NATIONAL RETAIL PROPERTIES, INC.
Form 10-Q
August 03, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended June 30, 2012
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

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 x No ¨

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

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

108,190,322 shares of common stock, $0.01 par value, outstanding as of July 27, 2012.

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Item 1. Financial Statements
NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)

	June 30, 2012	December 31, 2011
ASSETS	(unaudited)	
Real estate portfolio:		
Accounted for using the operating method, net of accumulated depreciation and amortization	$3,485,819	$3,225,119
Accounted for using the direct financing method	24,954	26,518
Real estate held for sale	40,351	36,105
Investment in unconsolidated affiliate	4,283	4,358
Mortgages, notes and accrued interest receivable, net of allowance	36,740	33,428
Commercial mortgage residual interests	12,395	15,299
Cash and cash equivalents	2,907	2,082
Receivables, net of allowance of $1,113 and $1,403, respectively	1,456	2,149
Accrued rental income, net of allowance of $3,086 and $4,870, respectively	25,330	25,187
Debt costs, net of accumulated amortization of $16,986 and $15,332, respectively	9,148	10,802
Other assets	60,607	53,382
Total assets	$3,703,990	$3,434,429
LIABILITIES AND EQUITY		
Liabilities:		
Line of credit payable	$142,600	$65,600
Mortgages payable, including unamortized premium of $216 and $0, respectively	29,341	23,171
Notes payable – convertible, net of unamortized discount of $4,256 and $6,363, respectively	357,479	355,371
Notes payable, net of unamortized discount of $4,763 and $5,033, respectively	845,237	894,967
Accrued interest payable	14,440	15,108
Other liabilities	87,483	76,336
Total liabilities	1,476,580	1,430,553
Equity:		
Stockholders' equity:		
Preferred stock, $0.01 par value. Authorized 15,000,000 shares		
Series D, 11,500,000 depositary shares issued and outstanding, at stated liquidation value of $25 per share	287,500	—
Series C, 3,680,000 depositary shares issued and outstanding, at stated liquidation value of $25 per share	—	92,000
Common stock, $0.01 par value. Authorized 190,000,000 shares; 107,449,071 and 104,754,859 shares issued and outstanding, respectively	1,076	1,049
	—	—

Excess stock, $0.01 par value. Authorized 205,000,000 shares; none issued or outstanding		
Capital in excess of par value	2,015,121	1,958,225
Retained earnings (loss)	(74,123)	(44,946)
Accumulated other comprehensive income (loss)	(3,504)	(3,830)
Total stockholders' equity of NNN	2,226,070	2,002,498
Noncontrolling interests	1,340	1,378
Total equity	2,227,410	2,003,876
Total liabilities and equity	$3,703,990	$3,434,429

See accompanying notes to consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands, except per share data)
(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Rental income from operating leases	$77,927	$57,578	$151,494	$114,526
Earned income from direct financing leases	618	693	1,246	1,433
Percentage rent	221	132	332	247
Real estate expense reimbursement from tenants	2,505	2,142	5,337	4,422
Interest and other income from real estate transactions	764	543	1,470	1,164
Interest income on commercial mortgage residual interests	716	777	1,471	1,544
	82,751	61,865	161,350	123,336
Retail operations:				
Revenues	7,784	12,450	19,008	21,300
Operating expenses	(7,481)	(11,760)	(18,543)	(20,612)
Net	303	690	465	688
Operating expenses:				
General and administrative	7,024	6,568	14,627	13,226
Real estate	4,025	3,919	8,597	7,573
Depreciation and amortization	19,032	13,765	37,140	27,184
Impairment – commercial mortgage residual interests valuation	2,718	267	2,718	396
	32,799	24,519	63,082	48,379
Earnings from operations	50,255	38,036	98,733	75,645
Other expenses (revenues):				
Interest and other income	(361)	(283)	(719)	(625)
Interest expense	19,394	17,512	39,039	35,174
	19,033	17,229	38,320	34,549
Earnings from continuing operations before income tax expense and equity in earnings of unconsolidated affiliate	31,222	20,807	60,413	41,096
Income tax expense	(140)	(210)	(236)	(191)
Equity in earnings of unconsolidated affiliate	155	104	305	213
Earnings from continuing operations	31,237	20,701	60,482	41,118
Earnings from discontinued operations, net of income tax expense (Note 7)	2,239	568	2,817	1,005
Earnings including noncontrolling interests	33,476	21,269	63,299	42,123
Loss (earnings) attributable to noncontrolling interests:				
Continuing operations	34	67	55	93
Discontinued operations	(5)	(33)	(17)	(93)
	29	34	38	—
Net earnings attributable to NNN	$33,505	$21,303	$63,337	$42,123

