CapLease, Inc.
Form 10-Q
August 07, 2013

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

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 001-32039

CapLease, Inc.
(Exact name of registrant as specified in its charter)

Maryland	**52-2414533**

(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
1065 Avenue of the Americas, New York, NY	**10018**
(Address of Principal Executive Offices)	**(ZIP Code)**
Registrant's Telephone Number, Including Area Code:	**(212) 217-6300**

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

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

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

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

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

As of August 7, 2013, there were 88,845,604 shares of common stock of CapLease, Inc., $0.01 par value per share, outstanding ("Common Stock").

CapLease, Inc.

Index to Form 10-Q

		Page
PART I. FINANCIAL INFORMATION		2
Item 1.	Financial Statements	2
	Consolidated Balance Sheets as of June 30, 2013 (unaudited) and December 31, 2012	2
	Consolidated Statements of Operations (unaudited) for the Three and Six Months Ended June 30, 2013 and 2012	3
	Consolidated Statements of Comprehensive Income (Loss) (unaudited) for the Three and Six Months Ended June 30, 2013 and 2012	4
	Consolidated Statement of Changes in Equity (unaudited) for the Six Months Ended June 30, 2013	5
	Consolidated Statements of Cash Flows (unaudited) for the Six Months Ended June 30, 2013 and 2012	6
	Notes to Consolidated Financial Statements (unaudited)	7
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	39
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	53
Item 4.	Controls and Procedures	56
PART II. OTHER INFORMATION		56
Item 1.	Legal Proceedings	56
Item 1A.	Risk Factors	57
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	57
Item 3.	Defaults Upon Senior Securities	57
Item 4.	Mine Safety Disclosures	57
Item 5.	Other Information	58
Item 6.	Exhibits	58
SIGNATURES		59

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CapLease, Inc. and Subsidiaries

Consolidated Balance Sheets

As of June 30, 2013 (unaudited) and December 31, 2012

(Amounts in thousands, except share and per share amounts)	As Of June 30, 2013	As Of December 31, 2012
Assets		
Real estate investments, net	$1,628,482	$1,541,416
Loans held for investment, net	24,061	26,972
Commercial mortgage-backed securities	58,859	62,318
Cash and cash equivalents	24,618	30,177
Other assets	86,000	89,560
Total Assets	$1,822,020	$1,750,443
Liabilities and Equity		
Mortgages on real estate investments	$991,483	$1,012,075
Credit agreements	99,457	67,655
Secured term loan	63,045	72,417
Convertible senior notes	19,210	19,210
Other long-term debt	30,930	30,930
Total Debt Obligations	1,204,125	1,202,287
Intangible liabilities on real estate investments	32,887	33,032
Accounts payable and other liabilities	27,113	27,926
Dividends and distributions payable	10,138	8,826
Total Liabilities	1,274,263	1,272,071
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value, 100,000,000 shares authorized:		
	39,363	79,776

Series A cumulative redeemable preferred, liquidation preference $25.00 per share, 1,832,000 and 3,447,182 shares issued and outstanding, respectively		
Series B cumulative redeemable preferred, liquidation preference $25.00 per share, 2,941,073 shares issued and outstanding	71,665	71,665
Series C cumulative redeemable preferred, liquidation preference $25.00 per share, 1,700,000 and 0 shares issued and outstanding, respectively	39,689	–
Common stock, $0.01 par value, 500,000,000 shares authorized, 88,845,604 and 73,658,045 shares issued and outstanding, respectively	888	737
Additional paid in capital	395,445	325,824
Accumulated other comprehensive loss	(297)	(666)
Total Stockholders' Equity	546,753	477,336
Non-controlling interest in consolidated subsidiaries	1,004	1,036
Total Equity	547,757	478,372
Total Liabilities and Equity	$1,822,020	$1,750,443

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

(Amounts in thousands, except per share amounts)	For the Three Months Ended June 30, 2013	For the Three Months Ended June 30, 2012	For the Six Months Ended June 30, 2013	For the Six Months Ended June 30, 2012
Revenues:				
Rental revenue	$37,237	$33,697	$72,536	$66,678
Interest income from loans and securities	1,481	2,091	3,392	4,106
Tenant reimbursements	6,249	3,556	12,239	7,387
Other revenue	159	352	311	511
Total revenues	45,126	39,696	88,478	78,682
Expenses:				
Interest expense	16,210	16,965	32,507	33,943
Property expenses	9,266	6,615	18,340	13,032
Gain on derivatives	(5)	–	(5)	–
General and administrative expenses	3,170	2,863	6,313	5,851
General and administrative expenses-stock based compensation	995	907	1,770	1,611
Merger-related costs	2,421	–	2,421	–
Depreciation and amortization expense on real property	12,607	11,898	24,633	23,712
Other expenses	–	16	–	32
Total expenses	44,664	39,264	85,979	78,181
Other gains:				
Gain on investment	–	–	–	709
Gain on extinguishment of debt, net	–	9,000	–	11,012
Total other gains	–	9,000	–	11,721
Income from continuing operations	462	9,432	2,499	12,222
Discontinued operations:				
Loss from discontinued operations	–	(634)	–	(1,366)
Loss on investment	–	(15,229)	–	(15,229)
Total discontinued operations	–	(15,863)	–	(16,595)
Net income (loss) before non-controlling interest in consolidated subsidiaries	462	(6,431)	2,499	(4,373)
Non-controlling interest in consolidated subsidiaries	5	18	8	17
Net income (loss)	467	(6,413)	2,507	(4,356)
Dividends allocable to preferred shares	(3,254)	(2,453)	(6,791)	(4,081)
Net loss allocable to common stockholders	$(2,787)	$(8,866)	$(4,284)	$(8,437)
Income (loss) per common share, basic:				
Income (loss) from continuing operations	$(0.03)	$0.11	$(0.05)	$0.12

