equity	$ 12,536,453	$ 11,845,379

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

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REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

For the three and nine months ended September 30, 2016 and 2015

(dollars in thousands, except per share data) (unaudited)

	Three months ended September 30, 2016	Three months ended September 30, 2015	Nine months ended September 30, 2016	Nine months ended September 30, 2015
REVENUE				
Rental	$ 265,332	$ 247,578	$ 782,189	$ 724,131
Tenant reimbursements	11,524	10,187	31,741	31,757
Other	318	1,124	1,399	3,729
Total revenue	277,174	258,889	815,329	759,617
EXPENSES				
Depreciation and amortization	113,917	104,338	332,192	303,476
Interest	52,952	63,950	171,039	181,098
General and administrative	12,103	10,861	38,407	36,331
Property (including reimbursable)	15,678	13,542	45,454	42,455
Income taxes	894	745	2,812	2,448
Provisions for impairment	8,763	3,864	16,955	9,182
Total expenses	204,307	197,300	606,859	574,990
Gain on sales of real estate	4,335	6,224	15,283	17,117
Net income	77,202	67,813	223,753	201,744
Net income attributable to noncontrolling interests	(130)	(338)	(623)	(919)
Net income attributable to the Company	77,072	67,475	223,130	200,825
Preferred stock dividends	(6,770)	(6,770)	(20,310)	(20,310)
Net income available to common stockholders	$ 70,302	$ 60,705	$ 202,820	$ 180,515
Amounts available to common stockholders per common share:				
Net income, basic and diluted	$ 0.27	$ 0.26	$ 0.80	$ 0.78
Weighted average common shares outstanding:				
Basic	258,085,633	236,211,706	253,953,149	231,434,521
Diluted	258,673,914	236,739,942	254,540,323	231,862,767

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

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REALTY INCOME CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the nine months ended September 30, 2016 and 2015

(dollars in thousands) (unaudited)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 223,753	$ 201,744
Adjustments to net income:		
Depreciation and amortization	332,192	303,476
Amortization of share-based compensation	9,204	7,598
Non-cash rental adjustments	(7,583)	(6,462)
Amortization of net premiums on mortgages payable	(2,669)	(5,608)
Amortization of deferred financing costs	6,510	6,806
Loss on interest rate swaps	5,835	7,138
Gain on sales of real estate	(15,283)	(17,117)
Provisions for impairment on real estate	16,955	9,182
Change in assets and liabilities		
Accounts receivable and other assets	2,964	2,351
Accounts payable, accrued expenses and other liabilities	7,332	(36,160)
Net cash provided by operating activities	579,210	472,948
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment in real estate	(1,027,917)	(1,061,871)
Improvements to real estate, including leasing costs	(5,295)	(5,861)
Proceeds from sales of real estate	55,114	51,958
Collection of loans receivable	12,486	-
Restricted escrow deposits for Section 1031 tax-deferred exchanges and pending acquisitions	(7,757)	20,517
Net cash used in investing activities	(973,369)	(995,257)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash distributions to common stockholders	(453,774)	(392,767)
Cash dividends to preferred stockholders	(20,310)	(20,310)
Borrowings on line of credit	3,120,000	1,059,000
Payments on line of credit	(2,276,000)	(843,000)
Principal payment on notes payable	(275,000)	-
Proceeds from mortgages payable	9,963	-
Principal payments on mortgages payable	(183,697)	(140,825)
Proceeds from term loans	-	250,000
Proceeds from common stock offerings, net	383,572	276,430
Proceeds from dividend reinvestment and stock purchase plan	8,174	360,941
Proceeds from At-the-Market (ATM) program	85,780	-
Redemption of preferred units	-	(6,750)
Redemption of common units	(9,026)	-
Distributions to noncontrolling interests	(1,018)	(1,267)
Debt issuance costs	-	(10,358)
Other items, including shares withheld upon vesting	(4,998)	(5,563)
Net cash provided by financing activities	383,666	525,531
Net (decrease) increase in cash and cash equivalents	(10,493)	3,222
Cash and cash equivalents, beginning of period	40,294	3,852
Cash and cash equivalents, end of period	$ 29,801	$ 7,074

For supplemental disclosures, see note 16.

