

NATIONAL RETAIL PROPERTIES, INC.
Form 10-K
February 21, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from _____ to _____.

Commission file number 001-11290

NATIONAL RETAIL PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

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

56-1431377
(I.R.S. Employer Identification No.)

450 South Orange Avenue, Suite 900

Orlando, Florida 32801

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (407) 265-7348

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:
Common Stock, \$0.01 par value

Name of exchange on which registered:
New York Stock Exchange

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7.375% Non-Voting Series C Preferred Stock

New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of voting common stock held by non-affiliates of the registrant as of June 30, 2006 was \$1,144,188,520.

The number of shares of common stock outstanding as of February 14, 2007 was 60,272,926.

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DOCUMENTS INCORPORATED BY REFERENCE:

Registrant incorporates by reference portions of the National Retail Properties, Inc. Proxy Statement for the 2007 Annual Meeting of Stockholders (Items 10, 11, 12, 13 and 14 of Part III).

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PART I

Statements contained in this annual report on Form 10-K, 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 and Section 21E of the Securities Exchange Act of 1934. Also, when the Company uses any of the words anticipate, assume, believe, estimate, expect, intend, or similar expressions, the Company is making forward-looking statements. Although management believes that the expectations reflected in such forward-looking statements are based upon present expectations and reasonable assumptions, the Company's actual results could differ materially from those set forth in the forward-looking statements. Certain factors that could cause actual results or events to differ materially from those the Company anticipates or projects are described in Item 1A. Risk Factors of this Annual Report on Form 10-K.

Given these uncertainties, readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this Annual Report on Form 10-K or any document incorporated herein by reference. The Company undertakes no obligation to publicly release any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date of this Annual Report on Form 10-K.

Item 1. Business

The Company

National Retail Properties, Inc. (formerly known as Commercial Net Lease Realty, Inc.), a Maryland corporation, is a fully integrated real estate investment trust (REIT) formed in 1984. The terms Registrant or Company refer to National Retail Properties, Inc. and its majority owned and controlled subsidiaries. These subsidiaries include the wholly owned qualified REIT subsidiaries of National Retail Properties, Inc., as well as the taxable REIT subsidiaries and their majority owned and controlled subsidiaries (the NNN TRS). Effective May 1, 2006, Commercial Net Lease Realty, Inc. changed its name to National Retail Properties, Inc.

The Company's operations are divided into two primary business segments: (i) investment assets, including real estate assets, structured finance investments (included in mortgages and notes receivable on the consolidated balance sheets) and mortgage residual interests (collectively, Investment Assets), and (ii) inventory real estate assets (Inventory Assets). The Investment Assets are operated through National Retail Properties, Inc. and its wholly owned qualified REIT subsidiaries. The Inventory Assets are operated through the NNN TRS.

Real Estate Assets

The Company acquires, owns, invests in, manages and develops properties that are leased primarily to retail tenants under long-term net leases (Investment Properties or Investment Portfolio). As of December 31, 2006, the Company owned 710 Investment Properties, with an aggregate leasable area of 9,341,000 square feet, located in 44 states. Approximately 98 percent of the Company's Investment Portfolio was leased at December 31, 2006. The NNN TRS, directly and indirectly, through investment interests, owns real estate primarily for the purpose of selling the real estate (Inventory Properties or Inventory Portfolio). As of December 31, 2006, the NNN TRS owned 97 Inventory Properties.

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Structured Finance Investments

Structured finance agreements (included in mortgages, notes and accrued interest receivable on the consolidated balance sheets) are typically loans secured by a borrower's pledge of ownership interests in the entity that owns the real estate. These agreements are typically subordinated to senior loans secured by first mortgages encumbering the underlying real estate. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans. As of December 31, 2006, the structured finance agreements had an outstanding principal balance of \$13,917,000.