Loss from discontinued operations	–	(0.24)	–	(0.25)
Net loss per common share, basic	$(0.03)	$(0.13)	$(0.05)	$(0.13)
Weighted average common shares outstanding, basic	87,975	66,767	82,111	66,540
Income (loss) per common share, diluted:				
Income (loss) from continuing operations	$(0.03)	$0.11	$(0.05)	$0.12
Loss from discontinued operations	–	(0.24)	–	(0.25)
Net loss per common share, diluted	$(0.03)	$(0.13)	$(0.05)	$(0.13)
Weighted average common shares outstanding, diluted	88,104	66,767	82,240	66,540
Dividends declared per common share	$0.0775	$0.065	$0.155	$0.130
Dividends declared per preferred A share	$0.50781	$0.50781	$1.01563	$1.01563
Dividends declared per preferred B share	$0.52344	$0.50017	$1.04688	$0.50017
Dividends declared per preferred C share	$0.45313	$ –	$0.85590	$ –

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

(Amounts in thousands)	For the Three Months Ended June 30, 2013	For the Three Months Ended June 30, 2012	For the Six Months Ended June 30, 2013	For the Six Months Ended June 30, 2012
Net income (loss) before non-controlling interest in consolidated subsidiaries	$462	$(6,431)	$2,499	$(4,373)
Other comprehensive income (loss):				
Change in fair value of securities available for sale	(126)	1,247	7	6,457
Change in fair value of derivatives	92	–	92	–
Reclassification of derivative items into earnings	131	(71)	265	(18)
Other comprehensive income	97	1,176	364	6,439
Comprehensive income (loss)	559	(5,255)	2,863	2,066
Comprehensive (income) loss attributable to non-controlling interests	(1)	11	(5)	(4)
Comprehensive income (loss) attributable to CapLease, Inc.	$558	$(5,244)	$2,858	$2,062

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries

Consolidated Statement of Changes in Equity

(Unaudited)

(in thousands)

	Stockholders' Equity						
	Preferred Stock	Common Stock at Par	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Non-controlling Interest	Total Equity
Balance at December 31, 2012	$151,441	$ 737	$325,824	$ (666)	$ –	$ 1,036	$478,372
Incentive stock plan compensation expense	–	–	1,770	–	–	–	1,770
Incentive stock plan grants issued and forfeited	–	3	(3)	–	–	–	–
Net income	–	–	–	–	2,507	–	2,507
Non-controlling interest in consolidated subsidiaries	–	–	–	–	–	(8)	(8)
Issuance of common stock	–	150	86,373	–	–	–	86,523
Repurchase of common stock	–	(2)	(1,141)	–	–	–	(1,143)
Issuance of preferred stock	39,689	–	–	–		–	39,689
Repurchase of preferred stock	(40,413)	–	–	–		–	(40,413)
Dividends declared-preferred	–	–	(4,278)	–	(2,507)	–	(6,785)
Dividends declared-common	–	–	(13,100)	–	–	–	(13,100)
Distributions declared-operating partnership units	–	–	–	–	–	(24)	(24)
Increase in fair value of securities available for sale	–	–	–	7	–	–	7
Increase (decrease) in fair value of derivatives	–	–	–	92	–		92
Reclassification of derivative items into earnings	–	–	–	265	–	–	265
Realized gain on derivative (due to ineffectiveness)	–	–	–	5	–	–	5
Balance at June 30, 2013	$150,717	$ 888	$395,445	$ (297)	–	$ 1,004	$547,757

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

	For the Six Months Ended June 30,	
	2013	2012
Operating activities		
Net income (loss)	$2,507	$(4,356)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	24,413	24,315
Stock based compensation	1,770	1,611
Amortization of above and below market leases	(903)	(385)
Loss on investments	–	14,521
(Gain) on derivatives	(5)	–
(Gain) on extinguishment of debt, net	–	(11,012)
Non-controlling interest in consolidated subsidiaries	(8)	(17)
Straight-lining of rents	1,738	8,051
Amortization of discounts/premiums, and origination fees/costs, net	(255)	(227)
Amortization of debt issuance costs, leasing commissions and fair market value of debt issued or assumed	1,455	1,129
Changes in operating assets and liabilities:		
Other assets	3,854	(9,280)
Accounts payable and other liabilities	1,653	1,432
Deposits and escrows	1	1
Net cash provided by operating activities	36,220	25,783
Investing activities		
Principal received from borrowers	2,996	3,804
Repayments of commercial mortgage-backed securities	3,636	2,912
Proceeds from sale of real estate investments	–	9,611
Purchases of real estate investments	(66,306)	(86,450)
Real estate improvements, additions and construction in progress	(17,294)	(12,586)
Leasing commission costs	(2,178)	(1,279)
Purchases of furniture, fixtures, equipment and leasehold improvements	(597)	(15)
Net cash used in investing activities	(79,743)	(84,003)
Financing activities		
Borrowings from mortgages on real estate investments	14,806	39,900
Repayments of mortgages on real estate investments	(64,733)	(38,906)
Borrowings from credit agreements	43,000	53,056
Repayments on credit agreements	(11,199)	(59,339)
Repayments on secured term loan	(9,373)	(8,468)
Debt issuance costs	(598)	(2,422)
Common stock issued, net of offering costs	86,523	–

Common stock repurchased	(1,143)	–
Preferred stock issued, net of offering costs	39,689	48,317
Preferred stock repurchased	(40,413)	–
Distributions to non-controlling interest	(24)	(20)
Dividends paid on common and preferred stock	(18,571)	(11,903)
Net cash provided by financing activities	37,964	20,215
Net decrease in cash and cash equivalents	(5,559)	(38,005)
Cash and cash equivalents at beginning of period	30,177	71,160
Cash and cash equivalents at end of period	$24,618	$33,155
Supplemental disclosure of cash flow information		
Cash paid for interest expense	$32,162	$33,557
Capitalized interest on development properties	568	–
Distributions declared but not paid	12	10
Dividends declared but not paid	10,126	6,968
Supplemental disclosure of noncash operating, investing and financing information		
Value of in-place leases and above-market leases acquired	$12,546	$6,725
Value of below-market leases acquired	933	–
Mortgage notes payable assumed on properties acquired	29,427	–
Mortgage note payable-notional amount repurchased	–	11,000

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

1. Organization and Business

CapLease, Inc. ("CapLease" and collectively with its majority-owned subsidiaries, the "Company") is a real estate investment trust, or REIT, that primarily owns and manages a diversified portfolio of single tenant commercial real estate properties subject to long-term leases to high credit quality tenants. Many of the properties the Company owns are subject to a net lease, or a lease that requires the tenant to pay all or substantially all property operating expenses, such as utilities, real estate taxes, insurance and routine maintenance.