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

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REALTY INCOME CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2016

(unaudited)

1. Management Statement

The consolidated financial statements of Realty Income Corporation (Realty Income , the Company , we , our or us) were prepare from our books and records without audit and include all adjustments (consisting of only normal recurring accruals) necessary to present a fair statement of results for the interim periods presented. Readers of this quarterly report should refer to our audited consolidated financial statements for the year ended December 31, 2015, which are included in our 2015 Annual Report on Form 10-K, as certain disclosures that would substantially duplicate those contained in the audited financial statements have not been included in this report.

At September 30, 2016, we owned 4,703 properties, located in 49 states and Puerto Rico, containing over 80.5 million leasable square feet.

2. Summary of Significant Accounting Policies and Procedures and Recent Accounting Pronouncements

A. The accompanying consolidated financial statements include the accounts of Realty Income and other entities for which we make operating and financial decisions (i.e., control), after elimination of all material intercompany balances and transactions. We consolidate entities that we control and record a noncontrolling interest for the portion that we do not own. Noncontrolling interest that was created or assumed as part of a business combination was recognized at fair value as of the date of the transaction (see note 10). We have no unconsolidated investments.

B. We have elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended. We believe we have qualified and continue to qualify as a REIT. Under the REIT operating structure, we are permitted to deduct dividends paid to our stockholders in determining our taxable income. Assuming our dividends equal or exceed our taxable net income, we generally will not be required to pay federal corporate income taxes on such income. Accordingly, no provision has been made for federal income taxes in the accompanying consolidated financial statements, except for federal income taxes of our taxable REIT subsidiaries. The income taxes recorded on our consolidated statements of income represent amounts paid by Realty Income for city and state income and franchise taxes.

C. We recognize an allowance for doubtful accounts relating to accounts receivable for amounts deemed uncollectible. We consider tenant specific issues, such as financial stability and ability to pay rent, when determining collectability of accounts receivable and appropriate allowances to record. The allowance for doubtful accounts was $290,000 at September 30, 2016 and $429,000 at December 31, 2015.

D. We assign a portion of goodwill to our applicable property sales, which results in a reduction of the carrying amount of our goodwill. In order to allocate goodwill to the carrying amount of properties that we sell, we utilize a relative fair value approach based on the original methodology for assigning goodwill. As we sell properties, our goodwill will likely continue to gradually decrease over time. Based on our analyses of goodwill during the second quarters of 2016 and 2015, we determined there was no impairment on our existing goodwill.

E. In May 2014, the Financial Accounting Standards Board, or FASB, issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU outlines a comprehensive model for companies to use in accounting for revenue arising from contracts with customers, and will apply to transactions such as the sale of real estate. This ASU is effective for interim and annual periods beginning after December 15, 2017. We have not yet adopted this topic and do not expect it to have a material impact on our consolidated financial statements.

In February 2015, FASB issued ASU 2015-02, which amends Topic 810, *Consolidation*. This ASU amended the criteria used to evaluate whether an entity is a variable interest entity, or VIE, resulting in the conclusion that all limited partnerships are considered VIEs, unless substantive kick-out rights or participating rights exist. We adopted this ASU during the quarter ended March 31, 2016 and evaluated our applicable entities. The evaluation did not result in changes to our conclusions regarding consolidation of these entities (see note 10).

In April 2015, FASB issued ASU 2015-03, which amends Topic 835, *Other Presentation Matters*. The amendments in this ASU require that debt issuance costs be reported on the balance sheet as a direct reduction of the face amount of the debt instrument they relate to, and should not be classified as a deferred charge, as was previously required under the Accounting Standards Codification. We adopted this ASU during the quarter ended March 31, 2016 and, as a result, reclassified deferred financing costs from other assets, net, to the applicable debt caption on the December 31, 2015 balance sheet.

