

GETTY REALTY CORP /MD/  
Form 10-Q  
August 08, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10-Q**

(Mark one)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-13777

**GETTY REALTY CORP.**

(Exact name of registrant as specified in its charter)

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**MARYLAND**  
(State or other jurisdiction of  
incorporation or organization)

**11-3412575**  
(I.R.S. Employer  
Identification No.)

**125 Jericho Turnpike, Suite 103**

**Jericho, New York 11753**

(Address of principal executive offices)

(Zip Code)

**(516) 478 - 5400**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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  No

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  No

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

Large Accelerated Filer  Accelerated Filer

Non-Accelerated Filer  Smaller Reporting Company

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

Registrant had outstanding 33,396,880 shares of Common Stock, par value \$.01 per share, as of August 8, 2013.

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## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**GETTY REALTY CORP. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

(unaudited)

	June 30, 2013	December 31, 2012
<b>ASSETS:</b>		
Real Estate:		
Land	\$ 351,502	\$ 318,814
Buildings and improvements	202,471	208,325
	553,973	527,139
Less accumulated depreciation and amortization	(97,067)	(106,931)
Real estate held for use, net	456,906	420,208
Real estate held for sale, net	34,822	25,340
Real estate, net	491,728	445,548
Net investment in direct financing leases	97,701	91,904
Deferred rent receivable (net of allowance of \$1,531 as of June 30, 2013 and \$0 as of December 31, 2012)	15,105	12,448
Cash and cash equivalents	6,779	16,876
Notes, mortgages and accounts receivable (net of allowance of \$18,332 at June 30, 2013 and \$25,371 at December 31, 2012)	53,084	41,865
Prepaid expenses and other assets	39,869	31,940
Total assets	\$ 704,266	\$ 640,581
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Borrowings under credit lines	\$ 121,000	\$ 150,290
Term loans	100,000	22,030
Environmental remediation obligations	45,210	46,150
Dividends payable	6,739	4,202
Accounts payable and accrued liabilities	48,438	45,160
Total liabilities	321,387	267,832
Commitments and contingencies (notes 2, 3, 4 and 5)		
Shareholders' equity:		
Common stock, par value \$.01 per share; authorized 50,000,000 shares; issued 33,396,880 at June 30, 2013 and 33,396,720 at December 31, 2012	334	334
Paid-in capital	461,944	461,426
Dividends paid in excess of earnings	(79,399)	(89,011)
Total shareholders' equity	382,879	372,749

Total liabilities and shareholders equity	\$ 704,266	\$ 640,581
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The accompanying notes are an integral part of these consolidated financial statements.

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**GETTY REALTY CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
<b>Revenues:</b>				
Revenues from rental properties	\$ 24,140	\$ 24,357	\$ 46,998	\$ 50,547
Interest on notes and mortgages receivable	962	700	1,760	1,381
<b>Total revenues</b>	<b>25,102</b>	<b>25,057</b>	<b>48,758</b>	<b>51,928</b>
<b>Operating expenses:</b>				
Rental property expenses	6,691	6,973	14,496	12,812
Impairment charges	354	1,646	826	1,920
Environmental expenses	1,354	(594)	2,469	36
General and administrative expenses	2,357	8,846	5,903	19,233
Allowance for deferred rent receivable	1,531		1,531	
Depreciation and amortization expense	2,007	3,027	4,259	5,920
<b>Total operating expenses</b>	<b>14,294</b>	<b>19,898</b>	<b>29,484</b>	<b>39,921</b>
<b>Operating income</b>	<b>10,808</b>	<b>5,159</b>	<b>19,274</b>	<b>12,007</b>
Other income, net	(1)	(3)	34	292
Interest expense	(2,998)	(2,692)	(5,892)	(4,175)
<b>Earnings from continuing operations</b>	<b>7,809</b>	<b>2,464</b>	<b>13,416</b>	<b>8,124</b>
<b>Discontinued operations:</b>				
Earnings (loss) from operating activities	756	(1,548)	(2,933)	(1,256)
Gains from dispositions of real estate	4,174	2,710	12,606	3,243
<b>Earnings from discontinued operations</b>	<b>4,930</b>	<b>1,162</b>	<b>9,673</b>	<b>1,987</b>
<b>Net earnings</b>	<b>\$ 12,739</b>	<b>\$ 3,626</b>	<b>\$ 23,089</b>	<b>\$ 10,111</b>
<b>Basic and diluted earnings per common share:</b>				
Earnings from continuing operations	\$ 0.23	\$ 0.07	\$ 0.40	\$ 0.24
Earnings from discontinued operations	\$ 0.15	\$ 0.03	\$ 0.29	\$ 0.06
<b>Net earnings</b>	<b>\$ 0.38</b>	<b>\$ 0.11</b>	<b>\$ 0.69</b>	<b>\$ 0.30</b>
<b>Weighted-average shares outstanding:</b>				
Basic	33,397	33,395	33,397	33,395
Stock options				
<b>Diluted</b>	<b>33,397</b>	<b>33,395</b>	<b>33,397</b>	<b>33,395</b>

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



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**GETTY REALTY CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	Six months ended June 30,	
	2013	2012
<i>Cash flows from operating activities:</i>		
Net earnings	\$ 23,089	\$ 10,111
<i>Adjustments to reconcile net earnings to net cash flow provided by operating activities:</i>		
Depreciation and amortization expense	5,052	7,474
Impairment charges	4,452	3,146
Gains on dispositions of real estate	(12,606)	(3,241)
Deferred rent receivable, net of allowance	(2,657)	(1,379)
Allowance (credit) for accounts receivable	(6,895)	16,739
Other	3,500	2,599
<i>Changes in assets and liabilities:</i>		
Accounts receivable, net	1,512	(14,876)
Prepaid expenses and other assets	(154)	(4,522)
Environmental remediation obligations	(6,026)	(3,811)
Accounts payable and accrued liabilities	778	(1,804)
<b>Net cash flow provided by operating activities</b>	<b>10,045</b>	<b>10,436</b>
<i>Cash flows from investing activities:</i>		
Property acquisitions and capital expenditures	(72,702)	(2,465)
Proceeds from dispositions of real estate	20,920	4,002
Increase in cash held for property acquisitions	(673)	(2,016)
Issuance of notes, mortgages and other receivables	(5,108)	
Collection of notes and mortgages receivable	2,508	928
<b>Net cash flow provided by (used in) investing activities</b>	<b>(55,055)</b>	<b>449</b>
<i>Cash flows from financing activities:</i>		
Borrowings under credit agreements	121,000	4,000
Repayments under credit agreements	(150,290)	
Borrowings under term loan agreement	100,000	
Repayments under term loan agreement	(22,030)	(390)
Payments of cash dividends	(10,940)	
Payments of loan origination costs	(2,769)	(3,701)
Other	(58)	
<b>Net cash flow provided by (used in) financing activities</b>	<b>34,913</b>	<b>(91)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(10,097)</b>	<b>10,794</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>16,876</b>	<b>7,698</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 6,779</b>	<b>\$ 18,492</b>

Supplemental disclosures of cash flow information



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*Cash paid (refunded) during the period for:*

Interest paid	\$	4,281	\$	2,730
Income taxes paid, net		326		178
Environmental remediation obligations		5,301		1,162
<i>Non-cash transactions:</i>				
Issuance of mortgages related to property dispositions		3,236		1,011

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

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**GETTY REALTY CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. GENERAL**

*Basis of Presentation:* The consolidated financial statements include the accounts of Getty Realty Corp. and its wholly-owned subsidiaries. We are a real estate investment trust ( REIT ) specializing in the ownership, leasing and financing of retail motor fuel and convenience store properties. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ( GAAP ). We manage and evaluate our operations as a single segment. All significant intercompany accounts and transactions have been eliminated.

*Use of Estimates, Judgments and Assumptions:* The financial statements have been prepared in conformity with GAAP, which requires management to make estimates, judgments 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 revenues and expenses during the period reported. Estimates, judgments and assumptions underlying the accompanying consolidated financial statements include, but are not limited to, receivables, deferred rent receivable, net investment in direct financing leases, environmental remediation costs, real estate, depreciation and amortization, impairment of long-lived assets, litigation, environmental remediation obligations, accrued liabilities, income taxes and the allocation of the purchase price of properties acquired to the assets acquired and liabilities assumed. Application of these estimates and assumptions requires exercise of judgment as to future uncertainties, and as a result, actual results could differ materially from these estimates.

*Subsequent events:* We evaluated subsequent events and transactions for potential recognition or disclosure in our consolidated financial statements.

*Fair Value Hierarchy:* The preparation of financial statements in accordance with GAAP requires management to make estimates of fair value that affect the reported amounts of assets and liabilities and disclosure of assets and liabilities at the date of the financial statements and revenues and expenses during the period reported using a hierarchy (the Fair Value Hierarchy ) that prioritizes the inputs to valuation techniques used to measure the fair value. The Fair Value Hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The levels of the Fair Value Hierarchy are as follows: Level 1 - inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access at the measurement date; Level 2 - inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active; and Level 3 - inputs that are unobservable. Certain types of assets and liabilities are recorded at fair value either on a recurring or non-recurring basis. Assets required or elected to be marked-to-market and reported at fair value every reporting period are valued on a recurring basis. Other assets not required to be recorded at fair value every period may be recorded at fair value if a specific provision or other impairment is recorded within the period to mark the carrying value of the asset to market as of the reporting date. Such assets are valued on a non-recurring basis. We have a receivable of \$8,080,000 and \$2,972,000 as of June 30, 2013 and December 31, 2012, respectively, that is measured at fair value on a recurring basis using Level 3 inputs (See Marketing and the Master Lease in

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note 3 for additional information regarding the receivable.). The fair value of the receivable increased by \$5,108,000 primarily due to additional advances made during the six months ended June 30, 2013. The fair value of the receivable increased subsequently in July 2013 as a result of as a result of the parties agreeing to the settlement and the Bankruptcy Court's issuance of an order approving the Lukoil Settlement (both defined below). Pursuant to the terms of the Litigation Funding Agreement (as defined below), we expect to receive a payment of \$25,942,000 related to this receivable. (See "Marketing and the Master Lease" in note 3 for additional information regarding the Lukoil Settlement and the Litigation Funding Agreement.) We have certain real estate assets that are measured at fair value on a non-recurring basis using Level 3 inputs as of June 30, 2013 and December 31, 2012 of \$11,533,000 and \$4,967,000, respectively, where impairment charges have been recorded. Due to the subjectivity inherent in the internal valuation techniques used in estimating fair value, the amounts realized from the sale of such assets may vary significantly from these estimates.

