

GETTY REALTY CORP /MD/

Form 10-Q

August 10, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q**

(Mark one)

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

**For the quarterly period ended June 30, 2011**

**OR**

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

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

**Commission file number 001-13777**

**GETTY REALTY CORP.**

(Exact name of registrant as specified in its charter)

**MARYLAND**

**11-3412575**

(State or other jurisdiction of incorporation or  
organization)

(I.R.S. Employer  
Identification No.)

**125 Jericho Turnpike, Suite 103  
Jericho, New York 11753**

(Address of principal executive offices)

(Zip Code)

**(516) 478 5400**

(Registrant's telephone number, including area code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer.

See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐ Smaller Reporting Company ☐  
(Do not check if a smaller reporting company)

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

Registrant had outstanding 33,394,175 shares of Common Stock, par value \$.01 per share, as of August 9, 2011.



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## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**GETTY REALTY CORP. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share data)  
(unaudited)

	June 30, 2011	December 31, 2010
Assets:		
Real Estate:		
Land	\$ 353,422	\$ 253,413
Buildings and improvements	247,777	251,174
	601,199	504,587
Less accumulated depreciation and amortization	(147,075)	(144,217)
Real estate, net	454,124	360,370
Net investment in direct financing leases	90,231	20,540
Deferred rent receivable (net of allowance of \$7,212 as of June 30, 2011 and \$8,170 as of December 31, 2010)	27,569	27,385
Cash and cash equivalents	14,941	6,122
Other receivables, net	4,210	4,533
Notes, mortgages and accounts receivable, net	31,996	1,525
Prepaid expenses and other assets	13,771	6,669
Total assets	\$ 636,842	\$ 427,144
Liabilities and Shareholders' Equity:		
Borrowings under credit line	\$ 150,000	\$ 41,300
Term loan	23,200	23,590
Environmental remediation costs	15,000	14,874
Dividends payable	16,111	14,432
Accounts payable and accrued liabilities	29,780	18,013
Total liabilities	234,091	112,209
Commitments and contingencies (notes 2, 3, 5, and 6)		
Shareholders' equity:		
Common stock, par value \$.01 per share; authorized 50,000,000 shares; issued 33,394,175 at June 30, 2011 and 29,944,155 at December 31, 2010	334	299

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Paid-in capital	460,355	368,093
Dividends paid in excess of earnings	(57,938)	(52,304)
Accumulated other comprehensive loss		(1,153)
Total shareholders' equity	402,751	314,935
Total liabilities and shareholders' equity	\$ 636,842	\$ 427,144

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

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**GETTY REALTY CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share amounts)  
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Revenues:				
Revenues from rental properties	\$ 27,126	\$ 21,734	\$ 52,151	\$ 44,173
Interest on notes and mortgages receivable	741	35	1,146	67
Total revenues	27,867	21,769	53,297	44,240
Operating expenses:				
Rental property expenses	3,709	2,314	7,192	5,527
Impairment charges	1,513		2,507	
Environmental expenses, net	1,326	1,332	2,453	2,884
General and administrative expenses	2,736	1,820	7,621	4,158
Depreciation and amortization expense	2,204	2,405	4,528	4,794
Total operating expenses	11,488	7,871	24,301	17,363
Operating income	16,379	13,898	28,996	26,877
Other income (expense), net	(49)	18	(43)	107
Interest expense	(1,346)	(1,322)	(2,665)	(2,816)
Earnings from continuing operations	14,984	12,594	26,288	24,168
Discontinued operations:				
Earnings (loss) from operating activities	(13)	37	1	58
Gains from dispositions of real estate	231	1,328	299	1,638
Earnings from discontinued operations	218	1,365	300	1,696
Net earnings	\$ 15,202	\$ 13,959	\$ 26,588	\$ 25,864
Basic and diluted earnings per common share:				
Earnings from continuing operations	\$ 0.45	\$ 0.46	\$ 0.79	\$ 0.93
Earnings from discontinued operations	\$ 0.01	\$ 0.05	\$ 0.01	\$ 0.07
Net earnings	\$ 0.45	\$ 0.51	\$ 0.80	\$ 0.99
Weighted-average shares outstanding:				
Basic	33,394	27,150	32,948	25,958
Stock options and restricted stock units	1	2	2	2

Diluted	33,395	27,152	32,950	25,960
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*The accompanying notes are an integral part of these consolidated financial statements.*

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**GETTY REALTY CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in thousands)  
(unaudited)

	Three months ended June		Six months ended June	
	30,		30,	
	2011	2010	2011	2010
Net earnings	\$ 15,202	\$ 13,959	\$ 26,588	\$ 25,864
Other comprehensive income:				
Unrealized gain on interest rate swap	584	545	1,153	848
Comprehensive income	\$ 15,786	\$ 14,504	\$ 27,741	\$ 26,712

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

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**GETTY REALTY CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited)

	<b>Six months ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<i>Cash flows from operating activities:</i>		
Net earnings	\$ 26,588	\$ 25,864
<i>Adjustments to reconcile net earnings to net cash flow provided by operating activities:</i>		
Depreciation and amortization expense	4,530	4,804
Impairment charges	2,507	
Gains from dispositions of real estate	(319)	(1,638)
Deferred rental revenue, net of allowance	(184)	(159)
Amortization of above-market and below-market leases	(262)	(343)
Accretion expense	296	345
Stock-based employee compensation expense	311	231
<i>Changes in assets and liabilities:</i>		
Other receivables, net	220	(329)
Net investment in direct financing leases	211	(157)
Accounts receivable	65	156
Prepaid expenses and other assets	75	(323)
Environmental remediation costs	(330)	266
Accounts payable and accrued liabilities	(397)	(136)
Net cash flow provided by operating activities	33,311	28,581
<i>Cash flows from investing activities:</i>		
Property acquisitions and capital expenditures	(166,594)	(4,662)
Proceeds from dispositions of real estate	784	2,739
Decrease in cash held for property acquisitions	60	2,243
Issuance of notes and mortgages receivable	(30,640)	
Collection of notes and mortgages receivable	307	72
Net cash flow provided by (used in) investing activities	(196,083)	392
<i>Cash flows from financing activities:</i>		
Borrowings under credit agreement	231,253	29,000
Repayments under credit agreement	(122,553)	(135,200)
Repayments under term loan agreement	(390)	(390)
Payments of cash dividends	(30,543)	(23,625)
Payments of loan origination costs	(175)	
Security deposits received	2,013	78
Net proceeds from issuance of common stock	91,986	108,205

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Net cash flow provided by (used in) financing activities	171,591	(21,932)
Net increase in cash and cash equivalents	8,819	7,041
Cash and cash equivalents at beginning of period	6,122	3,050
Cash and cash equivalents at end of period	\$ 14,941	\$ 10,091
Supplemental disclosures of cash flow information		
Interest paid	\$ 2,466	\$ 2,763
Income taxes paid, net	146	252

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

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**GETTY REALTY CORP. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**1. GENERAL**

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

*Use of Estimates, Judgments and Assumptions:* The financial statements have been prepared in conformity with GAAP, which requires the Company's management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the period reported. While all available information has been considered, actual results could differ from those estimates, judgments and assumptions. Estimates, judgments and assumptions underlying the accompanying consolidated financial statements include, but are not limited to, deferred rent receivable, net investment in direct financing leases, recoveries from state underground storage tank (UST or USTs) funds, environmental remediation costs, real estate, depreciation and amortization, impairment of long-lived assets, litigation, accrued liabilities, income taxes and the allocation of the purchase price of properties acquired to the assets acquired and liabilities assumed.

*Discontinued Operations:* The operating results and gains from certain dispositions of real estate sold in 2011 and 2010 are reclassified as discontinued operations. The operating results of such properties for the three and six months ended June 30, 2010 has also been reclassified to discontinued operations to conform to the 2011 presentation. Discontinued operations for the three and six months ended June 30, 2011 and 2010 are primarily comprised of gains or losses from property dispositions. The revenue from rental properties and expenses related to these properties are insignificant for the each of the three and six months ended June 30, 2011 and 2010.

*Unaudited, Interim Financial Statements:* The consolidated financial statements are unaudited but, in the Company's opinion, reflect all adjustments (consisting of normal recurring accruals) necessary for a fair statement of the results for the periods presented. These statements should be read in conjunction with the consolidated financial statements and related notes, which appear in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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

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during the period. Diluted earnings per common share, also gives effect to the potential dilution from the exercise of stock options utilizing the treasury stock method.

