MONMOUTH REAL ESTATE INVESTMENT CORP
Form 424B5
November 28, 2011

SUBJECT TO COMPLETION, DATED NOVEMBER 28, 2011

This prospectus supplement relates to an effective registration statement under the Securities Act of 1933, but is not complete and may be changed. This prospectus supplement is not an offer to sell these securities, and it is not soliciting an offer to buy these securities, in any state where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)(5)
Registration No. 333-161668

PRELIMINARY PROSPECTUS SUPPLEMENT
(To Prospectus dated September 14, 2009)

1,500,000 Shares

Monmouth Real Estate Investment Corporation

Common Stock

$ Per Share

We are offering 1,500,000 shares of our common stock, par value $0.01 per share.

Our common stock is traded on the New York Stock Exchange under the symbol “MNR.” On November 25, 2011, the closing price for our common stock on the New York Stock Exchange was $8.70 per share.

We have retained CSCA Capital Advisors, LLC (“CSCA”) to act as placement agent in connection with this offering. CSCA has no commitment to purchase our common stock and will act only as an agent in obtaining indications of interest in the common stock from certain investors. We have agreed to pay CSCA a placement agent fee of 2.5% of gross proceeds and to pay certain of its expenses. After paying the placement agent fee and other estimated expenses payable by us, we anticipate receiving approximately $ in net proceeds from this offering (assuming the sale of all 1,500,000 shares being offered).

Investing in our common stock involves risks, including those that are described in the “Risk Factors” sections beginning on page S-6 of this prospectus supplement, page 2 of the accompanying prospectus and page 6 of our Annual Report on Form 10-K for the fiscal year ended September 30, 2010, which is incorporated herein by reference.

	Per Share	Total
Public Offering Price	$	$
Placement Agent Fees and Commissions	$	$
Proceeds to us (before expenses)	$	$

Neither the Securities and Exchange Commission (the “SEC”) nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

CSCA Capital Advisors, LLC

The date of this prospectus supplement is , 2011

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PROSPECTUS SUPPLEMENT

PROSPECTUS

ABOUT THIS PROSPECTUS SUPPLEMENT

You should carefully read this prospectus supplement along with the accompanying prospectus, as well as the information incorporated by reference herein and therein, before you invest in our common stock. These documents contain important information that you should consider before making your investment decision. This prospectus supplement and the accompanying prospectus contain the terms of this offering of common stock. The accompanying prospectus contains information about our securities generally, some of which does not apply to the common stock covered by this prospectus supplement. This prospectus supplement may add, update or change information contained in or incorporated by reference in the accompanying prospectus. If the information in this prospectus supplement is inconsistent with any information contained in or incorporated by reference in the accompanying prospectus, the information in this prospectus supplement will apply and will supersede the inconsistent information contained in or incorporated by reference in the accompanying prospectus.

It is important for you to read and consider all of the information contained in this prospectus supplement and the accompanying prospectus before making your investment decision. You should also read and consider the additional information incorporated by reference in this prospectus supplement and the accompanying prospectus before making your investment decision. See “Incorporation of Certain Documents by Reference” in this prospectus supplement.

You should rely only on the information contained in or incorporated by reference in this prospectus supplement, the accompanying prospectus and any related free writing prospectus required to be filed with the SEC. Neither we nor CSCA have authorized any other person to provide you with additional or different information. If anyone provides you with additional or different information, you should not rely on it. Neither we nor CSCA are making an offer to sell the common stock in any jurisdiction where the offer or sale is not permitted.

You should assume that the information appearing in this prospectus supplement, the accompanying prospectus, any free writing prospectus and the documents incorporated by reference herein and therein is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

Unless this prospectus supplement otherwise indicates or the context otherwise requires, the terms “our,” “us,” “our company” and “we” as used in this prospectus supplement refer to Monmouth Real Estate Investment Corporation and its consolidated subsidiaries.

FORWARD-LOOKING STATEMENTS

Statements contained in this prospectus supplement and the accompanying prospectus, including the documents that are incorporated by reference, that are not historical facts are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Also, when we use any of the words “anticipate,” “assume,” “believe,” “continue,” “estimate,” “expect,” “intend,” “may,” “plan,” “project,” “should,” “will” or similar expressions, we are forward-looking statements. These forward-looking statements are not guarantees and are based on our current intentions and on our current expectations and assumptions. These statements, intentions, expectations and assumptions involve risks and uncertainties, some of which are beyond our control that could cause actual results or events to differ materially from those we anticipate or project, such as:

- the ability of our tenants to make payments under their respective leases;
- our reliance on certain major tenants and our ability to re-lease properties that are currently vacant or that become vacant;
- our ability to obtain suitable tenants for our properties;
- changes in real estate market conditions and general economic conditions;
- the inherent risks associated with owning real estate, including local real estate market conditions, governing laws and regulations and illiquidity of real estate investments;
- our ability to sell properties at an attractive price;
- our ability to repay debt financing obligations;
- our ability to refinance amounts outstanding under our credit facilities at maturity on terms favorable to us;
- the loss of any member of our management team;
- our ability to comply with certain debt covenants;
- our ability to integrate acquired properties and operations into existing operations;
- continued availability of debt or equity capital;
- market conditions affecting our equity capital;
- changes in interest rates under our current credit facilities and under any additional variable rate debt arrangements that we may enter into in the future;
- our ability to implement successfully our selective acquisition strategy;
- our ability to maintain internal controls and procedures to ensure all transactions are accounted for properly, all relevant disclosures and filings are timely made in accordance with all rules and regulations and any potential fraud or embezzlement is thwarted or detected;
- changes in federal or state tax rules or regulations that could have adverse tax consequences; and
- our ability to qualify as a real estate investment trust for federal income tax purposes.

You should not place undue reliance on these forward-looking statements, as events described or implied in such statements may not occur. We undertake no obligation to update or revise any forward-looking statements as a result of new information, future events or otherwise.

For more information regarding risks that may cause our actual results to differ materially from any forward-looking statements, please see the discussion under “Risk Factors” contained in this prospectus supplement, the accompanying prospectus and our Annual Report on Form 10-K for the fiscal year ended September 30, 2010, as well as the other information contained in our publicly available filings with the SEC, including our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 and our Quarterly Reports on Form 10-Q for the quarters ended December 31, 2010, March 31, 2011 and June 30, 2011.

SUMMARY

The following summary is qualified in its entirety by the more detailed information and consolidated financial statements and notes thereto appearing elsewhere in, or incorporated by reference into, this prospectus supplement and the accompanying prospectus. This summary is not complete and does not contain all of the information you should consider before purchasing our common stock. You should carefully read the “Risk Factors” sections beginning on page S-6 of this prospectus supplement, page 2 of the accompanying prospectus and page 6 of our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 to determine whether an investment in our common stock is appropriate for you.

The Company

General

Monmouth Real Estate Investment Corporation is a Maryland corporation operating as a qualified real estate investment trust (“REIT”) under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the “Code”). Currently, we seek to invest in well-located, modern buildings leased to investment grade tenants on long-term leases. Our primary business is the ownership of real estate. Our investment focus is to own net leased industrial properties which are leased primarily to investment-grade tenants on long-term leases. In addition, we hold a portfolio of REIT securities.

Currently, we derive our income primarily from real estate rental operations. At November 25, 2011, we owned approximately 7,983,400 square feet of property, of which approximately 3,553,000 square feet, or 45%, was leased to Federal Express Corporation and its subsidiaries. In addition, approximately 388,700 square feet in St. Joseph, Missouri, or approximately 5%, was leased to Mead Corporation, which subleased the space to Hallmark Cards, Incorporated, and approximately 381,240 square feet in Lebanon, Tennessee, or approximately 5%, was leased to Cracker Barrel Old Country Store, Inc. During fiscal 2011, the only tenant that accounted for more than 5% of our total rental and reimbursement revenue was Federal Express Corporation and its subsidiaries. During fiscal 2011, 2010 and 2009, rental and reimbursement revenue from Federal Express Corporation and its subsidiaries represented approximately 56%, 57% and 59%, respectively, of our total rental and reimbursement revenue.

At November 25, 2011, we had investments in 68 properties totaling approximately 8,000,000 square feet, consisting of 67 industrial properties and one shopping center. Our occupancy rate at November 25, 2011 was 97%. These properties are located in twenty-five states: Alabama, Arizona, Colorado, Connecticut, Florida, Georgia, Illinois, Iowa, Kansas, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and Wisconsin. All of our properties are wholly owned, with the exception of two properties in New Jersey in which we own a majority interest. At November 25, 2011, all of our wholly-owned industrial properties and the shopping center were managed by a management company affiliated with one of our directors. All properties in which we have investments are leased on a net basis except an industrial property located in Monaca, Pennsylvania and the shopping center, located in Somerset, New Jersey.

During fiscal 2011, we purchased three industrial properties totaling approximately 562,000 square feet, located in Illinois, Tennessee and Texas, for approximately $28,300,000. In addition, during fiscal 2011 we paid approximately $1,134,000 to purchase, for future expansion, a parcel of land adjacent to an industrial property currently owned by us in El Paso, Texas. As of November 25, 2011, during the first quarter of fiscal 2012, we have purchased three industrial properties totaling approximately 489,000 square feet, located in New York , Ohio, and Texas, for approximately $30,600,000, and have sold a 37,660 square foot industrial building in Quakertown, Pennsylvania with gross proceeds to us of $2,765,000. We have entered into an agreement to purchase one industrial property located in Ohio for approximately $5,100,000 and expect to consummate this transaction during the first quarter of fiscal 2012. We have also entered into agreements to acquire two industrial properties in Texas and one industrial property in Oklahoma, subject to due diligence which we are currently conducting. Subject to satisfactory due diligence, we anticipate closing these three transactions during the second half of fiscal 2012 or the first quarter of fiscal 2013. We anticipate acquiring additional properties in fiscal 2012. The funds for these acquisitions are expected to come from our available line of credit, mortgages, other bank borrowings, proceeds from the Dividend Reinvestment and Stock Purchase Plan (“DRIP”) and private or public placements of common or preferred stock. To the extent that funds or appropriate properties are not available, few or no acquisitions may be made. Because of the contingent nature of contracts to purchase real property, we typically announce acquisitions only upon closing.

We compete with other investors in real estate for attractive investment opportunities. These investors include other “equity” real estate investment trusts, limited partnerships, syndications and private investors, among others. Competition in the market areas in which we operate is significant and affects our ability to acquire or expand properties, occupancy levels, rental rates and operating expenses of certain properties. Management has built relationships with merchant builders that have historically provided us with investment opportunities that fit our investment policy; however, the amount of construction of new industrial properties has significantly decreased in recent years due to the economic recession and subsequent low levels of GDP growth.

We have a flexible investment policy concentrating our investments in the area of long-term net-leased industrial properties, primarily to investment grade tenants. Our strategy is to obtain a favorable yield spread between the income from the net-leased industrial properties and the mortgage interest costs. We anticipate that we will continue to purchase well-located, net-leased industrial properties because our management believes that these investments offer a potential for long-term capital appreciation. There is the risk that, on expiration of leases, the properties can become vacant or re-leased at lower rents. The results we obtain by re-leasing the properties will depend on the market for industrial properties at that time.

We also continue to invest in both debt and equity securities of other REITs. We, from time to time, may purchase these securities on margin when the interest and dividend yields exceed the cost of the funds. This securities portfolio, to the extent not pledged to secure borrowings, provides us with liquidity and additional income. Such securities are subject to risk arising from adverse changes in market rates and prices, primarily interest rate risk relating to debt securities and equity price risk relating to equity securities. From time to time, we may use derivative instruments to mitigate interest rate risk.

Since June 1, 2010, our common stock has been traded on the New York Stock Exchange under the symbol “MNR.” Previously, our common stock was traded on the NASDAQ Global Select Market. As of November 25, 2011, our authorized capital stock consisted of 57,139,750 shares, classified as 50,000,000 shares of common stock, par value $0.01 per share (of which 37,260,740 shares were outstanding), 5,000,000 shares of excess stock, par value $0.01 per share (of which no shares were outstanding), and 2,139,750 shares of Series A 7.625% Cumulative Redeemable Preferred Stock, par value $0.01 per share, $25 liquidation value per share (of which 2,139,750 shares were outstanding).

Prior to July 31, 2007, we operated as part of a group of three public companies (all REITs) which included UMH Properties, Inc. (“UMH”) and Monmouth Capital Corporation (“Monmouth Capital” and together with UMH, the “affiliated companies”). Monmouth Capital was merged into us on July 31, 2007. We continue to operate in conjunction with UMH. UMH has focused its investing in manufactured home communities. General and administrative expenses are allocated between the two remaining affiliated companies based on use or services provided. We currently have ten employees. Allocations of salaries and benefits are made between the affiliated companies based on the amount of the employees’ time dedicated to each affiliated company.

Our executive offices are located at Juniper Business Plaza, Suite 3-C, 3499 Route 9 North, Freehold, New Jersey 07728, and our telephone number is (732) 577-9996. Our website is located at www.mreic.com. Information contained on our website is not a part of this prospectus supplement.

Recent Developments

On October 11, 2011, we purchased a 368,060 square foot industrial building located in Streetsboro, Ohio. The building is 100% net leased to Best Buy Warehousing Logistics, Inc. through January 31, 2022. The purchase price was approximately $19,600,000. We obtained a mortgage of $12,740,000 at a fixed interest rate of 5.5% for 10 years and paid the remaining amount with a draw on our line of credit. This mortgage matures on November 1, 2021. Annual rental income over the term of the lease is $1,586,000.

On October 18, 2011, we purchased a 46,000 square foot industrial building located in Corpus Christi, Texas. The building is 100% net leased to FedEx Ground Package Systems, Inc. through August 31, 2021 and is subject to a ground lease with the City of Corpus Christi. The purchase price was approximately $4,992,000. We obtained a mortgage of $3,150,000 at a fixed interest rate of 5.5% for the first 5 years and paid the remaining amount with a draw on our line of credit. On October 1, 2016, the interest rate resets to the Federal Home Loan Bank of New York rate plus 300 basis points with a floor of 5.5%. This mortgage matures on November 1, 2021. Annual rental income over the term of the lease is $417,000.

On November 10, 2011, we purchased a 75,000 square foot industrial building located in Halfmoon, New York. The building is 100% net leased to RHG Holdings, Inc. d/b/a/Edgepark Medical Supplies through December 1, 2021. The purchase price was approximately $6,019,000. We used a draw on our line of credit to fund this purchase. Annual rental income over the term of the lease is $575,000.

On October 31, 2011, we sold a 37,660 square foot industrial building in Quakertown, Pennsylvania with gross proceeds to us of $2,765,000. The property was leased to MagiKitch’n, Inc. at the time of the sale through March 31, 2015 and the lease was terminated in conjunction with the sale. We anticipate an immaterial gain to be recognized on the sale. The operating results of the property will be presented as discontinued operations in the financial statements for our fiscal year ended September 30, 2011. The net proceeds were used to pay down our line of credit.

We have entered into an agreement to purchase a new built-to-suit, 51,140 square foot industrial building in Lebanon, Ohio, to be net-leased to Siemens Real Estate, a division of Siemens AG, through May 31, 2019. The purchase price is approximately $5,100,000. We expect to consummate this transaction during the first quarter of fiscal 2012, once construction is completed and the building is ready for occupancy by the tenant.