The following summarizes as of June 30, 2013 our assets and liabilities measured at fair value on a recurring basis by level within the Fair Value Hierarchy:

(in thousands)	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Receivable	\$	\$	\$ 8,080	\$ 8,080
Mutual funds	\$ 3,165	\$	\$	\$ 3,165
<b>Liabilities</b>				
Deferred Compensation	\$ 3,165	\$	\$	\$ 3,165

The following summarizes as of December 31, 2012 our assets and liabilities measured at fair value on a recurring basis by level within the Fair Value Hierarchy:

(in thousands)	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Receivable	\$	\$	\$ 2,972	\$ 2,972
Mutual funds	\$ 3,013	\$	\$	\$ 3,013
<b>Liabilities</b>				
Deferred Compensation	\$ 3,013	\$	\$	\$ 3,013

*Discontinued Operations:* We report as discontinued operations 144 properties which meet the criteria to be accounted for as held for sale in accordance with GAAP as of the end of the current period and certain properties disposed of during the periods presented. Discontinued operations, including gains and losses, impairment charges and the operating results for properties disposed of in 2013 and 2012 and impairment charges and operating results of properties classified as held for sale, are included in a separate component of income in our consolidated statements of operations. The operating results and impairment charges of such properties for the three and six months ended 2012 have also been reclassified to discontinued operations to conform to the 2013 presentation. The properties currently being marketed for sale have a net carrying value aggregating \$34,822,000 and are included in real estate held for sale, net in our consolidated balance sheets.

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The revenue from rental properties, impairment charges, other operating expenses and gains from dispositions of real estate related to these properties are as follows:

(in thousands)	Three months ended		Six months ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Revenues from rental properties	\$ 711	\$ 2,476	\$ 1,531	\$ 7,513
Impairment charges	(114)	(1,137)	(3,626)	(1,226)
Other operating (expenses) credit	159	(2,887)	(838)	(7,543)
Earnings (loss) from operating activities	756	(1,548)	(2,933)	(1,256)
Gains from dispositions of real estate	4,174	2,710	12,606	3,243
Earnings from discontinued operations	\$ 4,930	\$ 1,162	\$ 9,673	\$ 1,987

*Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of:* Assets are written down to fair value when events and circumstances indicate that the assets might be impaired and the projected undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those assets. We review and adjust as necessary our depreciation estimates and method when long-lived assets are tested for recoverability. Assets held for disposal are written down to fair value less estimated disposition costs.

We recorded non-cash impairment charges aggregating \$468,000 and \$4,452,000 for the three and six months ended June 30, 2013, respectively and \$2,783,000 and \$3,146,000 for the three and six months ended June 30, 2012, respectively, in continuing operations and in discontinued operations. We record non-cash impairment charges and reduce the carrying amount of properties held for use to fair value where the carrying amount of the property exceeded the projected undiscounted cash flows expected to be received during the assumed holding period which includes the estimated sales value expected to be received at disposition. We record non-cash impairment charges and reduce the carrying amount of properties held for sale to fair value less disposal costs. The non-cash impairment charges recorded during the six months ended June 30, 2013 and 2012 were attributable to reductions in the assumed holding period used to test for impairment, reductions in our estimates of value for properties held for sale and the accumulation of asset retirement costs as a result of an increase in estimated environmental liabilities which increased the carrying value of certain properties in excess of their fair value. The estimated fair value of real estate is based on the price that would be received to sell the property in an orderly transaction between market participants at the measurement date. The internal valuation techniques that we used included discounted cash flow analysis, an income capitalization approach on prevailing or earnings multiples applied to earnings from the property, analysis of recent comparable lease and sales transactions, actual leasing or sale negotiations, bona fide purchase offers received from third parties and/or consideration of the amount that currently would be required to replace the asset, as adjusted for obsolescence. In general, we consider multiple internal valuation techniques when measuring the fair value of a property, all of which are based on unobservable inputs and assumptions that are classified within Level 3 of the fair value hierarchy. These unobservable inputs include assumed holding periods ranging up to 15 years, assumed average rent increases ranging up to 2.0% annually, income capitalized at a rate of 8.0% and cash flows discounted at a rate of 7.0%. These assessments have a direct impact on our net income because recording an impairment loss results in an immediate negative adjustment to net income. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future rental rates and operating expenses that could differ materially from actual results in future periods. Where properties held for use have been identified as having a potential for sale, additional

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judgments are required related to the determination as to the appropriate period over which the projected undiscounted cash flows should include the operating cash flows and the amount included as the estimated residual value. This requires significant judgment. In some cases, the results of whether impairment is indicated are sensitive to changes in assumptions input into the estimates, including the holding period until expected sale.

*Unaudited, Interim Financial Statements:* The consolidated financial statements are unaudited but, in our opinion, reflect all adjustments (consisting of normal recurring accruals) necessary for a fair statement of the results for the periods presented. These statements should be read in conjunction with the consolidated financial statements and related notes, which appear in our Annual Report on Form 10-K for the year ended December 31, 2012.

*Income Taxes:* We and our subsidiaries file a consolidated federal income tax return. Effective January 1, 2001, we elected to qualify, and believe we are operating so as to qualify, as a REIT for federal income tax purposes. Accordingly, we generally will not be subject to federal income tax on qualifying REIT income, provided that distributions to our shareholders equal at least the amount of our taxable income as defined under the Internal Revenue Code. We accrue for uncertain tax matters when appropriate. The accrual for uncertain tax positions is adjusted as circumstances change and as the uncertainties become more clearly defined, such as when audits are settled or exposures expire. Although tax returns for the years 2009, 2010 and 2011, and tax returns which will be filed for the years ended 2012 and 2013, remain open to examination by federal and state tax jurisdictions under the respective statute of limitations, we have not currently identified any uncertain tax positions related to those years and, accordingly, have not accrued for uncertain tax positions as of June 30, 2013 or December 31, 2012.

*Earnings per Common Share:* Basic earnings per common share gives effect, utilizing the two-class method, to the potential dilution from the issuance of common shares in settlement of restricted stock units ( RSUs or RSU ) which provide for non-forfeitable dividend equivalents equal to the dividends declared per common share. Basic earnings per common share is computed by dividing net earnings less dividend equivalents attributable to RSUs by the weighted-average number of common shares outstanding during the year. Diluted earnings per common share, also gives effect to the potential dilution from the exercise of stock options utilizing the treasury stock method.

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Earnings from continuing operations	\$ 7,809	\$ 2,464	\$ 13,416	\$ 8,124
Less dividend equivalents attributable to restricted stock units outstanding	(69)	(27)	(118)	(52)
Earnings from continuing operations attributable to common shareholders used for basic earnings per share calculation	7,740	2,437	13,298	8,072
Discontinued operations	4,930	1,162	9,673	1,987
Net earnings attributable to common shareholders used for basic earnings per share calculation	\$ 12,670	\$ 3,599	\$ 22,971	\$ 10,059
Weighted-average number of common shares outstanding:				
Basic	33,397	33,395	33,397	33,395
Stock options				
Diluted	33,397	33,395	33,397	33,395
Restricted stock units outstanding at the end of the period	296	216	296	216

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Our business model is to lease our properties on a triple-net basis primarily to petroleum distributors and, to a lesser extent, individual operators. Our tenants operate our properties directly or sublet our properties to operators who operate their gas stations, convenience stores, automotive repair service facilities or other businesses at our properties. These tenants are responsible for the operations conducted at these properties. Our triple-net tenants are generally responsible for the payment of all taxes, maintenance, repairs, insurance, environmental and other operating expenses relating to our properties. Substantially all of our tenants' financial results depend on the sale of refined petroleum products and rental income from their subtenants. As a result, our tenants' financial results are highly dependent on the performance of the petroleum marketing industry, which is highly competitive and subject to volatility. As of June 30, 2013, we owned 907 properties and leased 133 properties from third parties. Our 1,040 properties are located in 21 states across the United States and Washington, D.C., with concentrations in the Northeast and Mid-Atlantic regions.

Approximately 650 of the properties we own or lease as of June 30, 2013 were previously leased to Getty Petroleum Marketing Inc. ( "Marketing" ) comprising a unitary premises pursuant to a master lease (the "Master Lease" ) and we derived a majority of our revenues from the leasing of these properties under the Master Lease. On December 5, 2011, Marketing filed for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court" ). Marketing rejected the Master Lease pursuant to an Order issued by the Bankruptcy Court effective April 30, 2012. In accordance with GAAP, we recognized in revenue from rental properties in our consolidated statements of operations the full contractual rent and real estate obligations due to us by Marketing during the term of the Master Lease and provided bad debt reserves included in general and administrative expenses and in earnings (loss) from discontinued operations in our consolidated statements of operations for our estimate of uncollectible amounts due from Marketing. We provided net bad debt reserves related to uncollected rent and real estate taxes due from Marketing of \$16,221,000 for the six months ended June 30, 2012. We reduced \$8,788,000 of previously provided reserves in the six months ended June 30, 2013 as a result of receiving cash from the Marketing Estate (as defined below) and our estimate of cash we expect to receive from the Marketing Estate. We have provided bad debt reserves, net of reversals, aggregating \$13,994,000 for outstanding rent and real estate tax obligations due from Marketing as of June 30, 2013. (See note 3 for additional information regarding Marketing and the Master Lease.)

As a result of Marketing's bankruptcy filing and Marketing's rejection of the Master Lease, we commenced a process to reposition the portfolio of properties that were subject to the Master Lease after the properties became available to us free of Marketing's tenancy. As a result of that process, as of June 30, 2013, we have entered into long-term triple-net leases with petroleum distributors for ten separate property portfolios comprising 443 properties in the aggregate and month-to-month license agreements with occupants of approximately 135 properties (substantially all of whom were Marketing's former subtenants) allowing such occupants to continue to occupy and use these properties as gas stations, convenience stores, automotive repair service facilities or other businesses. Certain of the month-to-month license agreements require the operators to sell fuel provided by petroleum distributors with whom we have contracted for interim fuel supply and from whom we receive a fee based on gallons sold. Our month-to-month license agreements differ from our typical triple-net lease agreements in that we are responsible for the payment of certain environmental costs and property operating expenses, including real estate taxes. Approximately 70 properties previously subject to the Master Lease are currently vacant, and are being marketed for sale.