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Earnings from continuing operations	\$ 14,984	\$ 12,594	\$ 26,288	\$ 24,168
Less dividend equivalents attributable to restricted stock units outstanding	(82)	(56)	(164)	(112)
Earnings from continuing operations attributable to common shareholders used for basic earnings per share calculation	14,902	12,538	26,124	24,056
Discontinued operations	218	1,365	300	1,696
Net earnings attributable to common shareholders used for basic earnings per share calculation	\$ 15,120	\$ 13,903	\$ 26,424	\$ 25,752
Weighted-average number of common shares outstanding:				
Basic	33,394	27,150	32,948	25,958
Stock options	1	2	2	2
Diluted	33,395	27,152	32,950	25,960
Restricted stock units outstanding at the end of the period	171	118	171	118

**2. LEASES**

The Company leases or sublets its properties primarily to distributors and retailers engaged in the sale of gasoline and other motor fuel products, convenience store products and automotive repair services who are responsible for managing the operations conducted at these properties and for the payment of taxes, maintenance, repair, insurance and other operating expenses related to these properties. In those instances where the Company determines that the best use for a property is no longer as a retail motor fuel outlet, the Company will seek an alternative tenant or buyer for the property. The Company leases or subleases approximately twenty of its properties for uses such as fast food restaurants, automobile sales and other retail purposes. The Company's 1,163 properties are located in 21 states across the United States with concentrations in the Northeast and Mid-Atlantic regions.

As of June 30, 2011, Getty Petroleum Marketing Inc. ( Marketing ) leased 804 properties from the Company. Seven hundred ninety-five of the properties are leased to Marketing pursuant to a unitary master lease (the Master Lease ) and nine properties are leased under supplemental leases (collectively with the Master Lease, the Marketing Leases ). The Master Lease has an initial term of 15 years commencing December 9, 2000, and provides Marketing with options for three renewal terms of ten years each and a final renewal option of three years and ten months extending to 2049 (or such shorter initial or renewal term as the underlying lease may provide). Marketing is required to notify us of its election to exercise a renewal option one year in advance of the commencement of such renewal term. The Master Lease is a unitary lease and, therefore, Marketing's exercise of any renewal option can only be for all, and not less than all, of the properties subject of the Master Lease. The supplemental leases have initial terms of varying expiration dates. The Marketing Leases include provisions for 2.0% annual rent escalations. (See note 9 for additional

information regarding the portion of the Company's financial results that are attributable to Marketing. See note 3 for additional information regarding contingencies related to Marketing and the Marketing Leases).

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The Company estimates that Marketing makes annual real estate tax payments for properties leased under the Marketing Leases of approximately \$13,000,000. Marketing also makes additional payments for other operating expenses related to these properties, including environmental remediation costs other than those liabilities that were retained by the Company. These costs, which have been assumed by Marketing under the terms of the Marketing Leases, are not reflected in the Company's consolidated financial statements.

Revenues from rental properties included in continuing operations for the quarter and six months ended June 30, 2011 were \$27,126,000 and \$52,151,000, respectively, of which \$14,638,000 and \$29,809,000, respectively, were received from Marketing under the Marketing Leases and \$11,721,000 and \$21,353,000, respectively, were received from other tenants. Revenues from rental properties included in continuing operations for the quarter and six months ended June 30, 2010 were \$21,734,000 and \$44,173,000, respectively, of which \$15,126,000 and \$30,273,000, respectively, were received from Marketing under the Marketing Leases and \$6,346,000 and \$13,263,000, respectively, were received from other tenants. Rent received and rental property expenses included \$681,000 for the quarter ended June 30, 2011, \$221,000 for the quarter ended June 30, 2010, \$1,600,000 for the six months ended June 30, 2011 and \$1,033,000 for the six months ended June 30, 2010 for real estate taxes paid by the Company which were reimbursed by tenants. In accordance with GAAP, the Company recognizes rental revenue in amounts which vary from the amount of rent contractually due or received during the periods presented. As a result, revenues from rental properties include non-cash adjustments recorded for deferred rental revenue due to the recognition of rental income on a straight-line (or an average) basis over the current lease term, net amortization of above-market and below-market leases and recognition of rental income recorded under direct financing leases using the effective interest method which produces a constant periodic rate of return on the net investment in the leased property (the

Revenue Recognition Adjustments). Revenue Recognition Adjustments included in continuing operations increased rental revenue by \$767,000 and \$989,000 for the quarter and six months ended June 30, 2011, and increased rental revenue by \$262,000 and \$637,000 for the quarter and six months ended June 30, 2010.

The components of the \$90,231,000 net investment in direct financing lease as of June 30, 2011, are minimum lease payments receivable of \$216,152,000 plus unguaranteed estimated residual value of \$11,721,000 less unearned income of \$137,642,000.

### **3. COMMITMENTS AND CONTINGENCIES**

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

As of June 30, 2011, the Company leased 804, or 69% of its 1,163 properties, on a long-term triple-net basis to Marketing. (See note 2 for additional information). The Company's financial results are materially dependent upon the ability of Marketing to meet its rental, environmental and other obligations under the Marketing Leases. Marketing's financial results depend on retail petroleum marketing margins from the sale of refined petroleum products and rental income from its subtenants. Marketing's subtenants either operate their gas stations, convenience stores, automotive repair services or other businesses at the Company's properties or are petroleum distributors who may operate the Company's properties directly

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and/or sublet the Company's properties to the operators. Since a substantial portion of the Company's rental revenues (52% for the three months ended June 30, 2011), are derived from the Marketing Leases, any factor that adversely affects Marketing's ability to meet its obligations under the Marketing Leases may have a material adverse effect on the Company's business, financial condition, revenues, operating expenses, results of operations, liquidity, ability to pay dividends or stock price. (See note 9 for additional information regarding the portion of the Company's financial results that are attributable to Marketing.)

On August 8, 2011, the Company was informed by Marketing that based on Marketing's distressed financial position, weakness in operating margins, and cash flow deficiencies, it was unlikely to be able to pay full rent for August. Although Marketing described various contingencies which, if resolved favorably, may allow for payment of full or partial rent for August, the Company can provide no assurances that Marketing will meet its current or future rental or other obligations under the Marketing Leases. The Company issued a contractual notice of default to Marketing as a result of Marketing's non-payment of rent, and the Company intends to continue discussions with Marketing while the Company evaluates its options regarding this matter.

For the year ended December 31, 2010, Marketing's preliminary results showed a significant loss, continuing a trend of reporting large losses in recent years. The Company has not received any interim financial statements from Marketing for 2011. The Company believes that Marketing likely does not have the ability to generate cash flows from its business operations sufficient to meet its obligations as they come due in the ordinary course under the terms of the Marketing Leases unless Marketing shows significant improvement in its financial results, reduces the number of properties under the Marketing Leases, or receives additional capital or credit support. There can be no assurance that Marketing will be successful in any of these efforts. It is possible that the deterioration of Marketing's financial condition may continue or that Marketing may file bankruptcy and seek to reorganize or liquidate its business. It is also possible that Marketing may take other actions including seeking to modify the terms of the Marketing Leases. During the third quarter of 2011 or thereafter, the Company may be required to significantly increase the deferred rent receivable reserve, record additional impairment charges related to its properties, or accrue for environmental liabilities as a result of the potential or actual modification or termination of the Marketing Leases.

On February 28, 2011, OAO LUKoil ( Lukoil ), one of the largest integrated Russian oil companies, transferred its ownership interest in Marketing to Cambridge Petroleum Holding Inc. ( Cambridge ). The Company is not privy to the terms and conditions pertaining to this transaction between Lukoil and Cambridge and the Company does not know what type or amount of consideration, if any, was paid or is payable by Lukoil or its subsidiaries to Cambridge or by Cambridge to Lukoil or its subsidiaries in connection with the transfer.

The Company did not believe that while Lukoil owned Marketing Lukoil would allow Marketing to fail to meet its obligations under the Marketing Leases. However, there can be no assurance that Cambridge will have the capacity to provide capital or financial support to Marketing or will provide or arrange for the provision of additional capital investment or financial support to Marketing that Marketing may require to perform its obligations under the Marketing Leases. Without financial support, it is possible that Marketing may file for bankruptcy protection and seek to reorganize or liquidate its business. It is also possible that Marketing may take other actions including seeking to modify the terms of the Marketing Leases.