The Company's tenants are primarily large public companies or their significant operating subsidiaries and governmental entities with investment grade credit ratings, defined as a published senior unsecured credit rating of BBB-/Baa3 or above from one or both of Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"). The Company also implies an investment grade credit rating for tenants that are not publicly rated by S&P or Moody's but (i) are 100% owned by an investment grade parent, (ii) for which it has obtained a private investment grade rating from either S&P or Moody's, (iii) for which it has evaluated the creditworthiness of the tenant and estimated a credit rating that is consistent with an investment grade rating from S&P or Moody's, or (iv) are governmental entity branches or units of another investment grade rated governmental entity.

In addition to its portfolio of owned properties, the Company has a modest portfolio of first mortgage loans and other debt investments on single tenant properties.

The Company has invested in certain owned properties that are leased primarily but not exclusively by one tenant. The Company has also invested in certain owned properties which were previously leased by one tenant but as a result of lease non-renewals have now become multi-tenant properties. The Company expects these types of properties will continue to comprise a portion of its portfolio for the foreseeable future.

CapLease has made an election to qualify, and believes it is operating so as to qualify, as a REIT for federal income tax purposes. As such, it will generally not be subject to federal income tax on that portion of its taxable income that is distributed to stockholders if it distributes at least 90% of its taxable income to its stockholders by prescribed dates and complies with various other requirements.

CapLease conducts its business through a variety of subsidiaries. CapLease owns most of its owned properties through its predecessor and operating partnership, Caplease, LP (the “Operating Partnership”). CapLease is the indirect sole general partner of, and owns approximately 99.8% of the common equity of, the Operating Partnership.

The accompanying consolidated financial statements and related notes of the Company have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared under GAAP have been condensed or omitted. In the opinion of management, all adjustments considered necessary for a fair presentation of the Company’s financial position, results of operations and cash flows have been included and are of a normal and recurring nature. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. These financial statements should be read in conjunction with the Company’s consolidated financial statements for the fiscal year ended December 31, 2012 and notes thereto, included in the Company’s Form 10-K filed with the SEC on February 21, 2013.

2. Merger Agreement

On May 28, 2013, CapLease, and certain subsidiaries of CapLease, including the Operating Partnership, entered into an Agreement and Plan of Merger (the “Merger Agreement”) with American Realty Capital Properties, Inc., a Maryland corporation (“ARCP”), ARC Operating Partnership, L.P., a Delaware limited partnership and the operating partnership of ARCP (the “ARCP Operating Partnership”), and Safari Acquisition, LLC, a Delaware limited liability company and wholly owned subsidiary of ARCP (“Merger Sub”). The Merger Agreement provides for (i) the merger of CapLease with and into Merger Sub (the “Merger”), with Merger Sub surviving as a wholly owned subsidiary of ARCP, and (ii) the merger of the Operating Partnership with and into ARCP Operating Partnership, with ARCP Operating Partnership surviving (the “Partnership Merger” and, together with the Merger, the “Mergers”). The Board of Directors of CapLease has unanimously approved the Merger Agreement, the Mergers and the other transactions contemplated by the Merger Agreement, directed that the Merger and the other transactions contemplated by the Merger Agreement be submitted for consideration at a meeting of the holders of CapLease’s common stock, and resolved to recommend that the holders of CapLease common stock vote in favor of the Merger and the other transactions contemplated by the Merger Agreement.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, at the effective time of the Merger (the "Effective Time"), each outstanding share of CapLease common stock, other than shares owned by ARCP, CapLease or any of their respective wholly owned subsidiaries, will be converted into the right to receive $8.50 in cash without interest (the "Common Merger Consideration"). Each outstanding share of CapLease preferred stock, other than shares owned by ARCP, CapLease or any of their respective wholly owned subsidiaries, will be converted into the right to receive an amount in cash, without interest, equal to the sum of $25.00 plus all accrued and unpaid dividends on such shares up to, but excluding, the closing date of the Merger. The CapLease preferred stock consists of (i) 8.125% Series A Cumulative Redeemable Preferred Stock, (ii) 8.375% Series B Cumulative Redeemable Preferred Stock and (iii) 7.25% Series C Cumulative Redeemable Preferred Stock. In addition, in connection with the Partnership Merger, each outstanding unit of equity ownership of the Operating Partnership other than units owned by CapLease or any wholly owned subsidiary of CapLease will be converted into the right to receive $8.50 in cash, without interest.

The Merger Agreement provides that, immediately prior to the Effective Time, any outstanding shares of restricted stock held by any employee of the Company on the closing date of the Merger will become fully vested and will have the right to receive the Common Merger Consideration. The Merger Agreement also provides that, immediately prior to the Effective Time, any outstanding performance share unit awards held by any employee of the Company on the closing date of the Merger will become fully earned and settled as to 100% of the target number of shares of CapLease common stock, and all shares of CapLease common stock outstanding as a result of such settlement will have the right to receive the Common Merger Consideration.

Consummation of the Mergers is subject to various conditions, including, among other things, the approval by CapLease's stockholders of the Merger, and the absence of any law, order or injunction prohibiting the consummation of the Mergers. Moreover, each party's obligation to consummate the Mergers is subject to certain other conditions, including the accuracy of the other party's representations and warranties (subject to customary qualifications) and the other party's material compliance with its covenants and agreements contained in the Merger Agreement.

ARCP and CapLease have made certain customary representations and warranties to each other in the Merger Agreement. CapLease has also made certain covenants relating to the conduct of its business between the date of the Merger Agreement and the closing of the Merger and other matters, including the "go-shop" and "no-shop" covenants described below.

As permitted pursuant to the "go-shop" provisions of the Merger Agreement, CapLease conducted an extensive marketing process to solicit alternative acquisition proposals from third parties for a 40 day period beginning immediately upon execution of the Merger Agreement on May 28, 2013 (the "Go Shop Period"). During the Go Shop Period which expired on July 7, 2013 (the "No Shop Period Start Date"), CapLease was authorized to and with the assistance of its financial advisor, Wells Fargo Securities, LLC, did initiate, solicit and encourage alternative acquisition proposals from third parties, including by providing non-public information to a variety of third parties. However, such actions did not result in any alternative acquisition proposals. Starting on the No Shop Period Start Date, the Go Shop Period expired and CapLease became subject to customary "no-shop" covenants which prohibit CapLease from soliciting alternative acquisition proposals from third parties, but permit it to respond to any unsolicited alternative acquisition proposal that meets certain conditions.