We have also entered into agreements to acquire two industrial properties in Texas and one industrial property in Oklahoma, subject to due diligence which we are currently conducting. These are new constructions that will be subject to 10 year net-leases to FedEx Ground Package Systems, Inc. These properties are scheduled for completion and occupancy in the second half of fiscal 2012 or the first quarter of fiscal 2013. The combined purchase price for these three properties will be approximately $31,950,000. Subject to satisfactory due diligence, we anticipate closing these three transactions upon rent commencement. We anticipate acquiring additional properties in fiscal 2012.

On November 30, 2011, our common stock will be added to the MSCI US REIT Index. The MSCI US REIT Index is one of the most commonly used benchmarks for the overall U.S. public REIT market and includes the leading real estate investment trusts in the country.

For our fiscal year ended September 30, 2011, we expect to report rental and reimbursement revenue of approximately $48,141,000, compared to $45,213,000 for the fiscal year ended September 30, 2010. In addition, for fiscal 2011, we expect to report income from continuing operations of approximately $15,237,000 or $0.43 per diluted share as compared to $11,353,000 or $0.37 per diluted share for fiscal 2010. We expect to report net income attributable to common shareholders for fiscal 2011 of approximately $11,339,000 or $0.32 per diluted share as compared to $8,486,000 or $0.28 per diluted share for the prior fiscal year.

For the three months ended September 30, 2011, we expect to report rental and reimbursement revenue of approximately $11,958,000, compared to $11,750,000 for the three months ended September 30, 2010. In addition, for the three months ended September 30, 2011, we expect to report income from continuing operations of approximately $2,715,000 or $0.07 per diluted share, compared to $3,341,000 or $0.10 per diluted share for the same period in fiscal 2010. We expect to report net income attributable to common shareholders for the fourth quarter of fiscal 2011 of approximately $1,740,000 or $0.04 per diluted share, as compared to $2,407,000 or $0.07 per diluted share for the corresponding quarter of fiscal 2010.

As of September 30, 2011, we had total assets of approximately $476,987,000, total real estate investments of approximately $409,024,000, total debt outstanding of approximately $237,390,000 and total shareholders' equity of approximately $234,543,000.

The Offering

The following is a brief summary of some of the terms of this offering. For a more complete description of the terms of our common stock see “Summary – The Company” above and “Description of Capital Stock” in the accompanying prospectus.

Issuer	Monmouth Real Estate Investment Corporation, a Maryland corporation.
Securities Offered	1,500,000 shares of common stock, par value $0.01 per share.
Price per Share	$
Common Stock outstanding after this offering	38,760,740 shares
New York Stock Exchange symbol	MNR
Restriction on Ownership and Transfer	No person may own, or be deemed to own by virtue of the attribution rules of the Code, more than 9.8% in value or in number of shares of our outstanding stock (other than shares of our excess stock), subject to certain exceptions. In addition, no person may own, or be deemed to own, shares of our stock (other than shares of our excess stock) that would result in shares of our stock being owned by fewer than 100 persons, us being “closely held” within the meaning of Section 856 of the Code or us otherwise failing to qualify as a REIT under the Code. See “Description of Capital Stock—Restrictions on Ownership and Transfer” in the accompanying prospectus.
Use of Proceeds	We intend to use the proceeds of this offering to purchase properties in the ordinary course of our business and for general corporate purposes. See “Use of Proceeds” beginning on page S-13 of this prospectus supplement.
Risk Factors	You should read carefully the “Risk Factors” beginning on page S-6 of this prospectus supplement, page 2 of the accompanying prospectus and page 6 of our Annual Report on Form 10-K for the fiscal year ended September 30, 2010, for certain considerations relevant to investing in the common stock.

RISK FACTORS

Investing in our common stock involves risks. You should carefully consider the following risk factors and the information under the heading "Risk Factors" beginning on page 2 of the accompanying prospectus and page 6 of our Annual Report on Form 10-K for the fiscal year ended September 30, 2010, which is incorporated herein by reference.

Real Estate Industry Risks

Our business and financial results are affected by local real estate conditions in areas where we own properties.

We may be affected adversely by general economic conditions and local real estate conditions. For example, an oversupply of industrial properties in a local area or a decline in the attractiveness of our properties to tenants and potential tenants would have a negative effect on us.

Other factors that may affect general economic conditions or local real estate conditions include:

- population and demographic trends;
- employment and personal income trends;
- zoning, use and other regulatory restrictions;
- income tax laws;
- changes in interest rates and availability and costs of financing;
- competition from other available real estate;
- our ability to provide adequate maintenance and insurance; and
- increased operating costs, including insurance premiums, utilities and real estate taxes, which may not be offset by increased rents.

We may be unable to compete with our larger competitors and other alternatives available to tenants or potential tenants of our properties.

The real estate business is highly competitive. We compete for properties with other real estate investors and purchasers, including other real estate investment trusts, limited partnerships, syndications and private investors, many of whom have greater financial resources, revenues and geographical diversity than we have. Furthermore, we compete for tenants with other property owners. All of our industrial properties are subject to significant local competition. We also compete with a wide variety of institutions and other investors for capital funds necessary to support our investment activities and asset growth. To the extent that we are unable to effectively compete in the marketplace, our business may be adversely affected.

We are subject to significant regulation that inhibits our activities and may increase our costs.

Local zoning and use laws, environmental statutes and other governmental requirements may restrict expansion, rehabilitation and reconstruction activities. These regulations may prevent us from taking advantage of economic opportunities. Legislation such as the Americans with Disabilities Act may require us to modify our properties at a substantial cost and noncompliance could result in the imposition of fines or an award of damages to private litigants. Future legislation may impose additional requirements. We cannot predict what requirements may be enacted or amended or what costs we will incur to comply with such requirements.

Our investments are concentrated in the industrial distribution sector and our business would be adversely affected by an economic downturn in that sector.

Our investments in real estate assets are primarily concentrated in the industrial distribution sector. This concentration may expose us to the risk of economic downturns in this sector to a greater extent than if our business activities included a more significant portion of other sectors of the real estate industry.

Risks Associated with Our Properties

We may be unable to renew leases or relet space as leases expire.

While we seek to invest in well-located, modern buildings leased to investment grade tenants on long-term leases, a number of our properties are subject to short-term leases. When a lease expires, a tenant may elect not to renew it. We may not be able to relet the property on similar terms, if we are able to relet the property at all. The terms of renewal or re-lease (including the cost of required renovations and/or concessions to tenants) may be less favorable to us than the prior lease. If we are unable to relet all or a substantial portion of our properties, or if the rental rates upon such reletting are significantly lower than expected rates, our cash generated before debt repayments and capital expenditures and our ability to make expected distributions, may be adversely affected. We have established an annual budget for renovation and reletting expenses that we believe is reasonable in light of each property's operating history and local market characteristics. This budget, however, may not be sufficient to cover these expenses.

Our business is substantially dependent on Federal Express Corporation.

Federal Express is our largest tenant. As of November 25, 2011, Federal Express and its subsidiaries leased approximately 45% of the total square footage that we own. Annualized rental income and occupancy charges from Federal Express and its subsidiaries are estimated at approximately 56% of total rental and reimbursement revenue for fiscal 2011. If Federal Express were to terminate its leases with us or become unable to make lease payments because of a downturn in its business or otherwise, our financial condition and ability to make expected distributions would be materially and adversely affected.

We are subject to risks involved in single tenant leases.

We focus our acquisition activities on real properties that are net leased to single tenants. Therefore, the financial failure of, or other default by, a single tenant under its lease is likely to cause a significant reduction in the operating cash flow generated by the property leased to that tenant and might decrease the value of that property. In addition, we will be responsible for 100% of the operating costs following a vacancy at a single tenant building.

We may be affected negatively by tenant financial difficulties and leasing delays.

At any time, a tenant may experience a downturn in its business that may weaken its financial condition. Similarly, a general decline in the economy may result in a decline in the demand for space at our industrial properties. As a result, our tenants may delay lease commencement, fail to make rental payments when due, or declare bankruptcy. Any such event could result in the termination of that tenant’s lease and losses to us, resulting in a decrease of distributions to investors.

We receive a substantial portion of our income as rents under long-term leases.

If tenants are unable to comply with the terms of their leases because of rising costs or falling revenues, we, in our sole discretion, may deem it advisable to modify lease terms to allow tenants to pay a lower rental rate or a smaller share of operating costs, taxes and insurance. If a tenant becomes insolvent or bankrupt, we cannot be sure that we could recover the premises from the tenant promptly or from a trustee or debtor-in-possession in any bankruptcy proceeding relating to the tenant. We also cannot be sure that we would receive rent in the proceeding sufficient to cover our expenses with respect to the premises. If a tenant becomes bankrupt, the federal bankruptcy code will apply and, in some instances, may restrict the amount and recoverability of our claims against the tenant. A tenant’s default on its obligations to us for any reason could adversely affect our financial condition and the cash we have available for distribution.

We may be unable to sell properties when appropriate because real estate investments are illiquid.

Real estate investments generally cannot be sold quickly and, therefore, will tend to limit our ability to vary our property portfolio promptly in response to changes in economic or other conditions. In addition, the Code limits our ability to sell our properties. The inability to respond promptly to changes in the performance of our property portfolio could adversely affect our financial condition and ability to service debt and make distributions to our stockholders.

Environmental liabilities could affect our profitability.

We face possible environmental liabilities. Environmental laws today can impose liability on a previous owner or operator of a property that owned or operated the property at a time when hazardous or toxic substances were disposed on, or released from, the property. A conveyance of the property, therefore, does not relieve the owner or operator from liability. As a current or former owner and operator of real estate, we may be required by law to investigate and clean up hazardous substances released at or from the properties we currently own or operate or have in the past owned or operated. We may also be liable to the government or to third parties for property damage, investigation costs and cleanup costs. In addition, some environmental laws create a lien on the contaminated site in favor of the government for damages and costs the government incurs in connection with the contamination. Contamination may adversely affect our ability to sell or lease real estate or to borrow using the real estate as collateral. We are not aware of any environmental liabilities relating to our investment properties which would have a material adverse effect on our business, assets, or results of operations. However, we cannot assure you that environmental liabilities will not arise in the future and that such liabilities will not have a material adverse effect on our business, assets or results of operation.

Actions by our competitors may decrease or prevent increases in the occupancy and rental rates of our properties.

We compete with other owners and operators of real estate, some of which own properties similar to ours in the same submarkets in which our properties are located. If our competitors offer space at rental rates below current market rates or below the rental rates we currently charge our tenants, we may lose potential tenants, and we may be pressured to reduce our rental rates below those we currently charge in order to retain tenants when our tenants' leases expire. As a result, our financial condition, cash flow, cash available for distribution, market price of our preferred and common stock and ability to satisfy our debt service obligations could be materially adversely affected.

Coverage under our existing insurance policies may be inadequate to cover losses.

We generally maintain insurance policies related to our business, including casualty, general liability and other policies, covering our business operations, employees and assets. However, we would be required to bear all losses that are not adequately covered by insurance. In addition, there are certain losses that are not generally insured because it is not economically feasible to insure against them, including losses due to riots or acts of war. If an uninsured loss or a loss in excess of insured limits were to occur with respect to one or more of our properties, then we could lose the capital we invested in the properties, as well as the anticipated future revenue from the properties and, in the case of debt, which is with recourse to us, we would remain obligated for any mortgage debt or other financial obligations related to the properties. Although we believe that our insurance programs are adequate, we cannot assure you that we will not incur losses in excess of our insurance coverage, or that we will be able to obtain insurance in the future at acceptable levels and reasonable costs.

We may be unable to acquire properties on advantageous terms or acquisitions may not perform as we expect.

We have acquired individual properties and portfolios of properties, and intend to continue to do so. Our acquisition activities and their success are subject to the following risks:

- when we are able to locate a desired property, competition from other real estate investors may significantly increase the purchase price;
- acquired properties may fail to perform as expected;
- the actual costs of repositioning or redeveloping acquired properties may be higher than our estimates;

- acquired properties may be located in new markets where we face risks associated with an incomplete knowledge or understanding of the local market, a limited number of established business relationships in the area and a relative unfamiliarity with local governmental and permitting procedures;
- we may be unable to quickly and efficiently integrate new acquisitions, particularly acquisition of portfolios of properties, into our existing operations, and as a result, our results of operations and financial condition could be adversely affected; and
- we may acquire properties subject to liabilities and without any recourse, or with only limited recourse. As a result, if a claim were asserted against us based upon ownership of those properties, we might have to pay substantial sums to resolve it, which could adversely affect our cash flow and financial condition.

Financing Risks

We face inherent risks associated with our debt incurrence.

We finance a portion of our investments in properties and marketable securities through the incurrence of debt. We are subject to the risks normally associated with debt financing, including the risk that our cash flow will be insufficient to meet required payments of principal and interest. In addition, debt creates other risks, including:

- rising interest rates on our variable rate debt;
- failure to repay or refinance existing debt as it matures, which may result in forced disposition of assets on disadvantageous terms;
- refinancing terms less favorable than the terms of existing debt; and
- failure to meet required payments of principal and/or interest.

We mortgage our properties, which subjects us to the risk of foreclosure in the event of non-payment.

We mortgage many of our properties to secure payment of indebtedness and if we are unable to meet mortgage payments, then the property could be foreclosed upon or transferred to the mortgagee with a consequent loss of income and asset value. A foreclosure of one or more of our properties could adversely affect our financial condition, results of operations, cash flow, and ability to service debt and make distributions and the market price of our preferred and common stock.

We face risks related to “balloon payments” and refinancings.

Certain of our mortgages will have significant outstanding principal balances on their maturity dates, commonly known as “balloon payments.” There can be no assurance that we will be able to refinance the debt on favorable terms or at all. To the extent we cannot refinance debt on favorable terms or at all, we may be forced to dispose of properties on disadvantageous terms or pay higher interest rates, either of which would have an adverse impact on our financial performance and ability to service debt and make distributions.

We face risks associated with our dependence on external sources of capital.

In order to qualify as a REIT, we are required each year to distribute to our stockholders at least 90% of our REIT taxable income, and we are subject to tax on our income to the extent it is not distributed. Because of this distribution requirement, we may not be able to fund all future capital needs from cash retained from operations. As a result, to fund capital needs, we rely on third-party sources of capital, which we may not be able to obtain on favorable terms, if at all. Our access to third-party sources of capital depends upon a number of factors, including (i) general market conditions; (ii) the market’s perception of our growth potential; (iii) our current and potential future earnings and cash distributions; and (iv) the market price of our capital stock. Additional debt financing may substantially increase our debt-to-total capitalization ratio. Additional equity issuance may dilute the holdings of our current stockholders.

We may become more highly leveraged, resulting in increased risk of default on our obligations and an increase in debt service requirements which could adversely affect our financial condition and results of operations and our ability to pay distributions.

We have incurred, and may continue to incur, indebtedness in furtherance of our activities. Our governing documents do not limit the amount of indebtedness we may incur. Accordingly, our board of directors may vote to incur additional debt and would do so, for example, if it were necessary to maintain our status as a REIT. We could therefore become more highly leveraged, resulting in an increased risk of default on our obligations and in an increase in debt service requirements which could adversely affect our financial condition and results of operations and our ability to pay distributions to stockholders.

Covenants in our credit agreements could limit our flexibility and adversely affect our financial condition.

The terms of our various credit agreements and other indebtedness require us to comply with a number of customary financial and other covenants, such as maintaining debt service coverage and leverage ratios and maintaining insurance coverage. These covenants may limit our flexibility in our operations, and breaches of these covenants could result in defaults under the instruments governing the applicable indebtedness even if we had satisfied our payment obligations. If we were to default under credit agreements, our financial condition would be adversely affected.