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In November 2009, Marketing announced a restructuring of its business. Marketing announced that the restructuring included the sale of all assets unrelated to the properties it leases from the Company, the elimination of parent-guaranteed debt, and steps to reduce operating costs. Marketing sold certain assets unrelated to the properties it leases from the Company to its affiliates, LUKOIL Pan Americas LLC and LUKOIL North America LLC. As part of the restructuring, Marketing paid off debt which had been guaranteed or held by Lukoil with proceeds from the sale of assets to Lukoil affiliates. Notwithstanding Marketing's statement that its restructuring included the sale of all assets unrelated to the properties it leases from the Company, the Company has concluded, in part based on the Marketing/Bionol contract dispute described below, that Marketing retained certain assets, liabilities and business matters unrelated to the properties it leases from the Company.

In July 2011, an arbitration panel that had been convened to hear a contractual dispute which commenced in 2010 between Marketing and Bionol Clearfield LLC ( Bionol ) issued an award in favor of Bionol for approximately \$230.0 million. Marketing has filed a motion to vacate this award. The contractual dispute relates to a five-year contract under which Marketing agreed to purchase, at formula-based prices, substantially all of the ethanol production from Bionol's ethanol plant in Pennsylvania. The Company is not in a position to evaluate the strength of the positions taken by Marketing with respect to its motion to vacate, and the Company cannot predict the actions that may be taken by Marketing or Bionol with respect to the award, or the timing of any such actions, including as to settlement or enforcement. Also in July 2011 Bionol announced that it, along with its affiliates, Bioenergy Holdings LLC and Bionol Holdings LLC, filed a voluntary petition for Chapter 7 relief in the United States Bankruptcy Court in Delaware. The Company cannot predict what impact Bionol's Chapter 7 liquidation filing may have on its dispute with Marketing or what actions the Trustee may take to collect on or settle the award or whether the Trustee may pursue other possible remedies. The ultimate resolution of this matter may materially adversely affect Marketing's financial condition and its ability to meet its obligations to the Company as they become due under the terms of the Marketing Leases. It is possible that Marketing may file for bankruptcy protection and seek to reorganize or liquidate its business.

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From time to time when it was owned by Lukoil, the Company held discussions with representatives of Marketing regarding potential modifications to the Marketing Leases. These discussions did not result in a common understanding with Marketing that would form a basis for modification of the Marketing Leases. After Lukoil's transfer of its ownership of Marketing to Cambridge, the Company commenced discussions with Marketing's new owners and management. Marketing's new management has indicated a desire to reduce the number of properties it leases from the Company under the Marketing Leases in an effort to improve Marketing's financial results. As a result of these recent discussions, the Company started to pursue the removal of individual properties from the Marketing Leases on a case-by-case basis. The Company intended on focusing this initiative on the removal from the Marketing Leases of terminal properties which are not being operated by Marketing and approximately 165 of the Company's retail properties which have had or are scheduled to have the gasoline tanks and related equipment removed, and which, the Company believes, are either vacant or provide negative or marginal contribution to Marketing's results. The Company intended to remove these properties from the Marketing Leases pursuant to individual lease modification agreements executed on a property-by-property basis which the Company expected would allow for the sale and removal of the subject property from the Marketing Leases and a reduction of the rent payable by Marketing by an amount calculated based upon a percentage of net proceeds realized upon the sale of such property. While the Company had a general understanding with Marketing allowing for increased activity intended to remove properties from the Marketing Leases on mutually agreeable terms, there was and is no agreement in place providing for the removal of a significant number of properties from the Marketing Leases. In view of the recent nonpayment by Marketing of its August 2011 rent and the Company's subsequent discussion with Marketing, the Company is reevaluating its options related to the removal of properties from the Master Lease. Any modification of the Marketing Leases that result in the removal of a significant number of properties from the Marketing Leases would likely significantly reduce the amount of rent the Company receives from Marketing and increase the Company's operating expenses. The Company cannot predict if or when the properties will be removed from Marketing Leases; what composition of properties, if any, may be removed from the Marketing Leases; or what the terms of any agreement for modification of the Marketing Leases or agreements for the removal of individual properties from the Marketing Leases may be. The Company also cannot predict what actions Marketing may take, and what the Company's recourse may be, whether the Marketing Leases are modified or not. The Company cannot predict if or how Marketing's business strategy, including as it relates to the removal of properties from the Marketing Leases, may change in the future. During the third quarter of 2011 or thereafter, the Company may be required to significantly increase the deferred rent receivable reserve, record additional impairment charges related to its properties, or accrue for environmental liabilities as a result of the potential or actual modification or termination of the Marketing Leases.

The Company intends either to re-let or sell properties removed from the Marketing Leases, whether such removal arises consensually by negotiation or as a result of default by Marketing, and reinvest any realized sales proceeds in new properties. The Company intends to offer properties removed from the Marketing Leases to replacement tenants or buyers individually, or in groups of properties. In those instances where the Company determines that the best use for a property is no longer as a retail motor fuel outlet, at the appropriate time the Company will seek an alternative tenant or buyer for such property. With respect to properties that are vacant or have had underground gasoline storage tanks and related equipment removed, it may be more difficult or costly to re-let or sell such properties as gas stations because of capital costs or possible zoning or permitting rights that are required and that may have lapsed during the period since gasoline was last sold at the property. Conversely, it may be easier to re-let or sell properties where underground gasoline storage tanks and related equipment have been removed if the property will not be used as a retail motor fuel outlet or if environmental contamination has been or is being remediated. Although the Company is the fee or leasehold owner of the properties subject to the Marketing Leases and the owner of the Getty® brand and has prior experience with tenants who operate their convenience stores, automotive repair services or other businesses at its properties; in the event that properties are removed from the Marketing Leases, the Company cannot predict if, when, or on what terms, such properties could be re-let or sold.

Based in part on the Company's willingness to modify and remove properties from the Marketing Leases prior to the expiration of the current lease term, and the Company's intent to pursue the removal of retail and terminal properties from the Marketing Leases, the Company believes that it is probable that it will not collect all of the rent

due related to properties identified from time to time as being the most likely to be removed from the Marketing Leases. As of June 30, 2011 and December 31, 2010, the net carrying value of the deferred rent receivable attributable to the Marketing leases was \$20,409,000 and \$21,221,000, respectively, which was comprised of a gross deferred rent receivable of \$27,621,000 and \$29,391,000, respectively, partially offset by a valuation reserve of \$7,212,000 and \$8,170,000, respectively. The valuation reserves were estimated as of such dates based on the deferred rent receivable attributable to properties identified by the Company as being the most likely to be removed from the

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Marketing Leases. The Company has not provided deferred rent receivable reserves related to the remaining properties subject to the Marketing Leases since, based on its assessments and assumptions as of June 30, 2011, the Company continued to believe that it was probable that it will collect the deferred rent receivable related to those remaining properties. It is possible that as a result of the continued deterioration of Marketing's financial condition, that Marketing may file bankruptcy and seek to reorganize or liquidate its business, or seek a deferral or reduction in the rental payments owed under the Marketing Leases in connection with a removal of properties from the Marketing Leases or otherwise. It is possible that the Company may change its estimates, judgments, assumptions and beliefs regarding Marketing and the Marketing Leases, and accordingly, during the third quarter of 2011 or thereafter, the Company may be required to significantly increase the deferred rent receivable reserve as a result of the potential or actual modification or termination of the Marketing Leases.

The Company has performed an impairment analysis of the carrying amount of its properties (including the properties subject to the Marketing Leases) from time to time in accordance with GAAP when indicators of impairment exist. During the six months ended June 30, 2011, the Company reduced the carrying amount to fair value, and recorded non-cash impairment charges aggregating \$2,507,000 (of which \$994,000 was attributable to certain properties leased to Marketing and \$1,513,000 was attributable to certain properties leased to other tenants) where the carrying amount of the property exceeded the estimated undiscounted cash flows expected to be received during the assumed holding period and the estimated net sales value expected to be received at disposition. The non-cash impairment charges related to the properties leased to Marketing were attributable to reductions in real estate valuations primarily due to the removal or scheduled removal of underground storage tanks by Marketing. The non-cash impairment charges related to properties leased to other tenants resulted from reductions in real estate valuations and the reductions in the assumed holding period used to test for impairment. The fair value of real estate is estimated based on the price that would be received to sell the property in an orderly transaction between market participants at the measurement date, net of disposal costs. The valuation techniques that the Company used included discounted cash flow analysis, an income capitalization approach on prevailing or earnings multiples applied to earnings from the property, analysis of recent comparable sales transactions, actual sale negotiations and bona fide purchase offers received from third parties and/or consideration of the amount that currently would be required to replace the asset, as adjusted for obsolescence. In general, the Company considers multiple valuation techniques when measuring the fair value of a property, all of which are based on assumptions that are classified within Level 3 of the fair value hierarchy.

