Select Income REIT
Form 10-Q
October 27, 2014
Table of Contents

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

Commission File Number 1-35442

SELECT INCOME REIT

(Exact Name of Registrant as Specified in Its Charter)

Maryland	45-4071747

(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

Two Newton Place, 255 Washington Street, Suite 300, Newton, Massachusetts	02458-1634
(Address of Principal Executive Offices)	(Zip Code)

617-796-8303

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

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

Number of registrant's common shares of beneficial interest, $.01 par value per share, outstanding as of October 23, 2014: 59,952,883

SELECT INCOME REIT

FORM 10-Q

September 30, 2014

INDEX

References in this Form 10-Q to “we”, “us” and “our” refer to Select Income REIT and its consolidated subsidiaries, unless otherwise noted.

Table of Contents

PART IFinancial Information

Item 1. Financial Statements

SELECT INCOME REIT

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

(unaudited)

	September 30, 2014	December 31, 2013
ASSETS		
Real estate properties:		
Land	$ 754,759	$ 732,509
Buildings and improvements	1,099,474	913,948
	1,854,233	1,646,457
Accumulated depreciation	(87,231)	(67,223)
	1,767,002	1,579,234
Acquired real estate leases, net	121,501	129,426
Cash and cash equivalents	14,710	20,025
Restricted cash	42	42
Rents receivable, net of allowance for doubtful accounts of $1,551 and $936, respectively	65,116	55,335
Deferred leasing costs, net	6,134	5,599
Deferred financing costs, net	3,371	4,834
Other assets	11,966	7,364
Total assets	$ 1,989,842	$ 1,801,859
LIABILITIES AND SHAREHOLDERS' EQUITY		
Revolving credit facility	$ 65,000	$ 159,000
Term loan	350,000	350,000

Mortgage notes payable	18,952	27,147
Accounts payable and accrued expenses	25,440	20,655
Assumed real estate lease obligations, net	26,250	26,966
Rents collected in advance	9,993	8,637
Security deposits	10,336	8,359
Due to related parties	1,772	2,404
Total liabilities	507,743	603,168
Commitments and contingencies		
Shareholders' equity:		
Common shares of beneficial interest, $.01 par value: 125,000,000 and 75,000,000 shares authorized, respectively; 59,949,542 and 49,829,541 shares issued and outstanding, respectively	599	498
Additional paid in capital	1,440,792	1,160,894
Cumulative net income	223,352	144,343
Cumulative other comprehensive loss	(17)	(25)
Cumulative common distributions	(182,627)	(107,019)
Total shareholders' equity	1,482,099	1,198,691
Total liabilities and shareholders' equity	$ 1,989,842	$ 1,801,859

See accompanying notes

1

Table of Contents

SELECT INCOME REIT

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
REVENUES:				
Rental income	$ 48,523	$ 41,169	$ 142,051	$ 117,333
Tenant reimbursements and other income	8,177	7,415	24,234	21,057
Total revenues	56,700	48,584	166,285	138,390
EXPENSES:				
Real estate taxes	5,645	5,020	16,580	14,805
Other operating expenses	4,637	4,267	13,666	11,367
Depreciation and amortization	10,653	8,485	30,442	22,445
Acquisition related costs	5,365	790	5,739	1,479
General and administrative	3,749	3,208	11,123	8,884
Total expenses	30,049	21,770	77,550	58,980
Operating income	26,651	26,814	88,735	79,410
Interest expense (including amortization of debt premiums and deferred financing fees of $378, $369, $1,182 and $1,090, respectively)	(3,033)	(3,232)	(10,025)	(10,484)
Gain on early extinguishment of debt	-	-	243	-
Income before income tax expense and equity in earnings of an investee	23,618	23,582	78,953	68,926
Income tax expense	(30)	(52)	(120)	(132)
Equity in earnings of an investee	38	64	59	219
Income before gain on sale of property	23,626	23,594	78,892	69,013
Gain on sale of property	116	-	116	-
Net income	23,742	23,594	79,008	69,013
Other comprehensive income:				
Equity in unrealized gain (loss) of an investee	(33)	14	8	(67)
Other comprehensive income (loss)	(33)	14	8	(67)

Comprehensive income	$ 23,709	$ 23,608	$ 79,016	$ 68,946
Weighted average common shares outstanding	59,905	49,686	54,678	42,790
Basic and diluted net income per common share	$ 0.40	$ 0.47	$ 1.44	$ 1.61

See accompanying notes

Table of Contents

SELECT INCOME REIT

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

(unaudited)

	Nine Months Ended September 30,			
	2014		2013	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	$	79,008	$	69,013
Adjustments to reconcile net income to cash provided by operating activities				
Depreciation		20,020		14,890
Net amortization of debt premiums and deferred financing fees		1,182		1,090
Amortization of acquired real estate leases and assumed real estate lease obligations		9,625		7,732
Amortization of deferred leasing costs		711		625
Provision for losses on rents receivable		356		180
Straight line rental income		(12,757)		(9,763)
Gain on early extinguishment of debt		(243)		-
Gain on sale of property		(116)		-
Other non-cash expenses		1,671		1,115
Equity in earnings of equity investments		(59)		(219)
Change in assets and liabilities:				
Rents receivable		2,620		(3,705)
Deferred leasing costs		(1,246)		(1,350)
Other assets		(3,709)		(4,509)
Due from related parties		-		585
Accounts payable and accrued expenses		4,457		1,686

Rents collected in advance		1,356		2,973
Security deposits		1,977		323
Due to related parties		175		(463)
Net cash provided by operating activities		105,028		80,203
CASH FLOWS FROM INVESTING ACTIVITIES:				
Real estate acquisitions		(208,825)		(293,631)
Real estate improvements		(859)		(3,869)
Proceeds from sale of property, net		116		-
Investment in Affiliates Insurance Company		(825)		-
Net cash used in investing activities		(210,393)		(297,500)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from issuance of common shares, net		277,329		283,510
Proceeds from borrowings		256,000		308,000
Repayments of borrowings		(357,671)		(323,161)
Deferred financing fees		-		(1,194)
Distributions to common shareholders		(75,608)		(55,691)
Net cash provided by financing activities		100,050		211,464
Decrease in cash and cash equivalents		(5,315)		(5,833)
Cash and cash equivalents at beginning of period		20,025		20,373
Cash and cash equivalents at end of period	$	14,710	$	14,540
SUPPLEMENTAL DISCLOSURE:				
Interest paid	$	8,975	$	9,294
Income taxes paid	$	93	$	325

See accompanying notes

Table of Contents

SELECT INCOME REIT

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

Note 1. Basis of Presentation

The accompanying condensed consolidated financial statements of Select Income REIT and its subsidiaries, or SIR, we, us or our, are unaudited. Certain information and disclosures required by U.S. generally accepted accounting principles, or GAAP, for complete financial statements have been condensed or omitted. We believe the disclosures made are adequate to make the information presented not misleading. However, the accompanying condensed consolidated financial statements should be read in conjunction with the financial statements and notes contained in our Annual Report on Form 10-K for the year ended December 31, 2013, or our Annual Report. In the opinion of our management, all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation, have been included. All material intercompany transactions and balances with or among our consolidated subsidiaries have been eliminated. Our operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect reported amounts. Actual results could differ from those estimates. Significant estimates in the condensed consolidated financial statements include the allowance for doubtful accounts, purchase price allocations and useful lives of fixed assets.

Note 2. Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This update amends the criteria for reporting discontinued operations to, among other things, raise the threshold for disposals to qualify as discontinued operations. This update is effective for interim and annual reporting periods, beginning after December 15, 2014, with early adoption permitted. We currently expect that, when adopted, this update will reduce the number of any future property dispositions we make to be presented as discontinued operations in our condensed consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which provides guidance for revenue recognition. This update is effective for interim and annual reporting periods beginning after December 15, 2016. We are currently in the process of evaluating the impact, if any, the adoption of this ASU will have on our consolidated financial statements.

In August 2014, the FASB issued Accounting Standards Update 2014-15, Presentation of Financial Statements – Going Concern: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The update requires an entity to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the financial statements are available to be issued when applicable) and to provide related footnote disclosures in certain circumstances. The update is effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter with early adoption permitted. The implementation of this update is not expected to cause any significant changes to our condensed consolidated financial statements.

Note 3. Real Estate Properties

As of September 30, 2014, we owned 50 properties (280 buildings, leasable land parcels and easements) with approximately 27.0 million rentable square feet.

During the nine months ended September 30, 2014, we acquired two properties (two buildings) with a combined 986,937 rentable square feet for an aggregate purchase price of $207,860, excluding closing costs. We

Table of Contents

allocated the purchase prices of these acquisitions based on the estimated fair values of the acquired assets and assumed liabilities. Details of the accounting for these completed acquisitions are as follows:

Date	Location	Properties \Buildings	Square Feet	Purchase Price (1)	Land	Building and Improvements	Acquired Real Estate Leases	Assumed Real Estate Lease Obligations
April 2014	Naperville, IL (2)	1 / 1	819,513	$ 187,500	$ 13,757	$ 173,743	$ -	$ -
April 2014	Mahwah, NJ (3)	1 / 1	167,424	20,360	8,492	9,451	3,968	(1,551)
		2 / 2	986,937	$ 207,860	$ 22,249	$ 183,194	$ 3,968	$ (1,551)

(1)The allocation of purchase price is based on preliminary estimates and may change upon the completion of (i) third party appraisals and (ii) our analysis of acquired in place leases and building valuations. Purchase price excludes acquisition costs.

(2)Property was acquired and simultaneously leased back to an affiliate of the seller in a sale/leaseback transaction. We accounted for this transaction as an acquisition of assets. We recognized acquisition costs of $966 which we capitalized as part of the transaction.

(3)This acquisition was accounted for as business combination.

In August 2014, we and Cole Corporate Income Trust, Inc., a Maryland corporation, or CCIT, entered into a merger agreement, or the Merger Agreement. Upon and subject to the terms and conditions of the Merger Agreement, CCIT will merge with and into SC Merger Sub LLC, one of our wholly owned subsidiaries, or SIR Merger Sub, with SIR Merger Sub being the surviving entity, or the Merger. Upon and subject to the terms and conditions of the Merger Agreement, including those related to proration, at the effective time of the Merger, or the Effective Time, each share of common stock, $.01 par value per share, of CCIT, or CCIT Common Stock, other than shares held by any wholly owned subsidiary of CCIT or by us or any of our wholly owned subsidiaries, will be converted into the right to receive either (i) $10.50 in cash, without interest, subject to certain adjustments, or the Cash Consideration, or (ii) 0.360 of a common share of ours, subject to certain adjustments, or the Share Consideration, and together with the Cash Consideration, the Merger Consideration. The maximum aggregate number of shares of CCIT Common Stock that may be converted into the right to receive the Cash Consideration is 60% of the shares of CCIT Common Stock issued and outstanding immediately prior to the Effective Time, or the Maximum Cash Consideration Number. The minimum aggregate number of shares of CCIT Common Stock that may be converted into the right to receive the

Cash Consideration is 40% of the shares of CCIT Common Stock issued and outstanding immediately prior to the Effective Time, or the Minimum Cash Consideration Number. Subject to the foregoing and the other terms and conditions of the Merger Agreement, CCIT stockholders may elect to receive either the Cash Consideration or the Share Consideration for each share of CCIT Common Stock held. If a CCIT stockholder has not made an election, subject to the terms and conditions of the Merger Agreement, the shares of the CCIT Common Stock held by such stockholder will be converted into the right to receive the Share Consideration. If the aggregate number of shares of CCIT Common Stock electing to receive the Cash Consideration exceeds the Maximum Cash Consideration Number or is less than the Minimum Cash Consideration Number, notwithstanding CCIT stockholder elections, the Cash Consideration and Share Consideration will be allocated in accordance with the proration and allocation procedures set forth in the Merger Agreement so that the Cash Consideration does not exceed the Maximum Cash Consideration Number and is not less than the Minimum Cash Consideration Number. The Merger Consideration may also be adjusted in the event that we pay a special distribution to our shareholders or CCIT pays a special distribution to its stockholders prior to the closing date. The transaction is subject to approval by our shareholders and CCIT's stockholders and other customary conditions and contingencies, and it is expected to close during the first quarter of 2015.