Other Risks

Current economic conditions, including recent volatility in the capital and credit markets, could harm our business, results of operations and financial condition.

The United States is continuing to experience the effects of an economic recession, during which the capital and credit markets experienced extreme volatility and disruption. The current economic environment has been affected by dramatic declines in the stock and housing markets, increases in foreclosures, unemployment and living costs as well as limited access to credit. This economic situation has impacted and is expected to continue to impact consumer spending levels. A sustained economic downward trend could impact our tenants' ability to meet their lease obligations due to poor operating results, lack of liquidity, bankruptcy or other reasons. Our ability to lease space and negotiate rents at advantageous rates could also be affected in this type of economic environment. Additionally, if markets again experience periods of volatility, access to capital and credit markets could be disrupted over a more extended period, which may make it difficult to obtain the financing we may need for future growth and/or to meet our debt service obligations as they mature. Any of these events could harm our business, results of operations and financial condition.

We may not be able to access adequate cash to fund our business.

Our business requires access to adequate cash to finance our operations, distributions, capital expenditures, debt service obligations, development and redevelopment costs and property acquisition costs, if any. We expect to generate the cash to be used for these purposes primarily with operating cash flow, borrowings under secured term loans, proceeds from sales of strategically identified assets and, when market conditions permit, through the issuance of debt and equity securities from time to time. We may not be able to generate sufficient cash to fund our business, particularly if we are unable to renew leases, lease vacant space or re-lease space as leases expire according to expectations.

Moreover, difficult conditions in the financial markets and the economy generally, have caused many lenders to suffer substantial losses, thereby causing many financial institutions to seek additional capital, to merge with other institutions and, in some cases, to fail. As a result, the real estate debt markets are continuing to experience a period of uncertainty, which may reduce our access to funding alternatives, or our ability to refinance debt on favorable terms, or at all. In addition, market conditions, such as the current global economic environment, may also hinder our ability to sell strategically identified assets and access the debt and equity capital markets. If these conditions persist, we may need to find alternative ways to access cash to fund our business, including distributions to shareholders. Such alternatives may include, without limitation, curtailing development or redevelopment activity, disposing of one or more of our properties possibly on disadvantageous terms or entering into or renewing leases on less favorable terms than we otherwise would, all of which could adversely affect our profitability. If we are unable to generate, borrow or raise adequate cash to fund our business through traditional or alternative means, our business, operations, financial condition and distribution to shareholders will be adversely affected.

We are dependent on key personnel.

Our executive and other senior officers have a significant role in our success. Our ability to retain our management group or to attract suitable replacements should any members of the management group leave is dependent on the competitive nature of the employment market. The loss of services from key members of the management group or a limitation in their availability could adversely affect our financial condition and cash flow. Further, such a loss could be negatively perceived in the capital markets.

We may amend our business policies without stockholder approval.

Our board of directors determines our growth, investment, financing, capitalization, borrowing, REIT status, operations and distributions policies. Although our board of directors has no present intention to amend or reverse any of these policies, they may be amended or revised without notice to stockholders. Accordingly, stockholders may not have control over changes in our policies. We cannot assure you that changes in our policies will serve fully the interests of all stockholders.

The market value of our common stock could decrease based on our performance and market perception and conditions.

The market value of our common stock may be based primarily upon the market's perception of our growth potential and current and future cash dividends, and may be secondarily based upon the real estate market value of our underlying assets. Rising interest rates may lead potential buyers of our stock to expect a higher dividend rate, which would adversely affect the market price of our stock. In addition, rising interest rates would result in increased expense, thereby adversely affecting cash flow and our ability to service our indebtedness and pay distributions.

There are restrictions on the ownership and transfer of our capital stock.

To maintain our qualification as a REIT under the Code, no more than 50% in value of our outstanding capital stock may be owned, actually or by attribution, by five or fewer individuals, as defined in the Code to also include certain entities, during the last half of a taxable year. Accordingly, our charter and bylaws contain provisions restricting the ownership and transfer of our capital stock.

Our earnings are dependent, in part, upon the performance of our investment portfolio.

As permitted by the Code, we invest in and own securities of other real estate investment trusts. To the extent that the value of those investments declines or those investments do not provide an attractive return, our earnings and cash flow could be adversely affected.

We are subject to restrictions that may impede our ability to effect a change in control.

Certain provisions contained in our charter and bylaws and certain provisions of Maryland law may have the effect of discouraging a third party from making an acquisition proposal for us and thereby inhibit a change in control. These provisions include the following:

- Our charter provides for three classes of directors with the term of office of one class expiring each year, commonly referred to as a "staggered board." By preventing common stockholders from voting on the election of more than one class of directors at any annual meeting of stockholders, this provision may have the effect of keeping the current members of our board of directors in control for a longer period of time than stockholders may desire.
- Our charter generally limits any holder from acquiring more than 9.8% (in value or in number of shares, whichever is more restrictive) of our outstanding equity stock (defined as all of our classes of capital stock, except our excess stock). While this provision is intended to assure our ability to remain a qualified REIT for Federal income tax purposes, the ownership limit may also limit the opportunity for stockholders to receive a premium for their shares of common stock that might otherwise exist if an investor was attempting to assemble a block of shares in excess of 9.8% of the outstanding shares of equity stock or otherwise effect a change in control.
- The request of stockholders entitled to cast a majority or more of votes entitled to be cast at such meeting is necessary for stockholders to call a special meeting. We also require advance notice by stockholders for the nomination of directors or proposals of business to be considered at a meeting of stockholders.

Our Board of Directors may authorize and issue securities without stockholder approval.

Under our Charter, the board has the power to classify and reclassify any of our unissued shares of capital stock into shares of capital stock with such preferences, rights, powers and restrictions as the board of directors may determine. The authorization and issuance of a new class of capital stock could have the effect of delaying or preventing someone from taking control of us, even if a change in control were in our stockholders' best interests.

Maryland business statutes may limit the ability of a third party to acquire control of us.

The duties of directors of Maryland corporations do not require them to (a) accept, recommend or respond to any proposal by a person seeking to acquire control of the corporation, (b) authorize the corporation to redeem any rights under, or modify or render inapplicable, any stockholders rights plan, (c) make a determination under the Maryland Business Combination Act or the Maryland Control Share Acquisition Act, or (d) act or fail to act solely because of the effect of the act or failure to act may have on an acquisition or potential acquisition of control of the corporation or the amount or type of consideration that may be offered or paid to the stockholders in an acquisition. Maryland law also contains a statutory presumption that an act of a director of a Maryland corporation satisfies the applicable standards of conduct for directors under Maryland law.

The Maryland Business Combination Act provides that unless exempted, a Maryland corporation may not engage in business combinations, including mergers, dispositions of 10 percent or more of its assets, certain issuances of shares of stock and other specified transactions, with an "interested stockholder" or an affiliate of an interested stockholder for five years after the most recent date on which the interested stockholder became an interested stockholder, and thereafter unless specified criteria are met. An interested stockholder is generally a person owning or controlling, directly or indirectly, 10 percent or more of the voting power of the outstanding stock of the Maryland corporation. In our charter, we have expressly elected that the Maryland Business Combination Act not govern or apply to any transaction with our affiliated company UMH, a Maryland corporation.

We cannot assure you that we will be able to pay distributions regularly.

Our ability to pay distributions in the future is dependent on our ability to operate profitably and to generate cash from our operations and the operations of our subsidiaries. We cannot guarantee that we will be able to pay distributions on a regular quarterly basis in the future.

If our leases are not respected as true leases for federal income tax purposes, we would fail to qualify as a REIT.

To qualify as a REIT, we must, among other things, satisfy two gross income tests, under which specified percentages of our gross income must be passive income, such as rent. For the rent paid pursuant to our leases to qualify for purposes of the gross income tests, the leases must be respected as true leases for federal income tax purposes and not be treated as service contracts, joint ventures or some other type of arrangement. We believe that our leases will be respected as true leases for federal income tax purposes. However, there can be no assurance that the Internal Revenue Service ("IRS") will agree with this view. If the leases are not respected as true leases for federal income tax purposes, we would not be able to satisfy either of the two gross income tests applicable to REITs, and we could lose our REIT status.

Failure to make required distributions would subject us to additional tax.

In order to qualify as a REIT, we must, among other requirements, distribute, each year, to our stockholders at least 90 percent of our taxable income, excluding net capital gains. To the extent that we satisfy the 90 percent distribution requirement, but distribute less than 100 percent of our taxable income, we will be subject to federal corporate income tax on our undistributed income. In addition, we will incur a 4 percent nondeductible excise tax on the amount, if any, by which our distributions (or deemed distributions) in any year are less than the sum of:

- 85 percent of our ordinary income for that year;
- 95 percent of our capital gain net earnings for that year; and
- 100 percent of our undistributed taxable income from prior years.

To the extent we pay out in excess of 100 percent of our taxable income for any tax year, we may be able to carry forward such excess to subsequent years to reduce our required distributions for purposes of the 4 percent excise tax in such subsequent years. We intend to pay out our income to our stockholders in a manner intended to satisfy the 90 percent distribution requirement. Differences in timing between the recognition of income and the related cash receipts or the effect of required debt amortization payments could require us to borrow money or sell assets to pay out enough of our taxable income to satisfy the 90 percent distribution requirement and to avoid corporate income tax.

We may not have sufficient cash available from operations to pay distributions, and, therefore, distributions may be made from borrowings.

The actual amount and timing of distributions will be determined by our board of directors in its discretion and typically will depend on the amount of cash available for distribution, which will depend on items such as current and projected cash requirements and tax considerations. As a result, we may not have sufficient cash available from operations to pay distributions as required to maintain our status as a REIT. Therefore, we may need to borrow funds to make sufficient cash distributions in order to maintain our status as a REIT, which may cause us to incur additional interest expense as a result of an increase in borrowed funds for the purpose of paying distributions.

We may be required to pay a penalty tax upon the sale of a property.

The federal income tax provisions applicable to REITs provide that any gain realized by a REIT on the sale of property held as inventory or other property held primarily for sale to customers in the ordinary course of business is treated as income from a "prohibited transaction" that is subject to a 100 percent penalty tax. Under current law, unless a sale of real property qualifies for a safe harbor, the question of whether the sale of real estate or other property constitutes the sale of property held primarily for sale to customers is generally a question of the facts and circumstances regarding a particular transaction. We intend that we and our subsidiaries will hold the interests in the real estate for investment with a view to long-term appreciation, engage in the business of acquiring and owning real estate, and make occasional sales as are consistent with our investment objectives. We do not intend to engage in prohibited transactions. We cannot assure you, however, that we will only make sales that satisfy the requirements of the safe harbors or that the IRS will not successfully assert that one or more of such sales are prohibited transactions.

We may be adversely affected if we fail to qualify as a REIT.

If we fail to qualify as a REIT, we will not be allowed to deduct distributions to stockholders in computing our taxable income and will be subject to Federal income tax, including any applicable alternative minimum tax, at regular corporate rates. In addition, we might be barred from qualification as a REIT for the four years following disqualification. The additional tax incurred at regular corporate rates would reduce significantly the cash flow available for distribution to stockholders and for debt service.

Furthermore, we would no longer be required to make any distributions to our stockholders as a condition to REIT qualification. Any distributions to stockholders would be taxable as ordinary income to the extent of our current and accumulated earnings and profits, although such dividend distributions would be subject to a top federal tax rate of 15% through 2012. Corporate distributees, however, may be eligible for the dividends received deduction on the distributions, subject to limitations under the Code.

To qualify as a REIT, we must comply with certain highly technical and complex requirements.

We cannot be certain we have complied, and will always be able to comply, with the requirements to qualify as a REIT because there are few judicial and administrative interpretations of these provisions. In addition, facts and circumstances that may be beyond our control may affect our ability to continue to qualify as a REIT. We cannot assure you that new legislation, regulations, administrative interpretations or court decisions will not change the tax laws significantly with respect to our qualification as a REIT or with respect to the Federal income tax consequences of qualification. We believe that we have qualified as a REIT since our inception and intend to continue to qualify as a REIT. However, we cannot assure you that we are qualified or will remain qualified.

There is a risk of changes in the tax law applicable to real estate investment trusts.

Because the IRS, the United States Treasury Department and Congress frequently review federal income tax legislation, we cannot predict whether, when or to what extent new federal tax laws, regulations, interpretations or rulings will be adopted. Any of such legislative action may prospectively or retroactively modify our tax treatment and, therefore, may adversely affect taxation of us and/or our investors.

We may be unable to comply with the strict income distribution requirement applicable to REITs.

As noted above, to maintain qualification as a REIT under the Code, a REIT must annually distribute to its stockholders at least 90% of its REIT taxable income, excluding the dividends paid deduction and net capital gains. This requirement limits our ability to accumulate capital. We may not have sufficient cash or other liquid assets to meet the 90% distribution requirement. Difficulties in meeting the 90% distribution requirement might arise due to competing demands for our funds or to timing differences between tax reporting and cash receipts and disbursements, because income may have to be reported before cash is received, because expenses may have to be paid before a deduction is allowed, because deductions may be disallowed or limited or because the IRS may make a determination that adjusts reported income. In those situations, we might be required to borrow funds or sell properties on adverse terms in order to meet the 90% distribution requirement and interest and penalties could apply which could adversely affect our financial condition. If we fail to satisfy the 90% distribution requirement, we would cease to be taxed as a REIT.

Notwithstanding our status as a REIT, we are subject to various federal, state and local taxes on our income and property.

Even if we continue to qualify as a REIT, we will be taxed at regular corporate rates on any undistributed taxable income, including undistributed net capital gains; provided, however, that properly designated undistributed capital gains will effectively avoid taxation at the stockholder level. We may be subject to other Federal income taxes and may also have to pay some state income or franchise taxes because not all states treat REITs in the same manner as they are treated for Federal income tax purposes.

Future terrorist attacks and military conflicts could have a material adverse effect on general economic conditions, consumer confidence and market liquidity.

Among other things, it is possible that interest rates may be affected by these events. An increase in interest rates may increase our costs of borrowing, leading to a reduction in our earnings. Terrorist acts could also result in significant damages to, or loss of, our properties.

We and our tenants may be unable to obtain adequate insurance coverage on acceptable economic terms for losses resulting from acts of terrorism. Our lenders may require that we carry terrorism insurance even if we do not believe this insurance is necessary or cost effective. We may also be prohibited under the applicable lease from passing all or a portion of the cost of such insurance through to the tenant. Should an act of terrorism result in an uninsured loss or a loss in excess of insured limits, we could lose capital invested in a property, as well as the anticipated future revenues from a property, while remaining obligated for any mortgage indebtedness or other financial obligations related to the property. Any loss of these types would adversely affect our financial condition.

We are subject to risks arising from litigation.

We may become involved in litigation. Litigation can be costly, and the results of litigation are often difficult to predict. We may not have adequate insurance coverage or contractual protection to cover costs and liability in the event we are sued, and to the extent we resort to litigation to enforce our rights, we may incur significant costs and ultimately be unsuccessful or unable to recover amounts we believe are owed to us. We may have little or no control of the timing of litigation, which presents challenges to our strategic planning.

Future sales or issuances of our common stock may cause the market price of our common stock to decline.

The sale of substantial amounts of our common stock, whether directly by us or in the secondary market, the perception that such sales could occur or the availability of future issuances of shares of our common stock or other securities convertible into or exchangeable or exercisable for our common stock, could materially and adversely affect the market price of our common stock and our ability to raise capital through future offerings of equity or equity-related securities. In addition, we may issue capital stock that is senior to our common stock in the future for a number of reasons, including to finance our operations and business strategy, to adjust our ratio of debt to equity or for other reasons.