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In February 2016, FASB issued Topic 842, *Leases*, which amended Topic 840, *Leases.* Under this amended topic, the accounting applied by a lessor is largely unchanged from that applied under Topic 840, *Leases*. The large majority of operating leases should remain classified as operating leases, and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term. The amendments included in this topic are effective, on a retrospective or modified retrospective basis, for interim and annual periods beginning after December 15, 2018. We have not yet adopted this topic and are currently evaluating the impact this amendment will have on our consolidated financial statements.

In March 2016, FASB issued ASU 2016-09, which amends Topic 718, *Compensation Stock Compensation.* The FASB issued this ASU to simplify several aspects of the accounting for share-based payment transactions, including classification of awards as either equity or liabilities, estimation of forfeitures, and classification on the statement of cash flows. The ASU is effective for interim and annual periods beginning after December 15, 2016, and early adoption is permitted. We early adopted this ASU during the quarter ended March 31, 2016 and it did not have a material impact on our consolidated financial statements.

3. Supplemental Detail for Certain Components of Consolidated Balance Sheets

A. Acquired lease intangible assets, net, consist of the following (dollars in thousands) at:	September 30, 2016	December 31, 2015
Acquired in-place leases	$ 1,142,053	$ 1,056,715
Accumulated amortization of acquired in-place leases	(334,018)	(264,399)
Acquired above-market leases	361,490	304,548
Accumulated amortization of acquired above-market leases	(81,877)	(62,447)
	$ 1,087,648	$ 1,034,417

B. Other assets, net, consist of the following (dollars in thousands) at:	September 30, 2016	December 31, 2015
Prepaid expenses	14,209	14,258
Restricted escrow deposits	11,586	4,179
Credit facility origination costs, net	8,043	10,226
Notes receivable issued in connection with property sales	5,419	17,905
Corporate assets, net	3,032	2,313
Impounds related to mortgages payable	2,637	5,860
Other items	757	44
	$ 45,683	$ 54,785

C. Distributions payable consist of the following declared distributions (dollars in thousands) at:	September 30, 2016	December 31, 2015
Common stock distributions	$ 52,429	$ 47,963
Preferred stock dividends	2,257	2,257
Noncontrolling interests distributions	82	124
	$ 54,768	$ 50,344

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D. Accounts payable and accrued expenses consist of the following (dollars in thousands) at:	September 30, 2016	December 31, 2015
Notes payable - interest payable	$ 30,145	$ 61,486
Property taxes payable	21,162	13,354
Mortgages, term loans, credit line - interest payable and interest rate swaps	12,616	6,813
Accrued costs on properties under development	11,428	9,976
Other items	22,190	24,197
	$ 97,541	$ 115,826

E. Acquired lease intangible liabilities, net, consist of the following (dollars in thousands) at:	September 30, 2016	December 31, 2015
Acquired below-market leases	$ 315,301	$ 288,412
Accumulated amortization of acquired below-market leases	(50,256)	(37,496)
	$ 265,045	$ 250,916

F. Other liabilities consist of the following (dollars in thousands) at:	September 30, 2016	December 31, 2015
Rent received in advance and other deferred revenue (1)	$ 86,479	$ 42,840
Security deposits	6,487	6,418
Capital lease obligations	4,939	4,707
	$ 97,905	$ 53,965

(1) In connection with Diageo s sale of its wine business to Treasury Wine Estates, we will release Diageo from its guarantee of our leases in exchange for Diageo s payment of $75 million of additional rent to us. The additional rent is being paid in two equal installments, one of which was received in August 2016 for $37.5 million and was recorded as prepaid rent. Upon our receipt of the final expected payment in January 2017 of $37.5 million, Treasury Wine Estates will become the guarantor of our leases on those properties. We have accounted for this transaction as a lease modification and the additional rent will be recognized on a straight-line basis over the remaining lease terms of approximately 15 years.