As part of the transaction, we will acquire CCIT's full property portfolio, which includes 64 office and industrial net leased properties as well as 23 healthcare properties, or the Healthcare Properties, for estimated total consideration of approximately $2,900,000 including the assumption of approximately $297,700 of mortgage principal and excluding transaction costs, based on the closing price of our common shares on October 7, 2014. To finance our acquisition of CCIT, we have entered an agreement to sell the Healthcare Properties to Senior Housing Properties Trust, or SNH, for a purchase price of $539,000 (consisting of approximately $509,000 in cash proceeds and assumed debt of approximately $30,000) immediately upon the completion of the Merger, resulting in an estimated net purchase price to us of approximately $2,400,000 excluding closing costs. In addition to the assumption of CCIT mortgage debt and Share

Table of Contents

Consideration, we expect to fund the net purchase price payable by us with borrowings on our revolving credit facility, and a new $1,000,000 senior unsecured bridge loan facility.

In October 2014, we entered an agreement to acquire an industrial property in Memphis, TN containing 646,000 square feet for $14,500. The property is 100% leased for 8.5 years. This acquisition is subject to completion of our diligence and other customary closing conditions, and we can provide no assurance this acquisition will close or that it will not be delayed or that its terms will not change.

As a result of an eminent domain taking in September 2014, we sold an ancillary portion of a land parcel located in Huntsville, AL resulting in a net gain on sale of $116.

Certain of our real estate assets contain hazardous substances, including asbestos. We believe the asbestos at our properties is contained in accordance with current environmental regulations and we have no current plans to remove it. If these properties were demolished today, certain environmental regulations specify the manner in which the asbestos must be removed and we could incur substantial costs complying with such regulations. Due to the uncertainty of the timing and amount of costs we may incur, we cannot reasonably estimate the fair value and we have not recognized a liability in our financial statements for these costs. Certain of our industrial lands in Hawaii may require environmental remediation, especially if the use of those lands is changed; however, we do not have any present plans to change the use of those land parcels or to undertake this environmental remediation. In general, we do not have any insurance designated to limit any losses that we may incur as a result of known or unknown environmental conditions which are not caused by an insured event, such as, for example, fire or flood, although some of our tenants may maintain such insurance. However, as of September 30, 2014 and December 31, 2013, accrued environmental remediation costs totaling $8,150 were included in accounts payable and accrued expenses in our condensed consolidated balance sheets. These accrued environmental remediation costs relate to maintenance of our properties for current uses and, because of the indeterminable timing of the remediation, these amounts have not been discounted to present value. We do not believe that there are environmental conditions at any of our properties that will have a material adverse effect on us. However, no assurances can be given that such conditions are not present in our properties or that other costs we incur to remediate contamination will not have a material adverse effect on our business or financial condition. Charges for environmental remediation costs are included in other operating expenses in our condensed consolidated statements of income and comprehensive income.

Note 4. Segment Information and Tenant Concentration

We operate in one business segment: ownership of properties that include buildings and leased industrial lands that are primarily net leased to single tenants, with no one tenant accounting for more than 10% of our total revenues. A “net leased property” or a property being “net leased” means that the building or land lease requires the tenant to pay rent and pay, or reimburse us, for all, or substantially all, property level operating expenses and capital expenditures, such as real estate taxes, insurance, utilities, maintenance and repairs, other than, in certain circumstances, roof and structural element related expenditures; in some instances, tenants instead reimburse us for all expenses in excess of certain amounts included in the stated rent. We define a single tenant leased building or leased land as a building or land parcel with at least 90% of its rentable square footage leased to one tenant. Our buildings and lands are primarily leased to single tenants; however, we also own some multi tenant buildings on the island of Oahu, HI.

Note 5. Indebtedness

In January 2014, we repaid, at par, a $7,500 mortgage note which was secured by a building located in Chelmsford, MA. This mortgage was scheduled to mature in 2016.

Table of Contents

At September 30, 2014 and December 31, 2013, our outstanding indebtedness consisted of the following:

	September 30, 2014	December 31, 2013
Revolving credit facility, due in 2016	$ 65,000	$ 159,000
Term loan, due in 2017	350,000	350,000
Mortgage note payable, 5.950% interest rate, including unamortized premium of $893 and $1,131, respectively, due in 2017 [1]	18,952	19,361
Mortgage note payable, 5.689% interest rate, including unamortized premium of $0 and $286, respectively, due in 2016 [1] [2]	-	7,786
	$ 433,952	$ 536,147

(1)We assumed these mortgages in connection with our acquisition of certain properties. The stated interest rates for these mortgage debts are the contractually stated rates; we recorded the assumed mortgages at estimated fair value on the date of acquisition and we amortize the fair value premiums to interest expense over the respective terms of the mortgages to reduce interest expense to the estimated market interest rates as of the date of acquisition.

(2)This mortgage note was repaid, at par, in January 2014.

We have a $750,000 unsecured revolving credit facility that is available for general business purposes, including acquisitions. The maturity date of our revolving credit facility is March 11, 2016 and, subject to the payment of an extension fee and meeting certain other conditions, our revolving credit facility includes an option for us to extend the stated maturity date by one year to March 11, 2017. In addition, our revolving credit facility includes a feature under which maximum borrowings may be increased to $1,000,000 in certain circumstances. Borrowings under our revolving credit facility bear interest at LIBOR plus a premium. We also pay a facility fee on the total amount of lending commitments under our revolving credit facility. Both the interest rate premium and the facility fee are subject to adjustment based upon changes to our leverage or credit ratings. As of September 30, 2014, the interest rate premium on our revolving credit facility was 130 basis points and our facility fee was 30 basis points. As of September 30, 2014, the interest rate payable on borrowings under our revolving credit facility was 1.45%. The weighted average interest rate for borrowings under the revolving credit facility was 1.45% for both the three and nine months ended September 30, 2014 and was 1.49% and 1.50% for the three and nine months ended September 30, 2013, respectively. We can borrow, repay and reborrow funds available under our revolving credit facility until maturity, and no principal repayment is due until maturity. As of September 30, 2014 and October 23, 2014, we had $65,000 and $60,000, respectively, outstanding under our revolving credit facility.

We also have a $350,000 unsecured term loan that matures on July 11, 2017 and is prepayable without penalty at any time. In addition, our term loan includes a feature under which maximum borrowings may be increased to up to

$700,000 in certain circumstances. Our term loan bears interest at a rate of LIBOR plus a premium, which was 155 basis points as of September 30, 2014. The interest rate premium is subject to adjustment based upon changes to our leverage or credit ratings. As of September 30, 2014, the interest rate payable for the amount outstanding under our term loan was 1.70%. The weighted average interest rate for the amount outstanding under our term loan was 1.69% for both the three and nine months ended September 30, 2014 and was 1.74% and 1.75% for the three and nine months ended September 30, 2013, respectively.

Our revolving credit facility agreement and our term loan agreement provide for acceleration of payment of all amounts due thereunder upon the occurrence and continuation of certain events of default, including a change of control of us, which includes Reit Management & Research LLC, or RMR, ceasing to act as our business manager and property manager. Our revolving credit facility agreement and our term loan agreement also contain a number of financial and other covenants, including covenants that restrict our ability to incur indebtedness or to make distributions under certain circumstances and require us to maintain financial ratios and a minimum net worth. We believe we were in compliance with the terms of our revolving credit facility and term loan covenants at September 30, 2014.

At September 30, 2014, one of our properties (two buildings) with an aggregate net book value of $20,418 secured a mortgage note we assumed in connection with our acquisition of the property. The aggregate principal amount outstanding under the mortgage note as of September 30, 2014, was $18,059. This mortgage note is non-recourse, subject to certain limited exceptions, and does not contain any material financial covenants.

Table of Contents

In connection with the Merger described in Note 3, during the third quarter of 2014, a group of lenders committed to provide us a 364-day senior unsecured bridge loan facility in an aggregate principal amount of $1,000,000.

Note 6. Fair Value of Financial Instruments

Our financial instruments at September 30, 2014 included cash and cash equivalents, rents receivable, equity investments, a mortgage note payable, our revolving credit facility, our term loan, amounts due to related persons and accounts payable. At September 30, 2014, the fair value of our financial instruments approximated their carrying values in our condensed consolidated financial statements due to their short term nature or variable interest rates, except as follows:

	Carrying Amount	Estimated Fair Value
Mortgage note payable	$ 18,952	$ 19,606

We estimate the fair values of our mortgage note payable by using discounted cash flow analyses and currently prevailing market rates for similar mortgage notes as of September 30, 2014. These inputs are categorized as level 3 inputs as defined in the fair value hierarchy under the accounting standards for Fair Value Measurements and Disclosures. Because level 3 inputs are unobservable, our estimated fair value may differ materially from the actual fair value.

Note 7. Shareholders' Equity

On August 30, 2014, our Board of Trustees approved an amendment to our declaration of trust to increase the number of our authorized shares of beneficial interest from 75,000,000 to 125,000,000.

Sale of Shares:

During the second quarter of 2014, we sold 10,000,000 of our common shares in a public offering, including 1,000,000 of our common shares sold when the underwriters partially exercised their option to purchase additional shares, at a price of $29.00 per share raising net proceeds of approximately $277,329, after deducting offering expenses and the underwriting discount. We used the net proceeds from this offering to partially repay amounts outstanding under our revolving credit facility and for general business purposes.

Issuance of Shares:

During the nine months ended September 30, 2014 and the period October 1, 2014 to October 23, 2014, we issued 56,001 and 3,341, respectively, of our common shares to RMR as part of the business management fees payable by us under our business management agreement. See Note 8 for further information regarding this agreement.

In May 2014, we granted 2,500 of our common shares, valued at $30.82 per share, the closing price of our common shares on the New York Stock Exchange, or the NYSE, on that day, to each of our five Trustees as part of their annual compensation.

In September 2014, pursuant to our 2012 Equity Compensation Plan, we granted an aggregate of 51,500 of our common shares to our officers and certain employees of our manager, RMR, valued at $25.63 per share, the closing price of our common shares on the NYSE, on that day.