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The long-term triple-net leases with petroleum distributors for the ten separate property portfolios comprising 443 properties in the aggregate are unitary triple-net lease agreements generally with an initial term of 15 years, and options for successive renewal terms of up to 20 years. Rent is scheduled to increase at varying intervals of up to three years on the anniversary of the commencement date of the leases. The majority of the leases provide for additional rent based on the volume of petroleum products sold. In addition, the majority of the leases require the tenants to make capital expenditures at our properties substantially all of which are related to the replacement of underground storage tanks ( USTs ) that are owned by our tenants. In certain of our new leases, we have committed to co-invest up to \$14,080,000 with our tenants for a portion of such capital expenditures, which deferred expense is recognized on a straight-line basis as amortization expense in our consolidated statements of operations over the terms of the various leases. As part of certain of these triple-net leases, we transferred title of the USTs to our tenants and the obligation to pay for the retirement and decommissioning or removal of USTs at the end of their useful life or earlier if circumstances warranted was fully or partially transferred to our new tenants. We remain contingently liable for this obligation in the event that our tenants do not satisfy their responsibilities. Accordingly, we removed \$11,955,000 of asset retirement obligations and \$10,173,000 of net asset retirement costs related to USTs from our balance sheet through June 30, 2013. The net amount of \$1,782,000 is recorded as deferred rental revenue and is recognized on a straight-line basis as additional revenues from rental properties over the terms of the various leases. We incurred \$3,472,000 of lease origination costs through June 30, 2013, which deferred expense is recognized on a straight-line basis as amortization expense in our consolidated statements of operations over the terms of the various leases.

Revenues from rental properties included in continuing operations for the three and six months ended June 30, 2013 were \$24,140,000 and \$46,998,000, respectively. Revenues from rental properties included in continuing operations for the three and six months ended June 30, 2012 were \$24,357,000 and \$50,547,000, respectively, of which \$4,559,000 and \$17,550,000, respectively, was contractually due or received from Marketing under the Master Lease prior to its rejection on April 30, 2012. Revenues from rental properties and rental property expenses included in continuing operations included \$3,653,000 and \$7,093,000 for the three and six months ended June 30, 2013, respectively, and \$2,997,000 and \$7,444,000 for the three and six months ended June 30, 2012, respectively, for real estate taxes paid by us which were reimbursable by our tenants. Revenues from rental properties included in continuing operations for the six months ended June 30, 2013 also included a net loss of \$1,075,000 for amounts realized under interim fuel supply agreements, as compared to a net gain of \$1,586,000 for the six months ended June 30, 2012.

In accordance with GAAP, we recognize rental revenue in amounts which vary from the amount of rent contractually due or received during the periods presented. As a result, revenues from rental properties include non-cash adjustments recorded for deferred rental revenue due to the recognition of rental income on a straight-line (or average) basis over the current lease term, net amortization of above-market and below-market leases and recognition of rental income recorded under direct financing leases using the effective interest method which produces a constant periodic rate of return on the net investments in the leased properties (the Revenue Recognition Adjustments ). Revenue Recognition Adjustments included in continuing operations increased rental revenue by \$1,361,000 and \$3,744,000 for the three and six months ended June 30, 2013, respectively, as compared to \$901,000 and \$1,535,000 for the three and six months ended June 30, 2012, respectively.

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The components of the \$97,701,000 net investment in direct financing leases as of June 30, 2013 are minimum lease payments receivable of \$209,304,000 plus unguaranteed estimated residual value of \$13,979,000 less unearned income of \$125,582,000.

On January 13, 2011, we acquired fee or leasehold title to 59 Mobil-branded gasoline station and convenience store properties and also took a security interest in six other Mobil-branded gasoline stations and convenience store properties in a sale/leaseback and loan transaction with CPD NY Energy Corp. ( CPD NY ), a subsidiary of Chestnut Petroleum Dist. Inc. On May 1, 2012, as part of the repositioning of the portfolio of properties previously leased to Marketing, we entered into a triple-net lease for 84 properties with NECG Holdings Corp. ( NECG ), a subsidiary of Chestnut Petroleum Dist. Inc., and an affiliate of CPD NY. We receive a significant portion of our revenues from CPD NY and NECG.

Eviction proceedings are ongoing in the State of Connecticut against approximately 26 of Marketing's former subtenants (or sub-subtenants) each of whom continue to occupy properties included in our lease with NECG. As a result of the disruption and costs associated with the litigation, NECG is not current in its rent and certain other obligations due to us under its lease. We have commenced discussions with NECG to restructure the NECG Lease including a modification which we believe is likely to result in the removal of approximately 25 to 30 properties. As such, we increased our accounts receivable bad debt reserves by approximately \$1,152,000 for the three months ended June 30, 2013, so that the total bad debt reserve related to NECG is approximately \$1,902,000 in aggregate.

We provide reserves for a portion of the recorded deferred rent receivable if circumstances indicate that a tenant will not make all of its contractual lease payments during the current lease term. Our assessments and assumptions regarding the recoverability of the deferred rent receivable are reviewed on an ongoing basis and such assessments and assumptions are subject to change. As a result of the developments with NECG described above, we concluded that it was probable that we would not receive from NECG the entire amount of the contractual lease payments owed to us under the unitary lease for the likely removal of properties and for rent payment deferrals previously agreed to related to the six months ended June 30, 2013. Accordingly, during the second quarter of 2013, we recorded a \$1,531,000 non-cash allowance for deferred rent receivable. This non-cash allowance reduced our net earnings for the three and six months ended June 30, 2013, but did not impact our cash flow from operating activities.



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The selected combined unaudited financial data of CPD NY and NECG (from inception on May 1, 2012), which has been prepared by Chestnut Petroleum Dist. Inc.'s management, is provided below.

(in thousands)

**Operating Data:**

	Three months ended		Six months ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Total revenue	\$ 147,046	\$ 115,495	\$ 266,991	\$ 222,150
Gross profit	10,947	10,504	19,787	18,047
Net income (loss)	1,621	2,400	1,459	2,468

**Balance Sheet Data:**

	June 30, 2013	December 31, 2012
Current assets	\$ 15,148	\$ 9,529
Noncurrent assets	24,538	21,326
Current liabilities	10,579	4,800
Noncurrent liabilities	18,049	21,624

**3. COMMITMENTS AND CONTINGENCIES***CREDIT RISK*

In order to minimize our exposure to credit risk associated with financial instruments, we place our temporary cash investments, if any, with high credit quality institutions. Temporary cash investments, if any, are currently held in an overnight bank time deposit with JPMorgan Chase Bank, N.A.

*MARKETING AND THE MASTER LEASE*

On December 5, 2011, Marketing filed for Chapter 11 bankruptcy protection in the Bankruptcy Court. On March 7, 2012, we entered into a stipulation with Marketing and with the Official Committee of Unsecured Creditors in the Bankruptcy proceedings (the "Creditors Committee"), which was approved and made an order by the Bankruptcy Court on April 2, 2012 (the "Stipulation"). Pursuant to the terms of the Stipulation, in addition to our other pre-petition and post-petition claims, we are entitled to recover an administrative claim capped at \$10,500,000 for the partial payment of fixed rent and performance of other obligations due from Marketing under the Master Lease from December 5, 2011 until possession of the properties subject to the Master Lease was returned to us effective April 30, 2012 (the "Administrative Claim"). Our Administrative Claim has priority over the claims of other creditors and certain of our other claims.

The Bankruptcy Court appointed a liquidating trustee (the "Liquidating Trustee") to oversee the liquidation of the Marketing estate (the "Marketing Estate"). The Liquidating Trustee continues to oversee the Marketing Estate and pursue claims for the benefit of its creditors, including those related to the recovery of various deposits, including surety bonds, insurance policy claims and claims made to state funded tank reimbursement programs.

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In December 2011, the Marketing Estate filed a lawsuit against Marketing's former parent, Lukoil Americas Corporation, and certain of its affiliates (collectively, "Lukoil"), as well as the former directors and officers of Marketing (the "Lukoil Complaint"). The Lukoil Complaint asserted, among other claims, that Marketing's sale of assets to Lukoil in November 2009 constituted a fraudulent conveyance, and that the assets or their value can be recovered from Lukoil. In addition, the Lukoil Complaint asserted that the former directors and officers violated their fiduciary duties to Marketing in approving and effectuating the challenged sale, and are liable for money damages. On July 17, 2013, the Marketing Estate, Lukoil and certain directors and officers of Marketing agreed to settle the Lukoil Complaint. The terms of the settlement include a release of the defendants from the claims alleged by the Marketing Estate in the Lukoil Complaint and a collective payment by or on behalf of the defendants to the Marketing Estate of \$93,000,000 (the "Lukoil Settlement"). On July 29, 2013, the Bankruptcy Court issued an order approving the Lukoil Settlement. We expect to realize initial proceeds in the third quarter of 2013 from the Lukoil Settlement aggregating approximately \$32,527,000, based on the return under the Litigation Funding Agreement (described in more detail below) and payment of our remaining Administrative Claim, plus additional distributions we may receive from the Marketing Estate for our pro-rata share of the remainder of the Lukoil Settlement amount available to satisfy unsecured claims. We are investigating whether a portion of the payments we receive pursuant to the Litigation Funding Agreement may be subject to federal income taxes. (For information regarding factors that could adversely affect us relating to tax matters, see Part II, Item 1A. Risk Factors in this Quarterly Report on Form 10-Q.)

In October 2012, we entered into an agreement with the Marketing Estate to make loans and otherwise fund up to an aggregate amount of \$6,725,000 to fund the prosecution of the Lukoil Complaint and certain Liquidating Trustee expenses incurred in connection with the wind-down of the Marketing Estate (the "Litigation Funding Agreement"). The Litigation Funding Agreement provides that we are entitled to receive proceeds, if any, from the successful prosecution of the Lukoil Complaint in an amount equal to the sum of (i) all funds advanced for wind-down costs and expert witness and consultant fees plus interest accruing at 15% per annum on such advances made by us; plus (ii) the greater of all funds advanced for legal fees and expenses relating to the prosecution of the Lukoil Complaint plus interest accruing at 15% per annum on such advances made by us, or 24% of the gross proceeds from any settlement or favorable judgment obtained by the Liquidating Trustee due to the Lukoil Complaint. We advanced \$5,108,000 in the first six months of 2013 and \$6,526,000 in the aggregate through June 30, 2013 to the Marketing Estate pursuant to the Litigation Funding Agreement. The Litigation Funding Agreement also provides that we are entitled to be reimbursed for up to \$1,300,000 of our legal fees in connection with the Litigation Funding Agreement. Based on the terms of the agreement, we have recorded a receivable of \$8,080,000 as of June 30, 2013, which includes amounts advanced, accrued interest and amounts due for reimbursable legal fees we incurred in connection with the Litigation Funding Agreement. Pursuant to the terms of the Litigation Funding Agreement, we expect to receive a payment of \$25,942,000, as a result of the Lukoil Settlement, which is comprised of \$2,172,000 related to advances for wind-down costs and expert witness and consultant fees, \$150,000 of accrued interest, \$22,320,000 of return on our investment due for advances of legal fees and expenses and \$1,300,000 for reimbursable legal fees. We are investigating whether a portion of the payments we receive pursuant to the Litigation Funding Agreement may be subject to federal income taxes. (For information regarding factors that could adversely affect us relating to tax matters, see Part II, Item 1A. Risk Factors in this Quarterly Report on Form 10-Q.)