Mortgage Residual Interests

Orange Avenue Mortgage Investments, Inc. (OAMI), a majority owned and consolidated subsidiary of the Company, holds the mortgage residual interests (Residuals) from seven commercial real estate loan securitizations. Each of the Residuals is reported at its market value based upon a third party valuation, with unrealized gains and losses reported as other comprehensive income in stockholders' equity. Losses that are considered other than temporary are reported through earnings. The Residuals had an estimated fair value of \$31,512,000 at December 31, 2006.

NNN TRS

Prior to January 1, 2005, the Company held a 98.7 percent, non-controlling and non-voting interest in Commercial Net Lease Realty Services, Inc. and its majority owned and controlled subsidiaries (collectively, Services). Kevin B. Habicht, an officer and director of the Company, James M. Seneff, Jr. and Gary M. Ralston, each a former officer and director of the Company, (collectively, the Services Investors), owned the remaining 1.3 percent interest, which represented 100 percent of the voting interest in Services. Effective January 1, 2005, the Company acquired the remaining 1.3 percent interest in Services, increasing the Company's ownership in Services to 100 percent. Effective November 1, 2005, Commercial Net Lease Realty Services, Inc. merged into National Retail Properties, Inc. CNLRS Exchange I, Inc., a taxable REIT subsidiary (TRS), became the TRS holding company for the Company's development and exchange activities. Effective October 2, 2006, CNLRS Exchange I, Inc. changed its name to NNN TRS, Inc.

Competition

The Company generally competes with numerous other REITs, commercial developers, real estate limited partnerships and other investors, including but not limited to, insurance companies, pension funds and financial institutions, that own, manage, finance or develop retail and net leased properties.

Employees

As of December 31, 2006, the Company employed 68 full-time associates including executive and administrative personnel.

The Company's executive offices are located at 450 S. Orange Avenue, Suite 900, Orlando, Florida 32801, and its telephone number is (407) 265-7348. The Company has an Internet website at www.nnnreit.com where the Company's filings with the Securities and Exchange Commission can be downloaded free of charge.

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Business Strategies and Policies

The following is a discussion of the Company's operating strategy and certain of its investment, financing and other policies. These strategies and policies have been set by management and/or the Board of Directors and, in general, may be amended or revised from time to time by management and/or the Board of Directors without a vote of the Company's stockholders.

Operating Strategies

The Company's strategy is to invest primarily in retail real estate that is typically located along high-traffic commercial corridors near areas of commercial and residential density. Management believes that these types of properties, when leased to national or regional retailers generally pursuant to triple-net leases, provide attractive opportunities for a stable current return and the potential for capital appreciation. Triple-net leases typically require the tenant to pay property operating expenses such as real estate taxes, assessments and other government charges, insurance, utilities, and repairs and maintenance.

In some cases, the Company's investment in real estate is in the form of structured finance investments, which are typically loans secured by a borrower's pledge of ownership interests in the entity that owns the real estate. These agreements are typically subordinated to senior loans secured by first mortgages encumbering the underlying real estate. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans.

Additionally, the Company may provide mortgage loans which are typically secured by a specific real estate asset owned by the borrower.

The Company holds investment real estate assets until it determines that the sale of such a property is advantageous in view of the Company's investment objectives. In deciding whether to sell a real estate investment asset, the Company may consider factors such as potential capital appreciation, net cash flow, potential use of sale proceeds and federal income tax considerations.

The Company acquires and develops inventory real estate assets primarily for the purpose of resale.

The Company's management team considers certain key indicators to evaluate the financial condition and operating performance of the Company. The key indicators for the Company may include items such as: the composition of the Company's Investment Portfolio (such as tenant, geographic and industry classification diversification), the occupancy rate of the Company's Investment Portfolio, certain financial performance ratios, profitability measures and industry trends compared to that of the Company.

Investment in Real Estate or Interests in Real Estate

The Company's management believes that attractive acquisition opportunities for retail properties will continue to be available and that the Company is suited to take advantage of these opportunities because of its access to capital markets, ability to underwrite and acquire properties, either for cash or securities, and because of management's experience in seeking out, identifying and evaluating potential acquisitions.