Distributions:

On February 19, 2014, we paid a distribution of $0.46 per common share, or approximately $22,922, to shareholders of record on January 13, 2014.

On May 20, 2014, we paid a distribution of $0.48 per common share, or approximately $23,938, to shareholders of record on April 14, 2014.

On August 21, 2014, we paid a distribution of $0.48 per common share, or approximately $28,748, to shareholders of record on July 25, 2014.

On September 2, 2014, we announced that we expect to increase our annualized distribution rate to $2.00 per share (or $0.50 per share per quarter) following the completion of the Merger.

On October 7, 2014, we declared a quarterly distribution of $0.48 per common share, or approximately $28,777, to shareholders of record on October 24, 2014. We expect to pay this distribution on or about November 20, 2014 using existing cash balances and borrowings under our revolving credit facility.

Note 8. Related Person Transactions

RMR: We have no employees. Personnel and various services we require to operate our business are provided to us by RMR. We have two agreements with RMR to provide management and administrative services to us: (i) a business management agreement, which relates to our business generally, and (ii) a property management agreement, which relates to our property level operations.

One of our Managing Trustees, Mr. Barry Portnoy, is Chairman, majority owner and an employee of RMR. Our other Managing Trustee, Mr. Adam Portnoy, is the son of Mr. Barry Portnoy, and an owner, President, Chief Executive Officer and a director of RMR. Each of our executive officers is also an officer of RMR. Our Independent Trustees also serve as independent directors or independent trustees of other public companies to which RMR provides management services. Mr. Barry Portnoy and Mr. Adam Portnoy serve as managing directors or managing trustees of a majority of the companies to which RMR or its affiliates provide management services. In addition, officers of RMR serve as officers of those companies.

Pursuant to our business management agreement with RMR, we recognized business management fees of $2,275 and $2,472 for the three months ended September 30, 2014 and 2013, respectively, and $7,608 and $6,899 for the nine months ended September 30, 2014 and 2013, respectively. The fees for the three and nine months ended September 30, 2014, include $(347) and $0 of estimated 2014 incentive fees payable in common shares in 2015 based on our common share total return as of September 30, 2014. The amount of estimated incentive fees recognized during the third quarter of 2014 reflects the reversal of incentive fees accrued as of June 30, 2014, due to changes in our common share total returns as of the applicable measurement dates. The business management fee we recognized for the 2014 and 2013 periods are included in general and administrative expenses in our condensed consolidated financial statements. In accordance with the terms of our business management agreement, we issued 26,477 of our common shares to RMR for the nine months ended September 30, 2014 as payment for a portion of the base business management fee we recognized for such period. In March 2014, we also issued 32,865 of our common shares to RMR for the incentive fee for 2013 pursuant to the business management agreement.

In connection with our property management agreement with RMR, the aggregate property management and construction supervision fees we recognized were $1,561 and $1,419 for the three months ended September 30, 2014 and 2013, respectively, and $4,628 and $3,988 for the nine months ended September 30, 2014 and 2013, respectively. These amounts are included in operating expenses or have been capitalized, as appropriate, in our condensed consolidated financial statements.

On May 9, 2014, we and RMR entered into amendments to our business management agreement and property management agreement. As amended, RMR may terminate the agreements upon 120 days' written notice. Prior to the amendments, RMR could terminate the agreements upon 60 days' written notice and could also terminate the property management agreement upon five business days' notice if we underwent a change of control. The amendments also provide for certain termination payments by us to RMR in the event that we terminate the agreements other than for cause. Also, as amended, RMR agrees to provide certain transition services to us for 120 days following an applicable termination by us or notice of termination by RMR.

EQC: We were formerly a 100% owned subsidiary of Equity Commonwealth (formerly CommonWealth REIT), or EQC. As of June 30, 2014, EQC was our largest shareholder and owned 22,000,000 of our common shares, or approximately 36.7% of our outstanding common shares. One of our Managing Trustees, Mr. Barry Portnoy, was a managing trustee of EQC until March 25, 2014. Our other Managing Trustee, Mr. Adam Portnoy, was the president of EQC until May 23, 2014 and a managing trustee of EQC until March 25, 2014. In addition, Mr. John Popeo, our

Table of Contents

Treasurer and Chief Financial Officer, also served as the treasurer and chief financial officer of EQC until May 23, 2014, and one of our Independent Trustees, Mr. William Lamkin, was an independent trustee of EQC until March 25, 2014. RMR currently provides management services to EQC in respect of EQC's Australian assets and certain transition services to EQC.

In 2012, we completed our initial public offering, or IPO. To facilitate our IPO, we and EQC entered into a transaction agreement that governed our separation from and relationship with EQC. The transaction agreement provides that, among other things, we will indemnify EQC with respect to any liability relating to any property transferred by EQC to us, including any liability which relates to periods prior to our formation, other than the pre-closing current assets and current liabilities that EQC retained with respect to the 29 properties (251 buildings, leasable land parcels and easements) contributed to us by EQC in connection with our IPO, or the Initial Properties.

On March 31, 2014, we notified EQC that, effective that same day, as a result of the removal, without cause, of all of the trustees of EQC which constituted a change of control of EQC as provided in that agreement, we had elected to terminate the registration agreement that we had entered into with EQC in March 2013, pursuant to which we agreed to register for resale by EQC up to 22,000,000 of our common shares owned by EQC.

On July 9, 2014, EQC sold 21,500,000 of our common shares that it owned to Government Properties Income Trust, a Maryland real estate investment trust, or GOV, and sold 500,000 of our common shares that it owned to RMR. We were not a contracting party to this transaction. We understand that, following these sales, EQC no longer owned any of our common shares. In connection with this transaction, and in light of the fact that GOV would own greater than 10% of our common shares, our disinterested Trustees, followed by the our full Board of Trustees, adopted a resolution exempting GOV and its affiliates (as defined in the Maryland General Corporation Law), including, without limitation, RMR, from being "interested stockholders" under the Maryland Business Combination Act. As a result of this acquisition, GOV is our largest shareholder owning approximately 35.9% of our issued and outstanding common shares as of September 30, 2014.

GOV: In connection with our proposed acquisition of CCIT pursuant to the Merger Agreement, concurrently with the execution and delivery of the Merger Agreement, GOV entered into a voting and standstill agreement with CCIT and American Realty Capital Properties, Inc., a Maryland corporation and parent of the advisor of CCIT, or ARCP, or the Voting Agreement. Pursuant to the Voting Agreement, GOV has agreed to vote all of our common shares beneficially owned by it in favor of the issuance of our common shares to the stockholders of CCIT as contemplated by the Merger Agreement, upon and subject to the terms and conditions of the Voting Agreement and the Merger Agreement. In the Voting Agreement, GOV also agreed, among other things, subject to certain exceptions, not to sell or otherwise assign or dispose of or pledge SIR common shares it owns or to deposit those shares into any voting trust or enter into any other voting agreement or arrangement with respect to those shares. The Voting Agreement will terminate upon certain circumstances, including upon termination of the Merger Agreement or the closing of the Merger. The Voting Agreement also contains standstill provisions pursuant to which ARCP has agreed, among other things, not to make unsolicited proposals to acquire us or GOV for a period of 36 months. Concurrently with our entering into the Merger Agreement, RMR, which is also GOV's manager, and Messrs. Barry Portnoy and Adam Portnoy, RMR's principals, our Managing Trustees and managing trustees of GOV, also entered into a voting and standstill agreement on terms and conditions substantially similar to the Voting Agreement that also includes a standstill in respect of SNH.

SNH: In connection with our proposed acquisition of CCIT, concurrently with our entering into the Merger Agreement, on August 30, 2014, SIR Merger Sub and SNH entered into a purchase and sale agreement and joint escrow instructions, or the Purchase and Sale Agreement, pursuant to which we have agreed to sell and SNH has agreed to acquire, substantially concurrently with the completion of the Merger, the subsidiaries of CCIT owning the Healthcare Properties, for approximately $539,000, including the assumption of approximately $30,000 of mortgage debt. The completion of the acquisition of the Healthcare Properties by SNH is subject to numerous conditions, including the completion of the Merger and the repayment of CCIT's existing credit facility and the absence of any law, order or injunction prohibiting the completion of such sale of the Healthcare Properties.

Our Managing Trustees, Mr. Barry Portnoy and Mr. Adam Portnoy, are managing trustees of SNH. One of our Independent Trustees also serves as an independent trustee of each of SNH and GOV.

AIC: We, RMR, GOV, SNH and three other companies to which RMR provides management services currently own Affiliates Insurance Company, or AIC, an Indiana insurance company. All of our Trustees and most of the trustees and directors of the other AIC shareholders currently serve on the board of directors of AIC. RMR provides management and administrative services to AIC pursuant to a management and administrative services agreement with AIC.

On March 25, 2014, as a result of the removal, without cause, of all of the trustees of EQC, EQC underwent a change in control, as defined in the shareholders agreement among us, the other shareholders of AIC and AIC. As a result of that change in control and in accordance with the terms of the shareholders agreement, on May 9, 2014, we and those other shareholders purchased pro rata the AIC shares EQC owned. Pursuant to that purchase, we purchased 2,857 AIC shares from EQC for $825. Following these purchases, we and the other remaining six shareholders each owned approximately 14.3% of AIC.

In June 2014, we and the other shareholders of AIC renewed our participation in an insurance program arranged by AIC. In connection with that renewal, we purchased a one-year property insurance policy providing $500,000 of coverage, with respect to which AIC is a reinsurer of certain coverage amounts. We paid AIC a premium, including taxes and fees, of approximately $434 in connection with that policy, which amount may be adjusted from time to time as we acquire or dispose of properties that are included in the policy. As of September 30, 2014, we had invested $6,160 in AIC. Although we own less than 20% of AIC, we use the equity method to account for this investment because we believe that we have significant influence over AIC as all of our Trustees are also directors of AIC. Our investment in AIC had a carrying value of $6,806 and $5,913 as of September 30, 2014 and December 31, 2013, respectively, which amounts are included in other assets on our condensed consolidated balance sheets. We recognized income of $38 and $64 for the three months ended September 30, 2014 and 2013, respectively, and $59 and $219 for the nine months ended September 30, 2014 and 2013, respectively, related to our investment in AIC.

Directors’ and Officers’ Liability Insurance: In June 2014, we, RMR and four other companies to which RMR provides management services extended the combined directors’ and officers’ liability insurance policy described in our Annual Report for an interim period. We paid an aggregate premium of approximately $15 for these extensions. In September 2014, we purchased a two year combined directors' and officers' insurance policy with RMR and five other companies managed by RMR that provides $10,000 in aggregate primary coverage, including certain errors and omission coverage. At that time, we also purchased separate additional one year directors' and officers' liability insurance policies that provide $20,000 of aggregate excess coverage plus $5,000 of excess non-indemnifiable coverage. The total premium payable by us for these policies purchased in September 2014 was approximately $482.

Note 9. Pro Forma Information (Unaudited)

During the year ended December 31, 2013, we acquired seven properties (11 buildings) for an aggregate purchase price of $384,820, excluding closing costs. During the third quarter of 2013, we sold 10,500,000 of our common shares in a public offering at a price of $28.25 per share.