4. Investments in Real Estate

We acquire land, buildings and improvements necessary for the successful operations of commercial tenants.

A. Acquisitions During the First Nine Months of 2016 and 2015

During the first nine months of 2016, we invested $1.1 billion in 236 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.4%. The 236 new properties and properties under development or expansion are located in 36 states, will contain approximately 5.2 million leasable square feet, and are 100% leased with a weighted average lease term of 15.0 years. The tenants occupying the new properties operate in 24 industries and the property types are 80.7% retail and 19.3% industrial, based on rental revenue. None of our investments during 2016 caused any one tenant to be 10% or more of our total assets at September 30, 2016.

The $1.1 billion invested during the first nine months of 2016 was allocated as follows: $267.8 million to land, $691.9 million to buildings and improvements, $140.4 million to intangible assets related to leases, and $26.3 million to intangible liabilities related to leases and other assumed liabilities. We also recorded mortgage premiums of $692,000. There was no material contingent consideration associated with these acquisitions.

The properties acquired during the first nine months of 2016 generated total revenues of $22.5 million and net income of $11.2 million during the nine months ended September 30, 2016.

Of the $1.1 billion we invested during the first nine months of 2016, $401.1 million of the purchase price allocation is based on a preliminary measurement of fair value that is subject to change. The allocation for these properties represents our current best estimate of fair value of real estate and acquired lease intangibles, and we expect to finalize the valuations and complete the purchase price allocations in 2016. During the first nine months of 2016, we finalized the purchase price allocations for $195.4 million invested in the fourth quarter of 2015. There were no material changes to our consolidated balance sheets or income statements as a result of these purchase price allocations being finalized.

In comparison, during the first nine months of 2015, we invested $1.1 billion in 195 new properties and properties under development or expansion with an initial weighted average contractual lease rate of 6.5%. The 195 new properties and properties under development or expansion, were located in 36 states, contained approximately 5.1 million leasable square feet and were 100% leased with a weighted average lease term of 16.7 years. The tenants occupying the new properties operated in 18 industries and the property types are 87.0% retail and 13.0% industrial, based on rental revenue.

The $1.1 billion invested during the first nine months of 2015 was allocated as follows: $214.8 million to land, $780.8 million to buildings and improvements, $86.6 million to intangible assets related to leases and $27.2 million to intangible liabilities related to leases and other assumed liabilities. There was no contingent consideration associated with these acquisitions.

The properties acquired during the first nine months of 2015 generated total revenues of $25.3 million and net income of $12.6 million for the nine months ended September 30, 2015.

The estimated initial weighted average contractual lease rate for a property is generally computed as estimated contractual net operating income, which, in the case of a net leased property, is equal to the aggregate base rent for the first full year of each lease, divided by the total cost of the property. Since it is possible that a tenant could default on the payment of contractual rent, we cannot provide assurance that the actual return on the funds invested will remain at the percentages listed above.

In the case of a property under development or expansion, the contractual lease rate is generally fixed such that rent varies based on the actual total investment in order to provide a fixed rate of return. When the lease does not provide for a fixed rate of return on a property under development or expansion, the estimated initial weighted average contractual lease rate is computed as follows: estimated net operating income (determined by the lease) for the first full year of each lease, divided by our projected total investment in the property, including land, construction and capitalized interest costs. Of the $1.1 billion we invested during the first nine months of 2016, $87.7 million was invested in 30 properties under development or expansion with an estimated initial weighted average contractual lease rate of 7.1%. Of the $1.1 billion we invested during the first nine months of 2015, $37.1 million was invested in 30 properties under development or expansion with an estimated initial weighted average contractual lease rate of 9.9%.

B. Acquisition Transaction Costs

Acquisition transaction costs of $119,000 and $368,000 were recorded to general and administrative expense on our consolidated statements of income during the first nine months of 2016 and 2015, respectively.