The Merger Agreement also includes certain termination rights for both ARCP and CapLease and provides that, in connection with the termination of the Merger Agreement, under specified circumstances, CapLease may be required to pay ARCP a termination fee of $21,000 and reimburse ARCP's transaction expenses in an amount equal to $4,000.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

3. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements include the assets, liabilities, and results of operations of the Company. Results of operations of properties acquired are included in the Consolidated Statements of Operations from the date of acquisition. All significant intercompany transactions, balances and accounts have been eliminated in consolidation.

References in these financial statements to the Company's carrying amount or value of an asset or liability means such asset's or liability's book value reported on the Company's Consolidated Balance Sheet in accordance with GAAP.

Accounting for Real Estate

Real estate held for investment is carried on the Company's Consolidated Balance Sheets at historical cost to the Company, less accumulated depreciation, amortization and impairment charges. Depreciation and amortization are determined by the straight-line method over the remaining estimated economic useful lives of the properties. The Company generally depreciates building and building improvements over periods not exceeding 40 years. Direct costs incurred in acquiring completed properties that meet the classification of a business for accounting purposes are charged to operations as incurred. Expenditures for maintenance and repairs of owned properties are also charged to operations as incurred. Significant renovations which extend the useful life of the properties are capitalized.

The Company reviews its owned real properties for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The evaluation includes estimating and reviewing anticipated future undiscounted cash flows to be derived from the asset. If such cash flows are less than the asset's net carrying value, an impairment charge is recognized to earnings to the extent by which the asset's carrying value exceeds the estimated fair value. Estimating future cash flows is highly subjective and includes an evaluation of factors such as the anticipated cash flows from the property, which may include rent from current leases in place and projected future leases, estimated capital expenditures, and an estimate of proceeds to be realized upon sale of the property. The Company's estimates could differ materially from actual results. The Company has determined that the significant inputs used to evaluate its owned properties for impairment primarily rely on Level 3 inputs in accordance with the fair value measurement topic in the applicable accounting guidance as described in Note 8 below. The Company did not recognize any impairment losses on long-lived assets during the six months ended June 30, 2013. The Company did not recognize any impairment losses on long-lived assets during the six months ended June 30, 2012, although it did recognize a loss on sale of one real property during the quarter ended June 30, 2012. See Note 7.

Assets and liabilities of properties that meet various held for sale criteria, including that it is probable that a sale will occur within 12 months, are presented separately in the Consolidated Balance Sheets, with assets and liabilities being separately stated. The operating results of properties held for sale and those that have been sold are reflected as discontinued operations in the Consolidated Statements of Operations. Properties that the Company has determined to classify as held for sale are also required to be simultaneously reviewed for impairment and carried on the Company's Consolidated Balance Sheets at the lower of net carrying value or estimated fair value.

The Company is required under GAAP to allocate the purchase price of rental real estate acquired to the following based on estimated fair values on the acquisition date:

- acquired tangible assets, consisting of land, building and improvements; and

- identified intangible assets and liabilities, consisting of above-market and below-market leases, in-place leases and tenant relationships.

The fair value of tangible and intangible assets acquired is considered to be a Level 3 input in accordance with the fair value measurement topic in the applicable accounting guidance as described in Note 8 below. In estimating the fair value of the tangible and intangible assets acquired, the Company considers information obtained about each property as a result of its due diligence activities and other market data, and utilizes various valuation methods, such as estimated cash flow projections utilizing appropriate discount and capitalization rates, estimates of replacement costs, and available market information. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant (the "dark value").

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

Above-market and below-market lease values for acquired properties are recorded based on the present value of the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management’s estimate of fair market lease rates for each corresponding in-place lease. Fair market lease rates are measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term of any below-market rate renewal options for below-market leases. In computing present value, the Company considers the costs which would need to be invested to achieve the fair market lease rates. The Company uses a discount rate which reflects the risks associated with the leases acquired. The capitalized above-market lease values are amortized as a reduction of base rental revenue over the remaining term of the respective leases, and the capitalized below-market lease values are amortized as an increase to base rental revenue over the remaining initial terms plus the terms of any below-market renewal options of the respective leases.

Other intangible assets acquired include amounts for in-place lease values and tenant relationship values which are based on management’s evaluation of the specific characteristics of each tenant’s lease and the Company’s overall relationship with the respective tenant. Factors considered by management in its analysis of in-place lease values include estimates of the dark value of the property, carrying costs during the hypothetical expected time it would take management to find a tenant to lease the space for the existing lease term (a “lease-up period”) considering current market conditions, and costs to execute similar leases. Management estimates carrying costs, including such factors as real estate taxes, insurance and other operating expenses during the expected lease-up period, considering current market conditions and costs to execute similar leases. In estimating costs to execute similar leases, management considers leasing commissions and other related expenses. Characteristics considered by management in estimating the value of tenant relationships include the nature and extent of the Company’s existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant’s credit quality and expectations of lease renewals. The value of in-place leases is amortized as a component of depreciation expense over the remaining initial terms of the respective leases. The value of tenant relationship intangibles, if any, is amortized as a component of depreciation expense over the anticipated life of the relationships. Through June 30, 2013, the Company has assigned no value to tenant relationships on any of its acquisitions.

For property acquisitions where the Company assumes existing mortgage debt, the debt is recorded at its estimated fair value, based on management’s estimate of current borrowing rates available for comparable financing. The Company amortizes any discount or premium as part of interest expense on the related debt using the effective interest method.

Development Activities

Project costs and expenses, which include interest expense, associated with the development, construction and lease-up of a real estate project are capitalized as construction in progress. Once the development and construction of the building is substantially completed, the amounts capitalized to construction in progress are transferred to (i) land and (ii) buildings and improvements. As required by GAAP, the Company computes interest expense on the full amount it has invested in the project, whether or not such investment is externally financed.