During the second quarter of 2014, we acquired two properties (two buildings) for an aggregate purchase price of $207,860, excluding closing costs, and sold 10,000,000 of our common shares in a public offering, including 1,000,000 common shares sold when the underwriters partially exercised their option to purchase additional shares, at a price of $29.00 per share.

The following table presents our pro forma results of operations for the nine months ended September 30, 2014 and 2013 as if these acquisitions and financing activities had occurred on January 1, 2013. This pro forma data is not necessarily indicative of what our actual results of operations would have been for the periods presented, nor does it represent the results of operations for any future period. Differences could result from numerous factors, including future changes in our portfolio of investments, changes in interest rates, changes in our capital structure, changes in net property level operating expenses, changes in property level revenues, including rents expected to be received on our existing leases or leases we may enter into during and after 2014, and for other reasons.

Table of Contents

	Nine Months Ended September 30, 2014	2013
Total revenues	$ 170,942	$ 159,581
Net income	$ 82,589	$ 78,037
Net income per share	$ 1.38	$ 1.31

During the nine months ended September 30, 2014, we recognized revenues of $40,419 and operating income of $33,774 arising from our 2013 and 2014 acquisitions.

Table of Contents

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

The following discussion should be read in conjunction with our financial statements and notes thereto included in this Quarterly Report on Form 10-Q and in our Annual Report.

OVERVIEW

We are a real estate investment trust, or REIT, organized under Maryland law. As of September 30, 2014, we owned 50 properties (280 buildings, leasable land parcels and easements), located in 21 states, that contain approximately 27.0 million rentable square feet and were approximately 96.1% leased (based on rentable square feet). For the nine months ended September 30, 2014, approximately 38.8% of our total revenue was from 11 properties (229 buildings, leasable land parcels and easements) with 17.8 million rentable square feet that we own on the island of Oahu, HI, or our Hawaii Properties. The remainder of our total revenue for the period ended September 30, 2014 was from 39 properties (51 buildings) located throughout the mainland United States, or our Mainland Properties. As of September 30, 2014, our properties were leased to 262 different tenants, with a weighted average remaining lease term (based on annualized rental revenue) of approximately 10.5 years.

Property Operations

As of September 30, 2014, 96.1% of our rentable square feet were leased, compared to 95.6% of our rentable square feet as of September 30, 2013. Occupancy data for 2014 and 2013 is as follows (square feet in thousands):

	All Properties As of September 30,		Comparable Properties (1) As of September 30,	
	2014	2013	2014	2013
Total properties	50	45	41	41
Total rentable square feet (2)	27,040	25,702	24,612	24,612
Percent leased (3)	96.1 %	95.6 %	95.7 %	95.4 %

(1)Consists of 41 properties (267 buildings, leasable land parcels and easements) that we owned continuously since January 1, 2013.

(2)Subject to modest adjustments when space is re-measured or re-configured for new tenants and when land leases are converted to building leases.

(3)Percent leased includes (i) space being fitted out for occupancy pursuant to existing leases, if any, and (ii) space which is leased but is not occupied or is being offered for sublease by tenants, if any.

While the occupancy increase at our comparable properties from September 30, 2013 to September 30, 2014 positively impacted our September 30, 2014 comparable financial results, our comparable financial results have been primarily impacted by rent increases during the period at some of our comparable leased land properties located in Hawaii, as further described below.

The average annualized effective rental rate per square foot, as defined below, for our properties for the periods ended September 30, 2014 and 2013 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Average annualized effective rental rate per square foot leased: (1)				
All Properties	$ 8.73	$ 7.92	$ 8.67	$ 7.62
Comparable Properties (2)	$ 7.70	$ 7.54	$ 7.15	$ 6.94

(1)Average annualized effective rental rate per square foot leased represents annualized total revenue during the period specified divided by the average rentable square feet leased during the period specified.

(2)Comparable properties for the three months ended September 30, 2014 and 2013 consist of 44 properties (272 buildings, leasable land parcels and easements) that we owned continuously since July 1, 2013. Comparable properties for the nine months ended September 30, 2014 and 2013 consist of 41 properties (267 buildings, leasable land parcels and easements) that we owned continuously since January 1, 2013.

Table of Contents

During the three months ended September 30, 2014, we entered lease renewals and new leases for approximately 353,000 square feet at weighted average rental rates (by square feet) that were approximately 7.5% lower than prior rates for the same space. The decline in weighted average rental rates primarily reflects a lease renewal at one of our Mainland Properties that reduced rent in exchange for an extended lease term and the elimination of future tenant improvement allowances. The weighted average lease term for new and renewal leases entered during the three months ended September 30, 2014 was 10.5 years. Commitments for tenant improvements, leasing costs and concessions for leases entered during the three months ended September 30, 2014 totaled approximately $26,000, or approximately $0.01 per square foot per year of the weighted average lease term.

During the three months ended September 30, 2014, we also executed a rent reset at one of our Hawaii Properties for approximately 96,000 square feet of land, at a reset rate that was approximately 19.5% higher than the prior rate.

Despite recent fluctuations in the global markets, we have observed that the U.S. real estate leasing market continues to improve, with growing national net absorption (15.7 million square feet in the third quarter of 2014 versus 13.9 million square feet in the second quarter of 2014), vacancy below 16.0% for the first time since 2008, and rent growth in 14 of the last 15 quarters according to Jones Lang LaSalle (JLL). However, we do not expect our occupancy rate or rental income to materially change through the end of 2015 because our current occupancy at 96.1% leaves very limited vacant space for lease and our weighted average remaining lease term (based on annualized rental revenue, as defined in footnote (2) of the table below) was approximately 10.5 years as of September 30, 2014, and because only 2.6% of our total leased square feet is subject to leases scheduled to expire through December 2015. Revenues from our Hawaii Properties, which represented approximately 38.8% of our total rental revenue for nine months ended September 30, 2014, have generally increased under our ownership as leases for those properties have reset or renewed to the then current fair market value and we expect such increases to continue. Nevertheless, because of the current global economic uncertainty, there are too many variables for us to reasonably project what the financial impact of changing market conditions will be on our occupancy, rents, or financial results.

As shown in the table below, approximately 2.6% of our total rented square feet and approximately 2.9% of our total annualized rental revenue (as defined in footnote (2) of the table below) are included in leases scheduled to expire by December 31, 2015. Lease renewals and rental rates for which available space may be relet in the future will depend on prevailing market conditions at the times these renewals, new leases and rent reset rates are negotiated. Some of our leases scheduled to expire through 2015 relate to our Hawaii Properties, and, as stated above, revenues from these properties have generally increased during our ownership as the leases for those properties have been reset or renewed. As of September 30, 2014, our lease expirations by year are as follows (square feet and dollars in thousands):

	Cumulative Percent of	Percent of Total	Cumulative Percent of Total

Year	Number of Tenants with Expiring Leases	Rented Square Feet Expiring (1)	Percent of Total Rented Square Feet Expiring (1)	Cumulative Percent of Total Rented Square Feet Expiring (1)	Annualized Rental Revenue Expiring (2)	Percent of Total Annualized Rental Revenue Expiring (2)	Cumulative Percent of Total Annualized Rental Revenue Expiring (2)
10/1/2014 - 12/31/2014	6	96	0.4 %	0.4 %	$ 381	0.2 %	0.2 %
2015	25	570	2.2 %	2.6 %	5,964	2.7 %	2.9 %
2016	24	1,108	4.3 %	6.9 %	8,810	3.9 %	6.8 %
2017	13	505	1.9 %	8.8 %	6,149	2.7 %	9.5 %
2018	14	1,483	5.7 %	14.5 %	14,922	6.7 %	16.2 %
2019	17	1,837	7.1 %	21.6 %	7,429	3.3 %	19.5 %
2020	5	318	1.2 %	22.8 %	4,286	1.9 %	21.4 %
2021	7	795	3.1 %	25.9 %	7,521	3.4 %	24.8 %
2022	65	3,028	11.7 %	37.6 %	24,271	10.9 %	35.7 %
2023	10	1,192	4.6 %	42.2 %	23,221	10.4 %	46.1 %
Thereafter	89	15,049	57.8 %	100.0 %	120,696	53.9 %	100.0 %
	275	25,981	100.0 %		$ 223,650	100.0 %	
Weighted average remaining lease term (in years):		11.5			10.5		

Table of Contents

(1)Rented square feet is pursuant to existing leases as of September 30, 2014, and includes (i) space being fitted out for occupancy pursuant to existing leases, if any, and (ii) space which is leased but is not occupied or is being offered for sublease by tenants, if any.

(2)Annualized rental revenue is the annualized contractual rents from our tenants pursuant to existing leases as of September 30, 2014, including straight line rent adjustments and estimated recurring expense reimbursements, excluding lease value amortization.

A majority of our Hawaii Properties are lands leased for rents that are periodically reset based on fair market values, generally every five to ten years. The following chart shows the annualized rental revenue as of September 30, 2014 scheduled to reset at our Hawaii lands.

Scheduled Rent Resets At Hawaii Lands

(dollars in thousands)

	Annualized Rental Revenue (1) as of September 30, 2014 Scheduled to Reset		
Resets open from prior periods	$	3,657	(2)
10/1/2014 - 12/31/2014		893	
2015		1,819	
2016		-	
2017 and thereafter		27,912	
Total	$	34,281	

(1)Annualized rental revenue is the annualized contractual rents from our tenants pursuant to existing leases as of September 30, 2014, including straight line rent adjustments and estimated recurring expense reimbursements, excluding lease value amortization.

(2)Amount includes rents currently being paid, excluding rent resets not yet established. However, rental income in our condensed consolidated statement of income includes an accrual for estimated rental rate adjustments. No accruals are recognized for three tenants in default representing $677 of annualized rental revenue.

With respect to our Hawaiian land leases, we intend to negotiate with our tenants as rents under their leases are scheduled to reset in order to achieve new rents based on the then current fair market values. If we are unable to reach an agreement with a tenant on a rent reset, our Hawaiian land leases typically provide that rent is reset based on an appraisal process. Despite our prior experience with rent resets in Hawaii, our ability to increase rents when rent resets occur depends upon market conditions, which are beyond our control. Accordingly, we can provide no assurance that the historical increases in rents which we have achieved in the past will be repeated in the future, and it is possible that rents could reset to a lower level if fair market values decrease.

We expect to seek to renew or extend the terms of leases relating to our Mainland Properties when they expire. Because of the capital many of these tenants have invested in improvements and because many of our properties may be of strategic importance to the tenants' business, we believe that there may be a greater likelihood that these tenants will renew or extend their leases when they expire as compared to tenants in a property with multiple tenants. However, we also believe that if a building previously occupied by a single tenant becomes vacant, it may take longer and cost more to locate a new tenant than when space becomes vacant in a multi-tenant property; also in place improvements designed specifically for the needs of the prior single tenant may need to be replaced.