The market price of our common stock may fluctuate significantly.

The market price of our common stock may fluctuate significantly in response to many factors, including:

- our ability to comply with applicable financial covenants under our lines of credit,
- actual or anticipated variations in our operating results, funds from operations, cash flows or liquidity,
- changes in our earnings estimates or those of analysts,

- changes in our dividend policy,
- publication of research reports about us or the real estate industry generally,
- the ability of our tenants to pay rent to us and meet their obligations to us under the current lease terms and our ability to re-lease space as leases expire,
- changes in market valuations of similar companies,
- adverse market reaction to the amount of our debt outstanding at any time, the amount of our debt maturing in the near- and medium-term and our ability to refinance our debt, or our plans to incur additional debt in the future,
- additions or departures of key management personnel,
- actions by institutional stockholders,
- speculation in the press or investment community,
- the realization of any of the other risk factors included or incorporated by reference in this prospectus supplement and the accompanying prospectus, and
- general market and economic conditions.

Many of the factors listed above are beyond our control. Those factors may cause the market price of our common stock to decline significantly, regardless of our financial condition, results of operations and prospects. It is impossible to provide any assurance that the market price of our common stock will not fall in the future, and it may be difficult for stockholders to resell shares of our common stock at prices they find attractive, or at all.

USE OF PROCEEDS

We estimate the net proceeds from the sale of all the 1,500,000 shares of common stock offered hereby will be approximately $, assuming a public offering price of $ per share and after deducting the placement agent fee and other estimated expenses of approximately $. It is possible that not all of the shares of common stock we are offering pursuant to this prospectus supplement will be sold, in which case our net proceeds would be reduced. We intend to use the net proceeds to purchase additional properties in the ordinary course of our business and for general corporate purposes. Until we use the net proceeds from this offering, they may be deposited in interest bearing cash accounts or invested in short-term securities, including securities that may not be investment grade.

ADDITIONAL MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following discussion supplements the discussion under the heading “Material United States Federal Income Tax Consequences” in the accompanying prospectus. Terms used in this section but not defined in this section have the meanings ascribed to them elsewhere in this prospectus supplement or in “Material United States Federal Income Tax Consequences” in the prospectus. You should refer to the discussion in the prospectus under “Material United States Federal Income Tax Consequences” for a discussion of the tax consequences of our election to be taxed as a REIT and the tax consequences to owners of shares of our common stock.

Recent Legislation

Legislation was recently enacted into law that will materially change the requirements for obtaining an exemption from United States federal withholding tax and impose withholding taxes on certain types of payments made to “foreign financial institutions” and certain other non-U.S. entities. In general, and depending on the specific facts and circumstances, the failure to comply with certain certification, information reporting and other specified requirements will result in a 30% withholding tax being imposed on “withholdable payments” to such institutions and entities, including payments of dividends and proceeds from the sale or exchange of our common stock. The legislation generally applies to payments made after December 31, 2012, although recent guidance from the IRS provides that withholding obligations under the legislation will not begin until January 1, 2014. Each prospective investor should consult its tax advisor regarding this legislation and the potential implications of this legislation on its investment in our common stock.

On March 30, 2010, President Obama signed into law the Health Care and Education Reconciliation Act of 2010 (the “Reconciliation Act”). The Reconciliation Act will require certain U.S. shareholders who are individuals, estates or trusts to pay a 3.8% Medicare tax on, among other things, dividends on and capital gains from the sale or other disposition of shares, subject to certain exceptions. This tax will apply for taxable years beginning after December 31, 2012.

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (the “2010 Tax Relief Act”). The 2010 Tax Relief Act continues the 15% maximum tax rate for long-term capital gains and qualified dividend income for taxable years through December 31, 2012. For taxable years beginning after December 31, 2012, the capital gains tax rate is scheduled to increase to 20%, and the rate applicable to dividends is scheduled to increase to the tax rate then applicable to ordinary income. In addition, the backup withholding rate remains at 28% through December 31, 2012. Because we are not generally subject to federal income tax on the portion of our REIT taxable income or capital gains distributed to our stockholders, our dividends will generally not be eligible for the 15% tax rate on qualified dividends. As a result, our ordinary REIT dividends will continue to be taxed at the higher tax rates applicable to ordinary income. However, the 15% tax rate for long-term capital gains and dividends will generally apply to: (i) long-term capital gains, if any, recognized on the disposition of our shares; (ii) our distributions designated as long-term capital gain dividends (except to the extent attributable to “unrecaptured Section 1250 gain,” in which case such distributions would continue to be subject to a 25% tax rate); (iii) our dividends attributable to dividends received by us from non-REIT corporations, such as taxable REIT subsidiaries; and (iv) the portion, if any, of our dividends to the extent attributable to income upon which we have paid corporate income tax (e.g., to the extent that we distribute less than 100% of our taxable income).

Changes to REIT Distributions

Internal Revenue Service Revenue Procedure 2010-12, 2010-3 I.R.B, updates the circumstances that permits us to make taxable distributions of our stock (in lieu of cash) if (x) any such distribution is declared on or before December

31, 2012 with respect to a taxable year ending on or before December 31, 2011, and (y) each of our stockholders is permitted to elect to receive its entire entitlement under such declaration in either cash or shares of equivalent value subject to a limitation in the amount of cash to be distributed in the aggregate; provided that (i) the amount of cash that we set aside for distribution is not less than 10 percent of the aggregate distribution so declared, and (ii) if too many of our stockholders elect to receive cash, a pro rata amount of cash will be distributed to each such stockholder electing to receive cash, but in no event will any such stockholder receive less than 10 percent of its entire entitlement under such declaration in cash. We have no present intentions of using our stock in connection with any dividend distributions.

PLAN OF DISTRIBUTION

We are offering the shares of our common stock through a placement agent. Subject to the terms and conditions contained in the placement agent agreement, dated , 2011, CSCA Capital Advisors, LLC ("CSCA") has agreed to act as the placement agent for this offering. The placement agent agreement provides that the obligation of the placement agent is subject to certain conditions precedent, including, among other things, the absence of any material adverse change in our business and the receipt of customary opinions, letters and closing certificates.

CSCA may be an underwriter within the meaning of the Securities Act in connection with its placement agent activities in this offering.

CSCA has no commitment to purchase any shares of our common stock and will act only as an agent in obtaining indications of interest in our common stock from certain investors. We have agreed to pay the placement agent a fee of 2.5% of the gross proceeds and to pay certain of its expenses.

We have agreed to indemnify the placement agent and each of its partners, directors, officers, associates, affiliates, subsidiaries, employees, consultants, attorneys, agents, and each person, if any, controlling the placement agent and any of its affiliates, against liabilities resulting from this offering and to contribute to payments the placement agent may be required to make for these liabilities.

In connection with this offering, CSCA may engage broker dealers as sub-placement agents to participate in the placement of the common stock. Such sub-placement agents may receive a portion of the placement agent fee paid to CSCA, as well as other compensation and fees.

In the ordinary course of business, CSCA and/or its affiliates have engaged, and may in the future engage, in financial advisory, investment banking and other transactions with us for which customary compensation has been, and will be, paid.

Subject to customary closing conditions, certain institutional investors have agreed to purchase, and we have agreed to sell, shares of common stock at a negotiated purchase price of $ per share. It is possible that not all of the shares of common stock we are offering pursuant to this prospectus supplement will be sold at the closing, in which case our net proceeds would be reduced. We expect that the sale will be completed on the date indicated on the cover page of this prospectus supplement. In negotiating the offering price per share of our common stock, we considered the dilution to our stockholders that will result from this offering.

Weeden & Co. LP is acting as settlement agent in connection with the sale of our common stock under the purchase agreements and will receive a fee of $.

Regulation M Restrictions

The placement agent may be deemed to be an underwriter within the meaning of Section 2(a)(11) of the Securities Act, and any commissions received by it and any profit realized on the resale of the securities sold by them while acting as principals might be deemed to be underwriting discounts or commissions under the Securities Act. As an underwriter, the placement agent would be required to comply with the requirements of the Securities Act and the Exchange Act, including, without limitation, Rule 415(a)(4) under the Securities Act and Rule 10b-5 and Regulation M under the Exchange Act. These rules and regulations may limit the timing of purchases and sales of securities by the placement agent acting as a principal. Under these rules and regulations, the placement agent:

- must not engage in any stabilization activity in connection with our securities; and
- must not bid for or purchase any of our securities or attempt to induce any person to purchase any of our securities, other than as permitted under the Exchange Act, until it has completed its participation in the distribution.

LEGAL MATTERS

Certain legal matters will be passed upon for us by Stroock & Stroock & Lavan LLP, as our securities and tax counsel. Certain matters of Maryland law will be passed on for us by Venable LLP.

EXPERTS

The consolidated financial statements and schedule of Monmouth Real Estate Investment Corporation as of September 30, 2010 and 2009, and for each of the years in the three-year period ended September 30, 2010, and management’s assessment of the effectiveness of internal control over financial reporting as of September 30, 2010, included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010, have been incorporated by reference herein in reliance upon the report of PKF LLP, our independent registered public accounting firm, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a shelf registration statement under the Securities Act with respect to the securities offered hereunder. As permitted by the rules and regulations of the SEC, this prospectus supplement and the accompanying prospectus do not contain all the information set forth in the registration statement. For further information regarding our company and our securities, please refer to the registration statement and the contracts, agreements and other documents filed as exhibits to the registration statement. Additionally, you should refer to our annual, quarterly and special reports, proxy statements and other information we file with the SEC.

You may read and copy all or any portion of the registration statement or any other materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Our SEC filings, including the registration statement, are also available to you on the SEC's website (http://www.sec.gov). We also have a website (www.mreic.com) through which you may access our recent SEC filings. Information contained on our website is not a part of this prospectus supplement. In addition, you may look at our SEC filings at the offices of the New York Stock Exchange, which is located at 20 Broad Street, New York, New York 10005. Our SEC filings are available at the New York Stock Exchange because our common stock and preferred stock are listed and traded on the New York Stock Exchange under the respective symbols "MNR" and "MNR PRA."

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to “incorporate by reference” the information contained in documents that we file with them. That means we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus supplement, and information that we later file with the SEC will automatically update and supersede this information.

We incorporate by reference the documents listed below and any future filings we make with the SEC pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act, until we sell all the securities offered by this prospectus supplement.

- Our Annual Report on Form 10-K for the fiscal year ended September 30, 2010, as filed with the SEC on December 9, 2010.
- Our Quarterly Reports on Form 10-Q for the fiscal quarters ended December 31, 2010, March 31, 2011 and June 30, 2011, as filed with the SEC on February 8, 2011, May 9, 2011 and August 8, 2011, respectively.
- All other reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act since September 30, 2010, except for information furnished under Current Reports on Form 8-K, which is not deemed filed and not incorporated herein by reference.
- The description of our common stock which is contained in a registration statement filed under the Exchange Act, including any amendment or reports filed for the purpose of updating such description.

You may request a free copy of these filings (other than the exhibits thereto, unless they are specifically incorporated by reference in the documents) by writing or telephoning us at the following address and telephone number:

Monmouth Real Estate Investment Corporation
Attention: Stockholder Relations
3499 Route 9 N, Suite 3-C
Juniper Business Plaza
Freehold, NJ 07728
(732) 577-9996

PROSPECTUS

$115,000,000

MONMOUTH REAL ESTATE INVESTMENT CORPORATION

Common Stock

Preferred Stock

Debt Securities

We may use this prospectus to offer and sell our common stock, preferred stock or debt securities from time to time. The aggregate public offering prices of the common stock, preferred stock and debt securities covered by this prospectus, which we refer to collectively as the securities, will not exceed $115,000,000. The securities may be offered, separately or together, in separate classes or series, in amounts, at prices and on terms to be determined at the time of the offering and set forth in one or more supplements to this prospectus. Our common stock is listed and traded on the Nasdaq Global Select Market under the symbol "MNRTA." Our 7.625% Series A Cumulative Redeemable Preferred Stock is listed and traded on the Nasdaq Global Select Market under the symbol "MNRTP."

We will provide the specific terms and conditions of these securities in supplements to this prospectus in connection with each offering. Such specific terms may include limitations on direct or beneficial ownership and restrictions on transfer of the securities, in each case as may be appropriate to preserve our status as a real estate investment trust ("REIT") for U.S. federal income tax purposes. See "Description of Capital Stock—Restrictions on Ownership and Transfer." Please read this prospectus and the applicable prospectus supplement carefully before you invest.

We may offer the securities directly, through agents designated by us from time to time, or to or through underwriters or dealers. If any agents, underwriters or dealers are involved in the sale of any of the securities, their names, and any applicable purchase price, fee, commission or discount arrangement between or among them will be set forth or will be calculable from the information set forth in the applicable prospectus supplement. See "Plan of Distribution."

An investment in our securities involves a high degree of risk. See "Risk Factors" beginning on page 2 of this prospectus for a discussion of risk factors that you should consider in connection with an investment in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is September 14, 2009.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the SEC using a "shelf" registration process. Under this process, we may from time to time sell in one or more offerings any of the securities described in this prospectus, or any combination thereof, up to a total amount of $100,000,000. In addition, we may sell up to an additional $15,000,000 in Common or Preferred Stock. In this prospectus, we refer collectively to our common stock and preferred stock as our "capital stock," and collectively to our senior and subordinated debt as our "debt securities."

You should read this prospectus and any applicable prospectus supplement together with the additional information described under the heading "Where You Can Find More Information" in this prospectus. The prospectus supplement may add, update or change the information contained in this prospectus. The registration statement that contains this prospectus and the exhibits to that registration statement contain additional important information about us and the securities offered under this prospectus. Specifically, we have filed certain legal documents that control the terms of the securities as exhibits to the registration statement. We may file certain other legal documents that control the terms of the securities as exhibits to reports we file with the SEC. That registration statement and the other reports can be read at the SEC's website or at the SEC offices mentioned under the heading "Where You Can Find More Information," or can be obtained by writing or telephoning us at the following address and telephone number:

Monmouth Real Estate Investment Corporation
Attention: Stockholder Relations
3499 Route 9 N, Suite 3-C
Juniper Business Plaza
Freehold, NJ 07728
(732) 577-9996

MONMOUTH REAL ESTATE INVESTMENT CORPORATION

Monmouth Real Estate Investment Corporation is a Maryland corporation operating as a qualified REIT under Sections 856 through 860 of the Internal Revenue Code (the "Code"). Currently, we seek to invest in well-located, modern buildings leased to investment grade tenants on long-term leases and derive our income primarily from the rental of these facilities. At June 30, 2009, we owned approximately 6,070,000 square feet of property, of which approximately 2,810,000 square feet, or 46%, was leased to Federal Express Corporation and its subsidiaries and approximately 279,000 square feet, or 5%, was leased to Keebler Company, a subsidiary of the Kellogg Company. During fiscal 2008, 2007 and 2006 rental and reimbursement revenue from properties leased to these two companies approximated 61%, 55% and 55%, respectively, of our total rental and reimbursement revenue.

At June 30, 2009, we owned fifty-seven industrial properties and one shopping center. These properties are located in Alabama, Arizona, Colorado, Connecticut, Florida, Georgia, Illinois, Iowa, Kansas, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New York, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia and Wisconsin. All properties are managed by a management company. All properties are leased on a net basis except the property located in Monaca, Pennsylvania and the shopping center in Somerset, New Jersey.