Loan Investments

The Company classifies its loans as long-term investments, as its strategy is to hold the loans for the foreseeable future or until maturity. Loan investments are carried on the Company's Consolidated Balance Sheet at amortized cost (unpaid principal balance adjusted for unearned discount or premium and loan origination fees), net of any allowance for loan losses. Unearned discounts or premiums and loan origination fees are amortized as a component of interest income using the effective interest method over the life of the loan.

From time to time, the Company may determine to sell a loan in which case it must reclassify the asset as held for sale. Loans held for sale are carried at lower of cost or estimated fair value. The Company did not sell any of its loan investments during the six months ended June 30, 2013, and, as of June 30, 2013, the Company has not classified any of its loans as held for sale. The Company also did not sell any of its loan investments during the six months ended June 30, 2012.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

The Company evaluates its loan investments for possible impairment on a quarterly basis. The Company's impairment analysis includes both a general reserve component and an asset-specific component. The general reserve component covers performing loans and in accordance with relevant accounting guidance an allowance for loan losses is recorded when (i) available information as of each balance sheet date indicates that it is probable a loss has occurred in the portfolio and (ii) the amount of the loss can be reasonably estimated. Actual loan losses are then charged against the allowance when management believes that uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Significant judgment is required in determining reserve balances for the performing loan portfolio, including estimates of the likelihood of default and lease rejection given the credit characteristics of the tenant, and estimates of stressed collateral values and potential bankruptcy claim recoveries. These estimates are highly subjective and could differ materially from actual results. As of June 30, 2013, the Company has a general loan loss reserve of $500. See Note 5.

The asset-specific component of the loan loss impairment analysis relates to specific loans where the Company has deemed it probable that it will not be able to collect all amounts due according to the contractual terms of the loan. Any resulting loan specific loss is measured based on the present value of expected future cash flows from the loan or the fair value of the loan collateral, if the loan is collateral dependent. Significant judgment is required in determining any resulting loan specific loss, including factors such as the status of the loans (i.e., current or actual or expected payment or other defaults), the credit quality of the underlying tenants, the present value of expected future cash flows on the loans, the fair value of any collateral, and the amount and status of any senior debt. These estimates are highly subjective and could differ materially from actual results. The Company's accounting policy is to continue to accrue interest income on specific impaired loans as long as it concludes it is likely to collect it. As of June 30, 2013, the Company did not have any asset-specific loan loss reserves.

Commercial Mortgage-Backed Securities

The Company classifies all of its securities investments as "available for sale" for financial accounting purposes. Under GAAP, securities classified as "available for sale" are carried on the Consolidated Balance Sheet at fair value with the net unrealized gains or losses included in Accumulated Other Comprehensive Income (Loss), a component of

Stockholders' Equity on the Company's Consolidated Balance Sheet.

Any premiums or discounts on securities are amortized as a component of interest income using the effective interest method.

The Company estimates fair value on all securities investments quarterly based on a variety of inputs. Under applicable accounting guidance, securities where the fair value is less than the Company's cost are deemed "impaired," and, therefore, must be measured for "other-than-temporary impairment." If an impaired security (i.e., fair value below cost) is intended to be sold or required to be sold prior to expected recovery of the impairment loss, the full amount of the loss must be charged to earnings as other-than-temporary impairment. Otherwise, impairment losses on the security must be further analyzed for separation into two categories: (i) credit losses and (ii) losses due to factors other than credit. The portion which is considered credit loss is charged to earnings as other-than-temporary impairment. The portion which is due to other factors is not charged to earnings. Also, if the security is classified as available for sale, the non-credit portion of the impairment loss is charged to other comprehensive income (loss), a component of equity on the Company's Consolidated Balance Sheet.

In estimating credit or other-than-temporary impairment losses, management considers a variety of factors including (1) the financial condition and near-term prospects of the credit, including credit rating of the security and the underlying tenant and an estimate of the likelihood, amount and expected timing of any default, (2) whether the Company expects to hold the investment for a period of time sufficient to allow for anticipated recovery in fair value, (3) the length of time and the extent to which the fair value has been below cost, (4) current market conditions, (5) expected cash flows from the underlying collateral and an estimate of underlying collateral values, and (6) subordination levels within the securitization pool. These estimates are highly subjective and could differ materially from actual results. The Company had no other-than-temporary impairment losses on securities charged to the Statement of Operations during the six months ended June 30, 2013. The Company also had no other-than-temporary impairment losses on securities charged to the Statement of Operations during the six months ended June 30, 2012.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

Deferred Fees and Costs

In connection with its leasing efforts, the Company may incur primarily two types of costs: (i) allowances paid to the tenant or on its behalf for the construction of leasehold improvements, or tenant improvement allowances, and (ii) commissions paid to leasing brokers, or leasing commissions. Tenant improvement allowances are initially capitalized as part of “Construction in progress” and then transferred to “Building and improvements” at completion and depreciated on a straight-line basis over periods not exceeding 40 years. Leasing commissions are capitalized as “Deferred leasing costs” (a component of “Other assets” on the Company’s Consolidated Balance Sheet) and amortized on a straight-line basis over the term of the related lease.

In accordance with applicable accounting guidance, the Company defers the recognition of fees and expenses associated with the origination of its loans held for investment. These items include lender fee income, rate lock income, direct loan origination costs, certain legal expenses, insurance costs, rating agency fees and certain other expenses. Net deferred fees and costs are presented as an offset to the carrying amount of loans held for investment on the Company’s Consolidated Balance Sheet and are recognized as an adjustment to the effective yield over the life of the related asset.

The Company also defers the recognition of expenses associated with the issuance of its debt obligations. These items include placement fees, lender fees, legal expenses, broker fees and certain other expenses. Deferred debt issuance costs are presented as a component of “Other assets” on the Company’s Consolidated Balance Sheet and are recognized as an adjustment to the effective financing rate over the term of the related debt obligation. Upon the retirement of the related debt obligation, any unamortized debt issuance costs are charged off as a component of gain or loss on extinguishment of debt.