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We have elected to account for the advances, accrued interest and litigation reimbursements due to us pursuant to the Litigation Funding Agreement on a fair value basis. We used unobservable inputs based on comparable transactions when determining the fair value of the Litigation Funding Agreement. We concluded that the terms of the Litigation Funding Agreement are within a range of terms representing the market for such arrangements when considering the unique circumstances particular to the counterparties to such funding agreements. These inputs include the potential outcome of the litigation related to the Lukoil Complaint including the probability of the Marketing Estate prevailing in its lawsuit and the potential amount that may be recovered by the Marketing Estate from Lukoil Americas Corporation. We also applied a discount factor commensurate with the risk that the Marketing Estate may not prevail in its lawsuit. We considered that fair value is defined as an amount of consideration that would be exchanged between a willing buyer and seller. Accordingly, we believe that as of June 30, 2013 a market participant would likely have purchased our rights from us for approximately the amounts then due to us under the terms of the Litigation Funding Agreement. The fair value of the receivable increased subsequently in July 2013 as a result of the parties agreeing to the settlement and the Bankruptcy Court's issuance of an order approving the Lukoil Settlement.

We received distributions from the Marketing Estate reducing our Administrative Claim by \$3,310,000 in the first six months of 2013 and by \$4,658,000 in the aggregate in 2012 through June 30, 2013. As a result of the Lukoil Settlement, we expect to receive the remaining amount due for our Administrative Claim and accrued interest aggregating \$6,585,000. As a result, in the first six months of 2013, we reduced our bad debt reserve for uncollectible amounts due from Marketing by \$8,788,000 which reduced general and administrative expenses by \$6,379,000 and increased earnings from operating activities included in discontinued operations by \$2,409,000 in our consolidated statement of operations. We cannot provide any assurance as to the amount or timing of recoveries, if any, with respect to our remaining claims against the Marketing Estate.

Under the Master Lease, Marketing was responsible to pay for certain environmental related liabilities and expenses. As a result of Marketing's bankruptcy filing, we have accrued for the Marketing Environmental Liabilities and are funding remediation activities related to such accruals. We expect to continue to incur and fund costs associated with the Marketing bankruptcy proceedings and associated eviction proceedings as well as costs associated with repositioning properties previously leased to Marketing. We incurred \$365,000 of lease origination costs in the first six months of 2013 and \$3,512,000 through June 30, 2013, which deferred expense is recognized on a straight-line basis as amortization expense in our consolidated statements of operations over the terms of the various leases. We expect to continue to incur operating expenses such as maintenance, repairs, real estate taxes, insurance and general upkeep related to vacant properties and properties subject to our month-to-month license agreements. In certain of our new leases, we have also agreed to co-invest as much as \$14,080,000 with our tenants to fund capital improvements including replacing underground storage tanks and related equipment or renovating some of the properties previously leased to Marketing.

It is possible that our estimates for the Marketing Environmental Liabilities and other expenses relating to the properties previously leased to Marketing will be higher than the amounts we have accrued and that issues involved in re-letting or repositioning these properties may require significant management

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attention that would otherwise be devoted to our ongoing business. In addition, we increased our number of tenants significantly and are performing property related functions previously performed by Marketing, both of which have resulted in permanent increases in our annual operating expenses. The incurrence of these various expenses may materially negatively impact our cash flow and ability to pay dividends.

Our estimates, judgments, assumptions and beliefs regarding Marketing and the Master Lease affect the amounts reported in our financial statements and are subject to change. Actual results could differ from these estimates, judgments and assumptions and such differences could be material. If we do not realize the proceeds we are expecting from the Lukoil Settlement; if the Bankruptcy Court takes actions that are detrimental to our interests; if we are unable to re-let or sell, upon terms that are favorable to us, the properties previously leased to Marketing which are not subject to triple-net leases; if the amounts realized from the disposition of assets held for sale vary significantly from our estimates of fair value; or if we change our estimates, judgments, assumptions and beliefs; our business, financial condition, revenues, operating expenses, results of operations, liquidity, ability to pay dividends and stock price may be materially adversely affected or adversely affected to a greater extent than we have experienced.

*LEGAL PROCEEDINGS*

We are subject to various legal proceedings and claims which arise in the ordinary course of our business. As of June 30, 2013 and December 31, 2012, we had accrued an aggregate of \$4,003,000 and \$3,615,000, respectively, for certain of these matters which we believe were appropriate based on information then currently available. We are unable to estimate ranges in excess of the amount accrued with any certainty for these matters. It is possible that our assumptions regarding the ultimate allocation method and share of responsibility that we used to allocate environmental liabilities may change, which may result in our providing an accrual, or adjustments to the amounts recorded, for environmental litigation accruals. Matters related to our Newark, New Jersey Terminal and the Lower Passaic River and the MTBE multi-district litigation case, in particular, could cause a material adverse effect on our business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

*Matters related to our Newark, New Jersey Terminal and the Lower Passaic River*

In September 2003, we received a directive (the Directive) from the State of New Jersey Department of Environmental Protection (the NJDEP) notifying us that we are one of approximately 66 potentially responsible parties for natural resource damages resulting from discharges of hazardous substances into the Lower Passaic River. The Directive calls for an assessment of the natural resources that have been injured by the discharges into the Lower Passaic River and interim compensatory restoration for the injured natural resources. There has been no material activity with respect to the NJDEP Directive since early after its issuance. The responsibility for the alleged damages, the aggregate cost to remediate the Lower Passaic River, the amount of natural resource damages and the method of allocating such amounts among the potentially responsible parties have not been determined. Effective May 2007, the United States Environmental Protection Agency (EPA) entered into an Administrative Settlement Agreement and Order on Consent (AOC) with over 70 parties comprising a Cooperating Parties Group (CPG) (many of whom are also named in the Directive) who have collectively agreed to perform a Remedial Investigation and Feasibility Study (RI/FS) for the Lower Passaic River. We are a party to the AOC and are a member of the CPG. The RI/FS is intended to address the investigation and evaluation of alternative remedial actions with respect to alleged damages to the Lower Passaic River, and

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is scheduled to be completed in or about 2015. On June 18, 2012, all members of the CPG except Occidental Chemical Corporation ( Occidental ) entered into an Administrative Settlement Agreement and Order on Consent ( 10.9 AOC ) to perform certain remediation activities, including removal and capping of sediments at the river mile 10.9 area and certain testing. Similar to the RI/FS work, the CPG entered into an interim allocation for the costs of the river mile 10.9 work. The EPA issued a Unilateral Order to Occidental directing Occidental to participate and contribute to the cost of the river mile 10.9 work and discussions regarding Occidental's participation in the river mile 10.9 work are ongoing. Concurrently, the EPA is preparing a proposed Focused Feasibility Study ( FFS ) that the EPA claims will address sediment issues in the lower eight miles of the Lower Passaic River. The RI/FS and 10.9 AOC do not resolve liability issues for remedial work or restoration of, or compensation for, natural resource damages to the Lower Passaic River, which are not known at this time.

In a related action, in December 2005, the State of New Jersey through various state agencies brought suit against certain companies which the State alleges are responsible for various categories of past and future damages resulting from discharges of hazardous substances to the Passaic River. In February 2009, certain of these defendants filed third-party complaints against approximately 300 additional parties, including us, seeking contribution for such parties' proportionate share of response costs, cleanup and other damages, based on their relative contribution to pollution of the Passaic River and adjacent bodies of water. We believe that ChevronTexaco is contractually obligated to indemnify us, pursuant to an indemnification agreement, for most if not all of the conditions at the property identified by the NJDEP and the EPA. Accordingly, our potential range of loss including our ultimate legal and financial liability, if any, cannot be made with any certainty at this time.

Losses related to our Newark, New Jersey Terminal and the Lower Passaic River could cause a material adverse effect on our business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

*MTBE Litigation*

We are defending against one remaining lawsuit of many brought by or on behalf of private and public water providers and governmental agencies. These cases alleged (and, as described below with respect to one remaining case, continue to allege) various theories of liability due to contamination of groundwater with methyl tertiary butyl ether (a fuel derived from methanol, commonly referred to as MTBE ) as the basis for claims seeking compensatory and punitive damages, and name as defendant approximately 50 petroleum refiners, manufacturers, distributors and retailers of MTBE, or gasoline containing MTBE. During 2010, we agreed to, and subsequently paid, an aggregate of \$2,025,000 to settle two plaintiff classes covering 52 cases, and another case brought by the City of New York. Presently, we remain a defendant in one MTBE case involving multiple locations throughout the State of New Jersey brought by various governmental agencies of the State of New Jersey, including the NJDEP. Preliminary settlement communications from the plaintiffs indicate that they are seeking \$88,000,000 collectively from us, Marketing and Lukoil Americas Corporation. We do not believe these preliminary settlement communications have resulted in realistic proposals given the legal theories and facts applicable to our activities and gas stations, and affirmative defenses available to us, all of which we believe have not been sufficiently developed in the proceedings. We are unable to estimate ranges in excess of the amount accrued with any certainty for the case involving the State of New Jersey as there remains uncertainty as to the accuracy of the allegations in this case as they relate to us, our defenses to the claims, our rights to indemnification or contribution from other parties and the aggregate possible amount of damages for which we may be held liable. As no amount is a better estimate of loss relating to the remaining MTBE case, the low end of the range of loss has been accrued for as of June 30, 2013 and December 31, 2012, which we believe was appropriate based on information then currently available. Losses related to the remaining MTBE multi-district litigation case could cause a material adverse effect on our business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

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### **4. CREDIT AGREEMENT AND TERM LOAN AGREEMENT**

As of December 31, 2012, we were a party to a \$175,000,000 amended and restated senior secured revolving credit agreement with a group of commercial banks led by JPMorgan Chase Bank, N.A. and a \$25,000,000 amended term loan agreement with TD Bank, both of which were scheduled to mature in March 2013. As of December 31, 2012, borrowings under the credit agreement were \$150,290,000 bearing interest at a rate of 3.25% per annum and borrowings under the term loan agreement were \$22,030,000 bearing interest at a rate of 3.50% per annum. Loan origination costs incurred in March 2012 of \$4,144,000 were amortized over the one year extended term of these debt agreements. On February 25, 2013, the borrowings then outstanding under such credit agreement and term loan agreement were repaid with cash on hand and proceeds of the Credit Agreement and the Prudential Loan Agreement (both defined below).