We anticipate acquiring additional properties in the second half of 2009. The funds for these acquisitions are expected to come from our available line of credit, mortgages, other bank borrowings, proceeds from the Dividend Reinvestment and Stock Purchase Plan ("DRIP") and private or public placements of additional common or preferred stock. To the extent that funds or appropriate properties are

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not available, few or no acquisitions may be made. Because of the contingent nature of contracts to purchase real property, we will announce acquisitions only upon closing.

We compete with other investors in real estate for attractive investment opportunities. These investors include other “equity” real estate investment trusts, limited partnerships, syndications and private investors, among others. Competition in the market areas in which we operate is significant and affects our ability to acquire or expand properties, occupancy levels, rental rates and operating expenses of certain

properties. Management has built relationships with merchant builders that have historically provided us with investment opportunities that fit our investment policy.

We have a flexible investment policy concentrating our investments in the area of long-term net-leased industrial properties to investment grade tenants. Our strategy is to obtain a favorable yield spread between the yield from the net-leased industrial properties and interest costs. We anticipate that we will continue to purchase net-leased, well-located industrial properties, because our management believes these investments offer a potential for long-term capital appreciation. There is the risk that, on expiration of current leases, the properties can become vacant or released at lower rents. The results we obtain by re-leasing the properties will depend on the market for industrial properties at that time.

We also continue to invest in d
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(139,100
)
Financing activities

Acquisition of treasury stock

(18,600
)

—

Cash transactions related to stock-based compensation

7,100

3,100

Dividends paid to stockholders

(8,800

)

(5,800
)
Payments on notes payable and capital leases

(100
)

(400
)
Excess tax benefits from stock-based compensation

—

800

Net cash used in financing activities

(20,400
)

(2,300
)
Net increase (decrease) in cash and cash equivalents

27,500

(47,400
)
Cash and cash equivalents at the beginning of the period

56,600

103,600

Cash and cash equivalents at the end of the period

$
84,100

$
56,200

See accompanying unaudited notes to the consolidated financial statements.

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Employers Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation and Summary of Operations

Employers Holdings, Inc. (EHI) is a Nevada holding company. Through its wholly owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN), Employers Compensation Insurance Company (ECIC), Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC), EHI is engaged in the commercial property and casualty insurance industry, specializing in workers' compensation products and services. Unless otherwise indicated, all references to the “Company” refer to EHI, together with its subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of the Company’s consolidated financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

The Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company’s chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment, workers’ compensation insurance and related services.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses (LAE), evaluation of reinsurance recoverables, recognition of premium revenue, deferred income taxes, and investments.

Reclassifications

Certain prior period information has been reclassified to conform to the current period presentation.

2. Change in Estimates

The Company reduced its estimated reserves ceded under the Loss Portfolio Transfer Agreement (LPT Reserve Adjustment) as a result of the determination that an adjustment was necessary to reflect observed favorable paid loss trends during the second quarter of 2016. The following table shows the financial statement impact related to the reduction in estimated reserves ceded under the Loss Portfolio Transfer Agreement (LPT Agreement).

	Nine Months Ended September 30, 2016 (in millions, except per share data)
Change in estimated reserves ceded under the LPT Agreement	$ (5.0)
Cumulative adjustment to the Deferred Gain[1]	(3.1)
Net income impact of change in estimate	3.1

EPS impact of change in estimate	
Basic	0.10
Diluted	0.09

(1) The cumulative adjustment to the Deferred reinsurance gain–LPT Agreement (Deferred Gain) was also recognized in losses and LAE incurred in the Consolidated Statement of Comprehensive Income, so that the Deferred Gain reflects the balance that would have existed had the revised reserves been recognized at the inception of the LPT Agreement.

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The Company increased its estimate of contingent commission receivable – LPT Agreement (LPT Contingent Commission Adjustment) as a result of the determination that an adjustment was necessary to reflect observed favorable paid loss trends during the second quarter of 2016. The following table shows the financial statement impact related to these changes in estimates.

	Nine Months Ended September 30, 2016 (in millions, except per share data)
Change in estimate of contingent commission receivable – LPT Agreement	$ 1.9
Cumulative adjustment to the Deferred Gain[(1)]	(1.8)
Net income impact of change in estimate	1.8
EPS impact of change in estimate	
Basic	0.06
Diluted	0.05

(1) The cumulative adjustment to the Deferred Gain was also recognized in losses and LAE incurred in the Consolidated Statement of Comprehensive Income, so that the Deferred Gain reflects the balance that would have existed had the revised reserves been recognized at the inception of the LPT Agreement.

3. New Accounting Standards

Recently Adopted Accounting Standards

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) Number 2016-09, Compensation - Stock Compensation (Topic 718). This update simplifies several aspects of the accounting for share-based payment award transactions, including income taxes and classification of awards on the balance sheet and on the statement of cash flows. This update becomes effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2016 and early adoption is permitted. The Company elected to early adopt this standard in the quarter ended September 30, 2016 with an effective date of January 1, 2016. Adoption of this standard had the following impacts on the Company's consolidated financial statements:

- Consolidated Statements of Comprehensive Income – This standard requires that the tax effects of stock-based compensation be recognized in the income tax expense. Net tax benefits related to stock-based compensation of $0.1 million and $1.4 million were recognized as reductions to Income tax expense and increases to Net income in the Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016, respectively. These changes had no impact on the Company's basic and diluted earnings per share for the three months ended September 30, 2016, but increased basic and diluted earnings per share by $0.04 for the nine months ended September 30, 2016. This standard also requires that assumed proceeds under the treasury stock method be modified to exclude the excess tax benefits that would have been recognized in Additional paid-in capital. These changes were applied on a prospective basis.
- Consolidated Statements of Cash Flows – This standard requires that the excess tax benefits from stock-based compensation be reported as cash flows from operating activities rather than the previous requirement to present the excess tax benefits from stock-based compensation as an inflow from financing activities and an outflow from operating activities. This update resulted in a change in presentation that was applied on a prospective basis and prior periods have not been adjusted.

This standard allows the Company to make a policy election as to whether it will include an estimate of stock-based compensation awards expected to be forfeited or whether it will account for forfeitures as they occur. The Company

has elected to continue to estimate forfeitures in the computation of its stock-based compensation, consistent with previous guidance, and had no impact on the Company's consolidated financial statements.
Finally, this standard allows the Company to withhold an amount in excess of the supplemental rate from an employee’s stock-based compensation for federal tax withholding purposes without triggering liability accounting. It also clarifies that all cash payments made to tax authorities on an employee’s behalf should be presented as cash flows from financing activities in the Consolidated Statements of Cash Flows. This update related to tax withholding and presentation of cash flows had no impact on the Company's consolidated financial statements.
Recently Issued Accounting Standards – Not Yet Adopted
In January 2016, the FASB issued ASU Number 2016-01, Financial Instruments - Overall (Subtopic 825-10). This update replaces the guidance to classify equity securities with readily determinable fair values into different categories (trading or available-for-sale) and requires equity securities to be measured at fair value with changes in fair value recognized through net income.

Additionally, this update eliminates the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost. It requires financial instruments to be measured at fair value using the exit price notion. Furthermore, this update clarifies that an evaluation of deferred tax assets related to available-for-sale securities is needed, in combination with an evaluation of other deferred tax assets, to determine if a valuation allowance is required. This update becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This update will result in a reclassification adjustment, net of tax, to retained earnings from accumulated other comprehensive income, which will be determined based on the fair value of securities at the effective date of adoption.

In February 2016, the FASB issued ASU Number 2016-02, Leases (Topic 842). This update provides guidance on a new lessee model that includes the recognition of assets and liabilities arising from lease transactions on the balance sheet. Additionally, the update provides clarity on the definition of a lease and the distinction between finance and operating leases. Furthermore, the update requires certain qualitative and quantitative disclosures pertaining to the amounts recorded in the financial statements. This update becomes effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2018 and early adoption is permitted. The Company has not yet estimated the full impact that the adoption will have on its consolidated financial condition and results of operations.

In June 2016, the FASB issued ASU Number 2016-13, Financial Instruments - Credit Losses (Topic 326). This update replaces the incurred loss impairment methodology for recognizing credit losses on financial instruments with a methodology that reflects an entity's current estimate of all expected credit losses. This update requires financial assets measured at amortized cost to be presented net of an allowance for credit losses. Additionally, this update requires credit losses on available-for-sale debt securities to be presented as an allowance rather than as a write-down, allowing an entity to also record reversals of credit losses in current period net income. This update becomes effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company has not yet estimated the full impact that the adoption will have on its consolidated financial condition and results of operations.

In August 2016, the FASB issued ASU Number 2016-15, Statement of Cash Flows (Topic 230). This update provides guidance and clarification on eight specific cash flow issues due to diversity in practice of how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The cash flow issues affected are debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, distributions received from equity method investees, beneficial interest in securitization transactions, and separately identifiable cash flows and application of the predominance principle. This update becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company has not yet estimated the full impact that the adoption will have on its consolidated financial condition and results of operations.

4. Fair Value of Financial Instruments

The carrying value and the estimated fair value of the Company's financial instruments were as follows:

	September 30, 2016		December 31, 2015	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(in millions)			
Financial assets				
Investments	$2,582.4	$2,582.4	$2,487.2	$2,487.2
Cash and cash equivalents	84.1	84.1	56.6	56.6

Restricted cash and cash equivalents	2.7	2.7	2.5	2.5
Financial liabilities				
Notes payable	$32.0	$35.0	$32.0	$36.6

Assets and liabilities recorded at fair value on the consolidated balance sheets are categorized based upon the levels of judgment associated with the inputs used to measure their fair value. Level inputs are defined as follows:

- Level 1 - Inputs are unadjusted quoted market prices for identical assets or liabilities in active markets at the measurement date.
- Level 2 - Inputs other than Level 1 prices that are observable for similar assets or liabilities through corroboration with market data at the measurement date.

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- Level 3 - Inputs that are unobservable that reflect management's best estimate of what willing market participants would use in pricing the assets or liabilities at the measurement date.

Fair values of available-for-sale fixed maturity and equity securities are based on quoted market prices, where available. If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price, as it represents what a third-party market participant would be willing to pay in an arm's length transaction.

These methods of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, making assumptions for market-based inputs that are unavailable.

The Company's estimates of fair value for financial liabilities are based on the interest rates for notes with similar durations to discount the projection of future payments on notes payable. The fair value measurements for notes payable have been determined to be Level 2.

The following table presents the items on the accompanying Consolidated Balance Sheets that are stated at fair value and the corresponding fair value measurements.

	September 30, 2016			December 31, 2015		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(in millions)					
Fixed maturity securities						
U.S. Treasuries	$—	$127.9	$—	$—	$120.2	$ —
U.S. Agencies	—	13.0	—	—	24.4	—
States and municipalities	—	897.2	—	—	854.5	—
Corporate securities	—	996.5	—	—	925.3	—
Residential mortgage-backed securities	—	235.0	—	—	237.9	—
Commercial mortgage-backed securities	—	86.5	—	—	80.3	—
Asset-backed securities	—	27.8	—	—	45.9	—
Total fixed maturity securities	$—	$2,383.9	$—	$—	$2,288.5	$ —
Equity securities						
Corporate equity securities	$179.6	$—	$—	$198.7	$—	$ —
Federal Home Loan Bank stock	—	—	4.9	—	—	—
Total equity securities	$179.6	$—	$4.9	$198.7	$—	$ —
Short-term investments	$—	$14.0	$—	$—	$—	$ —

The following table provides a reconciliation of the beginning and ending balances that are measured using Level 3 inputs for the nine months ended September 30, 2016.

	Equity Securities (in millions)
Beginning balance, January 1, 2016	$ —
Purchases	4.9
Ending balance, September 30, 2016	$ 4.9

Each of the Company's insurance operating subsidiaries is a member of the Federal Home Loan Bank (FHLB) of San Francisco. Members are required to purchase stock in the FHLB in addition to maintaining collateral deposits that back any funds advanced. Investment in FHLB stock is recorded at cost, as purchases and sales of these securities are at par value with the issuer. The stock is considered a restricted security and is periodically evaluated for impairment based on the ultimate recovery of par value. Due to the nature of FHLB stock, its carrying value approximates fair value.

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5. Investments

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the Company's investments were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in millions)			
At September 30, 2016				
Fixed maturity securities				
U.S. Treasuries	$122.9	$ 5.0	$ —	$127.9
U.S. Agencies	11.9	1.1	—	13.0
States and municipalities	842.9	54.6	(0.3)	897.2
Corporate securities	957.9	39.4	(0.8)	996.5
Residential mortgage-backed securities	225.3	9.7	—	235.0
Commercial mortgage-backed securities	84.5	2.0	—	86.5
Asset-backed securities	27.7	0.1	—	27.8
Total fixed maturity securities	2,273.1	111.9	(1.1)	2,383.9
Equity securities				
Corporate equity securities	109.5	71.4	(1.3)	179.6
Federal Home Loan Bank stock	4.9	—	—	4.9
Total equity securities	114.4	71.4	(1.3)	184.5
Short-term investments	14.0	—	—	14.0
Total investments	$2,401.5	$ 183.3	$ (2.4)	$2,582.4
At December 31, 2015				
Fixed maturity securities				
U.S. Treasuries	$116.4	$3.9	$(0.1)	$120.2
U.S. Agencies	23.0	1.4	—	24.4
States and municipalities	809.4	45.1	—	854.5
Corporate securities	913.4	19.9	(8.0)	925.3
Residential mortgage-backed securities	231.8	7.1	(1.0)	237.9
Commercial mortgage-backed securities	81.1	0.2	(1.0)	80.3
Asset-backed securities	46.0	—	(0.1)	45.9
Total fixed maturity securities	2,221.1	77.6	(10.2)	2,288.5
Equity securities				
Corporate equity securities	137.5	65.8	(4.6)	198.7
Total equity securities	137.5	65.8	(4.6)	198.7
Total investments	$2,358.6	$143.4	$(14.8)	$2,487.2

The amortized cost and estimated fair value of fixed maturity securities at September 30, 2016, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due in one year or less	$149.6	$151.2
Due after one year through five years	920.1	958.6
Due after five years through ten years	600.6	641.2
Due after ten years	265.3	283.6
Mortgage and asset-backed securities	337.5	349.3

Total	$2,273.1	$2,383.9

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The following is a summary of investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or greater as of September 30, 2016 and December 31, 2015.