C. Investments in Existing Properties

During the first nine months of 2016, we capitalized costs of $5.3 million on existing properties in our portfolio, consisting of $564,000 for re-leasing costs, $486,000 for recurring capital expenditures and $4.2 million for non-recurring building improvements. In comparison, during the first nine months of 2015, we capitalized costs of $5.9 million on existing properties in our portfolio.

D. Properties with Existing Leases

Of the $1.1 billion we invested during the first nine months of 2016, approximately $574.0 million was used to acquire 75 properties with existing leases. In comparison, of the $1.1 billion we invested during the first nine months of 2015, approximately $304.2 million was used to acquire 47 properties with existing leases. The value of the in-place and above-market leases is recorded to acquired lease intangible assets, net on our consolidated balance sheets, and the value of the below-market leases is recorded to acquired lease intangible liabilities, net on our consolidated balance sheets.

The values of the in-place leases are amortized as depreciation and amortization expense. The amounts amortized to expense for all of our in-place leases, for the first nine months of 2016 and 2015, were $69.6 million and $65.5 million, respectively.

The values of the above-market and below-market leases are amortized over the term of the respective leases, including any bargain renewal options, as an adjustment to rental revenue on our consolidated statements of income. The amounts amortized as a net decrease to rental revenue for capitalized above-market and below-market leases for the first nine months of 2016 and 2015 were $6.7 million and $5.8 million, respectively. If a lease was to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be recorded to revenue or expense, as appropriate.

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The following table presents the estimated impact during the next five years and thereafter related to the amortization of the acquired above-market and below-market lease intangibles and the amortization of the in-place lease intangibles for properties held for investment at September 30, 2016 (in thousands):

	Net increase (decrease) to rental revenue	Increase to amortization expense
2016	$ (2,512)	$ 24,248
2017	(10,006)	95,904
2018	(9,758)	93,409
2019	(8,803)	83,084
2020	(8,042)	77,569
Thereafter	24,553	433,821
Totals	$ (14,568)	$ 808,035

5. Credit Facility

In June 2015, we entered into a $2.0 billion unsecured revolving credit facility, or our credit facility, which replaced our $1.5 billion credit facility that was scheduled to expire in May 2016. The initial term of our credit facility expires in June 2019 and includes, at our option, two six-month extensions. Our credit facility has a $1.0 billion accordion expansion option. Under our credit facility, our investment grade credit ratings as of September 30, 2016 provide for financing at the London Interbank Offered Rate, commonly referred to as LIBOR, plus 0.90% with a facility commitment fee of 0.15%, for all-in drawn pricing of 1.05% over LIBOR. The borrowing rate is subject to an interest rate floor and may change if our investment grade credit ratings were to change. We also have other interest rate options available to us under our credit facility. Our credit facility is unsecured and, accordingly, we have not pledged any assets as collateral for this obligation.

At September 30, 2016, credit facility origination costs of $8.0 million are included in other assets, net on our consolidated balance sheet. This balance includes $9.1 million of credit facility origination costs incurred during 2015 as a result of entering into our credit facility. These costs, as well as a portion of the costs incurred as a result of entering into our previous credit facilities, are being amortized over the remaining term of our credit facility.

At September 30, 2016, we had a borrowing capacity of $918.0 million available on our credit facility (subject to customary conditions to borrowing) and an outstanding balance of $1.08 billion, as compared to an outstanding balance of $238.0 million at December 31, 2015. In October 2016, the outstanding balance on our credit facility decreased as a result of a note offering (see note 20).

The weighted average interest rate on outstanding borrowings under our credit facility was 1.4% during the first nine months of 2016 and 1.2% during the first nine months of 2015. At September 30, 2016, the weighted average interest rate on borrowings outstanding was 1.4%. Our credit facility is subject to various leverage and interest coverage ratio limitations, and at September 30, 2016, we remain in compliance with the covenants on our credit facility.