On February 25, 2013, we entered into a \$175,000,000 senior secured revolving credit agreement (the Credit Agreement) with a group of commercial banks led by JPMorgan Chase Bank, N.A. (the Bank Syndicate), which is scheduled to mature in August 2015. Subject to the terms of the Credit Agreement, we have the option to extend the term of the Credit Agreement for one additional year to August 2016. The Credit Agreement allocates \$25,000,000 of the total Bank Syndicate commitment to a term loan and \$150,000,000 to a revolving credit facility. Subject to the terms of the Credit Agreement, we have the option to increase by \$50,000,000 the amount of the revolving credit facility to \$200,000,000. The Credit Agreement permits borrowings at an interest rate equal to the sum of a base rate plus a margin of 1.50% to 2.00% or a LIBOR rate plus a margin of 2.50% to 3.00% based on our leverage at the end of each quarterly reporting period. The annual commitment fee on the undrawn funds under the Credit Agreement is 0.30% to 0.40% based on our leverage at the end of each quarterly reporting period. The Credit Agreement does not provide for scheduled reductions in the principal balance prior to its maturity.

The Credit Agreement provides for security in the form of, among other items, mortgage liens on certain of our properties. The parties to the Credit Agreement and the Prudential Loan Agreement (as defined below) share the security pursuant to the terms of an inter-creditor agreement. The Credit Agreement contains customary financial covenants such as loan to value, leverage and coverage ratios and minimum tangible net worth, as well as limitations on restricted payments, which may limit our ability to incur additional debt or pay dividends. The Credit Agreement contains customary events of default, including default under the Prudential Loan Agreement, change of control and failure to maintain REIT status. Any event of default, if not cured or waived, would increase by 200 basis points (2.00%) the interest rate we pay under the Credit Agreement and prohibit us from drawing funds against the Credit Agreement and could result in the acceleration of our indebtedness under the Credit Agreement and could also give rise to an event of default and could result in the acceleration of our indebtedness under the Prudential Loan Agreement. We may be prohibited from drawing funds against the revolving credit facility if there is a material adverse effect on our business, assets, prospects or condition.

On February 25, 2013, we entered into a \$100,000,000 senior secured long-term loan agreement with the Prudential Insurance Company of America (the Prudential Loan Agreement), which matures in February 2021. The Prudential Loan Agreement bears interest at 6.00%. The Prudential Loan Agreement does not provide for scheduled reductions in the principal balance prior to its maturity. The parties to the Credit Agreement and the Prudential Loan Agreement share the security described above pursuant to the terms of an inter-creditor agreement. The Prudential Loan Agreement contains customary financial

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covenants such as loan to value, leverage and coverage ratios and minimum tangible net worth, as well as limitations on restricted payments, which may limit our ability to incur additional debt or pay dividends. The Prudential Loan Agreement contains customary events of default, including default under the Credit Agreement and failure to maintain REIT status. Any event of default, if not cured or waived, would increase by 200 basis points (2.00%) the interest rate we pay under the Prudential Loan Agreement and could result in the acceleration of our indebtedness under the Prudential Loan Agreement and could also give rise to an event of default and could result in the acceleration of our indebtedness under our Credit Agreement.

We repaid the then outstanding borrowings related to our debt outstanding as of December 31, 2012 partially with cash on hand and proceeds from the Credit Agreement and the Prudential Loan Agreement entered into in February 2013.

On July 9, 2013, we entered into an amendment of the Credit Agreement and an amendment of the Prudential Loan Agreement (collectively, the Agreements ). The Agreements were entered into as a result of our preliminary calculations indicating that we may not comply with the respective debt to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) financial covenant in the Credit Agreement and the Prudential Loan Agreement for the three months ending June 30, 2013 (the Financial Covenant ). Under the terms of the Agreements, our interest rate under the Credit Agreement and Prudential Loan Agreement increased by 50 basis points (0.50%) to 3.75% and 6.50%, respectively, effective July 7, 2013; the total amount available to us for additional borrowings under the Credit Agreement was capped at \$2,000,000, in the aggregate; and we were not permitted to acquire any properties for a purchase price that equaled or exceeded \$20,000,000, individually or in the aggregate, without prior written consent from the Bank Syndicate and Prudential. The Agreements provided that these provisions would remain in effect until such time as we demonstrated compliance with our Financial Covenants or obtained permanent waivers or amendments under the Credit Agreement and the Prudential Loan Agreement.

The final calculation of the Financial Covenants for the period ended June 30, 2013, demonstrated that we were in compliance with all Financial Covenants and as such, as of the date of this Quarterly Report on Form 10-Q, the Bank Syndicate and Prudential acknowledged that the terms of the Amendments are no longer in effect. We cannot provide any assurance that we will not seek additional waivers or amendments from the Bank Syndicate and Prudential and that we will be successful in our efforts to obtain permanent waivers or amendments under the Credit Agreement and the Prudential Loan Agreement.

Due to the near-term maturity of our outstanding debt as of December 31, 2012, the carrying value of the borrowings outstanding as of December 31, 2012 approximated fair value. As of June 30, 2013, the carrying value of the borrowings outstanding under the Credit Agreement and the Prudential Loan Agreement approximated fair value. The fair value of the projected average borrowings outstanding under our revolving credit agreements and the borrowings outstanding under our term loan agreements were determined using a discounted cash flow technique that incorporates a market interest yield curve based on market data obtained from sources independent of us that are observable at commonly quoted intervals and are defined by GAAP as Level 2 inputs in the Fair Value Hierarchy with adjustments for duration, optionality, risk profile and projected average borrowings outstanding or borrowings outstanding, which are based on unobservable Level 3 inputs. We classified our valuations of the borrowings outstanding under the Credit Agreement and the Term Loan Agreement entirely within Level 3 of the Fair Value Hierarchy.

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**5. ENVIRONMENTAL OBLIGATIONS**

We are subject to numerous existing federal, state and local laws and regulations, including matters relating to the protection of the environment such as the remediation of known contamination and the retirement and decommissioning or removal of long-lived assets including buildings containing hazardous materials, USTs and other equipment. Environmental costs are principally attributable to remediation costs which include installing, operating, maintaining and decommissioning remediation systems, monitoring contamination and governmental agency reporting incurred in connection with contaminated properties. We seek reimbursement from state UST remediation funds related to these environmental costs where available. In July 2012, we purchased for \$3,062,000 a ten-year pollution legal liability insurance policy covering all of our properties for pre-existing unknown environmental liabilities and new environmental events. The policy has a \$50,000,000 aggregate limit and is subject to various self-insured retentions and other conditions and limitations. Our intention in purchasing this policy is to obtain protection predominantly for significant events. No assurances can be given that we will obtain a net financial benefit from this investment.

We enter into leases and various other agreements which allocate responsibility for known and unknown environmental liabilities by establishing the percentage and method of allocating responsibility between the parties. In accordance with the leases with certain tenants, we have agreed to bring the leased properties with known environmental contamination to within applicable standards, and to either regulatory or contractual closure ( Closure ). Generally, upon achieving Closure at each individual property, our environmental liability under the lease for that property will be satisfied and future remediation obligations will be the responsibility of our tenant.

For our triple-net leases, our tenants are directly responsible to pay for: (i) the retirement and decommissioning or removal of USTs and other equipment, (ii) remediation of environmental contamination they cause and compliance with various environmental laws and regulations as the operators of our properties, and (iii) environmental liabilities allocated to them under the terms of our leases and various other agreements. We are contingently liable for these obligations in the event that our tenants do not satisfy their responsibilities. Under the Master Lease, Marketing was responsible to pay for the retirement and decommissioning or removal of USTs at the end of their useful life or earlier if circumstances warranted as well as all environmental liabilities discovered during the term of the Master Lease, including: (i) remediation of environmental contamination Marketing caused and compliance with various environmental laws and regulations as the operator of our properties, and (ii) known and unknown environmental liabilities allocated to Marketing under the terms of the Master Lease and various other agreements with us relating to Marketing s business and the properties it leased from us (collectively, the Marketing Environmental Liabilities ). A liability has not been accrued for obligations that are the responsibility of our tenants (other than the Marketing Environmental Liabilities accrued in the fourth quarter of 2011) based on our tenants history of paying such obligations and/or our assessment of their financial ability and intent to pay their share of such costs. However, there can be no assurance that our assessments are correct or that our tenants who have paid their obligations in the past will continue to do so.



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As part of certain triple-net leases whose term commenced through June 30, 2013, we transferred title of the USTs to our tenants and the obligation to pay for the retirement and decommissioning or removal of USTs at the end of their useful life or earlier if circumstances warranted was fully or partially transferred to our new tenants. Accordingly, through June 30, 2013, we removed \$11,955,000 of asset retirement obligations and \$10,173,000 of net asset retirement costs related to USTs from our balance sheet. The cumulative net amount of \$1,782,000 is recorded as deferred rental revenue and will be recognized on a straight-line basis as additional revenues from rental properties over the terms of the various leases. (See note 2 for additional information.)

It is possible that our assumptions regarding the ultimate allocation method and share of responsibility that we used to allocate environmental liabilities may change, which may result in material adjustments to the amounts recorded for environmental litigation accruals and environmental remediation liabilities. We are required to accrue for environmental liabilities that we believe are allocable to others under various other agreements if we determine that it is probable that the counterparty will not meet its environmental obligations. The ultimate resolution of these matters could cause a material adverse effect on our business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

The estimated future costs for known environmental remediation requirements are accrued when it is probable that a liability has been incurred and a reasonable estimate of fair value can be made. The accrued liability is the aggregate of the best estimate of the fair value of cost for each component of the liability net of estimated recoveries from state UST remediation funds considering estimated recovery rates developed from prior experience with the funds.

Environmental exposures are difficult to assess and estimate for numerous reasons, including the extent of contamination, alternative treatment methods that may be applied, location of the property which subjects it to differing local laws and regulations and their interpretations, as well as the time it takes to remediate contamination. In developing our liability for estimated environmental remediation obligations on a property by property basis, we consider among other things, enacted laws and regulations, assessments of contamination and surrounding geology, quality of information available, currently available technologies for treatment, alternative methods of remediation and prior experience. Environmental accruals are based on estimates which are subject to significant change, and are adjusted as the remediation treatment progresses, as circumstances change and as environmental contingencies become more clearly defined and reasonably estimable.