In evaluating a particular acquisition, management may consider a variety of factors, including:

the location and accessibility of the property;

the geographic area and demographic characteristics of the community, as well as the local real estate market, including potential for growth;

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the size of the property;

the purchase price;

the non-financial terms of the proposed acquisition;

the availability of funds or other consideration for the proposed acquisition and the cost thereof;

the fit of the property with the Company's existing portfolio;

the potential for, and current extent of, any environmental problems;

the quality of construction and design and the current physical condition of the property;

the financial and other characteristics of the existing tenant;

the tenant's business plan, operating history and management team;

the tenant's industry; and

the terms of any existing leases.

The Company intends to engage in future investment activities in a manner that is consistent with the maintenance of its status as a REIT for federal income tax purposes and that will not make the Company an investment company under the Investment Company Act of 1940, as amended. Equity investments in acquired properties may be subject to existing mortgage financings and other indebtedness or to new indebtedness which may be incurred in connection with acquiring or refinancing these investments.

Investments in Real Estate Mortgages, Mortgage Residual Interests, and Securities of or Interests in Persons Engaged in Real Estate Activities

While the Company's current portfolio of, and its business objectives primarily emphasize, equity investments in retail properties, the Company may invest in (i) a wide variety of retail properties or other property and tenant types, (ii) mortgages, participating or convertible mortgages, deeds of trust, mortgage residual interests and other types of real estate interests, or (iii) securities of other REITs, other entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities. For example, the Company from time to time has made investments in mortgage loans or held mortgages on properties the Company sold and has made structured finance investments (as discussed above), which are typically loans secured by a pledge of ownership interests in the borrowers (or their subsidiaries) that own the underlying real estate.

Financing Strategy

The Company's financing objective is to manage its capital structure effectively in order to provide sufficient capital to execute its operating strategies while servicing its debt requirements and providing value to its stockholders. The Company generally utilizes debt and equity security offerings, bank borrowings, the sale of properties, and to a lesser extent, internally generated funds to meet its capital needs.

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The Company typically funds its short-term liquidity requirements including investments in additional retail properties with cash from its \$300,000,000 unsecured revolving credit facility (Credit Facility). As of December 31, 2006, \$28,000,000 was outstanding and approximately \$272,000,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling \$5,159,000.

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For the year ended December 31, 2006, the Company's ratio of total indebtedness to total gross assets (before accumulated depreciation) was approximately 41 percent and the secured indebtedness to total gross assets was approximately three percent. The total debt to total market capitalization was approximately 35 percent. Certain financial agreements to which the Company is a party contain covenants that limit the Company's ability to incur debt under certain circumstances.

The Company anticipates it will be able to obtain additional financing for short-term and long-term liquidity requirements as further described in *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity*. However, there can be no assurance that additional financing or capital will be available, or that the terms will be acceptable or advantageous to the Company.

The organizational documents of the Company do not limit the absolute amount or percentage of indebtedness that the Company may incur. Additionally, the Company may change its financing strategy at any time. The Company has not engaged in trading, underwriting or agency distribution or sale of securities of other issues and does not intend to do so.

Strategies and Policy Changes

Any of the Company's strategies or policies described above may be changed at any time by the Company without notice to or a vote of the Company's stockholders.

Item 1A. Risk Factors.

Carefully consider the following risks and all of the other information set forth in this Annual Report on Form 10-K, including the consolidated financial statements and the notes thereto. If any of the events or developments described below were actually to occur, the Company's business, financial condition or results of operations could be adversely affected.

Loss of revenues from tenants would reduce the Company's cash flow.

The Company's five largest tenants accounted for an aggregate of approximately 23 percent of the Company's annual base rent as of December 31, 2006. The default, financial distress or bankruptcy of one or more of the Company's tenants could cause substantial vacancies among the Company's Investment Portfolio. Vacancies reduce the Company's revenues until the Company is able to re-lease the affected properties and could decrease the ultimate sale value of each such vacant property. Upon the expiration of the leases that are currently in place, the Company may not be able to re-lease a vacant property at a comparable lease rate or without incurring additional expenditures in connection with such re-leasing.