	September 30, 2016			December 31, 2015		
	Estimated Fair Value	Gross Unrealized Losses	Number of Issues	Estimated Fair Value	Gross Unrealized Losses	Number of Issues
	(in millions, except number of issues data)					
Less than 12 months:						
Fixed maturity securities						
U.S. Treasuries	$—	$ —	—	$27.4	$ (0.1)	20
States and municipalities	44.3	(0.3)	12	—	—	—
Corporate securities	—	—	—	328.4	(4.7)	122
Residential mortgage-backed securities	—	—	—	50.5	(0.8)	24
Commercial mortgage-backed securities	—	—	—	51.5	(1.0)	22
Asset-backed securities	—	—	—	34.1	—	27
Total fixed maturity securities	44.3	(0.3)	12	491.9	(6.6)	215
Equity securities	13.5	(1.1)	30	35.8	(4.6)	45
Total less than 12 months	$57.8	$ (1.4)	42	$527.7	$ (11.2)	260
12 months or greater:						
Fixed maturity securities						
Corporate securities	$24.4	$ (0.8)	10	$34.6	$ (3.3)	15
Residential mortgage-backed securities	—	—	—	7.1	(0.2)	25
Asset-backed securities	—	—	—	11.1	(0.1)	4
Total fixed maturity securities	24.4	(0.8)	10	52.8	(3.6)	44
Equity securities	2.2	(0.2)	7	—	—	—
Total 12 months or greater	$26.6	$ (1.0)	17	$52.8	$ (3.6)	44
Total available-for-sale:						
Fixed maturity securities						
U.S. Treasuries	$—	$ —	—	$27.4	$ (0.1)	20
States and municipalities	44.3	(0.3)	12	—	—	—
Corporate securities	24.4	(0.8)	10	363.0	(8.0)	137
Residential mortgage-backed securities	—	—	—	57.6	(1.0)	49
Commercial mortgage-backed securities	—	—	—	51.5	(1.0)	22
Asset-backed securities	—	—	—	45.2	(0.1)	31
Total fixed maturity securities	68.7	(1.1)	22	544.7	(10.2)	259
Equity securities	15.7	(1.3)	37	35.8	(4.6)	45
Total available-for-sale	$84.4	$ (2.4)	59	$580.5	$ (14.8)	304

Based on reviews of the fixed maturity securities, the Company determined that unrealized losses for the nine months ended September 30, 2016 were primarily the result of changes in prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose total fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company’s intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above amortized cost, or principal value upon maturity.
Based on reviews of the equity securities, the Company recognized a total impairment of $5.3 million in the fair value of 32 equity securities for the nine months ended September 30, 2016, as a result of the Company's intent to sell and/or the severity and duration of the change in fair value of the securities. The remaining unrealized losses on equity

securities were not considered to be other-than-temporary due to the financial condition and near-term prospects of the issuers. The other-than-temporary impairment of equity securities was primarily due to the Company's intent to sell certain securities and the downturn in the energy sector that continued through the first quarter of 2016.

Net realized gains on investments and the change in unrealized gains (losses) on fixed maturity and equity securities are determined on a specific-identification basis and were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in millions)			
Net realized gains on investments				
Fixed maturity securities				
Gross gains	$—	$0.2	$1.3	$0.5
Gross losses	—	(0.2)	(0.5)	(0.4)
Net realized gains on fixed maturity securities	$—	$—	$0.8	$0.1
Equity securities				
Gross gains	$1.6	$2.2	$14.3	$5.6
Gross losses	—	(0.2)	(6.0)	(0.6)
Net realized gains on equity securities	$1.6	$2.0	$8.3	$5.0
Total	$1.6	$2.0	$9.1	$5.1
Change in unrealized gains (losses)				
Fixed maturity securities	$(10.2)	$8.0	$43.4	$(11.0)
Equity securities	2.1	(27.0)	8.9	(34.8)
Total	$(8.1)	$(19.0)	$52.3	$(45.8)

Net investment income was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in millions)			
Fixed maturity securities	$16.9	$17.3	$50.8	$51.6
Equity securities	1.7	1.7	5.4	4.0
Cash equivalents and restricted cash	0.1	0.1	0.2	0.1
Gross investment income	18.7	19.1	56.4	55.7
Investment expenses	(0.8)	(0.6)	(2.3)	(1.9)
Net investment income	$17.9	$18.5	$54.1	$53.8

The Company is required by various state laws and regulations to keep securities or letters of credit in depository accounts with certain states in which it does business. Securities having a fair value of $1.0 billion and $881.2 million were on deposit as of September 30, 2016 and December 31, 2015, respectively. These laws and regulations govern not only the amount, but also the types of securities that are eligible for deposit.

Certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of fixed maturity securities and restricted cash and cash equivalents held in trust for the benefit of ceding reinsurers was $27.7 million and $32.7 million at September 30, 2016 and December 31, 2015, respectively.

6. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. The following is a reconciliation of the federal statutory income tax rate to the Company’s effective tax rates for the periods presented.

	Nine Months Ended September 30,	
	2016	2015
Statutory tax rate	35.0 %	35.0 %
Dividends received deduction and tax-exempt interest	(7.1)	(7.6)
LPT deferred gain amortization	(3.3)	(4.3)
LPT reserve adjustment	(1.5)	(2.0)
Pre-privatization reserve adjustment, excluding LPT	—	(4.6)
Stock based compensation	(1.1)	—
Other	0.9	0.7
Effective tax rate	22.9 %	17.2 %

7. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE.

	Nine Months Ended September 30,	
	2016	2015
	(in millions)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	$2,347.5	$2,369.7
Less reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	628.2	669.5
Net unpaid losses and LAE at beginning of period	1,719.3	1,700.2
Losses and LAE, net of reinsurance, incurred during the period related to:		
Current period	343.1	339.7
Prior periods	(1.5)	1.3
Total net losses and LAE incurred during the period	341.6	341.0
Paid losses and LAE, net of reinsurance, related to:		
Current period	42.8	43.9
Prior periods	279.6	274.2
Total net paid losses and LAE during the period	322.4	318.1
Ending unpaid losses and LAE, net of reinsurance	1,738.5	1,723.1
Reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	591.5	634.8
Unpaid losses and LAE, gross of reinsurance, at end of period	$2,330.0	$2,357.9

Total net losses and LAE included in the above table excludes the impact of the aggregate of amortization of the deferred reinsurance gain—LPT Agreement, LPT Reserve Adjustments, and LPT Contingent Commission Adjustments, which totaled $13.6 million and $17.5 million for the nine months ended September 30, 2016 and 2015, respectively (Note 8).

The changes in the estimates of incurred losses and LAE attributable to insured events for prior periods were related to the Company's assigned risk business.

8. LPT Agreement

The Company is party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which $1.5 billion in liabilities for losses and LAE related to claims incurred by EICN prior to July 1, 1995 were reinsured for consideration of $775.0 million. The LPT Agreement provides coverage up to $2.0 billion. The initial Deferred Gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets as Deferred reinsurance gain–LPT Agreement. The Company is also entitled to receive a contingent profit commission under the LPT Agreement. The contingent profit commission is an amount based on the favorable difference between actual paid losses and LAE and expected paid losses and LAE as established in the LPT Agreement. The Company records its estimate of contingent profit commission in the accompanying consolidated balance sheets as Contingent commission receivable–LPT Agreement and a corresponding liability is recorded in the accompanying consolidated balance sheets in Deferred reinsurance gain–LPT Agreement. The Deferred Gain is being amortized using the recovery method. Amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries over the life of the LPT Agreement, except for the contingent profit commission, which is amortized through June 30, 2024, the date through

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which the Company is entitled to receive a contingent profit commission under the LPT Agreement. The amortization is recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income. Any adjustments to the Deferred Gain are recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income.

The Company amortized $8.7 million and $8.5 million of the Deferred Gain for the nine months ended September 30, 2016 and 2015, respectively. Additionally, the Deferred Gain was reduced by $3.1 million and $6.4 million for the nine months ended September 30, 2016 and 2015, respectively, due to favorable LPT Reserve Adjustments and by $1.8 million and $2.6 million for the nine months ended September 30, 2016 and 2015, respectively, due to favorable LPT Contingent Commission Adjustments. The remaining Deferred Gain was $177.8 million and $189.5 million as of September 30, 2016 and December 31, 2015, respectively. The estimated remaining liabilities subject to the LPT Agreement were $472.3 million and $498.0 million as of September 30, 2016 and December 31, 2015, respectively. Losses and LAE paid with respect to the LPT Agreement totaled $715.9 million and $695.2 million from inception through September 30, 2016 and December 31, 2015, respectively.

9. Accumulated Other Comprehensive Income, net

Accumulated other comprehensive income, net, is comprised of unrealized gains on investments classified as available-for-sale, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income, net:

	September 30, 2016	December 31, 2015
	(in millions)	
Net unrealized gain on investments, before taxes	$180.9	$ 128.6
Deferred tax expense on net unrealized gains	(63.3)	(45.0)
Total accumulated other comprehensive income, net	$117.6	$ 83.6

10. Stock-Based Compensation

The Company awarded stock options, restricted stock units (RSUs) and performance share units (PSUs) to certain officers of the Company as follows:

	Number Awarded	Weighted Average Fair Value on Date of Grant	Weighted Average Exercise Price	Aggregate Fair Value on Date of Grant
				(in millions)
March 2016				
Stock options(1)	67,431	$ 8.38	$ 27.72	$ 0.6
RSUs(1)	80,816	27.72	—	2.2
PSUs(2)	97,236	27.72	—	2.7
May 2016				
RSUs(1)	17,892	30.18	—	0.5

(1) The stock options and RSUs awarded in March 2016 were awarded to certain officers of the Company and vest 25% on March 15, 2017, and each of the subsequent three anniversaries of that date. The stock options and RSUs are subject to accelerated vesting in certain circumstances, including but not limited to: death, disability, retirement, or in connection with change of control of the Company. The stock options expire seven years from the date of grant.

The RSUs awarded in May 2016 were awarded to non-employee Directors of the Company and have a service vesting period of one year from the date of grant.

(2)

The PSUs awarded in March 2016 were awarded to certain officers of the Company and have a performance period of two years followed by an additional one year vesting period. The PSU awards are subject to certain performance goals with payouts that range from 0% to 200% of the target awards. The value shown in the table represents the aggregate number of PSUs awarded at the target level.

A total of 484,829 and 463,466 stock options were exercised during the nine months ended September 30, 2016 and the year ended December 31, 2015, respectively.

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11. Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income applicable to stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilutive impact of all convertible securities on earnings per share. Diluted earnings per share includes shares assumed issued under the "treasury stock method," which reflects the potential dilution that would occur if outstanding RSUs and PSUs had vested and options were to be exercised. The following table presents the net income and the weighted average number of shares outstanding used in the earnings per common share calculations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in millions, except share data)			
Net income available to stockholders—basic and diluted	$ 22.6	$ 24.5	$ 71.2	$ 67.7
Weighted average number of shares outstanding—basic	32,449,621	31,784,143	32,497,478	32,000,142
Effect of dilutive securities:				
PSUs	238,637	72,612	196,898	161,335
Stock options	192,822	245,708	251,068	289,348
RSUs	67,885	21,877	70,429	47,268
Dilutive potential shares	499,344	340,197	518,395	497,951
Weighted average number of shares outstanding—diluted	32,948,965	32,124,340	33,015,873	32,498,093

Diluted earnings per share excludes outstanding options and other common stock equivalents in periods where the inclusion of such options and common stock equivalents would be anti-dilutive. The following table presents options, PSUs, and RSUs that were excluded from diluted earnings per share.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Options excluded as the exercise price was greater than the average market price	—	80,800	—	26,933
Options, PSUs and RSUs excluded under the treasury method as the potential proceeds on settlement or exercise price were greater than the value of shares acquired	67,431	336,006	98,021	316,273

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

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to "we," "us," "our," "the Company," or similar terms refer to Employers Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended December 31, 2015 (Annual Report).

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, strategic initiatives, expected losses, loss experience, loss reserves, acquisitions, competition, the impact of changes in interest rates, rate increases with respect to our business, and the insurance industry in general. Statements including words such as "expect," "intend," "plan," "believe," "estimate," "may," "anticipate," "will," or similar statements of a future or forward-looking nature identify forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those described in our Annual Report and other documents that we have filed with the SEC.

Overview

We are a Nevada holding company. Through our insurance subsidiaries, we provide workers' compensation insurance coverage to select, small businesses in low to medium hazard industries. Workers' compensation insurance is provided under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We provide workers' compensation insurance in 34 states and the District of Columbia, with a concentration in California, where over one-half of our business is generated. Our revenues are primarily comprised of net premiums earned, net investment income, and net realized gains on investments.

We target small businesses, as we believe that this market is traditionally characterized by fewer competitors, more attractive pricing, and stronger persistency when compared to the U.S. workers' compensation insurance industry in general. We believe we are able to price our policies at levels that are competitive and profitable over the long term. Our underwriting approach is to consistently underwrite small business accounts at appropriate and competitive prices without sacrificing long-term profitability and stability for short-term top-line revenue growth.

Our strategy is to pursue profitable growth opportunities across market cycles and maximize total investment returns within the constraints of prudent portfolio management. We pursue profitable growth opportunities by focusing on disciplined underwriting and claims management, utilizing medical provider networks designed to produce superior medical and indemnity outcomes, establishing and maintaining strong, long-term relationships with independent insurance agencies, and developing important alternative distribution channels. We continue to execute a number of strategic initiatives, including: focusing on internal and customer facing business process excellence; emphasizing the settlement of open claims; diversifying our risk exposure across our geographic markets; utilizing a three-company pricing platform; utilizing territorial multipliers in California; and targeting profitable classes of business across all of our markets.

Results of Operations

A primary measure of our performance is our ability to increase our Adjusted stockholders' equity over the long term. The following table shows a reconciliation of our stockholders' equity on a GAAP basis to our Adjusted stockholders' equity and the number of common shares outstanding.

	September 30, 2016	December 31, 2015
	(in millions, except share data)	
GAAP stockholders' equity	$850.1	$ 760.8
Deferred reinsurance gain–LPT Agreement	177.8	189.5
Less: Accumulated other comprehensive income, net	117.6	83.6
Adjusted stockholders' equity(1)	$910.3	$ 866.7
Common shares outstanding	32,109,976	32,216,480

(1) Adjusted stockholders' equity is a non-GAAP measure that is defined as total stockholders' equity plus the Deferred reinsurance gain–LPT Agreement (Deferred Gain), less Accumulated other comprehensive income, net. We believe that Adjusted stockholders' equity is an important supplemental measure of our capital position.

Overall, net income was $22.6 million and $71.2 million for the three and nine months ended September 30, 2016, respectively, compared to $24.5 million and $67.7 million for the corresponding periods of 2015. We recognized underwriting income before tax of $11.3 million and $29.7 million for the three and nine months ended September 30, 2016, respectively, compared to $10.6 million and $24.9 million for the corresponding periods of 2015. Underwriting income or loss is determined by deducting losses and LAE, commission expense, and underwriting and other operating expenses from net premiums earned.

Our results of operations during the nine months ended September 30, 2016 were impacted by: (1) favorable development in the estimated reserves ceded under the LPT Agreement that resulted in a $3.1 million cumulative adjustment to the Deferred Gain and reduced our losses and LAE by the same amount during the second quarter of 2016 (LPT Reserve Adjustment) and (2) an increase in the contingent commission receivable under the LPT Agreement that resulted in a $1.8 million cumulative adjustment, which reduced our losses and LAE by the same amount (LPT Contingent Commission Adjustment) during the second quarter of 2016. Collectively, these items increased net income by $4.9 million during the second quarter of 2016.

Our results of operations during the nine months ended September 30, 2015 were impacted by: (1) favorable development in the estimated reserves ceded under the LPT Agreement that resulted in a $6.4 million LPT Reserve Adjustment during the nine months ended September 30, 2015; (2) an increase in the contingent commission receivable under the LPT Agreement that resulted in a $2.6 million LPT Contingent Commission Adjustment during the nine months ended September 30, 2015; and (3) a reallocation of $19.4 million of reserves from non-taxable periods prior to January 1, 2000 during the second quarter of 2015, which reduced our tax expenses by $3.8 million and reduced our effective tax rate by 4.6 percentage points for the nine months ended September 30, 2015. Collectively, these items increased net income by $12.8 million for the nine months ended September 30, 2015.