See accompanying notes to consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in thousands, except per share data)
(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net earnings attributable to NNN	$33,505	$21,303	$63,337	$42,123
Series C preferred stock dividends	—	(1,696)	(1,979)	(3,392)
Series D preferred stock dividends	(5,926)	—	(5,926)	—
Excess of redemption value over carrying value of preferred shares redeemed	—	—	(3,098)	—
Net earnings attributable to common stockholders	$27,579	$19,607	$52,334	$38,731
Net earnings per share of common stock:				
Basic:				
Continuing operations	$0.24	$0.23	$0.47	$0.46
Discontinued operations	0.02	—	0.02	—
Net earnings	$0.26	$0.23	$0.49	$0.46
Diluted:				
Continuing operations	$0.24	$0.23	$0.46	$0.46
Discontinued operations	0.02	—	0.03	—
Net earnings	$0.26	$0.23	$0.49	$0.46
Weighted average number of common shares outstanding:				
Basic	105,992,014	84,409,788	105,417,595	83,771,728
Diluted	107,458,993	84,725,968	106,844,080	84,271,352
Other comprehensive income:				
Net earnings attributable to NNN	$33,505	$21,303	$63,337	$42,123
Amortization of interest rate hedges	58	(42)	114	(85)
Fair value treasury locks	—	(6,881)	—	(5,218)
Unrealized gain - commercial mortgage residual interests	213	539	213	599
Stock value adjustments	—	(7)	(1)	(26)
Comprehensive income attributable to NNN	$33,776	$14,912	$63,663	$37,393

See accompanying notes to consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Earnings including noncontrolling interests	$63,299	$42,123
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Performance incentive plan expense	3,889	3,297
Depreciation and amortization	37,383	27,678
Impairment losses and other charges	380	—
Impairment – commercial mortgage residual interests valuation	2,718	396
Amortization of notes payable discount	2,378	3,335
Amortization of deferred interest rate hedges	114	(85)
Equity in earnings of unconsolidated affiliate	(305)	(213)
Distributions received from unconsolidated affiliate	362	286
Gain on disposition of real estate portfolio	(2,752)	(132)
Gain on note receivable and property foreclosure	(198)	—
Other	—	82
Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Additions to held for sale real estate	(4,472)	(212)
Proceeds from disposition of held for sale real estate	—	1,058
Decrease in real estate leased to others using the direct financing method	807	802
Increase in work in process	(889)	(575)
Increase in mortgages, notes and accrued interest receivable	(345)	(88)
Decrease in receivables	633	998
Decrease (increase) in commercial mortgage residual interests	399	(127)
Decrease (increase) in accrued rental income	(218)	149
Decrease (increase) in other assets	487	(19)
Decrease in accrued interest payable	(668)	(57)
Decrease in other liabilities	(3,490)	(1,631)
Increase in current tax liability	255	794
Net cash provided by operating activities	99,767	77,859
Cash flows from investing activities:		
Proceeds from the disposition of real estate, Investment Portfolio	12,024	807
Additions to real estate:		
Accounted for using the operating method	(287,923)	(111,673)
Accounted for using the direct financing method	—	(1,747)
Increase in mortgages and notes receivable	(7,861)	(4,090)
Principal payments on mortgages and notes receivable	3,085	2,107
Payment of lease costs	(1,154)	(672)
Other	557	402
Net cash used in investing activities	(281,272)	(114,866)