A significant portion of the source of the Company's annual base rent is heavily concentrated in a specific industry classification and in specific geographic locations.

As of December 31, 2006, an aggregate of approximately 33 percent of the Company's annual base rent is generated from two retail lines of trade, convenience stores and restaurants, each representing more than 10 percent. In addition, as of December 31, 2006, an aggregate of approximately 36 percent of the Company's annual base rent is generated from properties in Texas and Florida, each representing more than 10 percent. Any financial hardship and/or changes in these industries or states could have an adverse effect on the Company's financial results.

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There are a number of risks inherent in owning real estate and indirect interests in real estate.

Factors beyond the Company's control affect the Company's performance and value. Changes in national, regional and local economic and market conditions may affect the Company's economic performance and the value of the Company's real estate assets. Local real estate market conditions may include excess supply and intense competition for tenants, including competition based on rental rates and attractiveness and location of the property.

In addition, other factors may adversely affect the performance and value of the Company's properties, including (i) changes in laws and governmental regulations, including those governing usage, zoning and taxes; (ii) changes in interest rates; and (iii) the availability of financing.

The Company's real estate investments are illiquid.

Because real estate investments are relatively illiquid, the Company's ability to adjust the portfolio promptly in response to economic or other conditions is limited. Certain significant expenditures generally do not change in response to economic or other conditions, including: (i) debt service (if any), (ii) real estate taxes, and (iii) operating and maintenance costs. This combination of variable revenue and relatively fixed expenditures may result, under certain market conditions, in reduced income from investment. Such reduction in investment income could have an adverse effect on the Company's financial condition.

The Company may be subject to unknown environmental liabilities.

The Company may acquire a property that contains some level of contamination or potential contamination exists, subject to a determination of the level of risk and potential cost of remediation. Investments in real property create a potential for substantial environmental liability on the part of the owner of such property from the presence or discharge of hazardous substances on the property, regardless of fault. It is the Company's policy, as a part of its acquisition due diligence process, generally to obtain an environmental site assessment for each property. In such cases that the Company intends to acquire real estate where contamination or potential contamination exists, the Company generally requires the seller or tenant to (i) remediate the problem, (ii) indemnify the Company for environmental liabilities, or (iii) agree to other arrangements deemed appropriate by the Company to address environmental conditions at the property.

The Company has 25 Investment Properties currently under some level of environmental remediation. In general, the seller, the tenant or an adjacent land owner is responsible for the cost of the environmental remediation for each of these Investment Properties. In the event of a bankruptcy or other inability on the part of these parties to cover these costs, the Company may have to cover the costs of remediation, fines or other environmental liabilities at these and other properties. The Company may also own properties where required remediation has not begun or adverse environmental conditions have not yet been detected. This may require remediation or otherwise subject the Company to liability. The Company cannot assure that (i) it will not be required to undertake or pay for removal or remediation of any contamination of the properties currently or previously owned by the Company, (ii) the Company will not be subject to fines by governmental authorities or litigation, or (iii) the costs of such removal, remediation fines or litigation would not be material.

The Company may not be able to successfully execute its acquisition or development strategies.

The Company cannot assure that it will be able to implement its investment strategies successfully. Additionally, the Company cannot assure that its property portfolio will expand at all, or if it will

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expand at any specified rate or to any specified size. In addition, investment in additional real estate assets is subject to a number of risks. Because the Company expects to invest in markets other than the ones in which its current properties are located or which may be leased to tenants other than those to which the Company has historically leased properties, the Company will also be subject to the risks associated with investment in new markets or with new tenants that may be relatively unfamiliar to the Company's management team.

The Company's development activities are subject to without limitation, risks relating to the availability and timely receipt of zoning and other regulatory approvals, the cost and timely completion of construction (including risks from factors beyond the Company's control, such as weather or labor conditions or material shortages), the risk of finding tenants for the properties and the ability to obtain both construction and permanent financing on favorable terms. These risks could result in substantial unanticipated delays or expenses and, under certain circumstances, could prevent completion of development activities once undertaken or provide a tenant the opportunity to terminate a lease. Any of these situations delay or eliminate proceeds or cash flows the Company expects from these projects, which could have an adverse effect on the Company's financial condition.