During the third quarter of 2013, one of our mainland tenants defaulted on its obligation to pay real estate taxes and rent under its lease with us. Pursuant to the lease, a portion of this tenant's security deposit was applied to cover all unpaid amounts billed as of June 1, 2014. We commenced litigation to pursue our contractual rights under the lease, including reimbursement of amounts drawn on the security deposit and payment in full of all past due amounts plus amounts that become due if we elect to accelerate the expiration of the lease. On June 19, 2014, we were awarded summary judgment on some of our claims in the litigation, including our claim for restoration of the security deposit,

Table of Contents

and the tenant has deposited such amounts with us pursuant to the order. The tenant also has paid rent through October 2014. Litigation with this tenant is continuing with respect to our other claims.

Whenever we extend, renew or enter into new leases for our properties, we intend to seek rents which are equal to or higher than our historical rents for the same properties; however, our ability to maintain or increase the rents for our current properties will depend in large part upon market conditions, which are beyond our control.

Our principal source of funds for our operations to pay our debt service and our distributions to shareholders is rents from tenants at our properties. Rents are generally received from our tenants monthly in advance. As of September 30, 2014, tenants representing 1% or more of our total annualized rental revenues were as follows (square feet in thousands):

Tenants Representing 1% or More of Our Total Annualized Rental Revenues:

Tenant	Property Type	Sq. Ft. (1)	% of Total Sq. Ft. (1)	% of Annualized Rental Revenue (2)
1. Tellabs, Inc.	Mainland Properties	820	3.2 %	7.5 %
2. Bank of America, N.A.	Mainland Properties	554	2.1 %	6.3 %
3. MeadWestvaco Corporation	Mainland Properties	311	1.2 %	4.9 %
4. Orbital Sciences Corporation	Mainland Properties	337	1.3 %	4.6 %
5. Cinram Group, Inc.	Mainland Properties	1,371	5.3 %	4.1 %
6. Novell, Inc.	Mainland Properties	406	1.6 %	3.6 %
7. The Southern Company	Mainland Properties	448	1.7 %	2.1 %
8. Hawaii Independent Energy, LLC (formerly Tesoro)	Hawaii Properties	3,148	12.1 %	1.9 %
9. Bookspan	Mainland Properties	502	1.9 %	1.7 %
10. Vivint, Inc.	Mainland Properties	125	0.5 %	1.6 %
11. Merkle Group, Inc.		120	0.5 %	1.6 %

		Mainland Properties			
12.	Micron Technology, Inc.	Mainland Properties	96	0.4 %	1.6 %
13.	Shurtape Technologies, LLC	Mainland Properties	645	2.5 %	1.6 %
14.	Servco Pacific, Inc.	Hawaii Properties	537	2.1 %	1.5 %
15.	Stratus Technologies, Inc.	Mainland Properties	287	1.1 %	1.5 %
16.	Colgate - Palmolive Company	Mainland Properties	142	0.5 %	1.4 %
17.	Ruckus Wireless, Inc.	Mainland Properties	96	0.4 %	1.3 %
18.	Hartford Fire Insurance Company	Mainland Properties	100	0.4 %	1.3 %
19.	SunPower Corporation	Mainland Properties	129	0.5 %	1.2 %
20.	Arrowhead General Insurance Agency, Inc.	Mainland Properties	95	0.4 %	1.2 %
21.	Safeway Stores, Inc.	Hawaii Properties	146	0.6 %	1.1 %
22.	Valassis Communications, Inc.	Mainland Properties	268	1.0 %	1.1 %
23.	BCI Coca-Cola Bottling Company	Hawaii Properties	351	1.4 %	1.1 %
24.	Sprint Nextel Corporation	Mainland Properties	140	0.5 %	1.0 %
	Total		11,174	43.2 %	56.8 %

(1)Square feet is pursuant to existing leases as of September 30, 2014, and includes (i) space being fitted out for occupancy pursuant to existing leases, if any, and (ii) space which is leased but is not occupied or is being offered for sublease by tenants, if any.

(2)Annualized rental revenue is the annualized contractual rents from our tenants pursuant to existing leases as of September 30, 2014, including straight line rent adjustments and estimated recurring expense reimbursements, excluding lease value amortization.

Investment Activities (dollar amounts in thousands)

In April 2014, we acquired two single tenant, net leased properties (two buildings) with approximately 986,937 of combined rentable square feet for an aggregate purchase price of $207,860, excluding closing costs. In October, we entered an agreement to acquire an industrial property in Memphis, TN containing 646,000 square feet for $14,500. This acquisition is subject to completion of our diligence and other customary closing conditions, and we can provide no assurance the acquisition will close. For more information regarding properties that we have acquired and properties that we have agreed to acquire pursuant to existing agreements we have entered, see Note 3 to our condensed consolidated

16

financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

In August 2014, we and CCIT entered into the Merger Agreement to acquire all of the outstanding common stock of CCIT for approximately $2,900,000, payable in a combination of cash and our common shares plus the assumption of certain mortgage debt. As part of the transaction, we will acquire CCIT's full property portfolio, which includes 64 office and industrial net lease properties as well as the Healthcare Properties, for total consideration of approximately $2,900,000 including the assumption of approximately $297,700 of mortgage principal and excluding transaction costs, based on the closing price of our common shares on October 7, 2014. To finance our acquisition of CCIT, we have entered an agreement to sell the Healthcare Properties to SNH for a purchase price of $539,000 (consisting of approximately $509,000 in cash proceeds and assumed debt of approximately $30,000) immediately upon the completion of the Merger, resulting in an estimated net purchase price to us of approximately $2,400,000, excluding closing costs. For more information regarding the proposed Merger and our proposed sale of the Healthcare Properties, see Notes 3 and 8 to our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which, to the extent they relate to these transactions, are incorporated herein by reference.

We currently intend to continue to expand our investments by primarily acquiring additional single tenant, net leased properties throughout the mainland United States and we expect to use the extensive nationwide resources of RMR to locate and acquire such properties. One of our goals in acquiring additional properties will be to further diversify our sources of rents with the intention of improving the security of our revenues. Another goal will be to purchase properties that produce rents, less property operating expenses, that are greater than our capital costs to acquire the properties and, accordingly, allow us to increase distributions to our shareholders over time. We expect that most of our acquisition efforts will focus on office and industrial properties; however, we may consider acquiring other types of properties, including properties which are net leased to single tenants for retail uses and special purpose properties specifically suited to particular tenants' requirements. We also may acquire additional properties in Hawaii, but we currently expect this will not be a significant part of our future acquisitions because there are limited opportunities to acquire properties in Hawaii, especially to acquire lands which are leased to third party tenants.

As a result of an eminent domain taking in September 2014, we sold an ancillary portion of a land parcel located in Huntsville, AL, resulting in a net gain on sale of $116.

Financing Activities (dollar amounts in thousands except per share amounts)

In January 2014, we repaid, at par, a $7,500 mortgage note which was secured by a property (one building) located in Chelmsford, MA. This mortgage was scheduled to mature in 2016.

During the second quarter of 2014, we sold 10,000,000 of our common shares in a public offering, including 1,000,000 of our common shares sold when the underwriters partially exercised their option to purchase additional shares, at a price of $29.00 per share raising net proceeds of approximately $277,329, after deducting offering expenses and the underwriting discount. We used the net proceeds from this offering to partially repay amounts outstanding under our revolving credit facility and for general business purposes.

In connection with the Merger described above, during the third quarter of 2014, a group of lenders committed to provide us a 364-day senior unsecured bridge loan facility in an aggregate principal amount of $1,000,000.

Table of Contents

RESULTS OF OPERATIONS

Three Months Ended September 30, 2014, Compared to Three Months Ended September 30, 2013 (dollars in thousands, except per share data)

	Comparable Properties Results (1)				Acquired Properties Results (2)			Consolidated Results		
	Three Months Ended September 30,				Three Months Ended September 30,			Three Months Ended September 30,		
	2014	2013	$ Change	% Change	2014	2013	$ Change	2014	2013	Change
ne	$ 39,242	$ 38,246	$ 996	2.60 %	$ 9,281	$ 2,923	$ 6,358	$ 48,523	$ 41,169	$ 7,354
nts										
	7,599	7,415	184	2.50 %	578	-	578	8,177	7,415	762
es	46,841	45,661	1,180	2.60 %	9,859	2,923	6,936	56,700	48,584	8,116
axes	5,284	5,020	264	5.30 %	361	-	361	5,645	5,020	625
ing	4,264	4,188	76	1.80 %	373	79	294	4,637	4,267	370
ng	9,548	9,208	340	3.70 %	734	79	655	10,282	9,287	995
g	$ 37,293	$ 36,453	$ 840	2.30 %	$ 9,125	$ 2,844	$ 6,281	$ 46,418	$ 39,297	$ 7,121
ses										
								10,653	8,485	2,168
								5,365	790	4,575
re								3,749	3,208	541
								19,767	12,483	7,284
								26,651	26,814	(163)
nse								(3,033)	(3,232)	199
re								23,618	23,582	36

n			
	(30)	(52)	22
n			
	38	64	(26)
re			
of			
	23,626	23,594	32
of			
	116	-	116
	$ 23,742	$ 23,594	$ 148
res			
	59,905	49,686	10,219
per			
re	$ 0.40	$ 0.47	$ (0.20)
of Funds From Operations and Normalized Funds From Operations (4)			
	$ 23,742	$ 23,594	
and amortization	10,653	8,485	
of property	(116)	-	
operations	34,279	32,079	
related costs	5,365	790	
siness management incentive fees (5)	(347)	196	
funds from operations	$ 39,297	$ 33,065	
operations per common share	$ 0.57	$ 0.65	
funds from operations per common share	$ 0.66	$ 0.67	

(1)Consists of 44 properties (272 buildings, leasable land parcels and easements) that we owned continuously since July 1, 2013.

(2)Consists of six properties (eight buildings) we acquired during the period from July 1, 2013 to September 30, 2014. One property (one building) was acquired during the three months ended September 30, 2013 and the remaining five properties (seven buildings) were acquired during the period from October 1, 2013 to September 30, 2014.

(3)We calculate net operating income, or NOI, as shown above. We define NOI as income from our rental of real estate less our property operating expenses. NOI excludes amortization of capitalized tenant improvement costs and leasing commissions. We consider NOI to be an appropriate supplemental measure to net income because it may help both investors and management to understand the operations of our properties. We use NOI to evaluate individual and company wide property level performance, and we believe that NOI provides useful information to investors regarding our results of operations because it reflects only those income and expense items that are incurred at the property level and may facilitate comparisons of our operating performance between periods and with other REITs. The calculation of NOI excludes certain components of net income in order to provide results that are more closely related to our properties' results of operations. NOI does not represent cash generated by operating activities in accordance with GAAP and should not be considered as an alternative to net income, operating income or cash flow from operating activities, determined in accordance with GAAP, or as an indicator of our financial performance or liquidity, nor

Table of Contents

is this measure necessarily indicative of sufficient cash flow to fund all of our needs. This measure should be considered in conjunction with net income, operating income and cash flow from operating activities as presented in our Condensed Consolidated Statements of Income and Comprehensive Income and Condensed Consolidated Statements of Cash Flows. Other REITs and real estate companies may calculate NOI differently than we do.