See accompanying notes to consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2012	2011
Cash flows from financing activities:		
Proceeds from line of credit payable	$614,400	$328,800
Repayment of line of credit payable	(537,400)	(270,600)
Payment of interest rate hedge	—	(5,300)
Repayment of notes payable	(50,000)	—
Payment of debt costs	—	(2,920)
Repayment of mortgages payable	(680)	(541)
Proceeds from issuance of common stock	60,319	56,391
Proceeds from issuance of preferred stock	287,500	—
Redemption of preferred stock	(92,000)	—
Payment of Series C preferred stock dividends	(1,979)	(3,392)
Payment of Series D preferred stock dividends	(5,926)	—
Payment of common stock dividends	(81,511)	(63,887)
Noncontrolling interest distributions	—	(45)
Noncontrolling interest contributions	—	41
Stock issuance costs	(10,393)	—
Net cash provided by financing activities	182,330	38,547
Net increase in cash and cash equivalents	825	1,540
Cash and cash equivalents at beginning of year	2,082	2,048
Cash and cash equivalents at end of year	$2,907	$3,588
Supplemental disclosure of cash flow information:		
Interest paid, net of amount capitalized	$38,800	$33,230
Taxes paid (received)	$78	$(487)
Supplemental disclosure of noncash investing and financing activities:		
Issued 396,577 and 139,351 shares of restricted and unrestricted common stock in 2012 and 2011, respectively, pursuant to NNN's performance incentive plan	$8,576	$3,407
Issued 8,389 and 4,623 shares of common stock in 2012 and 2011, respectively, to directors pursuant to NNN's performance incentive plan	$229	$118
Issued 10,247 and 13,879 shares of common stock in 2012 and 2011, respectively, pursuant to NNN's Deferred Director Fee Plan	$149	$245
Surrender of 4,178 and of 4,494 shares of restricted common stock in 2012 and 2011, respectively	$98	$94
Change in other comprehensive income	$(326)	$(4,730)
Change in lease classification (direct financing lease to operating lease)	$757	$2,243
Mortgage payable assumed in connection with real estate transaction	$6,634	$—
Real estate acquired in connection with mortgage receivable foreclosure	$490	$—
Real estate received in note receivable foreclosure	$1,595	$—

See accompanying notes to consolidated financial statements.

NATIONAL RETAIL PROPERTIES, INC.
and SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2012
(unaudited)

Note 1 – Organization and Summary of Significant Accounting Policies:
Organization and Nature of Business – National Retail Properties, Inc., a Maryland corporation, is a fully integrated real estate investment trust ("REIT") formed in 1984. The term "NNN" or the "Company" refers to National Retail Properties, Inc. and all of its consolidated subsidiaries. NNN has elected to treat certain subsidiaries as taxable REIT subsidiaries. These taxable subsidiaries and their majority owned and controlled subsidiaries are collectively referred to as the "TRS."
NNN's assets include: real estate assets, mortgages and notes receivable, and commercial mortgage residual interests. NNN acquires, owns, invests in and develops properties that are leased primarily to retail tenants under long-term net leases and primarily held for investment ("Properties" or "Property Portfolio").

	June 30, 2012
Property Portfolio:	
Total properties	1,506
Gross leasable area (square feet)	17,798,000
States	47

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America. The unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. Operating results for the quarter and six months ended June 30, 2012, may not be indicative of the results that may be expected for the year ending December 31, 2012. Amounts as of December 31, 2011, included in the condensed consolidated financial statements have been derived from the audited consolidated financial statements as of that date. The unaudited condensed consolidated financial statements, included herein, should be read in conjunction with the consolidated financial statements and notes thereto as well as Management's Discussion and Analysis of Financial Condition and Results of Operations in NNN's Form 10-K for the year ended December 31, 2011.
Principles of Consolidation – NNN's condensed consolidated financial statements include the accounts of each of the respective majority owned and controlled affiliates, including transactions whereby NNN has been determined to be the primary beneficiary in accordance with the Financial Accounting Standards Board ("FASB") guidance included in Consolidation. All significant intercompany account balances and transactions have been eliminated. NNN applies the equity method of accounting to investments in partnerships and joint ventures that are not subject to control by NNN due to the significance of rights held by other parties.
Real Estate Portfolio – NNN records the acquisition of real estate which is not subject to a lease at cost, including acquisition and closing costs. The cost of properties developed by NNN includes direct and indirect costs of construction, property taxes, interest and other miscellaneous costs incurred during the development period until the project is substantially complete and available for occupancy. During the quarter and six months ended June 30, 2012, NNN recorded $436,000 and $868,000, respectively, in capitalized interest and recorded $247,000 and $569,000 in capitalized interest during the same periods in 2011, respectively.
Purchase Accounting for Acquisition of Real Estate Subject to a Lease – In accordance with the FASB guidance on business combinations, the fair value of the real estate acquired with in-place leases is allocated to the acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, value of in-place leases and value of tenant relationships, based in each case on their relative fair values. Acquisition costs incurred in connection with a business