The Company may not be able to dispose of properties consistent with its operating strategy.

The Company may be unable to sell properties targeted for disposition (including its Inventory Properties) at a profit if interest rates increase, or adverse market conditions exist, thereby, rendering the Company unable to sell these properties.

A change in the assumptions used to determine the value of mortgage residual interests could adversely affect the Company's financial position.

As of December 31, 2006, the Residuals had a carrying value of \$31,512,000. The value of these Residuals is based on delinquency, loan loss, prepayment and interest rate assumptions made by the Company to determine their value. If actual experience differs materially from these assumptions, the actual future cash flow could be less than expected and the value of the Residuals, as well as the Company's earnings, could decline.

The Company may suffer a loss in the event of a default or bankruptcy of a structured finance loan borrower.

If a borrower defaults on a structured finance loan and does not have sufficient assets to satisfy the loan, the Company may suffer a loss of principal and interest. In the event of the bankruptcy of a borrower, the Company may not be able to recover against all of the assets of the borrower, or the assets of the borrower may not be sufficient to satisfy the balance due on the loan. In addition, certain of the Company's loans may be subordinate to other debt of a borrower. The structured finance agreements are typically loans secured by a borrower's pledge of its ownership interests in the entity that owns the real estate. These agreements are typically subordinated to senior loans secured by first mortgages encumbering the underlying real estate. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans. As of December 31, 2006, the structured finance investments had an outstanding principal balance of \$13,917,000. If a borrower defaults on the debt senior to the Company's loan, or in the event of the bankruptcy of a borrower, the Company's loan will be satisfied only after the borrower's senior creditors' claims are satisfied. Where debt senior to the Company's loans exists, the presence of intercreditor arrangements may limit the Company's ability to amend loan documents, assign the loans, accept prepayments, exercise remedies and control decisions made in bankruptcy proceedings relating to borrowers.

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Bankruptcy proceedings and litigation can significantly increase the time needed for the Company to acquire underlying collateral in the event of a default, during which time the collateral may decline in value. In addition, there are significant costs and delays associated with the foreclosure process.

Certain provisions of the leases or structured finance loan agreements may be unenforceable.

The Company's rights and obligations with respect to its leases or structured finance loans are governed by written agreements. A court could determine that one or more provisions of an agreement are unenforceable, such as a particular remedy, a loan prepayment provision or a provision governing the Company's security interest in the underlying collateral of a borrower. The Company could be adversely impacted if this were to happen with respect to an asset or group of assets.

Property ownership through joint ventures and partnerships could limit the Company's control of those investments.

Joint ventures or partnerships involve risks not otherwise present for direct investments by the Company. It is possible that the Company's co-venturers or partners may have different interests or goals than the Company at any time and they may take actions contrary to the Company's requests, policies or objectives, including the Company's policy with respect to maintaining its qualification as a REIT. Other risks of joint venture investments include impasses on decisions, because no single co-venturer or partner has full control over the joint venture or partnership.

Competition with numerous other REITs, commercial developers, real estate limited partnerships and other investors may impede the Company's ability to grow.

The Company may not be in a position or have the opportunity in the future to make suitable property acquisitions on advantageous terms due to competition for such properties with others engaged in real estate investment activities. The Company's inability to successfully acquire new properties may affect the Company's ability to achieve anticipated return on investment, which could have an adverse effect on its results of operations.

Uninsured losses may adversely affect the Company's ability to pay outstanding indebtedness.

The Company's properties are generally covered by comprehensive liability, fire, flood, extended coverage and business interruption insurance. The Company believes that the insurance carried on its properties is adequate in accordance with industry standards. There are, however, types of losses (such as from hurricanes, wars or earthquakes) which may be uninsurable, or the cost of insuring against these losses may not be economically justifiable. If an uninsured loss occurs, the Company could lose both the invested capital in and anticipated revenues from the property. In that event, the Company's cash flow could be reduced.