(4)We calculate funds from operations, or FFO, and normalized funds from operations, or Normalized FFO, as shown above. FFO is calculated on the basis defined by The National Association of Real Estate Investment Trusts, or NAREIT, which is net income, calculated in accordance with GAAP, plus real estate depreciation and amortization less gain on a sale of property, as well as certain other adjustments currently not applicable to us. Our calculation of Normalized FFO differs from NAREIT's definition of FFO because we exclude acquisition related costs, estimated business management incentive fees and gain on early extinguishment of debt. We consider FFO and Normalized FFO to be appropriate measures of operating performance for a REIT, along with net income, operating income and cash flow from operating activities. We believe that FFO and Normalized FFO provide useful information to investors because by excluding the effects of certain historical amounts, such as depreciation expense, FFO and Normalized FFO may facilitate a comparison of our operating performance between periods and with other REITs. FFO and Normalized FFO are among the factors considered by our Board of Trustees when determining the amount of distributions to our shareholders. Other factors include, but are not limited to, requirements to maintain our status as a REIT, limitations in our revolving credit facility agreement and term loan agreement, the availability of debt and equity capital, our expectation of our future capital requirements and operating performance, and our expected needs and availability of cash to pay our obligations. FFO and Normalized FFO do not represent cash generated by operating activities in accordance with GAAP and should not be considered as alternatives to net income, operating income or cash flow from operating activities, determined in accordance with GAAP, or as indicators of our financial performance or liquidity, nor are these measures necessarily indicative of sufficient cash flow to fund all of our needs. These measures should be considered in conjunction with net income, operating income and cash flow from operating activities as presented in our Condensed Consolidated Statements of Income and Comprehensive Income and Condensed Consolidated Statements of Cash Flows. Other REITs and real estate companies may calculate FFO and Normalized FFO differently than we do.

(5)Amounts represent estimated incentive fees under our business management agreement payable in common shares after the end of each calendar year calculated: (i) prior to 2014 based upon increases in annual FFO per share, and (ii) beginning in 2014 based on common share total return. In calculating net income in accordance with GAAP, we recognize estimated business management incentive fee expense, if any, each quarter. Although we recognize this expense, if any, each quarter for purposes of calculating net income, we do not include these amounts in the calculation of Normalized FFO until the fourth quarter, which is when the actual expense amount for the year is determined. Adjustments were made to prior period amounts to conform to the current period Normalized FFO calculation.

References to changes in the income and expense categories below relate to the comparison of results for the three months ended September 30, 2014, compared to the three months ended September 30, 2013. Our acquisition activity reflects our acquisition of one property (one building) during the three months ended September 30, 2013 and five properties (seven buildings) during the period from October 1, 2013 to September 30, 2014.

Rental income. The increase in rental income primarily reflects our acquisition activity plus increases from leasing activity and rent resets at our comparable properties located in Hawaii, partially offset by a decrease from leasing activity at one of our Mainland Properties as a result of a lease renewal at one of our Mainland Properties that reduced rent in exchange for an extended lease term and the elimination of future tenant improvement allowances. Rental income includes non-cash straight line rent adjustments totaling approximately $4,700 for the 2014 period and approximately $4,107 for the 2013 period, and net amortization of acquired real estate leases and assumed real estate lease obligations totaling approximately $60 for the 2014 period and approximately ($264) for the 2013 period.

Tenant reimbursements and other income. The increase in tenant reimbursements and other income primarily reflects our acquisition activity, plus increases in real estate tax and operating expense reimbursements from tenants at various comparable properties.

Real estate taxes. The increase in real estate taxes primarily reflects our acquisition activity and tax valuation and rate increases throughout our comparable property portfolio, plus real estate taxes that had previously been paid directly by a tenant now being paid by us and reimbursed to us by the tenant.

Other operating expenses. Other operating expenses primarily include property maintenance, environmental remediation, utilities, insurance, bad debt, legal and property management fees. The increase in other operating expenses primarily reflects our acquisition activity, plus an increase in general operating expenses at our comparable properties, including increases in legal fees related to tenant collection efforts, and increases in reimbursable expenses, including parking lot repairs, maintenance, utilities and other expenses.

Depreciation and amortization. The increase in depreciation and amortization primarily reflects our acquisition activity, plus a modest increase resulting from depreciation of capital improvements and amortization of leasing costs at our comparable properties.

Acquisition related costs. Acquisition related costs for the 2014 period primarily reflect acquisition costs related to our potential acquisition of CCIT that will be accounted for as a business combination. Acquisition related costs for the 2013 period primarily reflect acquisition related costs related to our July 2013 and October 2013 acquisitions.

General and administrative. General and administrative expenses primarily include fees paid in cash and common shares pursuant to our business management agreement, legal fees, audit fees, trustee cash fees and non-cash equity compensation expense related to awards to our Trustees, our officers and certain other RMR employees. The increase in general and administrative expenses primarily reflects an increase in annual audit fees recognized during the 2014 period compared to the 2013 period, an increase in non-cash equity compensation related to awards to our officers and certain other RMR employees, an increase in other professional and public company fees, and an increase in business management fees resulting from our acquisition activity, partially offset by the reversal of incentive fees accrued as of June 30, 2014, due to changes in our common share total returns as of the applicable measurement dates.

Interest expense. The decrease in interest expense reflects (i) a lower average outstanding debt balance for the 2014 period compared to the 2013 period and (ii) a slightly lower weighted average interest rate during the 2014 period compared to the 2013 period.

Income tax expense. Income tax expense represents state income taxes.

Equity in earnings of an investee. Equity in earnings of an investee represents our proportionate share of earnings from our investment in AIC.

Gain on sale of property. Gain on sale of property represents the net gain from the sale of a portion of a land parcel as a result of an eminent domain taking in the 2014 period.

Net income. The increase in net income for the 2014 period compared to the 2013 period reflects the changes noted above.

Weighted average common shares outstanding. The increase in weighted average common shares outstanding primarily reflects shares that were outstanding for part or all of the quarter ended September 30, 2014, but only partially or not outstanding for any of the corresponding 2013 period, including (i) shares granted to our Trustees in May 2014, (ii) shares sold in our public offerings in the third quarter of 2013 and the second quarter of 2014, (iii) shares granted to our officers and certain employees of RMR in September 2013 and September 2014 and (iv) shares issued to RMR during 2014 pursuant to our business management agreement.

Net income per common share. The decrease in net income per common share primarily reflects the increase in weighted average common shares outstanding noted above, as well as the changes to net income noted above.

Table of Contents

Nine Months Ended September 30, 2014, Compared to Nine Months Ended September 30, 2013 (dollars in thousands, except per share data)

parable Properties Results (1)				Acquired Properties Results (2)			Consolidated Results		
Months Ended September 30,				Nine Months Ended September 30,			Nine Months Ended September 30,		
	2013	$ Change	% Change	2014	2013	$ Change	2014	2013	Change
07,721	$ 104,928	$ 2,793	2.70 %	$ 34,330	$ 12,405	$ 21,925	$ 142,051	$ 117,333	$ 24,718 $
3,145	16,933	1,212	7.20 %	6,089	4,124	1,965	24,234	21,057	

Our cash flows from operating activities are largely a reflection of the size and composition of trading positions held by our market making subsidiaries and of the changes in customer cash and margin debit balances in our electronic brokerage business. Our cash flows from investing activities are primarily related to capitalized internal software development, purchases and sales of memberships at exchanges where we trade and strategic investments in exchanges where such investments will enable us to offer better execution alternatives to our current and prospective customers, or create new opportunities for ourselves as market makers or where we can influence exchanges to provide competing products at better prices using sophisticated technology. Our cash flows from financing activities are comprised of short-term borrowings, long-term borrowings and capital transactions. Short-term borrowings from banks are part of our daily cash management in support of operating activities. Other borrowings provide us with flexible sources of excess liquidity and regulatory capital. These borrowings include senior notes issued in private placements to certain qualified customers of IB LLC and a committed two-year $100.0 million senior secured revolving credit facility, from a syndicate of banks.

Nine Months Ended September 30, 2010: Our cash and cash equivalents increased by $485.2 million to $1,291.7 million for the nine months ended September 30, 2010. We raised $773.3 million in net cash in operating activities. We used net cash of $323.7 million in our investing and financing activities primarily due to a decrease in short-term borrowings and dividends paid to and redemption of member interests from IBG Holdings LLC.

Nine Months Ended September 30, 2009: Our cash and cash equivalents decreased by $83.6 million to $859.9 million for the nine months ended September 30, 2009. We raised $280.1 million in net cash from operating activities. We used net cash of $391.9 million in our investing and financing activities primarily due to repayments on our senior secured revolving credit facility, dividends paid to and redemption of member interests from IBG Holdings LLC.

Regulatory Capital Requirements

Our principal operating subsidiaries are subject to separate regulation and capital requirements in the United States and other jurisdictions. Timber Hill LLC and Interactive Brokers LLC are registered U.S. broker-dealers and futures commission merchants, and their primary regulators include the SEC, the Commodity Futures Trading Commission, the Chicago Board Options Exchange, the Chicago Mercantile Exchange, the Financial Industry Regulatory Authority and the National Futures Association. Timber Hill Europe AG is registered to do business in Switzerland as a securities dealer and is regulated by the Swiss Financial Market Supervisory Authority. Interactive Brokers (U.K.) Limited is subject to regulation by the U.K. Financial Services Authority. Our various other operating subsidiaries are similarly regulated. See Note 11 to the unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information regarding our regulatory capital requirements.

At September 30, 2010, aggregate excess regulatory capital for all of the Operating Companies was $3.39 billion.

Principal Indebtedness

IBG LLC is the borrower under a $100.0 million senior secured revolving credit facility, which had no balance outstanding as of September 30, 2010, and is the issuer of senior notes, of which $219.6 million were outstanding as of September 30, 2010.

Senior Secured Revolving Credit Facility

On May 18, 2010, IBG LLC entered into a $100 million two-year senior secured revolving credit facility with a syndicate of banks. IBG LLC is the sole borrower under this credit facility, which is required to be guaranteed by IBG LLC's domestic non-regulated subsidiaries (currently there are no such entities). The facility's interest rate is indexed to the LIBOR rate for the relevant term, at the borrower's option, and is secured by a first priority interest in all of the capital stock of each entity owned directly by IBG LLC (subject to customary limitations with respect to foreign subsidiaries). The facility may be used to finance working capital needs and general corporate purposes. The financial covenants contained in this credit facility are as follows:

- minimum consolidated shareholders' equity, as defined, of $3.6 billion, with quarterly increases equal to 25% of positive consolidated income;
- maximum total debt to capitalization ratio of 30%;
- minimum liquidity ratio of 1.0 to 1.0; and
- maximum total debt to net regulatory capital ratio of 35%.

At maturity, subject to meeting certain terms of the facility, IBG LLC will have an option to convert the facility to a one-year term loan. As of September 30, 2010, no borrowings were outstanding under this credit facility and IBG LLC was in compliance with all of the covenants. This credit facility replaced a $100 million senior secured revolving credit facility that expired on May 19, 2010.