Environmental remediation obligations are initially measured at fair value based on their expected future net cash flows which have been adjusted for inflation and discounted to present value. As of June 30, 2013 and December 31, 2012, we had accrued \$45,210,000 and \$46,150,000, respectively, as our best estimate of the fair value of reasonably estimable environmental remediation obligations net of estimated recoveries and obligations to remove USTs. Environmental liabilities are accreted for the change in present value due to the passage of time and, accordingly, \$1,301,000 and \$1,584,000 of net accretion expense was recorded for the six months ended June 30, 2013 and 2012, respectively, which is included in environmental expenses. In addition, during the six months ended June 30, 2013 and 2012, we recorded credits to environmental expenses included in continuing operations and to earnings from operating activities in discontinued operations in our consolidated statements of operations aggregating \$727,000 and \$2,648,000, respectively, where decreases in estimated remediation costs exceeded the depreciated carrying value of previously capitalized asset retirement costs. Environmental expenses also include project management fees, legal fees and provisions for environmental litigation loss reserves.

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During the six months ended June 30, 2013 and 2012, we increased the carrying value of certain of our properties by \$4,741,000 and \$3,691,000, respectively, due to increases in estimated remediation costs. The recognition, and subsequent changes in estimates, in environmental liabilities and the increase or decrease in carrying value of the properties are non-cash transactions which do not appear on the face of the consolidated statements of cash flows. Capitalized asset retirement costs are being depreciated over the estimated remaining life of the underground storage tank, a ten year period if the increase in carrying value related to environmental remediation obligations or such shorter period if circumstances warrant, such as the remaining lease term for properties we lease from others. Depreciation and amortization expense included in continuing operations and earnings from operating activities in discontinued operations in our consolidated statements of operations for the six months ended June 30, 2013 and 2012 aggregated \$1,242,000 and \$3,168,000, respectively, for depreciation related to capitalized asset retirement costs. Capitalized asset retirement costs were \$22,128,000 and \$23,549,000 as of June 30, 2013 and December 31, 2012, respectively.

We cannot predict what environmental legislation or regulations may be enacted in the future or how existing laws or regulations will be administered or interpreted with respect to products or activities to which they have not previously been applied. We cannot predict if state UST fund programs will be administered and funded in the future in a manner that is consistent with past practices and if future environmental spending will continue to be eligible for reimbursement at historical recovery rates under these programs. Compliance with more stringent laws or regulations, as well as more vigorous enforcement policies of the regulatory agencies or stricter interpretation of existing laws, which may develop in the future, could have an adverse effect on our financial position, or that of our tenants, and could require substantial additional expenditures for future remediation.

In view of the uncertainties associated with environmental expenditure contingencies, we are unable to estimate ranges in excess of the amount accrued with any certainty; however, we believe it is possible that the fair value of future actual net expenditures could be substantially higher than amounts currently recorded by us. Adjustments to accrued liabilities for environmental remediation obligations will be reflected in our financial statements as they become probable and a reasonable estimate of fair value can be made. Future environmental expenses could cause a material adverse effect on our business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

**Table of Contents****6. SHAREHOLDERS EQUITY**

A summary of the changes in shareholders equity for the six months ended June 30, 2013 is as follows (in thousands, except share amounts):

	COMMON STOCK		PAID-IN	DIVIDENDS PAID IN EXCESS	TOTAL
	SHARES	AMOUNT	CAPITAL	OF EARNINGS	
Balance, December 31, 2012	33,396,720	\$ 334	\$ 461,426	\$ (89,011)	\$ 372,749
Net earnings				23,089	23,089
Dividends				(13,477)	(13,477)
Stock-based employee compensation expense	160		518		518
Balance, June 30, 2013	33,396,880	\$ 334	\$ 461,944	\$ (79,399)	\$ 382,879

We are authorized to issue 20,000,000 shares of preferred stock, par value \$.01 per share, of which none were issued as of June 30, 2013 or December 31, 2012.

**7. PROPERTY ACQUISITIONS**

On May 9, 2013, we acquired 16 Mobil branded gasoline station and convenience store properties in the metro New York region and 20 Exxon and Shell branded gasoline station and convenience store properties located within the Washington, D.C. Beltway for \$72,500,000 in two sale/leaseback transactions with subsidiaries of Capitol Petroleum Group, LLC (Capitol). The two new triple-net unitary leases have an initial term of 15 years plus three renewal options with provisions for rent escalations during the initial and renewal terms. As triple-net lessees, our tenants in this acquisition are required to pay all amounts pertaining to the properties subject to the unitary leases, including environmental expenses, taxes, assessments, licenses and permit fees, charges for public utilities and all governmental charges. The acquisition was financed with \$11,500,000 of proceeds from 1031 exchanges, \$57,500,000 of borrowings under our Credit Agreement and cash on hand.

We accounted for these transactions as business combinations. We estimated the fair value of acquired tangible assets (consisting of land, buildings and equipment) as if vacant. Based on these estimates, we allocated \$62,365,000 of the purchase price to land, buildings and equipment, \$6,267,000 to direct financing leases and \$3,868,000 to in-place leases and other intangible assets. We incurred transaction costs of \$410,000 directly related to these acquisitions which are included in general and administrative expenses in our consolidated statements of operations. The future contractual minimum annual rent receivable from Capitol on a calendar year basis is as follows: 2013 \$3,762,000, 2014 \$5,830,000, 2015 \$5,830,000, 2016 \$5,908,000, 2017 \$6,026,000, 2018 \$6,147,000 and \$64,195,000 thereafter.

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As of June 30, 2013, our allocations of the purchase price among the assets acquired are preliminary and subject to change. The purchase price has been allocated among the assets acquired based on the initial estimates of fair value. These allocations are preliminary and may not be indicative of the final allocations. We anticipate finalizing these allocations in the third quarter of 2013. A change in the final allocation from what is presented may result in an increase or decrease in identified assets and changes in revenue and expenses, including amortization and other expenses.

*UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL INFORMATION*

The following unaudited pro forma condensed consolidated financial information has been prepared utilizing our historical financial statements and the combined effect of additional revenue and expenses from the properties acquired from Capitol assuming that the acquisitions had occurred as of the beginning of the earliest period presented, after giving effect to certain adjustments including: (a) rental income adjustments resulting from the straight-lining of scheduled rent increases; and (b) rental income adjustments resulting from the recognition of revenue under direct financing leases over the lease term using the effective interest rate method which produces a constant periodic rate of return on the net investment in the leased properties. The following information also gives effect to the additional interest expense resulting from the assumed increase in borrowings outstanding under the Credit Agreement to fund the acquisition and the elimination of acquisition costs. The unaudited pro forma condensed financial information is not indicative of the results of operations that would have been achieved had the acquisition from Capitol reflected herein been consummated on the dates indicated or that will be achieved in the future.

(in thousands, except per share data)	Three months ended		Six months ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Revenues	\$ 25,766	\$ 26,638	\$ 51,001	\$ 55,087
Net earnings	\$ 13,145	\$ 4,432	\$ 24,302	\$ 11,722
Basic and diluted net earnings per common share	\$ 0.39	\$ 0.13	\$ 0.73	\$ 0.35

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the sections entitled Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, which appears in our Annual Report on Form 10-K for the year ended December 31, 2012, and Part I, Item 1. Financial Statements and Part II, Item 1A. Risk Factors which appear in this Quarterly Report on Form 10-Q.

#### **GENERAL**

##### ***Real Estate Investment Trust***

We are a real estate investment trust ( REIT ) specializing in the ownership, leasing and financing of retail motor fuel and convenience store properties. As of June 30, 2013, we owned 907 properties and leased 133 properties from third parties. We elected to be treated as a REIT under the federal income tax laws beginning January 1, 2001. As a REIT, we are not subject to federal corporate income tax on the taxable income we distribute to our shareholders. In order to continue to qualify for taxation as a REIT, we are required, among other things, to distribute at least 90% of our ordinary taxable income to our shareholders each year.

##### ***Retail Petroleum Marketing Business***

Our business model is to lease our properties on a triple-net basis primarily to petroleum distributors and, to a lesser extent, individual operators. Our tenants operate our properties directly or sublet our properties to operators who operate their gas stations, convenience stores, automotive repair service facilities or other businesses at our properties. These tenants are responsible for the operations conducted at these properties. Our triple-net tenants are generally responsible for the payment of all taxes, maintenance, repairs, insurance, environmental and other operating expenses relating to our properties. Substantially all of our tenants' financial results depend on the sale of refined petroleum products and rental income from their subtenants. As a result, our tenants' financial results are highly dependent on the performance of the petroleum marketing industry, which is highly competitive and subject to volatility. (For additional information regarding our real estate business and our properties, see Part I, Item 1. Business Real Estate Business and Part I, Item 2. Properties, which appear in our Annual Report on Form 10-K for the year ended December 31, 2012.)

##### ***Core Net Lease Portfolio***

As of June 30, 2013, we leased approximately 750 properties to tenants under long-term triple-net leases. Included in the core net lease portfolio are approximately 660 properties leased to approximately 20 regional and national fuel distributor tenants. The remaining approximately 90 locations are single unit triple-net leases.

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The core net lease portfolio includes nine of the ten long-term triple-net leases with petroleum distributors entered into in 2012 related to properties previously leased to Marketing. As a result of the uncertainty surrounding the NECG Lease (discussed below), we have not classified the NECG Lease as part of our core net lease portfolio at this time. These leases generally have initial terms of 15 years, and options for successive renewal terms of up to 20 years. Rent is scheduled to increase at varying intervals of up to three years on the anniversary of the commencement date of the leases. The majority of the leases provide for additional rent based on the volume of petroleum products sold.

The core net lease portfolio also includes the 16 Mobil branded gasoline station and convenience store properties in the metro New York region and 20 Exxon and Shell branded gasoline station and convenience store properties located within the Washington, D.C. Beltway we acquired for \$72.5 million in two sale/leaseback transactions with Capitol in May 2013.

As part of our overall growth strategy, we regularly review acquisition and financing opportunities to acquire additional properties, and we expect to continue to pursue acquisitions that we believe will benefit our financial performance. Our investment strategy is aimed at achieving a high quality real estate portfolio and geographic diversification. A key element of our investment strategy is to acquire properties in strong primary markets that serve high density population centers. We cannot provide any assurance that we will be successful in acquiring additional portfolios of properties, or that our current sources of liquidity will be sufficient to fund such acquisitions.

### ***Transitional Properties***

As of June 30, 2013, we had approximately 290 transitional properties in our portfolio, substantially all of which were previously leased to Marketing, which are not considered core to our business. We continue to reposition these properties and expect that we will sell and lease these properties over time. The timing of pending transactions may be affected by factors beyond our control and we cannot predict the timing or terms of any future sales or leases.