Terrorist attacks, such as the attacks that occurred in New York City and Washington, D.C., on September 11, 2001, and other acts of violence or war may affect the markets in which the Company operates and the Company's results of operations.

Terrorist attacks may negatively affect the Company's operations. There can be no assurance that there will not be further terrorist attacks against the United States or United States businesses. These attacks may directly impact the Company's physical facilities or the businesses of the Company's tenants.

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Also, the United States has been engaged in armed conflict, which could have an impact on the Company's tenants. The consequences of armed conflict are unpredictable, and the Company may not be able to foresee events that could have an adverse effect on its business.

More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the United States and worldwide financial markets and economies. They also could result in, or cause a deepening of, economic recession in the United States or abroad. Any of these occurrences could have a significant adverse impact on the Company's financial condition or results of operations.

Vacant properties or bankrupt tenants could adversely affect the Company.

As of December 31, 2006, the Company owned nine vacant, unleased Investment Properties, which accounted for approximately two percent of the total gross leasable area of the Company's Investment Portfolio and four unleased land parcels. The Company is actively marketing these properties for sale or lease but may not be able to sell or lease these properties on favorable terms or at all. The lost revenues and increased property expenses resulting from the rejection by any bankrupt tenant of any of their respective leases with the Company could have a material adverse effect on the liquidity and results of operations of the Company if the Company is unable to re-lease the Investment Properties at comparable rental rates and in a timely manner. Less than one percent of the total gross leasable area of the Company's Investment Portfolio is leased to one tenant that has filed a voluntary petition for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. As a result, the tenant has the right to reject or affirm its lease with the Company.

The amount of debt the Company has and the restrictions imposed by that debt could adversely affect the Company's business and financial condition.

As of December 31, 2006, the Company had total mortgage debt and secured notes payable outstanding of approximately \$60,392,000, total unsecured notes payable of \$662,304,000 and \$28,000,000 outstanding on the Credit Facility. The Company's organizational documents do not limit the level or amount of debt that it may incur. If the Company incurs additional indebtedness and permits a higher degree of leverage, debt service requirements would increase and could adversely affect the Company's financial condition and results of operations, as well as the Company's ability to pay principal and interest on the outstanding indebtedness or dividends to its stockholders. In addition, increased leverage could increase the risk that the Company may default on its debt obligations. The Credit Facility contains financial covenants that could limit the amount of distributions to the Company's common and preferred stockholders.

The amount of debt outstanding at any time could have important consequences to the Company's stockholders. For example, it could:

require the Company to dedicate a substantial portion of its cash flow from operations to payments on Company debt, thereby reducing funds available for operations, real estate investments and other appropriate business opportunities that may arise in the future;

limit the Company's ability to obtain any additional financing it may need in the future for working capital, debt refinancing, capital expenditures, real estate investments, development or other general corporate purposes;

make it difficult to satisfy the Company's debt service requirements;

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limit the Company's ability to pay dividends on its outstanding common and preferred stock;

require the Company to dedicate increased amounts of cash flow from operations to payments on its variable rate, unhedged debt if interest rates rise;

limit the Company's flexibility in planning for, or reacting to, changes in its business and the factors that affect the profitability of its business; and

limit the Company's flexibility in conducting its business, which may place the Company at a disadvantage compared to competitors with less debt or debt with less restrictive terms.

The Company's ability to make scheduled payments of principal or interest on its debt, or to refinance such debt will depend primarily on its future performance, which to a certain extent is subject to the creditworthiness of its tenants, competition, as well as economic, financial, and other factors beyond its control. There can be no assurance that the Company's business will continue to generate sufficient cash flow from operations in the future to service its debt or meet its other cash needs. If the Company is unable to generate this cash flow from its business, it may be required to refinance all or a portion of its existing debt, sell assets or obtain additional financing to meet its debt obligations and other cash needs.