Senior Notes

IBG LLC periodically issues senior notes in private placements to certain qualified customers of IB LLC. IBG LLC uses the proceeds from sales of the senior notes to provide capital to IBG LLC's broker-dealer subsidiaries in the form of subordinated loans and for other general purposes. In September of this year we reduced the interest rate on new notes to 5% per annum. The outstanding senior notes have a 7% and 5% per annum interest rate, and either a 15-month or an 18-month maturity. IBG LLC may, solely at its option, redeem the senior notes at any time on or after a specified date in the third month or the sixth month, respectively, after the date on which the senior notes are issued and sold, at a redemption price equal to 100% of the principal amount of the senior notes to be redeemed plus accrued interest.

Total senior notes outstanding at September 30, 2010 were $219.6 million, with $174.2 million being 7% notes and $45.4 million being 5% notes. Senior notes outstanding at December 31, 2009 of $205.8 million all carried a 7% per annum rate. During the period from January 1 through September 30, 2010, total senior notes issued were $471.6 million, and senior notes redeemed totaled $457.7 million.

The senior notes are secured, as is the senior secured revolving credit facility, by a first priority interest in all of the capital stock of each entity owned directly by IBG LLC (subject to customary limitations with respect to foreign subsidiaries). The senior notes contain covenants that may limit IBG LLC's ability to:

- incur, or permit its subsidiaries to incur, additional indebtedness;

- create, or permit its subsidiaries to create, liens on any capital stock or equity interests of its subsidiaries;
- declare and pay dividends or make other equity distributions; and
- consolidate, merge or sell all or substantially all of its assets.

Capital Expenditures

Our capital expenditures are comprised of compensation costs of our software engineering staff for development of software for internal use and expenditures for computer, networking and communications hardware. These expenditure items are reported as property and equipment. Capital expenditures for property and equipment were approximately $14.5 million and $17.4 million for the nine month periods ending September 30, 2010 and 2009, respectively. We anticipate that our gross capital expenditures will be level with the first nine months of the year, including costs related to expansion of our data center and backup facilities. We expect our future capital expenditures to rise as we continue our focus on technology infrastructure initiatives in order to further enhance our competitive position. We anticipate that we will fund capital expenditures with cash from operations and cash on hand. In response to changing economic conditions, we believe we have the flexibility to modify our capital expenditures by adjusting them (either upward or downward) to match our actual performance. If we pursue any strategic acquisitions, we may incur additional capital expenditures.

Seasonality

Our businesses are subject to seasonal fluctuations, reflecting varying numbers of market participants at times during the year and varying numbers of trading days from quarter-to-quarter, including declines in trading activity due to holidays. Typical seasonal trends may be superseded by market or world events, which can have a significant impact on prices and trading volume.

Inflation

Although we cannot accurately anticipate the effect of inflation on our operations, we believe that inflation has not had for the three most recent years, and is not likely in the foreseeable future to have, a material impact on our results of operations.

Strategic Investments and Acquisitions

We periodically engage in evaluations of potential strategic investments and acquisitions. The Company holds strategic investments in electronic trading exchanges including: Boston Options Exchange, LLC; OneChicago LLC and CBOE Stock Exchange, LLC. During 2009, the company made investments in Quadriserv Inc., an electronic securities lending platform provider and Factor Advisors, LLC, an Exchange Traded Funds (“ETF”) issuer.

We intend to continue making acquisitions on an opportunistic basis, generally only when the acquisition candidate will, in our opinion, enable us to acquire either technology or customers faster than we could develop them on our own. At September 30, 2010, there were no definitive agreements with respect to any material acquisition.

Certain Information Concerning Off-Balance-Sheet Arrangements

IBG, Inc. may be exposed to a risk of loss not reflected in the unaudited condensed consolidated financial statements for futures products, which represent obligations of the Company to settle at contracted prices, which may require repurchase or sale in the market at prevailing prices. Accordingly, these transactions result in off-balance sheet risk as IBG, Inc.'s cost to liquidate such futures contracts may exceed the amounts reported in our unaudited condensed consolidated statements of financial condition.

Critical Accounting Policies

Valuation of Financial Instruments

Due to the nature of our operations, substantially all of our financial instrument assets, comprised of securities owned, securities purchased under agreements to resell, securities borrowed and receivables from brokers, dealers and clearing organizations are carried at fair value based on published market prices and are marked to market daily, or are assets which are short-term in nature (such as U. S. government treasury bills or spot foreign exchange) and are reflected at amounts approximating fair value. Similarly, all of our financial instrument liabilities that arise from securities sold but not yet purchased, securities sold under agreements to repurchase, securities loaned and payables to brokers, dealers and clearing organizations are short-term in nature and are reported at quoted market prices or at amounts approximating fair value. Our long and short positions are valued at either the last consolidated trade price or the last consolidated bid/offer mid-point (where applicable) at the close of regular trading hours, in their respective markets. Given that we manage a globally integrated market making portfolio, we have large and substantially offsetting positions in securities and commodities that trade on different exchanges that close at different times of the trading day. As a result, there may be large and anomalous swings in the value of our positions daily and, accordingly, in our earnings in any period. This is especially true on the last business day of each calendar quarter, although such swings tend to come back into equilibrium on the first business day of the succeeding calendar quarter.

Contingencies

Our policy is to estimate and accrue for potential losses that may arise out of litigation and regulatory proceedings, to the extent that such losses are probable and can be estimated, in accordance with ASC 450, Contingencies. Potential losses that might arise out of tax audits, to the extent that such losses are "more likely than not," would be estimated and accrued in accordance with ASC 740-10. Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total liability accrued with respect to litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses based on, among other factors, the progress of each case, our experience with and industry experience with similar cases and the opinions and views of internal and external legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, or where cases or proceedings are in the early stages, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred.

We have been from time to time subject to certain pending and legal actions which arise out of the normal course of business. Litigation is inherently unpredictable, particularly in proceedings where claimants seek substantial or indeterminate damages, or which are in their early stages. We cannot predict with certainty the actual loss or range of loss related to such legal proceedings, the manner in which they will be resolved, the timing of final resolution or the ultimate settlement. Consequently, we cannot estimate losses or ranges of losses related to such legal matters, even in instances where it is reasonably possible that a future loss will be incurred. As of September 30, 2010, we, along with certain of our subsidiaries, have been named parties to legal actions, which we and/or such subsidiaries intend to defend vigorously. Although the results of legal actions cannot be predicted with certainty, it is the opinion of management that the resolution of these actions is not expected to have a material adverse effect, if any, on our business or financial condition, but may have a material impact on the results of operations for a given period. As of September 30, 2010 and December 31, 2009, reserves provided for potential losses related to litigation matters were not material.

Use of Estimates

The preparation of financial statements in conformity with the Codification requires management to make estimates and assumptions that affect the reported amounts and disclosures in the unaudited condensed consolidated financial statements and accompanying notes. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ materially from those estimates. Such estimates include the estimated fair value of investments accounted for under the equity method of accounting, the estimated useful lives of property and equipment, including capitalized internally developed software, the allowance for doubtful accounts, compensation accruals, tax liabilities and estimated contingency reserves.

Recent Accounting Pronouncements

Subsequent to the adoption of the ASC, the FASB will issue Accounting Standards Updates (“ASU’s”) as the means to add to or delete from, or otherwise amend the ASC. In 2010, prior to the issuance of the Company’s unaudited condensed consolidated financial statements, ASU’s 2010-1 through ASU 2010-26 were issued. Following is a summary of recently issued ASU’s that may affect the Company’s unaudited condensed consolidated financial statements:

	Affects	Status
ASU 2009-12	Investments in Certain Entities That Calculate Net Asset Value per Share (or its equivalent) – Amends ASC 820 to offer investors a practical expedient for measuring the fair value of investments in certain entities that calculate net asset value per share	Periods ending after December 15, 2009
ASU 2009-13	Multiple Deliverable Revenue Arrangements – Amends ASC 605-25	Fiscal years beginning on or after June 15, 2010, early adoption permitted
ASU 2009-14	Certain Revenue Arrangements That Include Software Elements – Amends ASC 985-605 and 985-605-13 to exclude from their scope tangible products that contain software and non-software components that function together to deliver the products essential functionality	Fiscal years beginning on or after June 15, 2010, early adoption permitted
ASU 2009-15	Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing	Periods beginning on or after December 15, 2009
ASU 2009-16	Transfers and Servicing: Accounting or Transfers of Financial Assets – Amends ASC 860 – eliminates exceptions for qualifying special purpose entities and for certain mortgage securitizations	Periods beginning after November 15, 2009
ASU 2009-17	Improvements to Financial Reporting by Enterprises Involved with Variable Interest Enterprises – Amends ASC 810 for the issuance of SFAS No. 167	Periods beginning on or after December 15, 2009
ASU 2010-09	Subsequent Events (Topic 855) – Amendments to Certain Recognition and Disclosure Requirements	Effective on issuance
ASU 2010-11	Derivatives and Hedging (Topic 815) - Scope Exception related to Embedded Credit Derivatives	First fiscal quarter beginning after June 15, 2010, early adoption permitted at the beginning of the first fiscal quarter after issuance.
ASU 2010-12	Income Taxes (Topic 740) - Accounting for Certain Tax Effects of the 2010 Health Care Reform Acts	Effective on issuance.
ASU 2010-13	Compensation - Stock Compensation (Topic 718) - Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades	Fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early application is permitted.

Adoption of those ASU's that became effective during 2009 and in 2010, prior to the issuance of the Company's unaudited condensed consolidated financial statements, did not have a material effect on those financial statements. Management is assessing the potential impact on the Company's financial statements of adopting ASU's that will become effective in the future.

ASC/IFRS Convergence

In February 2010, the SEC issued "Commission Statement in Support of Convergence and Global Accounting Standards", a formal statement updating the status of its November 2008 "Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers" ("IFRS Roadmap"). The statement supported convergence of accounting standards and the development of a single set of global accounting standards. As directed in this statement, the SEC staff issued "Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers" (the "Work Plan") in May 2010. The Work Plan is expected to provide the SEC with information to be able to conclude whether IFRS should be adopted for U.S. registrants. While neither the February statement nor the Work Plan define a certain date for adoption of IFRS, both documents stated an expectation that a decision on whether the SEC would mandate adoption of IFRS is expected to be made in 2011. If a decision to adopt IFRS is made at that point in time, initial adoption for U.S. registrants would be approximately December 31, 2015 or 2016, with a transition date of either January 1, 2013 or 2014 for the initial three year retrospective comparative reporting period. Management continues to assess the potential impact of adopting IFRS on the Company's unaudited condensed consolidated financial statements.

Other

ASC 860, Transfers and Servicing, incorporates former SFAS No. 166, Accounting for Transfers of Financial Assets, an amendment of FASB No. 140, was issued in June 2009 and became effective for interim and annual periods beginning after January 1, 2010. These provisions of ASC 860 require more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. The concept of a "qualifying special-purpose entity" ("SPE") was eliminated under these provisions of ASC 860, which also changed the requirements for derecognizing financial assets and requires additional disclosures. Adoption of these provisions did not have a material effect on the Company's unaudited condensed consolidated financial statements.