6. Term Loans

In June 2015, in conjunction with entering into our credit facility, we entered into a $250 million senior unsecured term loan maturing on June 30, 2020. Borrowing under this term loan bears interest at the current one-month LIBOR, plus 0.95%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.67%.

In January 2013, in conjunction with our acquisition of American Realty Capital Trust, Inc., or ARCT, we entered into a $70 million senior unsecured term loan maturing January 21, 2018. Borrowing under this term loan bears interest at the current one-month LIBOR, plus 1.20%. In conjunction with this term loan, we also entered into an interest rate swap which effectively fixes our per annum interest rate on this term loan at 2.15%.

Deferred financing costs of $1.2 million incurred in conjunction with the $250 million term loan and $303,000 incurred in conjunction with the $70 million term loan are being amortized over the remaining terms of each respective term loan. The net balance of these deferred financing costs, which was $946,000 at September 30, 2016, and $1.2 million at December 31, 2015, is included within term loans, net on our consolidated balance sheets.

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7. Mortgages Payable

During the first nine months of 2016, we made $183.7 million in principal payments, including the repayment of eight mortgages in full for $161.5 million, and we assumed mortgages totaling $32.5 million, excluding net premiums. During the third quarter of 2016, we refinanced one of these assumed mortgages and received an additional $10.0 million in proceeds. The assumed mortgages are secured by the properties on which the debt was placed and are considered non-recourse debt with limited customary exceptions for items such as solvency, bankruptcy, misrepresentation, fraud, misapplication of payments, environmental liabilities, failure to pay taxes, insurance premiums, liens on the property, violations of the single purpose entity requirements, and uninsured losses. We expect to pay off our mortgages as soon as prepayment penalties make it economically feasible to do so.

During the first nine months of 2016, aggregate net premiums totaling $692,000 were recorded upon the assumption of a mortgage with an above-market interest rate. Amortization of our net premiums is recorded as a reduction to interest expense over the remaining term of the respective mortgages, using a method that approximates the effective-interest method. These mortgages contain customary covenants, such as limiting our ability to further mortgage each applicable property or to discontinue insurance coverage without the prior consent of the lender. At September 30, 2016, we remain in compliance with these covenants.

During the first nine months of 2015, we made $140.8 million in principal payments, including the repayment of ten mortgages in full for $135.3 million. No mortgages were assumed during the first nine months of 2015.

We did not incur any deferred financing costs on our mortgages assumed in 2016. The balance of our deferred financing costs, which are classified as part of mortgages payable, net, on our consolidated balance sheets, was $374,000 at September 30, 2016 and $553,000 at December 31, 2015. These costs are being amortized over the remaining term of each mortgage.

The following is a summary of all our mortgages payable as of September 30, 2016 and December 31, 2015, respectively (dollars in thousands):

As Of	Number of Properties(1)	Weighted Average Stated Interest Rate(2)	Weighted Average Effective Interest Rate(3)	Weighted Average Remaining Years Until Maturity	Remaining Principal Balance	Unamortized Premium and Deferred Finance Costs Balance, net	Mortgage Payable Balance
9/30/16	129	4.9%	4.3%	3.9	$ 496,470	$ 6,731	$ 503,201
12/31/15	183	4.9%	4.1%	3.6	$ 637,658	$ 8,529	$ 646,187

(1) At September 30, 2016, there were 38 mortgages on 129 properties, while at December 31, 2015, there were 44 mortgages on 183 properties. The mortgages require monthly payments, with principal payments due at maturity. The mortgages are at fixed interest rates, except for five mortgages on 14 properties totaling $68.1 million at September 30, 2016, including net unamortized discounts. At December 31, 2015, four

mortgages on 13 properties totaling $51.1 million, including net unamortized discounts, were at variable interest rates. After factoring in arrangements which limit our exposure to interest rate risk and effectively fix our per annum interest rates, our variable rate mortgage debt includes three mortgages totaling $32.4 million at September 30, 2016, and two mortgages totaling $15.5 million at December 31, 2015.