combination are expensed when incurred.

The fair value of the tangible assets of an acquired leased property is determined by valuing the property as if it were vacant, and the "as-if-vacant" value is then allocated to land, building and tenant improvements based on the determination of the fair values of these assets. The as-if-vacant fair value of a property is provided to management by a qualified appraiser.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, above-market and below-market in-place lease values are recorded as other assets or liabilities based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases, and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining term of the lease, including the probability of renewal periods. The capitalized above-market lease values are amortized as a reduction of rental income over the remaining terms of the respective leases. The capitalized below-market lease values are amortized as an increase to rental income over the initial term unless the Company believes that it is likely that the tenant would renew the option whereby the Company would amortize the value attributable to the renewal over the renewal period.

The aggregate value of other acquired intangible assets, consisting of in-place leases, is measured by the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as-if-vacant, determined as set forth above. The value of in-place leases exclusive of the value of above-market and below-market in-place leases is amortized to expense over the remaining non-cancelable periods of the respective leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off. The value of tenant relationships is reviewed on individual transactions to determine if future value was derived from the acquisition.

Intangible assets and liabilities consisted of the following as of (in thousands):

	June 30, 2012	December 31, 2011
Intangible lease assets (included in Other assets):		
Value of above market in-place leases, net	$6,999	$5,907
Value of in-place leases, net	38,342	31,970
Intangible lease liabilities (included in Other liabilities):		
Value of below market in-place leases, net	25,377	23,367

Investment in an Unconsolidated Affiliate – NNN accounts for its investment in an unconsolidated affiliate under the equity method of accounting. In September 2007, NNN entered into a joint venture, NNN Retail Properties Fund I LLC (the "NNN Crow JV") with an affiliate of Crow Holdings Realty Partners IV, L.P., which is accounted for under the equity method of accounting.

Cash and Cash Equivalents - NNN considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash and money market accounts. Cash equivalents are stated at cost plus accrued interest, which approximates fair value.

Cash accounts maintained on behalf of NNN in demand deposits at commercial banks and money market funds may exceed federally insured levels; however, NNN has not experienced any losses in such accounts.

Valuation of Receivables – NNN estimates the collectibility of its accounts receivable related to rents, expense reimbursements and other revenues. NNN analyzes accounts receivable and historical bad debt levels, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. In addition, tenants in bankruptcy are analyzed and estimates are made in connection with the expected recovery of pre-petition and post-petition claims.

Earnings Per Share – Earnings per share have been computed pursuant to the FASB guidance included in Earnings Per Share. Effective January 1, 2009, the guidance requires classification of the Company's unvested restricted share units which contain rights to receive nonforfeitable dividends, as participating securities requiring the two-class method of computing earnings per share. Under the two-class method, earnings per common share are computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities based on the weighted average shares outstanding during the period.