***Property Dispositions.*** During the year ended December 31, 2012, we sold 54 properties previously leased to Marketing which had their underground storage tanks removed for \$15.4 million in aggregate. During the six months ended June 30, 2013, we sold 77 properties, including two terminals, for \$26.7 million in aggregate. Subsequent to June 30, 2013, we have sold three properties for \$24.5 million in the aggregate, including a property in Manhattan for \$23.5 million and one terminal.

***Properties Held for Sale.*** We are continuing a process of disposing of assets which we have determined are not part of our core business. In accordance with GAAP, 144 properties have met the criteria to be classified as held for sale as of June 30, 2013. The majority of these properties are subject to month-to-month license agreements with occupants (substantially all of whom were Marketing's former subtenants) allowing such occupants to continue to occupy and use these properties as gas stations, convenience stores, automotive repair service facilities or other businesses. The remaining approximately 70 properties are currently vacant, many of which have had their underground storage tanks removed. The timing of pending transactions may be affected by factors beyond our control and we cannot predict the timing or terms of any future sales or leases.

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**Leasing Activities.** As of the date of this Quarterly Report on Form 10-Q, we are negotiating triple-net leases for approximately 50 properties previously leased to Marketing. Generally these properties are operating as gas stations and are subject to month-to-month license agreements and may be subject to interim fuel supply arrangements. We expect that we will lease substantially all of these remaining properties, either individually or in small portfolios. We may make investments in certain of these properties in anticipation of leasing them or by contributing to capital expenditures required to be made by our new tenants. We cannot predict the timing or the terms of any future leases. It is likely that we will dispose of those properties that are not leased.

**Property Evictions.** We are pursuing eviction proceedings involving approximately 40 of our properties in various jurisdictions against Marketing's former subtenants who have not vacated our properties and most of whom have not accepted license agreements with us or have not entered into new agreements with our distributor tenants and therefore occupy our properties without right. We are incurring significant costs, primarily legal expenses, in connection with such proceedings.

Eviction proceedings involving 26 of our properties in the State of Connecticut have materially adversely impacted our tenant, NECG Holdings Corp (NECG). We originally entered into a lease with NECG comprising 84 properties on May 1, 2012 (the NECG Lease). As of the date of this Quarterly Report on Form 10-Q, the Superior Court of the State of Connecticut designated to hear the eviction proceedings has ruled in our favor in substantially all of these locations. However, we anticipate that Marketing's former subtenants (or sub-subtenants) will appeal this ruling. We remain confident that we will prevail in any appeal; however, we cannot predict when such appeal will be resolved or when we will be able to deliver occupancy of the properties to our tenant, NECG. As a result of the disruption and costs associated with the litigation, NECG is not current in its rent and certain other obligations due to us under the NECG Lease.

We have commenced discussions with NECG to restructure the NECG Lease including a modification which we believe is likely to result in the removal of approximately 25 to 30 properties. As such, we increased our accounts receivable bad debt reserves by approximately \$1.2 million during the three months ended June 30, 2013, so that the total bad debt reserve related to the NECG Lease is approximately \$1.9 million in aggregate. In addition, in the second quarter of 2013, we provided a non-cash allowance for deferred rent receivable of \$1.5 million for the likely removal of these properties and for rent payment deferrals previously agreed to for the six months ended June 30, 2013. This non-cash allowance reduced our net earnings for the three and six months ended June 30, 2013, but did not impact our cash flow from operating activities. As a result of the uncertainty surrounding the NECG Lease, we have not classified the NECG Lease as part of our core net lease portfolio at this time. We cannot provide any assurance that we will be successful in our efforts to restructure the NECG Lease.

We will continue to pay operating expenses such as maintenance, repairs, real estate taxes, insurance and general upkeep related to the properties previously leased to Marketing which are not subject to triple-net leases (Property Expenditures) until we sell or lease on a triple-net basis these properties. For the first six months of 2013, we incurred \$4.6 million of such Property Expenditures related to these properties. In addition, we will continue to pay certain environmental related liabilities and expenses which Marketing was responsible to pay for (the Marketing Environmental Liabilities). In addition, we

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have increased the number of our tenants significantly and are performing other property related functions previously performed by Marketing, both of which have resulted in permanent increases in our annual operating expenses. Costs involved with re-letting or repositioning properties formerly leased to Marketing and pursuit of our claims in connection with Marketing's bankruptcy have resulted in increases to our operating expenses during the six months ended June 30, 2013, as compared to the respective prior year period; however, we anticipate these costs will decline from current levels in the second half of 2013 as properties are sold or leased on a triple-net basis and our litigation costs decline. We incurred significant costs associated with Marketing's bankruptcy, including legal and litigation expenses, of which \$2.8 million and \$1.7 million are included in general and administrative expense for the six months ended June 30, 2013 and 2012, respectively.

### ***Marketing and the Master Lease***

On December 5, 2011, Marketing filed for Chapter 11 bankruptcy protection in the Bankruptcy Court. On March 7, 2012, we entered into a stipulation with Marketing and with the Official Committee of Unsecured Creditors in the Bankruptcy proceedings (the "Creditors Committee"), which was approved and made an order by the Bankruptcy Court on April 2, 2012 (the "Stipulation"). Pursuant to the terms of the Stipulation, in addition to our other pre-petition and post-petition claims, we are entitled to recover an administrative claim capped at \$10.5 million for the partial payment of fixed rent and performance of other obligations due from Marketing under the Master Lease from December 5, 2011 until possession of the properties subject to the Master Lease was returned to us effective April 30, 2012 (the "Administrative Claim"). Our Administrative Claim has priority over the claims of other creditors and certain of our other claims.

The Bankruptcy Court appointed a liquidating trustee (the "Liquidating Trustee") to oversee the liquidation of the Marketing estate (the "Marketing Estate"). The Liquidating Trustee continues to oversee the Marketing Estate and pursue claims for the benefit of its creditors, including those related to the recovery of various deposits, including surety bonds, insurance policy claims and claims made to state funded tank reimbursement programs.

In December 2011, the Marketing Estate filed a lawsuit against Marketing's former parent, Lukoil Americas Corporation, and certain of its affiliates (collectively, "Lukoil"), as well as the former directors and officers of Marketing (the "Lukoil Complaint"). The Lukoil Complaint asserted, among other claims, that Marketing's sale of assets to Lukoil in November 2009 constituted a fraudulent conveyance, and that the assets or their value can be recovered from Lukoil. In addition, the Lukoil Complaint asserted that the former directors and officers violated their fiduciary duties to Marketing in approving and effectuating the challenged sale, and are liable for money damages. On July 17, 2013, the Marketing Estate, Lukoil and certain directors and officers of Marketing agreed to settle the Lukoil Complaint. The terms of the settlement include a release of the defendants from the claims alleged by the Marketing Estate in the Lukoil Complaint and a collective payment by or on behalf of the defendants to the Marketing Estate of \$93.0 million (the "Lukoil Settlement"). On July 29, 2013, the Bankruptcy Court issued an order approving the Lukoil Settlement. We expect to realize initial proceeds in the third quarter of 2013 from the settlement aggregating approximately \$32.5 million, based on the return under the Litigation Funding Agreement (described in more detail below) and payment of our remaining Administrative Claim (discussed above), plus additional distributions we may receive from the Marketing Estate for our pro-rata share of the remainder of the Lukoil Settlement amount available to satisfy unsecured claims. We are investigating whether a portion of the payments we receive pursuant to the Litigation Funding Agreement may be subject to federal income taxes. (For information regarding factors that could adversely affect us relating to tax matters, see Part II, Item 1A. Risk Factors, which appears in this Quarterly Report on Form 10-Q.)



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In October 2012, we entered into an agreement with the Marketing Estate to make loans and otherwise fund up to an aggregate amount of \$6.7 million to fund the prosecution of the Lukoil Complaint and certain Liquidating Trustee expenses incurred in connection with the wind-down of the Marketing Estate (the Litigation Funding Agreement). The Litigation Funding Agreement provides that we are entitled to receive proceeds, if any, from the successful prosecution of the Lukoil Complaint in an amount equal to the sum of (i) all funds advanced for wind-down costs and expert witness and consultant fees plus interest accruing at 15% per annum on such advances made by us; plus (ii) the greater of all funds advanced for legal fees and expenses relating to the prosecution of the Lukoil Complaint plus interest accruing at 15% per annum on such advances made by us, or 24% of the gross proceeds from any settlement or favorable judgment obtained by the Liquidating Trustee due to the Lukoil Complaint. We advanced \$5.1 million in the first six months of 2013 and \$6.5 million in the aggregate through June 30, 2013 to the Marketing Estate pursuant to the Litigation Funding Agreement. The Litigation Funding Agreement also provides that we are entitled to be reimbursed for up to \$1.3 million of our legal fees in connection with the Litigation Funding Agreement. Based on the terms of the agreement, we have recorded a receivable of \$8.1 million as of June 30, 2013, which includes amounts advanced, accrued interest and amounts due for reimbursable legal fees we incurred in connection with the Litigation Funding Agreement. Pursuant to the terms of the Litigation Funding Agreement, we expect to receive a payment of \$25.9 million, as a result of the Lukoil Settlement, which is comprised of \$2.2 million related to advances for wind-down costs and expert witness and consultant fees, \$0.1 million of accrued interest, \$22.3 million of return on our investment due for advances of legal fees and expenses and \$1.3 million for reimbursable legal fees. We are investigating whether a portion of the payments we receive pursuant to the Litigation Funding Agreement may be subject to federal income taxes. (For information regarding factors that could adversely affect us relating to tax matters, see Part II, Item 1A. Risk Factors, which appears in this Quarterly Report on Form 10-Q.)

We received distributions from the Marketing Estate reducing our Administrative Claim by \$3.3 million in the first six months of 2013 and by \$4.7 million in the aggregate through June 30, 2013. As a result of the Lukoil Settlement, we expect to receive the remaining amount due for our Administrative Claim and accrued interest aggregating \$6.6 million. As a result, in the first six months of 2013, we reduced our bad debt reserve for uncollectible amounts due from Marketing by \$8.8 million and reduced bad debt expense included in general and administrative expenses by \$6.4 million and increased earnings from operating activities included in discontinued operations by \$2.4 million in our consolidated statements of operations. We cannot provide any assurance as to the amount or timing of recoveries, if any, with respect to our remaining claims against the Marketing Estate.