Costs incurred in connection with debt obligations that have been modified or restructured are subject to the provisions of FASB ASC 470-50, *Debt -- Modification and Extinguishment*. If the terms of the modified debt instrument are deemed to be substantially different (i.e., a 10 percent or greater difference in the present value of cash flows between instruments), the original debt is deemed extinguished and all unamortized financing costs associated with the extinguished debt are charged to earnings in the current period. If the cash flows are deemed to be not substantially different, the original debt is deemed modified and the unamortized financing costs and any additional costs between the borrower and lender in connection with the modification are capitalized and amortized into interest expense over the remaining term of the related debt instrument, and other related costs of the modification are expensed.

Risk Management Transactions

The Company may enter into risk management transactions as part of its overall portfolio financing strategy. These transactions are intended to manage the Company's exposure to changes in interest rates associated with its present or expected future debt obligations. As of June 30, 2013, the Company was party to a single risk management transaction to manage its exposure to changes in interest rates under the loan agreement with Bank of Oklahoma which is a floating rate borrowing facility. See Note 13. The Company accounts for the interest rate swap agreement in accordance with FASB ASC Topic 815, Derivatives and Hedging ("Topic 815"). In accordance with Topic 815, the agreement is carried on the Company's Consolidated Balance Sheets at its fair value, as an asset if fair value is positive, or as a liability if fair value is negative. Since the interest rate swap is designated as a cash flow hedge, the effective portion of the interest rate swap's change in fair value is reported as a component of Other Comprehensive Income (Loss) on the Company's Consolidated Balance Sheets; the ineffective portion, if any, is recognized directly in earnings. The fixed rate interest rate payments that the Company makes pursuant to the swap agreement are recognized as a component of interest expense on the Company's Consolidated Statements of Operations.

The Company has been party to other risk management transactions in the past and these transactions continue to impact the Company's current results through amortization of the effective portion under GAAP of the realized gains and losses on these transactions into interest expense on the Company's Consolidated Statements of Operations. See Note 13.

Cash and Cash Equivalents

The Company defines cash equivalents as highly liquid investments purchased with maturities of three months or less at date of purchase. From time to time, the Company's account balance held at financial institutions exceeds Federal Depository Insurance Corporation ("FDIC") insurance coverage and, as a result, there is a concentration of credit risk related to the balance on deposit in excess of FDIC insurance coverage. The Company believes that the risk of loss is not significant.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

Revenue Recognition

The Company recognizes rental revenue on real estate on a straight-line basis over the non-cancelable term of the lease. The excess of straight-line rents over base rents under the lease is included in "Accrued rental income" on the Company's Consolidated Balance Sheet and any excess of base rents over the straight-line amount is included as "Deferred rental income" on the Company's Consolidated Balance Sheet. The Company's leases also generally require the tenants to pay directly or reimburse the Company for occupancy and operating costs of the properties, or in certain cases reimburse the Company for increases in certain operating costs and real estate taxes above their base year costs. The Company recognizes such income in the period the related expenses are incurred.

Interest income from loans, securities, and structuring fees receivable is recognized on the accrual basis of accounting. Interest income from securities (including interest-only strips) is recognized over the life of the investment using the effective interest method. The cost basis of interest-only strips is adjusted to reflect any prepayments from underlying assets, using the initial yield-to-maturity at the purchase date. The Company has adopted the cost-recovery method, in which all receipts are applied to reduce the Company's cost basis, on a limited number of its securities investments.

On occasion, the Company may consider a loan to be non-performing and place the loan on non-accrual status when there is sufficient doubt as to the ultimate ability to collect interest on the loan. While on non-accrual status, the loan is accounted for on either a cash basis, in which case interest income is recognized only upon actual receipt, or on a cost-recovery basis based upon management's judgment as to the collectibility of the investment.

Income Taxes

CapLease has made an election to qualify, and believes it is operating so as to qualify, as a REIT for federal income tax purposes. As such, it will generally not be subject to federal income tax on that portion of its taxable income that is distributed to stockholders if it distributes at least 90% of its taxable income to its stockholders by prescribed dates and complies with various other requirements. From time to time, the Company may conduct a portion of its business through a taxable REIT subsidiary ("TRS"), and the income from the activities of the TRS is subject to federal and state taxation at the applicable corporate rates.

Earnings per Share

As required by GAAP, the Company presents both basic and diluted earnings per share ("EPS"). Basic EPS excludes dilution and is computed by dividing net income (loss) allocable to common stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower EPS amount. For the 2013 periods, the Company's computation of diluted EPS includes 128,900 shares of common stock, which represents the target number of shares of common stock associated with outstanding performance share unit awards. As described in Note 2 above, the performance share unit awards will become fully earned and settled as to 100% of the target number of shares of common stock on the closing date of the Merger, and all such settled shares will have the right to receive the Common Merger Consideration. The Company's computation of diluted earnings per share does not include shares of common stock that may be issued in the future upon conversion of the convertible senior notes issued in October 2007, as the impact would not be dilutive. The number of weighted average common shares not included was 1,697,595 for each of the three and six months ended June 30, 2013, and 3,093,759 for each of the three and six months ended June 30, 2012.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

The following summarizes the Company's EPS computations for the three and six months ended June 30, 2013 and June 30, 2012 (in thousands, except per share amounts):

	For the three months ended June 30,		For the six months ended June 30,	
	2013	2012	2013	2012
Net loss allocable to common stockholders	$(2,787)	$(8,866)	$(4,284)	$(8,437)
Weighted average number of common shares outstanding, basic	87,975	66,767	82,111	66,540
Weighted average number of common shares outstanding, diluted	88,104	66,767	82,240	66,540
Net loss per share, basic	$(0.03)	$(0.13)	$(0.05)	$(0.13)
Net loss per share, diluted	$(0.03)	$(0.13)	$(0.05)	$(0.13)
Non-vested shares included in weighted average number of shares outstanding above	1,137	1,571	1,137	1,571

Recently Issued Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued new accounting guidance ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, which amends various sections of Accounting Standards Codification ("ASC") 820 and changes the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements in order to improve consistency in the application and description of fair value between U.S. GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 clarifies how the concepts of highest and best use and valuation premise in a fair value measurement are relevant only when measuring the fair value of nonfinancial assets and are not relevant when measuring the fair value of financial assets or of liabilities. In addition, the guidance expanded the disclosures for the unobservable inputs for Level 3 fair value measurements, requiring quantitative information to be disclosed related to (1) the valuation processes used, (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset's highest and best use. The revised guidance is effective for interim and annual periods beginning after December 15, 2011 and early application by public entities is prohibited. ASU 2011-04 is to be applied prospectively. The Company's adoption of this ASU for the reporting period ended March 31, 2012, as required, did not have a material effect on the Company's consolidated financial statements.