The following table is a reconciliation of the numerator and denominator used in the computation of basic and diluted earnings per common share using the two-class method (dollars in thousands):

	Quarter Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Basic and Diluted Earnings:				
Net earnings attributable to NNN	$33,505	$21,303	$63,337	$42,123
Less: Series C preferred stock dividends	—	(1,696)	(1,979)	(3,392)
Less: Series D preferred stock dividends	(5,926)	—	(5,926)	—
Less: Excess of redemption value over carrying value of preferred shares redeemed	—	—	(3,098)	—
Net earnings available to NNN's common stockholders	27,579	19,607	52,334	38,731
Less: Earnings attributable to unvested restricted shares	(180)	(152)	(312)	(286)
Net earnings used in basic earnings per share	27,399	19,455	52,022	38,445
Reallocated undistributed income (loss)	—	—	—	—
Net earnings used in diluted earnings per share	$27,399	$19,455	$52,022	$38,445
Basic and Diluted Weighted Average Shares Outstanding:				
Weighted average number of shares outstanding	107,006,399	85,309,082	106,321,014	84,635,929
Less: Unvested restricted stock	(696,804)	(647,468)	(631,329)	(612,375)
Less: Contingent shares	(317,581)	(251,826)	(272,090)	(251,826)
Weighted average number of shares outstanding used in basic earnings per share	105,992,014	84,409,788	105,417,595	83,771,728
Effects of dilutive securities:				
Contingent shares	—	—	12,735	—
Convertible debt	1,310,445	160,006	1,259,319	346,699
Common stock options	1,419	3,162	1,855	3,305
Directors' deferred fee plan	155,115	153,012	152,576	149,620
Weighted average number of shares outstanding used in diluted earnings per share	107,458,993	84,725,968	106,844,080	84,271,352

For the quarter and six months ended June 30, 2011, the potential dilutive shares related to certain convertible notes payable were not included in computing earnings per common share because their effects would be antidilutive.

Fair Value Measurement – NNN's estimates of fair value of financial and non-financial assets and liabilities are based on the framework established in the fair value accounting guidance. The framework specifies a hierarchy of valuation inputs which was established to increase consistency, clarity and comparability in fair value measurements and related disclosures. The guidance describes a fair value hierarchy based upon three levels of inputs that may be used to measure fair value, two of which are considered observable and one that is considered unobservable. The following describes the three levels:

- Level 1 – Valuation is based upon quoted prices in active markets for identical assets or liabilities.
- Level 2 – Valuation is based upon inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include option pricing models, discounted cash flow

models and similar techniques.

New Accounting Pronouncements – In December 2011, the FASB issued Accounting Standards Update ("ASU") 2011-10 entitled Derecognition of in Substance Real Estate - a Scope Clarification. The amendments in this update clarify the scope of current U.S. generally accepted accounting principals ("GAAP"). The amendments will resolve the diversity in practice about whether the guidance in subtopic 360-20 applies to the derecognition of in substance real estate when the parent ceases to have a controlling financial interest in a subsidiary that is in substance real estate because of a default by the subsidiary on its nonrecourse debt. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. The adoption of the standard did not have a significant impact on NNN's financial position or results of operations.

In December 2011, the FASB issued ASU 2011-11 amending its guidance on offsetting assets and liabilities in financial statements. The objective of this update will require disclosure to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of IFRS. The amendments in this update are effective for annual reporting periods beginning on or after January 1, 2013. NNN is currently evaluating the provisions to determine the potential impact, if any, the adoption will have on its financial position and results of operations.

In June 2011, the FASB issued ASU 2011-05 which amended its guidance on the presentation of comprehensive income in financial statements. The new guidance requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions of this new guidance were effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance changed the presentation of NNN's condensed consolidated financial statements but did not have an effect on NNN's results of operations.

In December 2011, the FASB issued ASU 2011-12, which indefinitely defers certain provisions of ASU 2011-05, including a requirement for entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net earnings is presented and the statement in which other comprehensive income is presented. The effective dates and expected changes to our presentation are the same as noted in ASU 2011-05 above.

Use of Estimates – Management of NNN has made a number of estimates and assumptions relating to the reporting of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with U.S. GAAP. Significant estimates include provision for impairment and allowances for certain assets, accruals, useful lives of assets and purchase price allocation. Actual results could differ from those estimates.

Reclassification – Certain items in the prior year’s consolidated financial statements and notes to consolidated financial statements have been reclassified to conform to the 2012 presentation.