(2) Stated interest rates ranged from 2.3% to 6.9% at September 30, 2016, while stated interest rates ranged from 2.0% to 6.9% at December 31, 2015.

(3) Effective interest rates ranged from 2.5% to 8.8% at September 30, 2016, while effective interest rates ranged from 2.2% to 8.9% at December 31, 2015.

The following table summarizes the maturity of mortgages payable, excluding net premiums of $7.1 million and deferred finance costs of $374,000, as of September 30, 2016 (dollars in millions):

Year of Maturity		**Principal**
2016	$	36.3
2017		109.4
2018		15.9
2019		42.3
2020		82.4
Thereafter		210.2
Totals	$	496.5

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8. Notes Payable

A. General

Our senior unsecured notes and bonds consist of the following, sorted by maturity date (dollars in millions):

		September 30, 2016		December 31, 2015
5.950% notes, issued in September 2006 and due in September 2016	$	-	$	275
5.375% notes, issued in September 2005 and due in September 2017		175		175
2.000% notes, issued in October 2012 and due in January 2018		350		350
6.750% notes, issued in September 2007 and due in August 2019		550		550
5.750% notes, issued in June 2010 and due in January 2021		250		250
3.250% notes, issued in October 2012 and due in October 2022		450		450
4.650% notes, issued in July 2013 and due in August 2023		750		750
3.875% notes, issued in June 2014 and due in July 2024		350		350
4.125% notes, issued in September 2014 and due in October 2026		250		250
5.875% bonds, $100 issued in March 2005 and $150 issued in June 2011, both due in March 2035		250		250
Total principal amount		3,375		3,650
Unamortized original issuance discounts and deferred financing costs		(29)		(32)
	$	3,346	$	3,618

The following table summarizes the maturity of our notes and bonds payable as of September 30, 2016, excluding unamortized original issuance discounts and deferred financing costs (dollars in millions):

Year of Maturity		**Principal**
2016	$	-
2017		175
2018		350
2019		550
2020		-
Thereafter		2,300
Totals	$	3,375

As of September 30, 2016, the weighted average interest rate on our notes and bonds payable was 4.6% and the weighted average remaining years until maturity was 6.2 years.

B. Note Repayment

In September 2016, we repaid $275.0 million of outstanding 5.950% notes, plus accrued and unpaid interest.

9. Equity

A. *Issuance of Common Stock*

In May 2016, we issued 6,500,000 shares of common stock. After underwriting discounts and other offering costs of $12.1 million, the net proceeds of $383.6 million were used to repay borrowings under our credit facility.

In April 2015, we issued 5,500,000 shares of common stock. After underwriting discounts and other offering costs of $1.4 million, the net proceeds of $276.4 million were used to repay borrowings under our credit facility.

B. *Dividend Reinvestment and Stock Purchase Plan*

Our Dividend Reinvestment and Stock Purchase Plan, or the DRSPP, provides our common stockholders, as well as new investors, with a convenient and economical method of purchasing our common stock and reinvesting their distributions. The DRSPP also allows our current stockholders to buy additional shares of common stock by reinvesting all or a portion of their distributions. The DRSPP authorizes up to 26,000,000 common shares to be issued. During the first nine months of 2016, we issued 133,432 shares and raised approximately $8.2 million under the DRSPP. During the first nine months of 2015, we issued 7,565,432 shares and raised approximately $360.9 million under the DRSPP. From the inception of the DRSPP through September 30, 2016, we have issued 12,833,294 shares and raised approximately $589.8 million.

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We pay for a majority of the plan-related fees related to our DRSPP. Additionally, our DRSPP includes a waiver approval process, allowing larger investors or institutions, per a formal approval process, to purchase shares at a small discount, if approved by us. During the first nine months of 2016, we did not issue shares under the waiver approval process. During the first nine months of 2015, we issued 7,413,207 shares and raised $353.7 million under the waiver approval process. These shares are included in the total activity for the first nine months of 2015 noted in the preceding paragraph.