In June 2011, the FASB issued new accounting guidance ASU 2011-05, *Presentation of Comprehensive Income*, which amends various sections of ASC 220 and allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in ASU 2011-05 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 should be applied retrospectively. For public entities, the amendments in ASU 2011-05 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company elected early adoption of this ASU for the reporting period ended December 31, 2011, as permitted by the ASU. The Company's adoption of this ASU did not have a material effect on the Company's consolidated financial statements.

In December 2011, the FASB issued new accounting guidance ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standard Update No. 2011-05*, which amends various sections of ASC 220-10. The amended sections indefinitely defer the effective date of the presentation of reclassification adjustments out of accumulated other comprehensive income on the components of net income and other comprehensive income, which ASU 2011-05 would require. All other requirements of ASU 2011-05 are unaffected by this new guidance. For public entities, the amendments in ASU 2011-12 are effective concurrent with ASU 2011-05, for fiscal years and interim periods within those years, beginning after December 15, 2011. The Company elected to adopt this ASU for the reporting period ended December 31, 2011, as it is required to be adopted concurrently with ASU 2011-05. The Company's adoption of this ASU did not have a material effect on the Company's consolidated financial statements.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

In December 2011, the FASB issued new accounting guidance ASU No. 2011-11, *Balance Sheet (ASC Topic 210): Disclosures about Offsetting Assets and Liabilities.* ASU No. 2011-11 creates new disclosure requirements about the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The changes to the ASC as a result of this update are effective for periods beginning on or after January 1, 2013 (January 1, 2013 for the Company) and must be shown retrospectively for all comparative periods presented. The Company's adoption of this ASU for the reporting period ended March 31, 2013, as required, did not have a material effect on the Company's consolidated financial statements.

In December 2011, the FASB issued new accounting guidance ASU No. 2011-10, *Derecognition of in Substance Real Estate – a Scope Clarification*, which amends ASC Topic 360, Property, Plant and Equipment. ASU No. 2011-10 states that when an investor ceases to have a controlling financial interest in an entity that is in-substance real estate as a result of a default on the entity's nonrecourse debt, the investor should apply the guidance under ASC Subtopic 360-20, Property, Plant and Equipment – Real Estate Sales to determine whether to derecognize the entity's assets (including real estate) and liabilities (including the nonrecourse debt). The changes to the ASC as a result of this update are effective prospectively for deconsolidation events occurring during fiscal years, and interim periods within those years, beginning on or after June 15, 2012 (January 1, 2013 for the Company). The Company's adoption of this ASU for the reporting period ended March 31, 2013, as required, did not have a material effect on the Company's consolidated financial statements.

In July 2012, the FASB issued new accounting guidance ASU 2012-02, *Intangibles – Goodwill and Other (Topic 250): Testing Indefinite-Lived Intangible Assets for Impairment*, which amends various sections of ASC 350. The amendments update guidance with respect to annual impairment testing of indefinite-lived intangible assets. The standards update is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, and early adoption is permitted. The Company's adoption of this ASU for the reporting period ended March 31, 2013, as required, did not have a material effect on the Company's consolidated financial statements.

In February 2013, the FASB issued new accounting guidance ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, an amendment to FASB ASC Topic 220. ASU No. 2013-02 requires disclosure of amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present either on the face of the statement of operations or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts not reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. This ASU is effective prospectively for fiscal and interim periods beginning after December 15, 2012. The Company’s adoption of this ASU for the reporting period ended March 31, 2013, as required, did not have a material effect on the Company’s consolidated financial statements.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current presentation. There was no effect on net income (loss) or equity related to these reclassifications.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

4. Real Estate Investments

Real estate held for investment and related intangible liabilities consisted of the following at June 30, 2013 and December 31, 2012:

	Jun 30, 2013 Unaudited	Dec 31, 2012
Real estate investments:		
Land	$235,282	$219,059
Building and improvements	1,543,880	1,410,767
Construction in progress, land	1,875	5,635
Construction in progress, building and improvements	486	47,113
Intangible assets	183,939	171,393
Less: Accumulated depreciation and amortization	(336,980)	(312,551)
Real estate investments, net	$1,628,482	$1,541,416
Intangible liabilities on real estate investments:		
Intangible liabilities	$46,884	$47,908
Less: Accumulated amortization	(13,997)	(14,876)
Intangible liabilities on real estate investments, net	$32,887	$33,032

During the quarter ended June 30, 2013, the Company acquired the following properties:

Month Acquired	Tenant or Guarantor	Location	Purchase Price	Lease Expires	Net Rentable Square Feet
May		41 Moores Road, Malvern, PA	$49,650		187,653

	Teva Pharmaceuticals Industries Limited			October 2022	
June	Con-Way Freight, Inc. (1)	2211 Old Earhart Road, Ann Arbor, MI	43,900	May 2023	196,057

---

(1) As of June 30, 2013, approximately 22% of the property was leased to six other tenants.

In addition to the above properties acquired during the quarter, the Company also agreed to construct a distribution warehouse for a large private company tenant and in connection with such build-to-suit agreement, purchased the land on which the warehouse is being constructed. The Company also substantially completed the construction of the warehouse for Vitamin Shoppe Inc. during the quarter ended June 30, 2013. A summary of the Company's build-to-suit projects, including their status as of June 30, 2013, is included below.

Lease Extension

During the six months ended June 30, 2013, Bob's Stores, LLC, the sole tenant at the Company's 88,420 square foot retail property located in Randolph, Massachusetts, exercised its right to extend the lease for five additional years, until January 31, 2019. The lease extension commences February 1, 2014 and the rental rate is $9.76 per square foot. The tenant's obligations under the foregoing lease are guaranteed by various subsidiaries of CVS Caremark Corporation.

Development Activities

During June 2013, the Company entered into an agreement to construct a distribution warehouse on a build-to-suit basis for a large private company tenant. The new build-to-suit project has an estimated total investment of $22,033. Construction activity and funding of the project commenced during the second quarter of 2013. The Company will fund all of the project costs from cash on hand and other sources of available liquidity.