Under the Master Lease, Marketing was responsible to pay for certain environmental related liabilities and expenses. As a result of Marketing's bankruptcy filing, we have accrued for the Marketing Environmental Liabilities and are funding remediation activities related to such accruals. We expect to continue to incur and fund costs associated with the Marketing bankruptcy proceedings and associated eviction proceedings as well as costs associated with repositioning properties previously leased to Marketing. We incurred \$0.4 million of lease origination costs in the first six months of 2013 and \$3.5 million through June 30, 2013, which deferred expense is recognized on a straight-line basis as

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amortization expense in our consolidated statements of operations over the terms of the various leases. We expect to continue to incur operating expenses such as maintenance, repairs, real estate taxes, insurance and general upkeep related to vacant properties and properties subject to our month-to-month license agreements. In certain of our new leases, we have also agreed to co-invest as much as \$14.1 million with our tenants to fund capital improvements including replacing underground storage tanks and related equipment or renovating some of the properties previously leased to Marketing.

It is possible that our estimates for the Marketing Environmental Liabilities and other expenses relating to the properties previously leased to Marketing will be higher than the amounts we have accrued and that issues involved in re-letting or repositioning these properties may require significant management attention that would otherwise be devoted to our ongoing business. In addition, we increased our number of tenants significantly and are performing property related functions previously performed by Marketing, both of which have resulted in permanent increases in our annual operating expenses. The incurrence of these various expenses may materially negatively impact our cash flow and ability to pay dividends.

Our estimates, judgments, assumptions and beliefs regarding Marketing and the Master Lease affect the amounts reported in our financial statements and are subject to change. Actual results could differ from these estimates, judgments and assumptions and such differences could be material. If we do not realize the proceeds we are expecting from the Lukoil Settlement; if the Bankruptcy Court takes actions that are detrimental to our interests; if we are unable to re-let or sell, upon terms that are favorable to us, the properties previously leased to Marketing which are not subject to triple-net leases; if the amounts realized from the disposition of assets held for sale vary significantly from our estimates of fair value; or if we change our estimates, judgments, assumptions and beliefs; our business, financial condition, revenues, operating expenses, results of operations, liquidity, ability to pay dividends and stock price may be materially adversely affected or adversely affected to a greater extent than we have experienced.

### ***Asset Impairment***

We perform an impairment analysis for the carrying amount of our properties in accordance with GAAP when indicators of impairment exist. We reduced the carrying amount to fair value, and recorded in continuing and discontinued operations, non-cash impairment charges aggregating \$0.5 million and \$4.5 million for the three and six months ended June 30, 2013, respectively, and \$2.8 million and \$3.1 million for the three and six months ended June 30, 2012, respectively, where the carrying amount of the property exceeded the estimated undiscounted cash flows expected to be received during the assumed holding period which includes the estimated sales value expected to be received at disposition. The non-cash impairment charges were attributable to reductions in the assumed holding period used to test for impairment, reductions in our estimates of value for properties held for sale and the accumulation of asset retirement costs as a result of an increase in estimated environmental liabilities which increased the carrying value of certain properties in excess of their fair value. The evaluation of and estimates of anticipated cash flows used to conduct our impairment analysis is highly subjective and actual results could vary significantly from our estimates.

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**Table of Contents*****Supplemental Non-GAAP Measures***

We manage our business to enhance the value of our real estate portfolio and, as a REIT, place particular emphasis on minimizing risk and generating cash sufficient to make required distributions to shareholders of at least 90% of our ordinary taxable income each year. In addition to measurements defined by accounting principles generally accepted in the United States of America ( GAAP ), our management also focuses on funds from operations available to common shareholders ( FFO ) and adjusted funds from operations available to common shareholders ( AFFO ) to measure our performance. FFO is generally considered to be an appropriate supplemental non-GAAP measure of the performance of REITs. In accordance with the National Association of Real Estate Investment Trusts' modified guidance for reporting FFO, we have restated reporting of FFO for all periods presented to exclude non-cash impairment charges. FFO is defined by the National Association of Real Estate Investment Trusts as net earnings before depreciation and amortization of real estate assets, gains or losses on dispositions of real estate (including such non-FFO items reported in discontinued operations), non-cash impairment charges, extraordinary items and cumulative effect of accounting change. Other REITs may use definitions of FFO and/or AFFO that are different than ours and; accordingly, may not be comparable. Beginning in 2011, we revised our definition of AFFO to exclude direct expensed costs related to property acquisitions and other unusual or infrequently occurring items.

We believe that FFO and AFFO are helpful to investors in measuring our performance because both FFO and AFFO exclude various items included in GAAP net earnings that do not relate to, or are not indicative of, our fundamental operating performance. FFO excludes various items such as gains or losses from property dispositions and depreciation and amortization of real estate assets and non-cash impairment charges. In our case; however, GAAP net earnings and FFO typically include the impact of Revenue Recognition Adjustments (as defined below) comprised of deferred rental revenue (straight-line rental revenue), the net amortization of above-market and below-market leases and income recognized from direct financing leases on our recognition of revenues from rental properties, as offset by the impact of related collection reserves. GAAP net earnings and FFO from time to time may also include property acquisition costs or other unusual or infrequently recurring items. Deferred rental revenue results primarily from fixed rental increases scheduled under certain leases with our tenants. In accordance with GAAP, the aggregate minimum rent due over the current term of these leases are recognized on a straight-line (or average) basis rather than when payment is contractually due. The present value of the difference between the fair market rent and the contractual rent for in-place leases at the time properties are acquired is amortized into revenue from rental properties over the remaining lives of the in-place leases. Income from direct financing leases is recognized over the lease terms using the effective interest method which produces a constant periodic rate of return on the net investments in the leased properties. Property acquisition costs are expensed, generally in the period when properties are acquired, and are not reflective of normal operations. Other unusual or infrequently occurring items are not reflective of normal operations.

Management pays particular attention to AFFO, a supplemental non-GAAP performance measure that we define as FFO less Revenue Recognition Adjustments, property acquisition costs and other unusual or infrequently occurring items. In management's view, AFFO provides a more accurate depiction than FFO of our fundamental operating performance related to: (i) the impact of scheduled rent increases from operating leases, net of related collection reserves; (ii) the rental revenue earned from acquired in-place leases; (iii) the impact of rent due from direct financing leases; (iv) our operating

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expenses (exclusive of direct expensed operating property acquisition costs); and (v) other unusual or infrequently occurring items. Neither FFO nor AFFO represent cash generated from operating activities calculated in accordance with GAAP and therefore these measures should not be considered an alternative for GAAP net earnings or as a measure of liquidity.

A reconciliation of net earnings to FFO and AFFO for the three and six months ended June 30, 2013 and 2012 is as follows (in thousands, except per share amounts):

	<i>Three months ended</i>		<i>Six months ended</i>	
	<i>June 30,</i>		<i>June 30,</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
Net earnings	\$ 12,739	\$ 3,626	\$ 23,089	\$ 10,111
Depreciation and amortization of real estate assets	2,409	3,487	5,052	7,474
Gains from dispositions of real estate	(4,174)	(2,708)	(12,606)	(3,241)
Impairment charges	468	2,783	4,452	3,146
<b>Funds from operations</b>	<b>11,442</b>	<b>7,188</b>	<b>19,987</b>	<b>17,490</b>
Revenue recognition adjustments	(1,361)	(901)	(3,744)	(1,535)
Allowance for deferred rent receivable	1,531		1,531	
Acquisition costs	410		410	
<b>Adjusted funds from operations</b>	<b>\$ 12,022</b>	<b>\$ 6,287</b>	<b>\$ 18,184</b>	<b>\$ 15,955</b>
Diluted per share amounts:				
Earnings per share	\$ 0.38	\$ 0.11	\$ 0.69	\$ 0.30
Funds from operations per share	\$ 0.34	\$ 0.22	\$ 0.59	\$ 0.52
Adjusted funds from operations per share	\$ 0.36	\$ 0.19	\$ 0.54	\$ 0.48
Diluted weighted-average shares outstanding	33,397	33,395	33,397	33,395

**RESULTS OF OPERATIONS*****Three months ended June 30, 2013 compared to the three months ended June 30, 2012***

Revenues from rental properties included in continuing operations decreased by \$0.3 million to \$24.1 million for the three months ended June 30, 2013, as compared to \$24.4 million for the three months ended June 30, 2012. For the three months ended June 30, 2012, revenues from rental properties included in continuing operations include approximately \$4.6 million in rent contractually due or received from Marketing under the Master Lease (for which bad debt reserves were fully provided and are included in general and administrative expenses in our consolidated statements of operations). The decrease in revenues from rental properties for the three months June 30, 2013 was primarily due to the fact that we are generating less net revenue from the leasing of properties that were previously subject to the Master Lease than the contractual rent historically due from Marketing under the Master Lease. The decrease in revenues from rental properties was partially offset by an increase in the real estate taxes we paid and billed to tenants pursuant to their triple-net lease agreements and approximately \$0.9 million of rental income from the properties acquired in May 2013. Revenues from rental properties and rental property expense included \$3.7 million for the three months ended June 30, 2013, as compared to \$3.0 million for the three months ended June 30, 2012 for real estate taxes paid by us and reimbursable by our tenants pursuant to their triple-net lease agreements. Revenues from rental properties included in continuing operations for the three months ended June 30, 2013 also include a net loss of \$0.4 million for amounts realized under interim fuel supply agreements, as compared to a net gain of \$1.6 million for the three months ended June 30, 2012.

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In accordance with GAAP, we recognize rental revenue in amounts which vary from the amount of rent contractually due or received during the periods presented. As a result, revenues from rental properties include Revenue Recognition Adjustments comprised of non-cash adjustments recorded for deferred rental revenue due to the recognition of rental income on a straight-line basis over the current lease term, net amortization of above-market and below-market leases and recognition of rental income under direct financing leases using the effective interest rate method which produces a constant periodic rate of return on the net investments in the leased properties. Rental revenue includes Revenue Recognition Adjustments which increased rental revenue by \$1.4 million for the three months ended June 30, 2013 and \$0.9 million for the three months ended June 30, 2012.

Interest income from notes and mortgages receivable increased by \$0.3 million to \$1.0 million for the three months ended June 30, 2013, as compared to \$0.7 million the three months ended June 30, 2012 due to a net increase in mortgage receivables outstanding as a result of the issuance of mortgage notes in connection with property dispositions.

Rental property expenses included in continuing operations, which are primarily comprised of rent expense, real estate and other state and local taxes and maintenance expense, were \$6.7 million for the three months ended June 30, 2013, as compared to \$7.0 million for the three months ended June 30, 2012. The decrease in rental property expenses is principally due lower maintenance expenses paid by us resulting from the cumulative effect of a declining number of properties which are not leased on a triple-net basis and property dispositions.

Non-cash impairment charges of \$0.4 million are included in continuing operations for the three months ended June 30, 2013, as compared to \$1.6 million recorded for the three months ended June 30, 2012. Impairment charges are incurred when