The Company cannot assure you that any such refinancing, sale of assets or additional financing would be possible on terms and conditions, including but not limited to the interest rate, which the Company would find acceptable.

The Company is obligated to comply with financial and other covenants in its debt that could restrict its operating activities, and the failure to comply with such covenants could result in defaults that accelerate the payment under its debt.

The Company's unsecured debt contains various restrictive covenants which include, among others, provisions restricting the Company's ability to:

incur or guarantee additional debt;

make certain distributions, investments and other restricted payments, including dividend payments on its outstanding common and preferred stock;

limit the ability of restricted subsidiaries to make payments to the Company;

enter into transactions with certain affiliates;

create certain liens; and

consolidate, merge or sell the Company's assets.

The Company's secured debt generally contains customary covenants, including, among others, provisions:

relating to the maintenance of the property securing the debt;

restricting its ability to sell, assign or further encumber the properties securing the debt;

restricting its ability to incur additional debt;

restricting its ability to amend or modify existing leases; and

relating to certain prepayment restrictions.

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The Company's ability to meet some of the covenants in its debt, including covenants related to the condition of the property or payment of real estate taxes, may be dependent on the performance by the Company's tenants under their leases.

In addition, certain covenants in the Company's debt, including its Credit Facility, require the Company and its subsidiaries, among other things, to:

maintain certain maximum leverage ratios;

maintain certain minimum interest and debt service coverage ratios;

limit dividends declared and paid to the Company's common and preferred stockholders; and

limit investments in certain types of assets.

The Company's failure to qualify as a real estate investment trust for federal income tax purposes could result in significant tax liability.

The Company intends to operate in a manner that will allow the Company to continue to qualify as a real estate investment trust (REIT). The Company believes it has been organized as, and its past and present operations qualify the Company as a REIT. However, the IRS could successfully assert that the Company is not qualified as such. In addition, the Company may not remain qualified as a REIT in the future. Qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which there are only limited judicial or administrative interpretations and involves the determination of various factual matters and circumstances not entirely within the Company's control.

If the Company fails to qualify as a REIT, it would not be allowed a deduction for dividends paid to stockholders in computing taxable income and would become subject to federal income tax at regular corporate rates. In this event, the Company could be subject to potentially significant tax liabilities. Unless entitled to relief under certain statutory provisions, the Company would also be disqualified from treatment as a REIT for the four taxable years following the year during which the qualification was lost. Even if the Company maintains its REIT status, the Company may be subject to certain federal, state and local taxes on its income and property.

Compliance with REIT requirements, including distribution requirements, may limit the Company's flexibility and negatively affect the Company's operating decisions.

To maintain its status as a REIT for U.S. federal income tax purposes, the Company must meet certain requirements, on an on-going basis, including requirements regarding its sources of income, the nature and diversification of its assets, the amounts the Company distributes to its stockholders and the ownership of its shares. The Company may also be required to make distributions to its stockholders when it does not have funds readily available for distribution or at times when the Company's funds are otherwise needed to fund capital expenditures or to fund debt service requirements. The Company generally will not be subject to federal income taxes on amounts distributed to stockholders, providing it distributes 100 percent of its REIT taxable income and meets certain other requirements for qualifying as a REIT. For each of the years in the three-year period ended December 31, 2006, the Company believes it has qualified as a REIT. Notwithstanding the Company's qualification for taxation as a REIT, the Company is subject to certain state taxes on its income and real estate.

Item 1B. Unresolved Staff Comments.

None.

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As of December 31, 2006, the Company owned 710 Investment Properties with an aggregate gross leasable area of 9,341,000 square feet, located in 44 states. Approximately 98 percent of the gross leasable area was leased at December 31, 2006. Reference is made to the Schedule of Real Estate and Accumulated Depreciation and Amortization filed with this report for a listing of the Company's Investment Properties and their respective carrying costs.

During 2006, the Company disposed of the properties leased to the United States of America which had accounted for more than 10 percent of the Company's total rental income in 2005. As of December 31, 2006, the Company does not have any one tenant that accounts for ten percent or more of its rental income.