The comparative components of net income are set forth in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in millions)			
Gross premiums written	$164.4	$168.5	$545.7	$533.1
Net premiums written	$163.0	$166.5	$540.4	$526.7
Net premiums earned	$173.3	$179.0	$522.8	$508.6
Net investment income	17.9	18.5	54.1	53.8
Net realized gains on investments	1.6	2.0	9.1	5.1
Other income	—	—	0.6	0.1
Total revenues	192.8	199.5	586.6	567.6
Losses and LAE	109.0	115.8	328.0	323.5
Commission expense	21.3	21.0	63.5	62.6
Underwriting and other operating expenses	31.7	31.6	101.6	97.6
Interest expense	0.4	0.7	1.2	2.1
Income tax expense	7.8	5.9	21.1	14.1
Total expenses	170.2	175.0	515.4	499.9
Net income	$22.6	$24.5	$71.2	$67.7
Less amortization of the Deferred Gain related to losses	$2.5	$2.3	$7.2	$7.1
Less amortization of the Deferred Gain related to contingent commission	0.5	0.4	1.5	1.4
Less impact of LPT Reserve Adjustments[1]	—	—	3.1	6.4
Less impact of LPT Contingent Commission Adjustments[1]	—	—	1.8	2.6
Net income before impact of the LPT Agreement[2]	$19.6	$21.8	$57.6	$50.2

(1) Any adjustment to the contingent profit commission under the LPT Agreement results in a cumulative adjustment to the Deferred Gain, which is recognized in losses and LAE incurred in the Consolidated Statements of Comprehensive Income, such that the Deferred Gain reflects the balance that would have existed had the revised contingent profit commission been recognized at the inception of the LPT Agreement (LPT Contingent Commission Adjustments).

(2) We define net income before impact of the LPT Agreement as net income before the impact of: (a) amortization of Deferred Gain; (b) adjustments to LPT Agreement ceded reserves; and (c) adjustments to contingent commission receivable–LPT Agreement. Deferred Gain reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method. Amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries over the life of the LPT Agreement, except for the contingent profit commission, which is amortized through June 30, 2024. The amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement and the expected losses and LAE subject to the contingent profit commission under the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, contingent commission receivable, and the Deferred Gain, with the net effect being an increase or decrease to net income. Net income before impact of the LPT Agreement is not a measurement of financial performance under GAAP, but rather reflects a difference in accounting treatment between statutory and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes or net income, or any other measure of performance derived in accordance with GAAP.

We present net income before impact of the LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors, and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction under which the Deferred Gain does not effect our ongoing operations, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the LPT Agreement has limited significance on our current and ongoing operations.

Gross Premiums Written

Gross premiums written is the sum of both direct premiums written and assumed premiums written before the effect of ceded reinsurance. Gross premiums written decreased 2.4% for the three months ended September 30, 2016 and increased 2.4% for the nine months ended September 30, 2016, compared to the same periods of 2015. The year-over-year decrease in gross premiums written for the quarter was primarily due to a $5.0 million decrease in our final audit premiums in the third quarter of 2016, compared to the third quarter of 2015. The year-over-year increase in gross premiums written for the nine months ended September 30, 2016 was primarily due to final audit premiums that were $18.9 million higher, partially offset by declines in premium due to lower levels of renewal premiums, year-over-year. The declines in renewal premiums year-over-year were due to declines in the LA Area of California, partially offset by increases in states outside California, as well as territories outside of southern California. While overall renewal premiums were down slightly year-over-year, primarily driven by lower net rates, our policy unit retention rate increased for the three and nine months ended September 30, 2016, compared to the same periods of 2015. Premiums from new business written increased for the three and nine months ended September 30, 2016, compared to the same periods of 2015.

Net Premiums Earned

Net premiums earned are those portions of the premiums that apply to the expired portions of the policies in force. Net premiums earned are recognized as revenue. Net premiums earned decreased 3.2% for the three months ended September 30, 2016 and increased 2.8% for the nine months ended September 30, 2016, compared to the same periods of 2015. The year-over-year decrease in net premiums earned was primarily the result of $5.0 million decrease in our final audit premiums for the three months ended September 30, 2016, while the year-over-year increase for the nine months ended September 30, 2016 was primarily due to final audit premiums that were $18.9 million higher, partially offset by declines in premium due to lower levels of renewal premiums. The declines in renewal premiums year-over-year were due to declines in the LA Area of California, partially offset by increases in states outside California, as well as territories outside of southern California. Fifty-six percent of our in-force premiums were generated in California and no other state represented a significant concentration of business as of September 30, 2016.

The following table shows the percentage change in our in-force premiums, policy count, average policy size, payroll exposure upon which our premiums are based, and net rate overall and for California:

	As of September 30, 2016					
	Year-to-Date (Decrease) Increase			Year-Over-Year (Decrease) Increase		
	Overall	California	All Other States	Overall	California	All Other States
In-force premiums	(0.3)%	(1.3)%	1.1 %	(0.5)%	(2.5)%	2.3 %
In-force policy count	0.6	(3.5)	5.0	—	(5.5)	6.2
Average in-force policy size	(0.9)	2.3	(3.8)	(0.5)	3.1	(3.7)
In-force payroll exposure	1.2	1.2	1.2	1.7	0.8	2.2
Net rate[1]	(1.4)	(2.4)	(0.2)	(2.1)	(3.3)	—

(1) Net rate, defined as total in-force premiums divided by total insured payroll exposure, is a function of a variety of factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our in-force premiums and policy count in the LA Area of California declined 13.2% and 13.9%, respectively, year-over-year as of September 30, 2016, while our in-force premiums and policy count in California outside of the LA Area increased 10.3% and 4.1%, respectively, during the same period. The declines in total in-force premiums were driven by lower net rate.

Our net rate (total in-force premiums divided by total insured payroll exposure) in California decreased 3.3% year-over-year as of September 30, 2016. Net rate is a function of a variety of factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our in-force premiums and number of policies in-force for California and all other states combined were as follows:

State	September 30, 2016		December 31, 2015		September 30, 2015		December 31, 2014	
	In-force Premiums	Policies In-force	In-force Premiums	Policies In-force	In-force Premiums	Policies In-force	In-force Premiums	Policies In-force
	(dollars in millions)							
California	$347.8	42,550	$352.2	44,080	$356.8	45,021	$370.8	47,093
Other	270.1	42,450	267.3	40,416	264.1	39,981	257.1	38,209

Total	$617.9	85,000	$619.5	84,496	$620.9	85,002	$627.9	85,302

Our alternative distribution channels that utilize partnerships and alliances generated $151.3 million and $147.4 million, or 24.5% and 23.7%, of our in-force premiums as of September 30, 2016 and 2015, respectively. We believe that the bundling of products and services through these relationships contributes to higher retention rates than business generated by our independent agents. These relationships also allow us to access new customers that we may not have access to through our independent agent distribution channel. We continue to actively seek new partnerships and alliances.

Net Investment Income and Net Realized Gains on Investments

We invest our holding company assets, statutory surplus, and the funds supporting our insurance liabilities, including unearned premiums and unpaid losses and LAE. We invest in fixed maturity securities, equity securities, and cash equivalents. Net investment

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income includes interest and dividends earned on our invested assets and amortization of premiums and discounts on our fixed maturity securities, less bank service charges and custodial and portfolio management fees. We have established a high quality/short duration bias in our investment portfolio.

Net investment income decreased 3.2% for the three months ended September 30, 2016 and increased 0.6% for the nine months ended September 30, 2016, compared to the same periods of 2015. The average pre-tax book yield on invested assets was 3.1% and 3.2% at September 30, 2016 and 2015, respectively. The tax-equivalent yield on invested assets was 3.7% and 3.8% at September 30, 2016 and 2015, respectively. The decrease in investment income year-over-year for the quarter was primarily related to the decrease in pre-tax book yield. The slight increase in net investment income for the nine months ended September 30, 2016 was primarily related to a slight change in the mix of invested assets in the investment portfolio.

Realized gains and losses on our investments are reported separately from our net investment income. Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original or adjusted cost (equity securities) or amortized cost (fixed maturity securities). Realized losses are also recognized when securities are written down as a result of an other-than-temporary impairment.

Net realized gains on investments were $1.6 million and $9.1 million for the three and nine months ended September 30, 2016, respectively, compared to $2.0 million and $5.1 million for the corresponding periods of 2015. The increase in net realized gains on investments year-over-year for the nine months ended September 30, 2016 was the result of the sale of equity securities as part of a regular rebalancing of our equity investment portfolio and to meet cash needs at the holding company. For the nine months ended September 30, 2016, these gains were partially offset by $5.3 million in other-than-temporary impairments of certain equity securities due to our intent to sell certain securities and the downturn in the energy sector that occurred in the first quarter of 2016.

Additional information regarding our Investments is set forth under “—Liquidity and Capital Resources—Investments.”

Combined Ratio

The combined ratio, a key measurement of underwriting profitability, is the sum of the loss and LAE ratio, the commission expense ratio, and the underwriting and other operating expenses ratio. When the combined ratio is below 100%, we have recorded underwriting income, and conversely, when the combined ratio is greater than 100%, we have recorded an underwriting loss and cannot be profitable without investment income. Because we have only one operating segment, holding company expenses are included in our calculation of the combined ratio and increased the combined ratio by 1.4 and 1.6 percentage points for the three and nine months ended September 30, 2016, respectively, compared to 1.7 and 1.9 percentage points for the corresponding periods of 2015.

The following table provides the calculation of our calendar period combined ratios.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Loss and LAE ratio	62.9%	64.7%	62.7%	63.6%
Underwriting and other operating expenses ratio	18.3	17.7	19.5	19.2
Commission expense ratio	12.3	11.7	12.1	12.3
Combined ratio	93.5%	94.1%	94.3%	95.1%

Loss and LAE Ratio. This is the ratio of losses and LAE to net premiums earned. Losses and LAE represents our largest expense item and includes claim payments made, amortization of the Deferred Gain, estimates for future claim payments and changes in those estimates for current and prior periods, and costs associated with investigating, defending, and adjusting claims. The quality of our financial reporting depends in large part on accurately predicting our losses and LAE, which are inherently uncertain as they are estimates of the ultimate cost of individual claims based on actuarial estimation techniques.

Our indemnity claims frequency (the number of claims expressed as a percentage of payroll) has decreased year-over-year; however, our loss experience indicates a slight upward movement in medical and indemnity costs per claim that is reflected in our current accident year loss estimate. We believe our current accident year loss and LAE estimate is adequate; however, given the long-tail nature of our business, ultimate losses will not be known with any certainty for many years.

Our loss and LAE ratio decreased 1.8 and 0.9 percentage points for the three and nine months ended September 30, 2016, compared to the same periods of 2015, while the amount of our losses and LAE decreased 5.9% year-over-year for the quarter and increased 1.4% for the nine months ended September 30, 2016. The decreases in the loss and LAE ratio were primarily due to decreases in the current accident year loss estimates.

Our current accident year loss estimates were 64.1% and 65.6% for the three and nine months ended September 30, 2016, compared to 66.3% and 66.8% for the three and nine months ended September 30, 2015, respectively. The decreases in our current accident year loss estimate reflects the impact of key business initiatives, including but not limited to: emphasizing the settlement of open claims; diversifying our risk exposure across our markets; non-renewing underperforming business; and targeting profitable classes of business across all of our markets. In addition, we have increased rates in the LA Area in California limiting our growth in that territory, while we continue to grow in other territories within and outside of California. The current accident year loss estimate for the nine months ended September 30, 2016 includes the impact of $6.5 million in large losses recognized in the second quarter of 2016, which increased the current accident year loss estimate for the nine months ended September 30, 2016.

Prior accident year favorable (unfavorable) loss development was $(0.8) million and $1.5 million for the three and nine months ended September 30, 2016, compared to $0.1 million and $(1.3) million for the three and nine months ended September 30, 2015, respectively. Prior accident year loss development was related to our Assigned Risk Business.

Excluding the impact from the LPT Agreement, losses and LAE would have been $112.0 million and $118.5 million, or 64.6% and 66.2% of net premiums earned, for the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, losses and LAE, excluding the impact of the LPT, would have been $341.6 million and $341.0 million, or 65.3% and 67.0% of net premium earned, respectively.

The table below reflects losses and LAE reserve adjustments and the impact of the LPT on net income before taxes.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in millions)			
Prior accident year favorable (unfavorable) loss development, net	$(0.8)	$0.1	$1.5	$(1.3)
Amortization of the Deferred Gain related to losses	$2.5	$2.3	$7.2	$7.1
Amortization of the Deferred Gain related to contingent commission	0.5	0.4	1.5	1.4
Impact of LPT Reserve Adjustments	—	—	3.1	6.4
Impact of LPT Contingent Commission Adjustments	—	—	1.8	2.6
Total impact of the LPT on losses and LAE	3.0	2.7	13.6	17.5
Total losses and LAE reserve adjustments	$2.2	$2.8	$15.1	$16.2

Underwriting and Other Operating Expenses Ratio. The underwriting and other operating expenses ratio is the ratio of underwriting and other operating expenses to net premiums earned and measures an insurance company's operational efficiency in producing, underwriting, and administering its insurance business.

Underwriting and other operating expenses are those costs that we incur to underwrite and maintain the insurance policies we issue, excluding commission. These expenses include premium taxes and certain other general expenses that vary with, and are primarily related to, producing new or renewal business. Other underwriting expenses include policyholder dividends, changes in estimates of future write-offs of premiums receivable, general administrative expenses such as salaries and benefits, rent, office supplies, depreciation, and all other operating expenses not otherwise classified separately. Policy acquisition costs are variable based on premiums earned. Other operating expenses are more fixed in nature and become a smaller percentage of net premiums earned as premiums increase.

Our underwriting and other operating expenses ratio increased 0.6 and 0.3 percentage points, while the amount of our underwriting and other operating expenses increased 0.3% and 4.1% for the three and nine months ended September 30, 2016, compared to the same periods of 2015. During the three months ended September 30, 2016 our policyholder dividends increased $0.3 million and our compensation-related expenses increased $0.2 million, partially offset by a $0.4 million decrease in our bad debt expense, compared to the same period of 2015. During the nine months ended September 30, 2016 our premium taxes and assessments increased $2.6 million, our compensation-related expenses increased $2.1 million, policyholder dividends increased $0.7 million and our IT related expenses increased $0.6 million, partially offset by a $1.6 million decrease in our bad debt expense, compared to the same period of 2015.

Commission Expense Ratio. The commission expense ratio is the ratio of commission expense to net premiums earned and measures the cost of compensating agents and brokers for the business we have written.

Commission expense includes direct commissions to our agents and brokers for the premiums that they produce for us, as well as incentive payments, other marketing costs, and fees.

Our commission expense ratio increased 0.6 percentage points for the three months ended September 30, 2016 and decreased 0.2 percentage points for the nine months ended September 30, 2016, compared to the same periods of 2015, while our commission expense was $0.3 million higher for the three months ended September 30, 2016 and $0.9 million lower nine months ended September 30, 2016, compared to the same periods of 2015.

Income Tax Expense

Income tax expense was $7.8 million and $21.1 million for the three and nine months ended September 30, 2016, respectively, compared to $5.9 million and $14.1 million for the corresponding periods of 2015. Our effective tax rate was 25.7% and 22.9% for the three and nine months ended September 30, 2016, respectively, compared to 19.4% and 17.2% for the same periods of 2015, respectively. The increases in income tax expense were primarily due to increases in our projected annual net income before taxes. Additionally, our income tax expense was decreased by $0.1 million and $1.4 million for the three and nine months ended September 30, 2016, respectively, as a result of the implementation of new accounting guidance related to stock-based compensation in the third quarter of 2016.