During August 2012, the Company entered into an agreement to construct a distribution warehouse on a build-to-suit basis for Vitamin Shoppe Industries, Inc. with an estimated total investment of $21,698. Construction activity and funding of the project commenced during the third quarter of 2012, and was substantially completed during the quarter ended June 30, 2013. During the quarter ended June 30, 2013, the Company's investment in the Vitamin Shoppe project was transferred from construction in progress to (i) land and (ii) buildings and improvements.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

The table below details the Company's investment in the June 2013 development project as of June 30, 2013. The information included in the table below represents management's estimates and expectations at June 30, 2013 which are subject to change. The Company's disclosures regarding certain projections or estimates of completion dates may not reflect actual results.

Location	Tenant	Property Type	Approximate Square Feet	Lease Term (years)	Investment through 6/30/13	Estimated Remaining Investment	Estimated Total Investment	Estimated Completion Date
Columbia, SC	Large private company	Warehouse	450,000	10.5[(1)]	$ 2,674	$ 19,359	$ 22,033	Q1 2014

(1) The lease is in force and rent and the 10.5 year lease term will commence upon substantial completion of the building.

Straight-Line Rent Adjustment

As described under "Revenue Recognition" in Note 2 above, the Company recognizes rental revenue from its owned properties on a straight-line basis as required by relevant accounting guidance. The impact of the straight-line rent adjustment on rental revenue is recorded on the Company's Consolidated Balance Sheet through accrued rental income and deferred rental income. Amounts for accrued rental income and deferred rental income as of June 30, 2013 and December 31, 2012, were as follows:

	Jun 30, 2013 Unaudited	Dec 31, 2012
Accrued Rental Income	$ 33,405	$35,144
Deferred Rental Income	-	-

Accrued rental income is included in “Other assets” on the Company’s Consolidated Balance Sheet. See Note 9.

Depreciation and Amortization Expense

Depreciation expense and amortization of intangible assets and liabilities on real estate investments for the three and six months ended June 30, 2013 and June 30, 2012, were as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2013	2012	2013	2012
Depreciation on real estate (included in depreciation and amortization expense)	$9,459	$8,252	$18,454	$16,356
Amortization of in-place leases (included in depreciation and amortization expense)	2,928	3,555	5,800	7,174
Amortization of above-market leases (included as a reduction of rental revenue)	99	348	176	708
Amortization of below-market leases (included as an increase to rental revenue)	532	547	1,079	1,093

As of June 30, 2013, the Company’s weighted average amortization period on intangible assets was 7.7 years, and the weighted average amortization period on intangible liabilities was 24.6 years.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

Scheduled amortization on existing intangible assets and liabilities on real estate investments as of June 30, 2013, was as follows:

	Intangible Assets	Intangible Liabilities
6 months ending December 31, 2013	$ 6,120	$ 1,024
2014	12,239	2,048
2015	11,580	1,772
2016	9,994	1,707
2017	7,284	1,525
Thereafter	27,281	24,812
Total	$ 74,496	$ 32,887

Owned Property Investment and Financing Strategy

Nearly all of the Company's owned properties are subject to financing and have been pledged as collateral to the Company's lender that has provided the applicable financing. Many of these properties are owned and financed on a long-term basis with fixed rate, non-recourse debt. Each property is owned through a separate and distinct special purpose entity, or SPE, with the property and the related lease or leases on the property generally representing the sole assets of the SPE and the sole collateral available to the Company's lender in the event the Company defaults on the debt that finances the property. Also see Note 10. Certain of the Company's owned properties are pledged to Wells Fargo Bank, N.A., as lender under the revolving credit agreement described at Note 10, to secure the Company's borrowings from time to time outstanding thereunder. These properties are otherwise unencumbered and the related debt can be repaid and the lender's lien released at any time without payment of a penalty or premium to the lender.

5. Loans Held for Investment

Loans held for investment at June 30, 2013 and December 31, 2012, are summarized in the following table. These investments consist predominantly of mortgage loans on properties subject to leases to investment grade tenants. As of June 30, 2013, the weighted average credit rating of the underlying tenants was BBB+ from Standard & Poor's. As of June 30, 2013, none of the Company's loans held for investment were on non-accrual status or past due 90 days or more.

	Jun 30, 2013 Unaudited	Dec 31, 2012
Principal	$ 28,350	$ 31,329
Discount	(3,732)	(3,797)
Cost basis	24,618	27,532
Allowance for loan losses	(500)	(500)
Carrying amount of loans	24,118	27,032
Deferred origination fees, net	(57)	(60)
Total	$ 24,061	$ 26,972

As of June 30, 2013, the Company's loan investments carried interest rates ranging from 5.28% to 7.24%. As of December 31, 2012, the Company's loan investments carried interest rates ranging from 5.28% to 9.32%. During May 2013, the mortgage loan on the property in Wilmington, DE leased to Hercules Incorporated matured and was paid in full. At June 30, 2013 and December 31, 2012, the weighted average effective interest rate on the Company's loan investments, as measured against its cost basis, was 6.6% and 6.9%, respectively.

The Company's loan portfolio is comprised primarily of fully amortizing or nearly fully amortizing first mortgage loans on commercial real estate leased to a single tenant. Payments of debt service on the Company's loans is, in substantially all cases, funded directly by rent payments paid into a lockbox account by the underlying tenant. Therefore, the Company's monitoring of the credit quality of its loans held for investment is focused primarily on an analysis of the tenant, including review of tenant credit ratings (including changes in ratings) and other measures of tenant credit quality, trends in the tenant's industry and general economic conditions, and an analysis of measures of collateral coverage, such as an estimate of the loan's loan-to-value (LTV) ratio (principal amount outstanding divided by estimated value of the property) and its remaining term until maturity.

CapLease, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

June 30, 2013 (unaudited)

The following table is a summary of the Company's loans held for investment by credit category with the credit ratings of the underlying tenants presented as of each applicable balance sheet date:

Credit rating (1)	Carry Value 6/30/13 (unaudited)	12/31/12
Investment grade rating of A- or A3 and above	$ 5,264	$