C. At-the-Market (ATM) Program

In September 2015, we established an at-the-market equity distribution program, or our ATM program, pursuant to which we can offer and sell up to 12,000,000 shares of common stock. The shares of common stock may be sold to, or through, a consortium of banks acting as our sales agents either by means of ordinary brokers transactions on the NYSE at prevailing market prices or at negotiated prices. During the first nine months of 2016, we issued 1,312,269 shares and raised approximately $85.8 million under the ATM program.

10. Noncontrolling Interests

In January 2013, we completed our acquisition of ARCT. Equity issued as consideration for this transaction included common and preferred partnership units issued by Tau Operating Partnership, L.P., or Tau Operating Partnership, the consolidated subsidiary which owns properties acquired through the ARCT acquisition. We and our subsidiaries hold a 99.4% interest in Tau Operating Partnership, and consolidate the entity.

In June 2013, we completed the acquisition of a portfolio of properties by issuing common partnership units in Realty Income, L.P. The units were issued as consideration for the acquisition. At September 30, 2016, the remaining units from this issuance represent a 0.4% ownership in Realty Income, L.P. We hold the remaining 99.6% interests in this entity and consolidate the entity.

A. Neither of the common partnership units have voting rights. Both common partnership units are entitled to monthly distributions equal to the amount paid to common stockholders of Realty Income, and are redeemable in cash or Realty Income common stock, at our option, and at a conversion ratio of one to one, subject to certain exceptions. Noncontrolling interests with redemption provisions that permit the issuer to settle in either cash or common stock, at the option of the issuer, were evaluated to determine whether temporary or permanent equity classification on the balance sheet was appropriate. We determined that the units meet the requirements to qualify for presentation as permanent equity.

The following table represents the change in the carrying value of all noncontrolling interests through September 30, 2016 (dollars in thousands):

	Tau Operating	Realty Income, L.P.

		Partnership units(1)		units(2)		Total
Carrying value at December 31, 2015	$	13,410	$	8,327	$	21,737
Reallocation of equity		491		52		543
Redemptions		-		(6,161)		(6,161)
Distributions		(570)		(406)		(976)
Allocation of net income		204		419		623
Carrying value at September 30, 2016	$	13,535	$	2,231	$	15,766

(1) 317,022 Tau Operating Partnership units were issued on January 22, 2013 and remained outstanding as of September 30, 2016 and December 31, 2015.

(2) 534,546 Realty Income, L.P. units were issued on June 27, 2013, 331,364 units were outstanding as of December 31, 2015, and 88,182 remain outstanding as of September 30, 2016.

B. The Tau Operating Partnership preferred units were recorded at fair value as of the date of acquisition. Since they were redeemable at a fixed price on a determinable date, we initially classified them in other liabilities on our consolidated balance sheets. Payments on these preferred units were made monthly at a rate of 2% per annum and were included in interest expense. In January 2015, we redeemed all 6,750 Tau Operating Partnership preferred units for $1,000 per unit, plus accrued and unpaid distributions.

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C. During the first quarter of 2016, we adopted ASU 2015-02, which amends Topic 810, *Consolidation*. This ASU amended the criteria used to evaluate whether an entity is a variable interest entity, or VIE, resulting in the conclusion that all limited partnerships are considered VIEs, unless substantive kick-out rights or participating rights exist. Accordingly, we determined that both Tau Operating Partnership and Realty Income, L.P. are VIEs. We have also concluded that we are the primary beneficiary of these VIEs, based on our controlling financial interests. We evaluated the minority unitholder rights noting that they do not hold substantive kick-out rights or participating rights. These conclusions did not result in changes to our historical accounting for these partnerships. Below is a summary of selected financial data of consolidated VIEs for which we are the primary beneficiary included in the consolidated balance sheets at September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	**December 31, 2015**
Net real estate	$ 3,003,824	$ 3,033,180
Total assets		