Marketing is directly responsible to pay for (i) remediation of environmental contamination it causes and compliance with various environmental laws and regulations as the operator of the Company's properties, and (ii) known and unknown environmental liabilities allocated to Marketing under the terms of the Marketing Leases and various other agreements with the Company relating to Marketing's business and the properties it leases from the Company (collectively the Marketing Environmental Liabilities). However, the Company continues to have ongoing environmental remediation obligations at 176 retail sites and for certain pre-existing conditions at six of the terminals the Company leases to Marketing. If

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Marketing fails to pay the Marketing Environmental Liabilities, the Company may ultimately be responsible to pay for Marketing Environmental Liabilities as the property owner. The Company does not maintain pollution legal liability insurance to protect it from potential future claims for Marketing Environmental Liabilities. The Company will be required to accrue for Marketing Environmental Liabilities if the Company determines that it is probable that Marketing will not meet its environmental obligations and the Company can reasonably estimate the amount of the Marketing Environmental Liabilities for which it will be responsible to pay, or if the Company's assumptions regarding the ultimate allocation methods or share of responsibility that it used to allocate environmental liabilities changes. However, as of June 30, 2011 the Company continued to believe that it was not probable that Marketing would not pay for substantially all of the Marketing Environmental Liabilities. Accordingly, the Company did not accrue for the Marketing Environmental Liabilities as of June 30, 2011. Nonetheless, the Company has determined that the aggregate amount of the Marketing Environmental Liabilities (as estimated by the Company) would be material to the Company if it was required to accrue for all of the Marketing Environmental Liabilities since as a result of such accrual, the Company would not be in compliance with the existing financial covenants in its Credit Agreement and its Term Loan Agreement. Such non-compliance would result in an event of default pursuant to each agreement which, if not waived, would prohibit the Company from drawing funds against the Credit Agreement and could result in the acceleration of the Company's indebtedness under the Company's restated senior unsecured revolving credit agreement expiring in March 2012 (the Credit Agreement) and the Company's \$25.0 million three-year term loan agreement expiring in September 2012 (the Term Loan Agreement or Term Loan). It is possible that the Company may change its estimates, judgments, assumptions and beliefs regarding Marketing and the Marketing Leases, and accordingly, during the third quarter of 2011 or thereafter, the Company may be required to accrue for the Marketing Environmental Liabilities.

The Company's estimates, judgments, assumptions and beliefs regarding Marketing and the Marketing Leases made effective June 30, 2011 are subject to reevaluation and possible change based on various factors including as the Company considers its options regarding Marketing's non-payment of August rent and as it develops a greater understanding of Marketing's business plan and strategies and its capital resources. It is possible that the deterioration of Marketing's financial condition may continue, that Marketing may file bankruptcy and seek to reorganize or liquidate its business or that Marketing may continue to pursue seeking a modification of the Marketing Leases, including, removal of either groups of or individual properties from the Marketing Leases, or a reduction in the rental payments owed by Marketing under the Marketing Lease.

Should the Company's assessments, assumptions and beliefs made effective as of June 30, 2011 prove to be incorrect, and as the Company considers its options regarding Marketing's non-payment of August rent or as circumstances change, the conclusions reached by the Company relating to the following may change (i) whether any or what combination of the properties subject to the Marketing Leases are likely to be removed from the Marketing Leases, (ii) recoverability of the deferred rent receivable for some or all of the properties subject to the Marketing Leases, (iii) potential impairment of the properties subject to the Marketing Leases and, (iv) Marketing's ability to pay the Marketing Environmental Liabilities. The Company intends to regularly review its assumptions that affect the accounting for deferred rent

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receivable; long-lived assets; environmental litigation accruals; environmental remediation liabilities; and related recoveries from state underground storage tank funds. The Company's estimates, judgments, assumptions and beliefs regarding Marketing and the Marketing Leases made effective June 30, 2011 are subject to reevaluation and possible change as the Company considers its options regarding Marketing's non-payment of August rent and as it develops a greater understanding of Marketing's business plan and strategies and its capital resources. Accordingly, it is possible that the Company may be required to (i) increase the deferred rent receivable reserve related to the properties subject to the Marketing Leases, (ii) record an additional impairment charge related to the properties subject to the Marketing Leases, or (iii) accrue for Marketing Environmental Liabilities that the Company believes are allocable to Marketing under the Marketing Leases and various other agreements as a result of the potential or actual filing for bankruptcy protection by Marketing or as a result of the potential or actual modification of the Marketing Leases or other factors, which may result in material adjustments to the amounts recorded for these assets and liabilities, and as a result of which, the Company may not be in compliance with the financial covenants in its Credit Agreement and its Term Loan Agreement.

The Company cannot provide any assurance that Marketing will meet its rental, environmental or other obligations under the Marketing Leases. Marketing's failure to meet its rental, environmental or other obligations under the Marketing Leases to the Company can lead to a protracted and expensive process for retaking control of the Company's properties. In addition to the risk of disruption in rent receipts, the Company is subject to the risk of incurring real estate taxes, maintenance, environmental and other expenses at properties subject to the Marketing Leases. If Marketing does not perform its rental, environmental or other obligations under the Marketing Leases; if the Marketing Leases are modified significantly or terminated; if the Company determines that it is probable that Marketing will not meet its rental, environmental or other obligations and the Company accrues for certain of such liabilities; if the Company is unable to promptly re-let or sell the properties upon recapture from the Marketing Leases; or, if the Company changes its assumptions that affect the accounting for rental revenue or Marketing Environmental Liabilities related to the Marketing Leases and various other agreements; the Company's business, financial condition, revenues, operating expenses, results of operations, liquidity, ability to pay dividends or stock price may be materially adversely affected.

The Company has also agreed to provide limited environmental indemnification to Marketing, capped at \$4,250,000, for certain pre-existing conditions at six of the terminals which are owned by the Company and leased to Marketing. Under the agreement, Marketing is required to pay (and has paid) the first \$1,500,000 of costs and expenses incurred in connection with remediating any such pre-existing conditions, Marketing and the Company share equally the next \$8,500,000 of those costs and expenses and Marketing is obligated to pay all additional costs and expenses over \$10,000,000. The Company has accrued \$300,000 as of June 30, 2011 and December 31, 2010 in connection with this indemnification agreement.

The Company is subject to various legal proceedings and claims which arise in the ordinary course of its business. In addition, the Company has retained responsibility for certain legal proceedings and claims relating to the petroleum marketing business that were identified at the time the Company's petroleum marketing business was spun-off to our shareholders in March 1997. As of June 30, 2011 and December 31, 2010, the Company had accrued \$2,893,000 and \$3,273,000, respectively, for certain of these matters which it believes were appropriate based on information then currently available. It is possible that the Company's assumptions regarding, among other items, the ultimate resolution of and/or

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the Company's ultimate share of responsibility for these matters may change, which may result in the Company providing or adjusting its accruals for these matters.

In September 2003, the Company received a directive (the Directive) from the State of New Jersey Department of Environmental Protection (the NJDEP) notifying the Company that it is one of approximately 66 potentially responsible parties for natural resource damages resulting from discharges of hazardous substances into the Lower Passaic River. The Directive calls for an assessment of the natural resources that have been injured by the discharges into the Lower Passaic River and interim compensatory restoration for the injured natural resources. There has been no material activity with respect to the NJDEP Directive since early after its issuance. The responsibility for the alleged damages, the aggregate cost to remediate the Lower Passaic River, the amount of natural resource damages and the method of allocating such amounts among the potentially responsible parties have not been determined. Effective May 2007, the United States Environmental Protection Agency (EPA) entered into an Administrative Settlement Agreement and Order on Consent (AOC) with over 70 parties comprising a Cooperating Parties Group (CPG) (many of whom also named in the Directive) who have collectively agreed to perform a Remedial Investigation and Feasibility Study (RI/FS) for the Lower Passaic River. The Company is a party to the AOC and is a member of the CPG. The RI/FS is intended to address the investigation and evaluation of alternative remedial actions with respect to alleged damages to the Lower Passaic River, and is scheduled to be completed in or about 2014. The RI/FS does not resolve liability issues for remedial work or restoration of, or compensation for, natural resource damages to the Lower Passaic River, which are not known at this time.