ASC 810, Consolidations, incorporates former SFAS No. 167, Amendments to FASB Interpretation No. 46(R). These pending provisions of ASC 810 revise former FASB Interpretation No. 46 (Revised December 2003), Consolidation of Variable Interest Entities, and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) and therefore should be consolidated. Consolidation of Variable Interest Entities ("VIE's") would be based on the target entity's purpose and design as well as the reporting entity's ability to direct the target's activities, among other criteria. SFAS No. 167 was issued in June 2009 and became effective for interim and annual periods beginning after January 1, 2010. Adoption of these provisions did not have a material effect on the Company's unaudited condensed consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks. Our exposures to market risks arise from assumptions built into our pricing models, equity price risk, foreign currency exchange rate fluctuations related to our international operations, changes in interest rates which impact our variable-rate debt obligations, and risks relating to the extension of margin credit to our customers.

Pricing Model Exposure

Our strategy as a market maker is to calculate quotes a few seconds ahead of the market and execute small trades at tiny but favorable differentials as a result. This is made possible by our proprietary pricing model, which continuously evaluates and monitors the risks inherent in our portfolio, assimilates market data and reevaluates the outstanding quotes in our entire portfolio each second. Certain aspects of the model rely on historical prices of securities. If the behavior of price movements of individual securities diverges substantially from what their historical behavior would predict, we might incur trading losses. We attempt to limit such risks by diversifying our portfolio across many different options, futures and underlying securities and avoiding concentrations of positions based on the same underlying security. Historically, our losses from these events have been immaterial in comparison to our annual trading profits.

Foreign Currency Exposure

As a result of our international market making activities and accumulated earnings in our foreign subsidiaries, our income and net worth is exposed to fluctuations in foreign exchange rates. Our European operations and some of our Asian operations are conducted by our Swiss subsidiary, THE. THE is regulated by the Swiss Financial Market Supervisory Authority as a securities dealer and its financial statements are presented in Swiss francs. Accordingly, THE is exposed to certain foreign exchange risks as described below:

- THE buys and sells futures contracts and securities denominated in various currencies and carries bank balances and borrows and lends such currencies in its regular course of business. At the end of each accounting period THE’s assets and liabilities are translated into Swiss francs for presentation in its financial statements. The resulting gains or losses are reported as translation gain or loss in THE’s income statement. When we prepare our consolidated financial statements, THE’s Swiss franc balances are translated into U.S. dollars for U.S. GAAP purposes. THE’s translation gains or losses appear as such on IBG, Inc.’s income statement, included in trading gains.

- THE’s net worth is carried on THE’s books in Swiss francs in accordance with Swiss accounting standards. At the end of each accounting period, THE’s net worth is translated at the then prevailing exchange rate into U.S. dollars and the resulting gain or loss is reported in our consolidated statement of financial condition as “other comprehensive income,” which is neither an income nor an expense item in our statement of income, in accordance with U.S. GAAP.

Historically, we have taken the approach of not hedging the above exposures, based on the notion that the cost of constantly hedging over the years would amount to more than the random impact of rate changes on our non-U.S. dollar balances. For instance, an increase in the value of the Swiss franc would be unfavorable to the earnings of THE but would be counterbalanced to some extent by the fact that the yearly translation gain or loss into U.S. dollars is likely to move in the opposite direction.

In late 2005, we began to expand our market making systems to incorporate cash forex and forex options in order to hedge our currency exposure at little or no cost. In 2006, we began hedging our currency exposure throughout the day on a continuous basis. In connection with the development of our currency hedging strategy, we have determined to base our net worth in GLOBALs. We currently define a GLOBAL as consisting of 55 U.S. cents, 24 Euro cents, 10

Japanese yen, 3 British pence, 4 Canadian cents and 3 Australian cents. With the growth of our international operations, we foresee including other currencies in our definition of the GLOBAL. As our forex market making systems continue to develop, and as more exchanges trade more forex-based products electronically, we expect more trading volume to flow through this system and, accordingly, we expect to be able to manage the risks in forex in the same low cost manner as we currently manage the risks of our market making in equity-based products.

We actively manage our global currency exposure by maintaining our equity in GLOBALs. As a result, we consider ourselves a global enterprise based in a diversified basket of currencies rather than a U.S. dollar based company. Approximately half of our equity is denominated in currencies other than U.S. Dollars. The weakening of the U.S. dollar relative to other key currencies during this quarter had a positive effect on our market making earnings, which are reported in U.S. dollars. The primary driver of this translation gain was the 11.4% appreciation of the Euro as expressed in U.S. dollars during the third quarter.

Interest Rate Risk

Under our senior secured revolving credit facility, we have the ability to choose borrowing tenors from overnight to twelve months, which permits us to minimize the risk of interest rate fluctuations. We have no borrowings outstanding under this facility as of September 30, 2010.

We pay our electronic brokerage customers interest based on benchmark overnight interest rates in various currencies. In a normal rate environment, we typically invest a portion of these funds in U.S. government treasury securities with maturities of up to three months. Under these circumstances, if interest rates were to increase rapidly and substantially, in increments that were not reflected in the yields on these treasury securities, our net interest income from customer deposits would decrease. Based upon investments outstanding at September 30, 2010, we had no exposure of this nature.

We also face the potential for reduced net interest income from customer deposits due to interest rate spread compression in a low rate environment. Due to a currently low rate environment, a decrease of the U.S. benchmark interest rates to zero, or roughly .19%, would reduce our net interest income by approximately $2.2 million on an annualized basis.

We also face substantial interest rate risk due to positions carried in our market making business to the extent that long or short stock positions may have been established for future or forward dates on options or futures contracts and the value of such positions are impacted by interest rates. We hedge such risks by entering into interest rate futures contracts. To the extent that these futures positions do not perfectly hedge this interest rate risk, our trading gains may be adversely affected. The amount of such risk cannot be quantified.

Dividend Risk

We face dividend risk in our market making business as we derive significant revenues and incur significant expenses in the form of dividend income and expense, respectively, from our substantial inventory of equity securities, and must make significant payments in lieu of dividends on short positions in securities in our portfolio. Projected future dividends are an important component of pricing equity options and other derivatives, and incorrect projections may lead to trading losses. The amount of these risks cannot be quantified.

Margin Credit

We extend margin credit to our customers, which is subject to various regulatory requirements. Margin credit is collateralized by cash and securities in the customers' accounts. The risks associated with margin credit increase during periods of fast market movements or in cases where collateral is concentrated and market movements occur. During such times, customers who utilize margin credit and who have collateralized their obligations with securities may find that the securities have a rapidly depreciating value and may not be sufficient to cover their obligations in the event of a liquidation. We are also exposed to credit risk when our customers execute transactions, such as short sales of options and equities that can expose them to risk beyond their invested capital.

We expect this kind of exposure to increase with growth in our overall business. Because we indemnify and hold harmless our clearing firms from certain liabilities or claims, the use of margin credit and short sales may expose us to significant off-balance-sheet risk in the event that collateral requirements are not sufficient to fully cover losses that customers may incur and those customers fail to satisfy their obligations. As of September 30, 2010, we had $5.42 billion in margin credit extended to our customers. The amount of risk to which we are exposed from the margin credit we extend to our customers and from short sale transactions by our customers is unlimited and not quantifiable as the risk is dependent upon analysis of a potential significant and undeterminable rise or fall in stock prices. Our account level margin credit requirements meet or exceed those required by Regulation T of the Board of Governors of the Federal Reserve or the SEC portfolio margining regulations, as appropriate. As a matter of practice, we enforce real-time margin compliance monitoring and liquidate customers' positions if their equity falls below required margin requirements.

We have a comprehensive policy implemented in accordance with regulatory standards to assess and monitor the suitability of investors to engage in various trading activities. To mitigate our risk, we also continuously monitor customer accounts to detect excessive concentration, large orders or positions, patterns of day trading and other activities that indicate increased risk to us.

Our credit exposure is to a great extent mitigated by our policy of automatically evaluating each account throughout the trading day and closing out positions automatically for accounts that are found to be under-margined. While this methodology is effective in most situations, it may not be effective in situations where no liquid market exists for the relevant securities or commodities or where, for any reason, automatic liquidation for certain accounts has been disabled.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures.

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are effective, in all material respects, to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during the period covered by this report quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There have been no material changes to the legal proceedings disclosed under Part 1, Item 3 of our Annual Report on Form 10-K filed with the SEC on February 26, 2010. During our normal course of business, the Company's regulated operating companies are in discussions with regulators about matters raised during regulatory examinations or otherwise subject to their inquiry. These matters could result in censures, fines or other sanctions. Management believes the outcome of any resulting actions will not be material to the Company's financial condition, results of operations or cash flows. However, the Company is unable to predict the outcome of these matters.

The Company believes, based on current knowledge and after consultation with counsel, that the outcome of the pending matters will not have a material adverse effect on the consolidated financial condition of the Company. Legal reserves have been established in accordance with ASC 450, Contingencies. The ultimate resolution may differ from the amounts reserved.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed in under Part 1, Item 1A of our Annual Report on From 10-K filed with the SEC on February 26, 2010.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number	Description
10.1	Amended and Restated Operating Agreement of IBG LLC (filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 2007 filed by the Company on June 15, 2007).**
10.2	Form of Limited Liability Company Operating Agreement of IBG Holdings LLC (filed as Exhibit 10.5 to Amendment No. 1 to the Registration Statement on Form S-1 filed by the Company on February 12, 2007).**
10.3	Exchange Agreement by and among Interactive Brokers Group, Inc., IBG Holdings LLC, IBG LLC and the Members of IBG LLC (filed as Exhibit 10.3 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 2009 filed by the Company on November 11, 2009).**
10.4	Tax Receivable Agreement by and between Interactive Brokers Group, Inc. and IBG Holdings LLC (filed as Exhibit 10.3 to the Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 2007 filed by the Company on June 15, 2007).**
10.5	Interactive Brokers Group, Inc. 2007 Stock Incentive Plan (filed as Exhibit 10.8 to Amendment No. 2 to the Registration Statement on Form S-1 filed by the Company on April 4, 2007).**+
10.6	Interactive Brokers Group, Inc. 2007 ROI Unit Stock Plan. (filed as Exhibit 10.9 to Amendment No. 2 to the Registration Statement on Form S-1 filed by the Company on April 4, 2007).**+
31.1	Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document*

101.SCH	XBRL Taxonomy Extension Schema*
101.CAL	XBRL Taxonomy Extension Calculation*
101.DEF	XBRL Extension Definition*
101.LAB	XBRL Taxonomy Extension Label*
101.PRE	XBRL Taxonomy Extension Presentation*

**	Previously filed; incorporated herein by reference.
+	These exhibits relate to management contracts or compensatory plans or arrangements.
*	Attached as Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, are the following materials formatted in XBRL (Extensible Business Reporting Language) (i) the Condensed Consolidated Statements of Financial Condition, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Cash Flows, (iv) the Condensed Consolidated Statement of Changes in Stockholders' Equity and (v) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTERACTIVE BROKERS GROUP, INC.

/s/ Paul J. Brody
Name: Paul J. Brody
Title: Chief Financial Officer, Treasurer and Secretary
(Signing both in his capacity as a duly authorized officer and
as principal financial officer of the registrant)

Date: November 8, 2010