The following table summarizes the Company's Investment Properties as of December 31, 2006 (dollars in thousands):

	Size ⁽¹⁾			Cost ⁽²⁾		
	High	Low	Average	High	Low	Average
Land	2,223,000	7,000	112,000	\$ 10,197	\$ 25	\$ 1,001
Building	135,000	1,000	14,000	13,877	44	1,352

⁽¹⁾ Approximate square feet.

⁽²⁾ Costs vary depending upon size and local demographic factors.

In connection with the development of 11 Investment Properties, the Company has agreed to fund construction commitments (including land costs) of \$35,020,000, of which \$17,845,000 has been funded as of December 31, 2006.

Leases. Although there are variations in the specific terms of the leases, the following is a summary of the general structure of the Company's leases. Generally, the leases of the Investment Properties owned by the Company provide for initial terms of 10 to 20 years. As of December 31, 2006, the weighted average remaining lease term was approximately 12 years. The Investment Properties are generally leased under net leases pursuant to which the tenant typically will bear responsibility for substantially all property costs and expenses associated with ongoing maintenance and operation, including utilities, property taxes and insurance. In addition, the majority of the Company's leases provide that the tenant is responsible for roof and structural repairs. The leases of the Investment Properties provide for annual base rental payments (payable in monthly installments) ranging from \$11,000 to \$1,635,000 (average of \$210,000). Tenant leases generally provide for limited increases in rent as a result of fixed increases, increases in the consumer price index, and/or increases in the tenant's sales volume.

Generally, the Investment Property leases provide the tenant with one or more multi-year renewal options subject to generally the same terms and conditions as the initial lease. Some of the leases also provide that in the event the Company wishes to sell the Investment Property subject to that lease, the Company first must offer the lessee the right to purchase the Investment Property on the same terms and conditions as any offer which the Company intends to accept for the sale of the Investment Property.

Certain of the Company's Investment Properties have leases that provide the tenant with a purchase option to acquire the Investment Property from the Company. The purchase price calculations are generally stated in the lease agreement or are based on current market value.

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The following table summarizes the lease expirations of the Company's Investment Portfolio as of December 31, 2006 (dollars in thousands):

			Gross				Gross
	% of	# of	Leasable		% of	# of	Leasable
	Total ⁽¹⁾	Properties	Area ⁽²⁾		Total ⁽¹⁾	Properties	Area ⁽²⁾
2007	1.2%	13	206,000	2013	5.6%	30	690,000
2008	1.8%	22	406,000	2014	7.3%	39	591,000
2009	2.6%	25	490,000	2015	4.6%	22	621,000
2010	3.9%	36	383,000	2016	4.2%	22	508,000
2011	3.8%	23	439,000	2017	7.2%	28	808,000
2012	4.6%	30	531,000	Thereafter	53.2%	407	3,500,000

⁽¹⁾ Based on annualized base rent for all leases in place as of December 31, 2006.

⁽²⁾ Approximate square feet.

The following table summarizes the diversification of trade of the Company's Investment Portfolio based on the top 10 lines of trade as of December 31, 2006 (dollars in thousands):

Top 10 Lines of Trade	2006 ⁽¹⁾	2005 ⁽¹⁾	2004 ⁽¹⁾
1. Convenience Stores	16.3%	12.1%	0.7%
2. Restaurants - Full Service	12.1%	6.6%	6.7%
3. Drug Stores	8.3%	10.0%	11.5%
4. Sporting Goods	7.3%	7.4%	7.8%
5. Books	5.7%	5.8%	6.9%
6. Grocery	5.7%	6.3%	7.7%
7. Consumer Electronics	5.6%	5.9%	7.1%
8. Restaurants - Limited Service	4.7%	3.0%	3.1%
9. Furniture	4.2%	4.7%	5.0%
10. Office Supplies	4.1%	4.4%	5.2%
Other	26.0%	33.8%	38.3%
	100.0%	100.0%	100.0%