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

During 2010, the Company was defending against 53 lawsuits brought by or on behalf of private and public water providers and governmental agencies. These cases alleged (and, as described below with respect to one remaining case, continue to allege) various theories of liability due to contamination of groundwater with methyl tertiary butyl ether (a fuel derived from methanol, commonly referred to as MTBE) as the basis for claims seeking compensatory and punitive damages, and name as defendant approximately 50 petroleum refiners, manufacturers, distributors and retailers of MTBE, or gasoline containing MTBE. During the quarter ended March 31, 2010, the Company agreed to, and subsequently paid, \$1,725,000 to settle two plaintiff classes covering 52 of the 53 pending cases. Presently, the Company remains a defendant in one MTBE case involving multiple locations throughout the State of New Jersey brought by various governmental agencies of the State of New Jersey, including the NJDEP.

As of June 30, 2011 and December 31, 2010, the Company maintained a litigation reserve relating to the remaining MTBE case in an amount which it believes was appropriate based on information then

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currently available. However, the Company is unable to estimate with certainty its liability for the case involving the State of New Jersey as there remains uncertainty as to the accuracy of the allegations in this case as they relate to it, the Company's defenses to the claims, its rights to indemnification or contribution from Marketing, and the aggregate possible amount of damages for which the Company may be held liable.

The ultimate resolution of the matters related to the Lower Passaic River for which no reserve has been provided for and the MTBE litigation discussed above for an amount above that which has been provided for could cause a material adverse effect on the Company's business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

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

The Company is a party to a \$175,000,000 amended and restated senior unsecured revolving credit agreement (the Credit Agreement) with a group of domestic commercial banks led by JPMorgan Chase Bank, N.A. (the Bank Syndicate) which was scheduled to expire in March 2011. During the first quarter of 2011, the Company exercised its option to extend the maturity date by an additional year to March 2012. As of June 30, 2011, borrowings under the Credit Agreement were \$150,000,000, bearing interest at a rate of 1.2688% per annum. The Company had \$25,000,000 available under the terms of the Credit Agreement as of June 30, 2011. The Credit Agreement does not provide for scheduled reductions in the principal balance prior to its maturity. The Credit Agreement permits borrowings at an interest rate equal to the sum of a base rate plus a margin of 0.0% or 0.25% or a LIBOR rate plus a margin of 1.0%, 1.25% or 1.5%. The applicable margin is based on the Company's leverage ratio at the end of the prior calendar quarter, as defined in the Credit Agreement, and is adjusted effective mid-quarter when the Company's quarterly financial results are reported to the Bank Syndicate. Based on the Company's leverage ratio as of June 30, 2011, the applicable margin will remain at 0.0% for base rate borrowings and 1.00% for LIBOR rate borrowings.

The annual commitment fee on the unused Credit Agreement ranges from 0.10% to 0.20% based on the amount of borrowings. The Credit Agreement contains customary terms and conditions, including financial covenants such as those requiring the Company to maintain minimum tangible net worth, leverage ratios and coverage ratios and other covenants which may limit the Company's ability to incur debt or pay dividends. The Credit Agreement contains customary events of default, including change of control, failure to maintain REIT status or a material adverse effect on the Company's business, assets, prospects or condition. Any event of default, if not cured or waived, would increase by 200 basis points (2.0%) the interest rate the Company pays under the Credit Agreement and prohibit the Company from drawing funds against the Credit Agreement and could result in the acceleration of the Company's indebtedness under the Credit Agreement and could also give rise to an event of default and consequent acceleration of the Company's indebtedness under its Term Loan Agreement described below. The Company may be required to enter into alternative loan agreements, sell assets or issue additional equity at unfavorable terms if it does not have access to funds under its Credit Agreement or as a result of acceleration of its indebtedness under the Credit Agreement or Term Loan Agreement.

The Company is a party to a \$25,000,000 three-year Term Loan Agreement with TD Bank (the Term Loan Agreement or Term Loan) which expires in September 2012. As of June 30, 2011, borrowings under the Term Loan Agreement were \$23,200,000 bearing interest at a rate of 3.5% per annum. The Term Loan Agreement provides for annual reductions of \$780,000 in the principal balance with a \$22,160,000 balloon payment due at maturity. The Term Loan Agreement bears interest at a rate equal to a thirty day LIBOR rate (subject to a floor of 0.4%) plus a margin of 3.1%. The Term Loan Agreement



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contains customary terms and conditions, including financial covenants such as those requiring the Company to maintain minimum tangible net worth, leverage ratios and coverage ratios and other covenants which may limit the Company's ability to incur debt or pay dividends. The Term Loan Agreement contains customary events of default, including change of control, failure to maintain REIT status or a material adverse effect on the Company's business, assets, prospects or condition. Any event of default, if not cured or waived, would increase by 300 basis points (3.0%) the interest rate the Company pays under the Term Loan Agreement and could result in the acceleration of the Company's indebtedness under the Term Loan Agreement and could also give rise to an event of default and would prohibit the Company from drawing funds against the Credit Agreement and could result in the acceleration of the Company's indebtedness under its Credit Agreement. The Company may be required to enter into alternative loan agreements, sell assets or issue additional equity at unfavorable terms if it does not have access to funds under its Credit Agreement or as a result of acceleration of its indebtedness under the Credit Agreement or Term Loan Agreement.

The fair value of the borrowings outstanding under the Credit Agreement was \$147,400,000 as of June 30, 2011. The fair value of the borrowings outstanding under the Term Loan Agreement was \$23,200,000 as of June 30, 2011. The fair value of the projected average borrowings outstanding under the Credit Agreement and the borrowings outstanding under the Term Loan Agreement were determined using a discounted cash flow technique that incorporates a market interest yield curve based on market data obtained from sources independent of the Company that are observable at commonly quoted intervals and are defined by GAAP as Level 2 inputs in the Fair Value Hierarchy, with adjustments for duration, optionality, risk profile and projected average borrowings outstanding or borrowings outstanding, which are based on unobservable Level 3 inputs.

Marketing is directly responsible to pay for (i) remediation of environmental contamination it causes and compliance with various environmental laws and regulations as the operator of the Company's properties, and (ii) known and unknown environmental liabilities allocated to Marketing under the terms of the Marketing Leases and various other agreements with the Company relating to Marketing's business and the properties it leases from the Company (collectively the Marketing Environmental Liabilities). If Marketing fails to pay the Marketing Environmental Liabilities, the Company may ultimately be responsible to pay for Marketing Environmental Liabilities as the property owner. The Company will be required to accrue for Marketing Environmental Liabilities if the Company determines that it is probable that Marketing will not meet its environmental obligations and the Company can reasonably estimate the amount of the Marketing Environmental Liabilities for which it will be responsible to pay, or if the Company's assumptions regarding the ultimate allocation methods or share of responsibility that it used to allocate environmental liabilities changes. However, as of June 30, 2011 the Company continued to believe that it was not probable that Marketing would not pay for substantially all of the Marketing Environmental Liabilities. Accordingly, the Company did not accrue for the Marketing Environmental Liabilities as of June 30, 2011. Nonetheless, the Company has determined that the aggregate amount of the Marketing Environmental Liabilities (as estimated by the Company) would be material to the Company if it was required to accrue for all of the Marketing Environmental Liabilities since as a result of such accrual, the Company would not be in compliance with the existing financial covenants in its Credit Agreement and its Term Loan Agreement. Such non-compliance would result in an event of default pursuant to each agreement which, if not waived, would prohibit the Company from drawing funds against the Credit Agreement and could result in the acceleration of the Company's indebtedness under the Company's restated senior unsecured revolving credit agreement expiring in March 2012 (the Credit Agreement) and the Company's \$25.0 million three-year term loan agreement expiring in September 2012 (the Term Loan Agreement or Term Loan). The Company's estimates, judgments, assumptions and beliefs regarding Marketing and the Marketing Leases made effective June 30, 2011 are subject to reevaluation and possible change as the Company considers its options regarding Marketing's non-payment of August rent and as it develops a greater understanding of Marketing's business plan and strategies and its capital resources. It is possible that the Company may change its estimates, judgments, assumptions and beliefs regarding Marketing and the Marketing Leases, and accordingly, during the third quarter of 2011 or thereafter, the Company may be required to accrue for the Marketing Environmental Liabilities.