Note 2 – Real Estate – Portfolio:

Leases – The following outlines key information for NNN’s leases:

	June 30, 2012
Lease classification:	
Operating	1,493
Direct financing	14
Building portion – direct financing / land portion – operating	5
Weighted average remaining lease term	12 Years

The 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 tenant is also required to pay all property taxes and assessments, substantially maintain the interior and exterior of the property and carry property and liability insurance coverage. Certain of NNN’s Properties are subject to leases under which NNN retains responsibility for specific costs and expenses of the property. Generally, the leases of the Properties provide the tenant with one or more multi-year renewal options subject to generally the same terms and conditions, including rent increases, consistent with the initial lease term.

Real Estate Portfolio – Accounted for Using the Operating Method – Real estate subject to operating leases consisted of the following as of (dollars in thousands):

	June 30, 2012	December 31, 2011
Land and improvements	$1,390,175	$1,315,339
Buildings and improvements	2,309,079	2,118,303
Leasehold interests	1,290	1,290
	3,700,544	3,434,932
Less accumulated depreciation and amortization	(302,435)	(270,023)
	3,398,109	3,164,909
Work in progress	87,710	60,210
	$3,485,819	$3,225,119

In connection with the improvements of leased Properties, NNN has the following funding commitments (dollars in thousands):

	June 30, 2012			
	# of Properties	Total Commitment[1]	Amount Funded	Remaining Commitment
Real Estate Portfolio	54	$ 167,243	$127,693	$39,550

(1) Includes land and construction costs.

Note 3 – Commercial Mortgage Residual Interests:

In 2010, NNN acquired the 21.1% non-controlling interest in its majority owned and controlled subsidiary, Orange Avenue Mortgage Investments, Inc. ("OAMI"), for $1,603,000, and OAMI became a wholly owned subsidiary of NNN. NNN accounted for the transaction as an equity transaction in accordance with the FASB guidance on consolidation. OAMI holds the residual interests ("Residuals") from seven commercial mortgage securitizations. Each of the Residuals is recorded at fair value based upon an independent valuation. Unrealized gains and losses are reported as other comprehensive income in stockholders' equity and other than temporary losses as a result of a change in the timing, or amount of estimated cash flows are recorded as an other than temporary valuation impairment.

Due to the expected timing of future cash flows relating to the Residuals, the independent valuation adjusted certain of the valuation assumptions. The following table summarizes the key assumptions used in determining the value of the Residuals as of:

	June 30, 2012	December 31, 2011
Discount rate	25%	25%
Average life equivalent CPR [1] speeds range	0.80% to 20.42% CPR	2.18% to 18.57% CPR
Foreclosures:		
Frequency curve default model	0.1% - 3.9% range	0.2% - 4.7% range
Loss severity of loans in foreclosure	20%	20%
Yield:		
LIBOR	Forward 3-month curve	Forward 3-month curve
Prime	Forward curve	Forward curve

(1) Conditional prepayment rate.

The following table summarizes the recognition of unrealized gains and/or losses recorded as other comprehensive income as well as other than temporary valuation impairments recorded in condensed consolidated statements of earnings (dollars in thousands):

	Quarter Ended June 30,	Six Months Ended June 30,

	2012	2011	2012	2011
Unrealized gains	$213	$539	$213	$599
Other than temporary valuation impairment	2,718	267	2,718	396

Note 4 – Line of Credit Payable:

In May 2011, NNN amended and restated its credit agreement increasing the borrowing capacity under its unsecured revolving credit facility from $400,000,000 to $450,000,000 and amending certain other terms under the former revolving credit facility (as the context requires, the previous and new revolving credit facility, the “Credit Facility”). The Credit Facility had a weighted average outstanding balance of $52,946,000 and a weighted average interest rate of 1.8 percent during the six months ended June 30, 2012. The Credit Facility matures May 2015, with an option to extend maturity to May 2016. The Credit Facility bears interest at LIBOR plus 150 basis points; however, such interest rate may change pursuant to a tiered interest rate structure based on NNN's debt rating. The Credit Facility also includes an accordion feature to increase the facility size up to $650,000,000, subject to lender approval. As of June 30, 2012, $142,600,000 was outstanding and $307,400,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling $3,800,000.

Note 5 – Stockholders' Equity:

The following table outlines the dividends declared and paid for each issuance of NNN's stock (in thousands, except per share data):

Six Months Ended June 30,