Liquidity and Capital Resources

Holding Company Liquidity

We are a holding company and our ability to fund our operations is contingent upon existing capital and the ability of our insurance subsidiaries to pay dividends up to the holding company. Payment of dividends by our insurance subsidiaries is restricted by state insurance laws and regulations, including laws establishing minimum solvency and liquidity thresholds. We require cash to pay stockholder dividends, repurchase common stock, make interest and principal payments on our outstanding debt obligations, provide additional surplus to our insurance subsidiaries, and fund our operating expenses.

The holding company had $53.6 million of cash and cash equivalents and fixed maturity securities maturing within the next 24 months at September 30, 2016. Total cash and investments at the holding company was $65.1 million at September 30, 2016. We believe that the liquidity needs of the holding company over the next 24 months will be met with cash, investments, and dividends from our insurance subsidiaries.

Operating Subsidiaries' Liquidity

The primary sources of cash for our insurance operating subsidiaries are funds generated from underwriting operations, investment income, maturities and sales of investments, and capital contributions from the parent holding company. The primary uses of cash are payments of claims and operating expenses, purchases of investments, and payments of dividends to the parent holding company, which are subject to state insurance laws and regulations.

Our insurance subsidiaries had $452.1 million of cash and cash equivalents, short-term investments, and fixed maturity securities maturing within the next 24 months at September 30, 2016. We believe that our subsidiaries' liquidity needs over the next 24 months will be met with cash from operations, investment income, and maturing investments.

Each of our insurance subsidiaries, EICN, ECIC, EPIC, and EAC, became a member of the Federal Home Loan Bank of San Francisco (FHLB) in January 2016. Membership allows our subsidiaries access to collateralized advances, which may be used to support and enhance liquidity management. The amount of advances that may be taken is dependent on statutory admitted assets on a per company basis. Currently, none of our subsidiaries has advances outstanding under the FHLB facility.

We purchase reinsurance to protect us against the costs of severe claims and catastrophic events. On July 1, 2016, we entered into a reinsurance program that is effective through June 30, 2017. The reinsurance program consists of one treaty covering excess of loss and catastrophic loss events in four layers of coverage. Our reinsurance coverage is $190.0 million in excess of our $10.0 million retention on a per occurrence basis, subject to certain exclusions. We believe that our reinsurance program meets our needs and that we are sufficiently capitalized.

Various state laws and regulations require us to hold securities or letters of credit on deposit with certain states in which we do business. Securities having a fair value of $1.0 billion and $0.9 billion were on deposit at September 30, 2016 and December 31, 2015, respectively. These laws and regulations govern both the amount and types of fixed maturity securities that are eligible for deposit. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities we assumed. The fair value of fixed maturity securities held in trust for the benefit of ceding reinsurers was $27.7 million and $32.7 million at September 30, 2016 and December 31, 2015, respectively.

Sources of Liquidity

We monitor cash flows at both the consolidated and subsidiary levels. We use trend and variance analyses to project future cash needs, making adjustments to our forecasts as appropriate. For additional information regarding our cash flows, see Item 1, Unaudited Consolidated Statements of Cash Flows.

The table below shows our net cash flows for the nine months ended:

	September 30,	
	2016	2015
	(in millions)	
Cash and cash equivalents provided by (used in):		
Operating activities	$97.0	$94.0
Investing activities	(49.1)	(139.1)
Financing activities	(20.4)	(2.3)
Increase (Decrease) in cash and cash equivalents	$27.5	$(47.4)

Operating Cash Flows. Major components of net cash provided by operating activities for the nine months ended September 30, 2016 included net premiums received of $525.0 million and investment income received of $65.8 million. These were partially offset by claims payments of $323.0 million (net of $22.7 million recovered from reinsurers), underwriting and other operating expenses paid of $97.2 million (including premium taxes paid of $24.1 million), and commissions paid of $62.3 million.

Major components of net cash provided by operating activities for the nine months ended September 30, 2015 included net premiums received of $510.7 million and investment income received of $63.8 million. These were partially offset by claims payments of $314.9 million (net of $25.7 million recovered from reinsurers), underwriting and other operating expenses paid of $95.9 million (including premium taxes paid of $16.2 million), and commissions paid of $61.4 million.

Investing Cash Flows. The major components of net cash used in investing activities for the nine months ended September 30, 2016 and 2015 were the purchases of fixed maturity and equity securities, partially offset by proceeds from sales, maturities, and redemptions of investments.

Financing Cash Flows. Cash used in financing activities for the nine months ended September 30, 2016 was to repurchase common stock and to pay dividends to stockholders, partially offset by cash received related to the exercise of stock options.

The majority of cash used in financing activities for the nine months ended September 30, 2015 was to pay dividends to stockholders, partially offset by cash received related to the exercise of stock options.

Dividends. Dividends paid to stockholders were $8.8 million and $5.8 million for the nine months ended September 30, 2016 and 2015, respectively. On October 26, 2016, the Board of Directors declared a $0.09 dividend per share, payable November 23, 2016, to stockholders of record on November 9, 2016.

Share Repurchases. On February 16, 2016, the Board of Directors authorized a share repurchase program for up to $50.0 million of our common stock from February 22, 2016 through February 22, 2018 (the 2016 Program). Through September 30, 2016, we repurchased a total of 642,024 shares of common stock under the 2016 Program at an average price of $28.91 per share, including commissions, for a total cost of $18.6 million.

Capital Resources

Our capital structure is comprised of outstanding debt and stockholders' equity. As of September 30, 2016, our capital structure consisted of $32.0 million in surplus notes maturing in 2034, and $1.0 billion of stockholders' equity, including the Deferred Gain. Outstanding debt was 3.0% of total capitalization, including the Deferred Gain, as of September 30, 2016.

Contractual Obligations and Commitments. The following table identifies our long-term debt and contractual obligations as of September 30, 2016.

	Payment Due By Period				
	Total	Less Than 1-Year	1-3 Years	4-5 Years	More Than 5 Years
	(in millions)				
Operating leases	$16.9	$5.1	$7.3	$4.2	$0.3
Purchased liabilities	5.4	3.4	1.4	0.6	—
Notes payable[(1)]	60.6	1.6	3.2	3.2	52.6

Capital leases	0.7	0.3	0.3	0.1	—
Losses and LAE reserves (2)(3)	2,330.0	375.6	465.0	273.4	1,216.0
Total contractual obligations	$2,413.6	$386.0	$477.2	$281.5	$1,268.9

(1) Notes payable obligations reflect payments for the principal and estimated interest expense based on LIBOR plus a margin. The estimated interest expense was based on the contractual obligations of the debt outstanding as of September 30, 2016. The interest rates range from 4.9% to 5.1%.

(2) Estimated losses and LAE reserve payment patterns have been computed based on historical information. Our calculation of loss and LAE reserve payments by period is subject to the same uncertainties associated with determining the level of reserves and to the additional uncertainties arising from the difficulty of predicting when claims (including claims that have not yet been reported to us) will be paid. Actual payments of losses and LAE by period will vary, perhaps materially, from the above table to the extent that current estimates of losses and LAE reserves vary from actual ultimate paid claims due to variations between expected and actual payout patterns.

(3) The losses and LAE reserves are presented gross of reinsurance recoverables for unpaid losses, which are as follows for each of the periods presented above:

	Recoveries By Period				
	Total	Less Than 1-Year	1-3 Years	4-5 Years	More Than 5 Years
	(in millions)				
Reinsurance recoverables for unpaid losses	$(591.5)	$(30.5)	$(57.7)	$(53.6)	$(449.7)

Investments

The cost or amortized cost of our investment portfolio was $2.4 billion and the fair value was $2.6 billion as of September 30, 2016.

We employ an investment strategy that emphasizes asset quality and considers the durations, maturities, and anticipated cash flows of securities against anticipated claim payments, other expenditures and liabilities, and capital and liquidity needs. Our investment portfolio is structured so that investments mature periodically in reasonable relation to current expectations of future claim payments. Currently, we make claim payments from positive cash flow from operations and use excess cash to fund growth in our business, invest in operations, invest in marketable securities, and return capital to our stockholders.

As of September 30, 2016, our investment portfolio, which is classified as available-for-sale, consisted of 92.9% fixed maturity securities whose fair values may fluctuate due to prevailing market interest rates. We strive to limit interest rate risk by managing the duration of our fixed maturity securities. Our fixed maturity securities (excluding cash and cash equivalents) had a duration of 4.2 at September 30, 2016. To minimize interest rate risk, our portfolio is weighted toward short-term and intermediate-term bonds; however, our investment strategy balances consideration of duration, yield, and credit risk. Our investment guidelines require that the minimum weighted average quality of our fixed maturity securities portfolio be "AA-," using ratings assigned by Standard & Poor's (S&P). Our fixed maturity securities portfolio had a weighted average quality of "AA-" as of September 30, 2016, with 56.9% of the portfolio rated "AA" or better, based on fair value.

We carry our portfolio of equity securities on our balance sheet at fair value. We seek to minimize our exposure to equity price risk by investing primarily in the equity securities of mid-to-large capitalization issuers and by diversifying our equity holdings across several industry sectors. Equity securities represented 7.1% of our investment portfolio at September 30, 2016.

Given current economic uncertainty and continuing market volatility, we believe that our current asset allocation best meets our strategy to preserve capital for policyholders, to provide sufficient income to support our insurance operations, and to effectively grow book value over a long-term investment horizon.

The following table shows the estimated fair value, the percentage of the fair value to total invested assets, the average book yield, and the average tax equivalent yield based on the fair value of each category of invested assets as of September 30, 2016.

Category	Estimated Fair Value	Percentage of Total	Book Yield	Tax Equivalent Yield
	(in millions, except percentages)			
U.S. Treasuries	$127.9	5.0 %	1.8 %	1.8 %
U.S. Agencies	13.0	0.5	4.3	4.3
States and municipalities	897.2	34.7	3.1	4.5

Corporate securities	996.5	38.7	3.1	3.1
Residential mortgage-backed securities	235.0	9.1	3.0	3.0
Commercial mortgage-backed securities	86.5	3.3	2.5	2.5
Asset-backed securities	27.8	1.1	1.8	1.8
Equity securities	184.5	7.1	5.7	7.5
Short-term investments	14.0	0.5	1.0	1.0
Total	$2,582.4	100.0 %		
Weighted average yield			3.1 %	3.7 %

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The following table shows the percentage of total estimated fair value of our fixed maturity securities as of September 30, 2016 by credit rating category, using the lower of ratings assigned by Moody's Investor Services and/or S&P.

Rating	Percentage of Total Estimated Fair Value	
“AAA”	9.7	%
“AA”	47.2	
“A”	28.8	
“BBB”	13.5	
Below investment grade	0.8	
Total	100.0	%

Investments that we currently own could be subject to default by the issuer or could suffer declines in fair value that become other-than-temporary. We regularly assess individual securities as part of our ongoing portfolio management, including the identification of other-than-temporary declines in fair value. Our other-than-temporary impairment assessment includes reviewing the extent and duration of declines in the fair value of investments below amortized cost, historical and projected financial performance and near-term prospects of the issuer, the outlook for industry sectors, credit rating, and macro-economic changes. We also make a determination as to whether it is not more likely than not that we will be required to sell the security before its fair value recovers above cost, or maturity.

Based on our reviews of fixed maturity and equity securities, we believe that we appropriately identified the declines in the fair values of our unrealized losses for the nine months ended September 30, 2016. We determined that the unrealized losses on fixed maturity securities were primarily the result of prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company’s intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above cost, or maturity.

Based on reviews of the equity securities, the Company recognized a total impairment of $5.3 million in the fair value of 32 equity securities for the nine months ended September 30, 2016, as a result of our intent to sell and/or the severity and duration of the change in fair value of the securities. The remaining unrealized losses on equity securities were not considered to be other-than-temporary due to the financial condition and near-term prospects of the issuers. The other-than-temporary impairment of equity securities was primarily due to the downturn in the energy sector that occurred in the first quarter of 2016.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Critical Accounting Policies

These unaudited interim consolidated financial statements include amounts based on the use of estimates and judgments of management for those transactions that are not yet complete. We believe that the estimates and judgments that were most critical to the preparation of the consolidated financial statements involved the following: (a) reserves for losses and LAE; (b) reinsurance recoverables; (c) recognition of premium income; (d) deferred income taxes; and (e) valuation of investments. These estimates and judgments require the use of assumptions about matters that are highly uncertain and therefore are subject to change as facts and circumstances develop. Our accounting policies are discussed under "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of potential economic loss principally arising from adverse changes in the fair value of financial instruments. The major components of market risk affecting us are credit risk, interest rate risk, and equity price risk, and are described in detail in our Annual Report. We have not experienced any material changes in market risk since December 31, 2015.

The primary market risk exposure to our investment portfolio, which consists primarily of fixed maturity securities, is interest rate risk. We have the ability to hold fixed maturity securities to maturity and we strive to limit interest rate risk by managing duration. As of September 30, 2016, our fixed maturity securities portfolio had a duration of 4.2. We continually monitor the impact of interest rate changes on our investment portfolio and liquidity obligations. Changes to our market risk, if any, since December 31, 2015 are reflected in Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements contained in this Form 10-Q.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (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 concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report. There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

From time-to-time, the Company is involved in pending and threatened litigation in the normal course of business in which claims for monetary damages are asserted. In the opinion of management, the ultimate liability, if any, arising from such pending or threatened litigation is not expected to have a material effect on our results of operations, liquidity, or financial position.

Item 1A. Risk Factors

We have disclosed in our Annual Report the most significant risk factors that can impact year-to-year comparisons and that may affect the future performance of the Company's business. On a quarterly basis, we review these disclosures and update the risk factors, as appropriate. As of the date of this report, there have been no material changes to the risk factors contained in our Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the repurchases of our common stock for each month within the third quarter of 2016:

Period	Total Number of Shares Purchased	Average Price Paid Per Share(1)	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program(2) (in millions)
July 1 – July 31, 2016	39,950	$ 29.63	39,950	$ 41.9
August 1 – August 31, 2016	255,634	28.65	255,634	34.6
September 1 – September 30, 2016	104,155	30.01	104,155	31.4
Total	399,739	$ 29.10	399,739	

(1) Includes fees and commissions paid on stock repurchases.

(2) On February 16, 2016, the Board of Directors authorized a share repurchase program for repurchases of up to $50 million of the Company's common stock (the 2016 Program). We expect that shares may be purchased at prevailing market prices through February 22, 2018 through a variety of methods, including open market or private transactions, in accordance with applicable laws and regulations and as determined by management. The timing and actual number of shares repurchased will depend on a variety of factors, including the share price, corporate and regulatory requirements, and other market and economic conditions. Repurchases under the 2016 Program may be commenced, modified, or suspended from time to time without prior notice, and the program may be suspended or discontinued at any time.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

			Incorporated by Reference Herein		
Exhibit No.	Description of Exhibit	Included Herewith	Form	Exhibit	Filing Date
*10.1	Amendment No. 1, dated January 29, 2016, to Employment Agreement effective November 10, 2014 by and between Employers Holdings, Inc. and Terry Eleftheriou		8-K	10.1	February 2, 2016
31.1	Certification of Douglas D. Dirks Pursuant to Section 302	X			
31.2	Certification of Terry Eleftheriou Pursuant to Section 302	X			
32.1	Certification of Douglas D. Dirks Pursuant to Section 906	X			