## **5. INTEREST RATE SWAP AGREEMENT**

The Company was a party to a \$45,000,000 LIBOR based interest rate swap which expired on June 30, 2011 (the Swap Agreement ). The Swap Agreement was intended to effectively fix, at 5.44%, a portion of the LIBOR component of the interest rate determined under the Company's LIBOR based loan agreements. The Company entered into the Swap Agreement with JPMorgan Chase Bank, N.A., designated and qualifying as a cash flow hedge, to reduce its exposure to the variability in cash flows attributable to changes in the LIBOR rate. The Company's primary objective when undertaking the hedging transaction and derivative position was to reduce its variable interest rate risk by effectively fixing a portion of the interest rate for existing debt and anticipated refinancing transactions. The Company determined, as of the Swap Agreement's inception and throughout its term, that the derivative used in the hedging transaction was highly effective in offsetting changes in cash flows associated with the hedged item and that no gain or loss was required to be recognized in earnings representing the hedge's ineffectiveness. At December 31, 2010, the Company's consolidated balance sheet included in accounts payable and accrued liabilities \$1,153,000 for the fair value of the Swap Agreement which expired on June 30, 2011. For the six months ended June 30, 2011 and 2010, the Company has recorded, in accumulated other comprehensive loss in the Company's consolidated balance sheets, a gain of \$1,153,000, and \$848,000, respectively, from the changes in the fair value of the Swap Agreement obligation related to the effective portion of the interest rate contract.

The fair values of the Swap Agreement obligation were determined using (i) discounted cash flow analyses on the expected cash flows of the Swap Agreement, which were based on market data obtained from sources independent of the Company consisting of interest rates and yield curves that are observable at commonly quoted intervals and are defined by GAAP as Level 2 inputs in the Fair Value Hierarchy, and (ii) credit valuation adjustments, which were based on unobservable Level 3 inputs.

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The Company classified its valuations of the Swap Agreement entirely within Level 2 of the Fair Value Hierarchy since the credit valuation adjustments were not significant to the overall valuations of the Swap Agreement.

**6. ENVIRONMENTAL EXPENSES**

The Company is subject to numerous existing federal, state and local laws and regulations, including matters relating to the protection of the environment such as the remediation of known contamination and the retirement and decommissioning or removal of long-lived assets including buildings containing hazardous materials, USTs and other equipment. Environmental expenses are principally attributable to remediation costs which include installing, operating, maintaining and decommissioning remediation systems, monitoring contamination, and governmental agency reporting incurred in connection with contaminated properties. The Company seeks reimbursement from state UST remediation funds related to these environmental expenses where available.

The Company enters into leases and various other agreements which allocate responsibility for known and unknown environmental liabilities by establishing the percentage and method of allocating responsibility between the parties. In accordance with the leases with certain tenants, the Company has agreed to bring the leased properties with known environmental contamination to within applicable standards, and to either regulatory or contractual closure ( Closure ). Generally, upon achieving Closure at each individual property, the Company s environmental liability under the lease for that property will be satisfied and future remediation obligations will be the responsibility of the Company s tenant. Generally the liability for the retirement and decommissioning or removal of USTs and other equipment is the responsibility of the Company s tenants. The Company is contingently liable for these obligations in the event that the tenants do not satisfy their responsibilities. A liability has not been accrued for obligations that are the responsibility of the Company s tenants based on the tenants history of paying such obligations and/or the Company s assessment of their financial ability to pay their share of such costs. However, there can be no assurance that the Company s assessments are correct or that the Company s tenants who have paid their obligations in the past will continue to do so.

Of the 804 properties leased to Marketing as of June 30, 2011, the Company has agreed to pay all costs relating to, and to indemnify Marketing for, certain environmental liabilities and obligations at 176 retail properties that have not achieved Closure and are scheduled in the Master Lease. The Company will continue to seek reimbursement from state UST remediation funds related to these environmental expenditures where available.

It is possible that the Company s assumptions regarding the ultimate allocation method and share of responsibility that it used to allocate environmental liabilities may change, which may result in material adjustments to the amounts recorded for environmental litigation accruals, environmental remediation liabilities and related assets. The Company is required to accrue for environmental liabilities that the Company believes are allocable to others under various other agreements if the Company determines that it is probable that the counter-party will not meet its environmental obligations. The ultimate resolution of these matters could cause a material adverse effect on the Company s business, financial condition, results of operations, liquidity, ability to pay dividends or stock price. (See note 3 for contingencies related to Marketing and the Marketing Leases for additional information.)

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The estimated future costs for known environmental remediation requirements are accrued when it is probable that a liability has been incurred and a reasonable estimate of fair value can be made. The environmental remediation liability is estimated based on the level and impact of contamination at each property. The accrued liability is the aggregate of the best estimate of the fair value of cost for each component of the liability. Recoveries of environmental costs from state UST remediation funds, with respect to both past and future environmental spending, are accrued at fair value as an offset to environmental expense, net of allowance for collection risk, based on estimated recovery rates developed from prior experience with the funds when such recoveries are considered probable.

Environmental exposures are difficult to assess and estimate for numerous reasons, including the extent of contamination, alternative treatment methods that may be applied, location of the property which subjects it to differing local laws and regulations and their interpretations, as well as the time it takes to remediate contamination. In developing the Company's liability for probable and reasonably estimable environmental remediation costs on a property by property basis, the Company considers among other things, enacted laws and regulations, assessments of contamination and surrounding geology, quality of information available, currently available technologies for treatment, alternative methods of remediation and prior experience. Environmental accruals are based on estimates which are subject to significant change, and are adjusted as the remediation treatment progresses, as circumstances change and as environmental contingencies become more clearly defined and reasonably estimable. As of June 30, 2011, the Company had regulatory approval for remediation action plans in place for 216 (92%) of the 236 properties for which it continues to retain environmental responsibility and the remaining 20 properties (8%) remain in the assessment phase. In addition, the Company has nominal post-closure compliance obligations at 32 properties where it has received no further action letters.

Environmental remediation liabilities and related assets are measured at fair value based on their expected future cash flows which have been adjusted for inflation and discounted to present value. The estimated environmental remediation cost and accretion expense included in environmental expenses included in continuing operations in the Company's consolidated statements of operations aggregated \$1,358,000 and \$1,928,000 for the six months ended June 30, 2011 and 2010, respectively, which amounts were net of changes in estimated recoveries from state UST remediation funds. In addition to estimated environmental remediation costs, environmental expenses also include project management fees, legal fees and provisions for environmental litigation loss reserves.

As of June 30, 2011 and December 31, 2010 and 2009, the Company had accrued \$15,000,000, \$14,874,000 and \$16,527,000, respectively, as management's best estimate of the fair value of reasonably estimable environmental remediation costs. As of June 30, 2011 and December 31, 2010 and 2009, the Company had also recorded \$3,906,000, \$3,966,000 and \$3,882,000, respectively, as management's best estimate for recoveries from state UST remediation funds, net of allowance, related to environmental obligations and liabilities. The net environmental liabilities of \$10,908,000 and \$12,645,000 as of December 31, 2010 and 2009, respectively, were subsequently accreted for the change in present value due to the passage of time and, accordingly, \$296,000 and \$345,000 of net accretion expense was recorded for the six months ended June 30, 2011 and 2010, respectively, substantially all of which is included in environmental expenses.

In view of the uncertainties associated with environmental expenditures, contingencies related to Marketing and the Marketing Leases and contingencies related to other parties, however, the Company

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believes it is possible that the fair value of future actual net expenditures could be substantially higher than amounts currently recorded by the Company. (See note 3 for contingencies related to Marketing and the Marketing Leases for additional information.) Adjustments to accrued liabilities for environmental remediation costs will be reflected in the Company's financial statements as they become probable and a reasonable estimate of fair value can be made. Future environmental expenses could cause a material adverse effect on our business, financial condition, results of operations, liquidity, ability to pay dividends or stock price.

**7. SHAREHOLDERS' EQUITY**

A summary of the changes in shareholders' equity for the six months ended June 30, 2011 is as follows (in thousands, except share amounts):

	COMMON STOCK		PAID-IN	DIVIDENDS PAID IN EXCESS OF EARNINGS	ACCUMULATED OTHER COMPREHENSIVE LOSS	TOTAL
	SHARES	AMOUNT	CAPITAL			
Balance, December 31, 2010	29,944,155	\$ 299	\$ 368,093	\$ (52,304)	\$ (1,153)	\$ 314,935
Net earnings				26,588		26,588
Dividends				(32,222)		(32,222)
Stock-based employee compensation expense	20		311			311
Issuance of common stock	3,450,000	35	91,951			91,986
Net unrealized gain on interest rate swap					1,153	1,153
Balance, June 30, 2011	33,394,175	\$ 334	\$ 460,355	\$ (57,938)	\$	\$ 402,751

The Company is authorized to issue 20,000,000 shares of preferred stock, par value \$.01 per share, of which none were issued as of June 30, 2011 or December 31, 2010.

In the first quarter of 2011, the Company completed a public stock offering of 3,450,000 shares of the Company's common stock, of which 3,000,000 shares were issued in January 2011 and 450,000 shares, representing the underwriter's over-allotment, were issued in February 2011. Substantially all of the aggregate \$91,986,000 net proceeds from the issuance of common stock (after related transaction costs of \$267,000) was used to repay a portion of the outstanding balance under the Company's Credit Agreement and the remainder was used for general corporate purposes.

**8. PROPERTY ACQUISITIONS*****CPD NY SALE/LEASEBACK***

On January 13, 2011, the Company acquired fee or leasehold title to 59 Mobil-branded gasoline station and convenience store properties and also took a security interest in six other Mobil-branded gasoline stations and convenience store properties in a sale/leaseback and loan transaction with CPD NY Energy Corp. (CPD NY), a subsidiary of Chestnut Petroleum Dist. Inc. The Company's total investment in the transaction was \$111,621,000 including acquisition costs, which was financed entirely with borrowings under the Company's Credit Agreement.

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The properties were acquired or financed in a simultaneous transaction among ExxonMobil, CPD NY and the Company whereby CPD NY acquired a portfolio of 65 gasoline station and convenience stores from ExxonMobil and simultaneously completed a sale/leaseback of 59 of the acquired properties and leasehold interests with the Company. The lease between the Company, as lessor, and CPD NY, as lessee, governing the properties is a unitary triple-net lease agreement (the "CPD Lease"), with an initial term of 15 years, and options for up to three successive renewal terms of ten years each. The CPD Lease requires CPD NY to pay a fixed annual rent for the properties (the "Rent"), plus an amount equal to all rent due to third party landlords pursuant to the terms of third party leases. The Rent is scheduled to increase on the third anniversary of the date of the CPD Lease and on every third anniversary thereafter. As a triple-net lessee, CPD NY is required to pay all amounts pertaining to the properties subject to the CPD Lease, including taxes, assessments, licenses and permit fees, charges for public utilities and all governmental charges. Partial funding to CPD NY for the transaction was also provided by the Company under a secured, self-amortizing loan having a 10-year term (the "CPD Loan").

The Company accounted for this transaction as a business combination. As of June 30, 2011, the Company's allocation of the purchase price among the assets acquired and liabilities assumed is preliminary and subject to change. The purchase price has been allocated among the assets acquired based on the initial estimates of fair value. These allocations remain preliminary and may not be indicative of the final allocations. The Company's preliminary purchase price allocation as of June 30, 2011 differs by immaterial amounts from the preliminary purchase price allocation recorded as of March 31, 2011. The Company continues to evaluate the assumptions used in valuing the real estate. The Company anticipates finalizing these allocations in the third quarter of 2011. A change in the final allocation from what is presented may result in an increase or decrease in identified assets and liabilities and changes in revenue and expenses, including amortization and other expenses. A change in the final allocation from what is presented may also result in changes in the unaudited pro forma condensed consolidated financial information presented below.

The Company estimated the fair value of acquired tangible assets (consisting of land, buildings and equipment) as if vacant and intangible assets consisting of above and below market leases. Based on these preliminary estimates, the Company allocated \$60,641,000 of the purchase price to land, which is accounted for as an operating lease, net above and below market leases related to leasehold interests with landlords of \$953,000 which is accounted for as a deferred asset, net above and below market leases related to leasehold interests with tenants of \$2,750,000 which is accounted for as a deferred liability, \$38,955,000 allocated to buildings and equipment, which is accounted for as a direct financing lease and capital lease assets, and \$18,400,000 which is accounted for in notes, mortgages and accounts receivable, net. In connection with the acquisition of certain leasehold interests, the Company also recorded capital lease obligations aggregating \$5,768,000. The Company also incurred transaction costs of \$1,190,000 directly related to the acquisition. The future contractual minimum annual rent receivable from CPD NY on a calendar year basis is as follows: 2011 \$8,090,000, 2012 \$8,826,000 2013 \$8,826,000, 2014 \$9,090,000, 2015 \$9,090,000, 2016 \$9,090,000 and \$86,820,000 thereafter.

***NOURIA SALE/LEASEBACK***

On March 31, 2011, the Company acquired fee or leasehold title to 66 Shell-branded gasoline station and convenience store properties in a sale/leaseback transaction with Nouria Energy Ventures I, LLC ("Nouria"), a subsidiary of Nouria Energy Group. The Company's total investment in the transaction was

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\$86,167,000 including acquisition costs, which was financed entirely with borrowings under the Company's Credit Agreement.

The properties were acquired in a simultaneous transaction among Motiva Enterprises LLC ( "Shell" ), Nouria and the Company whereby Nouria acquired a portfolio of 66 gasoline station and convenience stores from Shell and simultaneously completed a sale/leaseback of the 66 acquired properties and leasehold interests with the Company. The lease between the Company, as lessor, and Nouria, as lessee, governing the properties is a unitary triple-net lease agreement (the "Nouria Lease" ), with an initial term of 20 years, and options for up to two successive renewal terms of ten years each followed by one final renewal term of five years. The Nouria Lease requires Nouria to pay a fixed annual rent for the properties (the "Rent" ), plus an amount equal to all rent due to third party landlords pursuant to the terms of third party leases. The Rent is scheduled to increase on every annual anniversary of the date of the Nouria Lease. As a triple-net lessee, Nouria is required to pay all amounts pertaining to the properties subject to the Nouria Lease, including taxes, assessments, licenses and permit fees, charges for public utilities and all governmental charges.

The Company accounted for this transaction as a business combination. As of June 30, 2011, the Company's allocation of the purchase price among the assets acquired and liabilities assumed is preliminary and subject to change. The purchase price has been allocated among the assets acquired based on the initial estimates of fair value. These allocations remain preliminary and may not be indicative of the final allocations. The Company's preliminary purchase price allocation as of June 30, 2011 differs by immaterial amounts from the preliminary purchase price allocation recorded as of March 31, 2011. The Company continues to evaluate the assumptions used in valuing the real estate. The Company anticipates finalizing these allocations in the third quarter of 2011. A change in the final allocation from what is presented may result in an increase or decrease in identified assets and liabilities and changes in revenue and expenses, including amortization and other expenses. A change in the final allocation from what is presented may also result in changes in the unaudited pro forma condensed consolidated financial information presented below.

The Company estimated the fair value of acquired tangible assets (consisting of land, buildings and equipment) as if vacant and intangible assets consisting of above and below market leases. Based on these preliminary estimates, the Company allocated \$39,700,000 of the purchase price to land, which is accounted for as an operating lease, net above and below market leases relating to the leasehold interests with landlords of \$3,781,000, which is accounted for as a deferred asset, net above and below market leases related to leasehold interests with tenants of \$3,638,000, which is accounted for as a deferred liability, \$33,480,000 to buildings and equipment, which is accounted for as a direct financing lease and \$12,000,000 which is accounted for in notes, mortgages and accounts receivable, net. The Company also incurred transaction costs of \$844,000 directly related to the acquisition. The future contractual minimum annual rent receivable from Nouria on a calendar year basis is as follows: 2011 \$6,431,000, 2012 \$8,675,000 2013 \$8,812,000, 2014 \$8,952,000, 2015 \$9,095,000, 2016 \$9,240,000 and \$131,043,000 thereafter.

The following unaudited pro forma condensed consolidated financial information has been prepared utilizing the historical financial statements of the Company and the combined effect of additional revenue and expenses from the properties acquired from both CPD NY and Nouria assuming that the acquisitions had occurred as of the beginning of each of the periods presented, after giving effect to certain

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adjustments including (a) rental income adjustments resulting from the straight-lining of scheduled rent increases (b) rental income adjustments resulting from the recognition of revenue under direct financing leases over the lease term using the effective interest rate method which produces a constant periodic rate of return on the net investment in the leased property (c) rental income adjustments resulting from the amortization of above market leases with tenants and (d) rent expense adjustments resulting from the amortization of below market leases with landlords. The following information also gives effect to the additional interest expense resulting from the assumed increase in borrowing outstanding drawn under the Credit Agreement to fund the acquisitions and the elimination of acquisition costs. The unaudited pro forma condensed financial information is not indicative of the results of operations that would have been achieved had the acquisition from CPD NY and Nouria reflected herein been consummated on the dates indicated or that will be achieved in the future.

	Six months ended June 30,	
	2011	2010
Revenues	\$ 55,084	\$ 55,877
Net earnings	\$ 31,134	\$ 35,012
Basic and diluted net earnings per common share	\$ 0.94	\$ 1.35

**9. SUPPLEMENTAL CONDENSED COMBINING FINANCIAL INFORMATION**

Condensed combining financial information as of June 30, 2011 and December 31, 2010 and for the three and six months ended June 30, 2011 and 2010 has been derived from the Company's books and records and is provided below to illustrate, for informational purposes only, the net contribution to the Company's financial results that are realized from the leasing operations of properties leased to Marketing (which represents approximately 69% of the Company's properties as of June 30, 2011) and from properties leased to other tenants. The condensed combining financial information set forth below presents the results of operations, net assets, and cash flows of the Company, related to Marketing, the Company's other tenants and the Company's corporate functions necessary to arrive at the information for the Company on a combined basis. The assets, liabilities, lease agreements and other leasing operations attributable to the Marketing Leases and other tenant leases are not segregated in legal entities. However, the Company generally maintains its books and records in site specific detail and has classified the operating results which are clearly applicable to each owned or leased property as attributable to Marketing or to the Company's other tenants or to non-operating corporate functions. The condensed combining financial information has been prepared by the Company using certain assumptions, judgments and allocations. Each of the Company's properties were classified as attributable to Marketing, other tenants or corporate for all periods presented based on the property's use as of June 30, 2011 or the property's use immediately prior to its disposition or third party lease expiration.

Environmental remediation expenses have been attributed to Marketing or other tenants on a site specific basis and environmental related litigation expenses and professional fees have been attributed to Marketing or other tenants based on the pro rata share of specifically identifiable environmental expenses



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for the period from January 1, 2007 through June 30, 2011. The Company enters into leases and various other agreements which allocate responsibility for known and unknown environmental liabilities by establishing the percentage and method of allocating responsibility between the parties. In accordance with the leases with certain tenants, the Company has agreed to bring the leased properties with known environmental contamination to within applicable standards, and to either regulatory or contractual closure ( Closure ). Generally, upon achieving Closure at each individual property, the Company's environmental liability under the lease for that property will be satisfied and future remediation obligations will be the responsibility of the Company's tenant. Of the 804 properties leased to Marketing as of June 30, 2011, the Company has agreed to pay all costs relating to, and to indemnify Marketing for, certain environmental liabilities and obligations at 176 retail properties that have not achieved Closure and are scheduled in the Master Lease. (See note 6 for additional information.)

The heading Corporate in the statements below includes assets, liabilities, income and expenses attributed to general and administrative functions, financing activities and parent or subsidiary level income taxes, capital taxes or franchise taxes which were not incurred on behalf of the Company's leasing operations and are not reasonably allocable to Marketing or other tenants. With respect to general and administrative expenses, the Company has attributed those expenses clearly applicable to Marketing and other tenants. The Company considered various methods of allocating to Marketing and other tenants amounts included under the heading Corporate and determined that none of the methods resulted in a reasonable allocation of such amounts or an allocation of such amounts that more clearly summarizes the net contribution to the Company's financial results realized from the leasing operations of properties leased to Marketing and of properties leased to other tenants. Moreover, the Company determined that each of the allocation methods it considered resulted in a presentation of these amounts that would make it more difficult to understand the clearly identifiable results from its leasing operations attributable to Marketing and other tenants. The Company believes that the segregated presentation of assets, liabilities, income and expenses attributed to general and administrative functions, financing activities and parent or subsidiary level income taxes, capital taxes or franchise taxes provides the most meaningful presentation of these amounts since changes in these amounts are not fully correlated to changes in the Company's leasing activities.

While the Company believes these assumptions, judgments and allocations are reasonable, the condensed combining financial information is not intended to reflect what the net results would have been had assets, liabilities, lease agreements and other operations attributable to Marketing or its other tenants had been conducted through stand-alone entities during any of the periods presented.

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The condensed combining balance sheet of Getty Realty Corp. as of June 30, 2011 is as follows (in thousands):

	<b>Getty Petroleum Marketing</b>	<b>Other Tenants</b>	<b>Corporate</b>	<b>Consolidated</b>
<b>ASSETS:</b>				
Real Estate:				
Land	\$ 136,203	\$ 217,219	\$	\$ 353,422
Buildings and improvements	150,899	96,507	371	247,777
	287,102	313,726	371	601,199
Less accumulated depreciation and amortization	(119,586)	(27,276)	(213)	(147,075)
Real estate, net	167,516	286,450	158	454,124
Net investment in direct financing leases		90,231		90,231
Deferred rent receivable, net	20,409	7,160		27,569
Cash and cash equivalents			14,941	14,941
Other receivables, net	3,821	153	236	4,210
Notes, mortgages and accounts receivable, net	34	30,568	1,394	31,996
Prepaid expenses and other assets		10,547	3,224	13,771
Total assets	191,780	425,109	19,953	636,842
<b>LIABILITIES:</b>				
Borrowings under credit line			150,000	150,000
Term loan			23,200	23,200
Environmental remediation costs	13,970	1,030		15,000
Dividends payable			16,111	16,111
Accounts payable and accrued liabilities	1,054	20,424	8,302	29,780
Total liabilities	15,024	21,454	197,613	234,091
Net assets (liabilities)	\$ 176,756	\$ 403,655	\$ (177,660)	\$ 402,751

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The condensed combining balance sheet of Getty Realty Corp. as of December 31, 2010 is as follows (in thousands):

	<b>Getty Petroleum Marketing</b>	<b>Other Tenants</b>	<b>Corporate</b>	<b>Consolidated</b>
<b>ASSETS:</b>				
Real Estate:				
Land	\$ 137,151	\$ 116,262	\$	\$ 253,413
Buildings and improvements	152,570	98,233	371	251,174
	289,721	214,495	371	504,587
Less accumulated depreciation and amortization	(118,784)	(25,241)	(192)	(144,217)
Real estate, net	170,937	189,254	179	360,370
Net investment in direct financing lease		20,540		20,540
Deferred rent receivable, net	21,221	6,164		27,385
Cash and cash equivalents			6,122	6,122
Other receivables, net	3,874	363	296	4,533
Mortgages and accounts receivable, net	13	238	1,274	1,525
Prepaid expenses and other assets		3,444	3,225	6,669
Total assets	196,045	220,003	11,096	427,144
<b>LIABILITIES:</b>				
Borrowings under credit line			41,300	41,300
Term loan			23,590	23,590
Environmental remediation costs	13,841	1,033		14,874
Dividends payable			14,432	14,432
Accounts payable and accrued liabilities	962	6,953	10,098	18,013
Total liabilities	14,803	7,986	89,420	112,209
Net assets (liabilities)	\$ 181,242	\$ 212,017	\$ (78,324)	\$ 314,935

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The condensed combining statement of operations of Getty Realty Corp. for the three months ended June 30, 2011 is as follows (in thousands):

	<b>Getty Petroleum Marketing</b>	<b>Other Tenants</b>	<b>Corporate</b>	<b>Consolidated</b>
Revenues:				
Revenues from rental properties	\$ 14,172	\$ 12,954	\$	\$ 27,126
Interest on notes and mortgages receivable		710	31	741
Total revenues	14,172	13,664	31	27,867
Operating expenses:				
Rental property expenses	1,275	2,282	152	3,709
Impairment charges		1,513		1,513
Environmental expenses, net	1,295	31		1,326
General and administrative expenses	31	1,679	1,026	2,736
Depreciation and amortization expense	921	1,272	11	2,204
Total operating expenses	3,522	6,777	1,189	11,488
Operating income (loss)	10,650	6,887	(1,158)	16,379
Other income (expense), net	20		(69)	(49)
Interest expense			(1,346)	(1,346)
Earnings (loss) from continuing operations	10,670	6,887	(2,573)	14,984
Discontinued operations:				
Earnings (loss) from operating activities	(1)	(12)		(13)
Gains on dispositions of real estate	231			231
Earnings (loss) from discontinued operations	230	(12)		218
Net earnings (loss)	\$ 10,900	\$ 6,875	\$ (2,573)	\$ 15,202

The condensed combining statement of operations of Getty Realty Corp. for the three months ended June 30, 2010 is as follows (in thousands):

	<b>Getty Petroleum Marketing</b>	<b>Other Tenants</b>	<b>Corporate</b>	<b>Consolidated</b>
Revenues:				
Revenues from rental properties	\$ 14,817	\$ 6,917	\$	\$ 21,734
Interest on notes and mortgages receivable			35	35
Total revenues	14,817	6,917	35	21,769