CAPITAL LEASE FUNDING INC
Form 10-K
March 30, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO
SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004

OR

o 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

CAPITAL LEASE FUNDING, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	**52-2414533** (I.R.S. Employer Identification No.)
110 Maiden Lane, New York, NY (Address of Principal Executive Offices)	**10005** (Zip code)

(212) 217-6300
(Registrant’s Telephone Number, Including Area Code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of each exchange on which registered
Common stock, $0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 x No o

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of June 30, 2004, the aggregate market value of the common stock, $0.01 par value per share, of Capital Lease Funding, Inc. (“Common Stock”), held by non-affiliates (outstanding shares, excluding shares held by executive officers and directors) of the registrant was approximately $251.0 million, based upon the closing price of $10.40 on the New York Stock Exchange on such date.

As of March 15, 2005, there were 27,501,700 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the registrant's definitive proxy statement for the registrant's 2005 Annual Meeting, to be filed within 120 days after the close of the registrant's fiscal year, are incorporated by reference into Part III of this Annual Report on Form 10-K.

TABLE OF CONTENTS

* Items 10, 11, 12, 13 and 14 are incorporated by reference herein from the Proxy Statement.

PART I.

Item 1. Business.

Overview

We are an internally-managed specialty finance company that focuses on investing in commercial real estate properties that are leased typically on a long-term basis to primarily single tenants. We concentrate on properties that are leased to high credit quality tenants pursuant to what we call a net lease, where the tenant (rather than the landlord) has the obligation to pay for, or pay for and perform, all or substantially all aspects of the property and its operations during the lease term.

We invest at all levels of the capital structure of net lease properties, including direct investments in real estate (equity) and debt investments (mortgage loans and net lease mortgage-backed securities) and mezzanine investments secured by mortgages or other collateral on net lease properties. Tenants underlying our property investments generally are: (i) large public companies with investment grade or near investment grade ratings from either or both of Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("Standard & Poor's" or "S&P"), (ii) government and quasi-governmental entities and (iii) not-for-profit entities. The following tenants are representative of those underlying our current and expected future investments: Aon Corporation, Kohl's Corporation, Choice Hotels International, CVS Corporation, University of Connecticut Health Center, Koninklijke Ahold N.V., Best Buy Co., Inc., Home Depot USA, Inc., Yahoo, Inc. and General Services Administration. A significant majority of our investments have been and we expect will continue to be in properties net leased to investment grade tenants, although at any particular time our portfolio may not reflect this. As of December 31, 2004, approximately 73.2% of our assets in portfolio involved properties leased to, or leases guaranteed by, companies with an investment grade credit rating. Please see "Portfolio" below for how we define our assets in portfolio.

We were incorporated during October 2003 for the purpose of continuing the existing business operations and acquiring the assets and liabilities of Caplease, LP, the successor-in-interest to Capital Lease Funding, LLC, which has been in the net lease business since 1994. We completed this acquisition in connection with our initial public offering during March 2004. As discussed in more detail below, on March 24, 2004, we completed an initial public offering of 23.0 million shares of our common stock priced to the public at $10.50 per share. As of December 31, 2004, we have fully utilized all of the net proceeds and we are now using leverage.

We are organized and we conduct our operations to qualify as a real estate investment trust, or REIT, for federal income tax purposes. As such, we are generally not subject to federal income tax on that portion of our income that is distributed to stockholders if we distribute at least 90% of our REIT taxable income to our stockholders by prescribed dates and comply with various other requirements.

History

We were formed in October 2003 to continue the business of our predecessor, Caplease, LP, the successor-in-interest to Capital Lease Funding, LLC. Prior to our initial public offering, we were focused on originating net lease loan transactions and selling substantially all of the loans we originated, either through whole-loan or small pool sales or through gain-on-sale securitizations.

Our senior management team has worked together for over 10 years and has been an innovator in the net lease marketplace. Since 1996, we have originated, structured and closed approximately $3.0 billion in net lease transactions (primarily debt), involving more than 500 properties with more than 75 credit tenants. We believe we were the first lender to originate and securitize a rated transaction of commercial mortgage loans on properties with long-term, single-tenant net leases to a diverse group of high credit-quality tenants. This first securitization was completed in 1997. We also have played a lead role in working with the rating agencies to develop and implement lease enhancement mechanisms that have improved the ability to finance net lease properties based on the tenant's credit. Many of these mechanisms are now market standard. Prior to our initial public offering, we participated in four securitizations aggregating approximately $1.5 billion. In addition, we structured or sold in excess of $1.0 billion of loans on a whole-loan basis or in small structured loan pools.

In late 2000, we developed a 10-year credit tenant loan product designed to take advantage of the liquidity and pricing certainty provided by the commercial mortgage-backed securities, or CMBS, and collateralized debt obligation, or CDO markets. We were issued a United States patent for this product in January 2005. Our 10-year credit tenant loan product offers borrowers who own properties subject to shorter-term leases or leases to lower investment grade or near investment grade tenants the maximum leverage and low debt service coverage ratios typically only offered by long-term credit tenant loans.

Change In Strategy

Upon completion of our initial public offering, we made two important changes to our business strategy:

- expanding our investments beyond just mortgage financing to all levels of the capital structure of net lease properties, including direct acquisitions of net lease real estate properties; and
- holding our net lease investments in our portfolio generally for the medium to long-term.

Due to our shift in strategy, our net income or loss now depends on the spread between the yields on our assets and our cost to finance those assets, rather than our ability to generate gains from the sale of assets. We receive interest income from property loans that we finance and from the debt securities that we hold, and rental revenue on the properties that we own. Our other income consists of occasional gain-on-sale income, and fees charged to third parties, including our borrowers.

We incur some property level expenses on properties that we own that are not subject to what we call triple-net or bondable net leases. These expenses may include parking lot improvements or repair, roof replacement or repair or other such capital expenses. We also may incur additional property related expenses, such as real estate taxes, insurance and routine maintenance and operating expenses, on properties we own, although we typically pass these expenses through to the underlying tenant pursuant to the net lease. For property acquisitions where we have obligations to maintain and operate the property, we typically retain experienced third-party property managers.

Our Initial Public Offering

Pursuant to a registration statement declared effective by the Securities and Exchange Commission (the "SEC") on March 18, 2004 (File No. 333-110644), we issued and sold 20.0 million shares of our common stock, par value $0.01 per share, in an initial public offering. The managing underwriters were Friedman, Billings Ramsey & Co., Inc., Wachovia Capital Markets, LLC and RBC Capital Markets Corporation. As part of the initial public offering, the underwriters were granted an over-allotment option to purchase up to an additional 3.0 million shares of common stock. The underwriters exercised this option in full. In connection with that exercise, we filed a post-effective amendment to the registration statement (File No. 333-113817) which became effective upon filing on March 22, 2004. The aggregate offering price for the 23.0 million shares was $241.5 million. On March 24, 2004, the initial public offering closed and we received net proceeds of approximately $224.0 million from the sale, reflecting the aggregate offering price of $241.5 million less an underwriting discount of approximately $16.9 million and expenses paid to the underwriters of approximately $0.6 million, but before other expenses of the offering of approximately $2.2 million, primarily made up of legal and accounting fees.

We have fully utilized the net proceeds of our initial public offering as follows:

- $79.5 million to repay indebtedness under our short-term warehouse credit facilities;
- $143.2 million to fund investments in net lease assets;
- $0.8 million to pay other expenses of the offering; and
- $0.5 million for working capital purposes.

Net Leases and Net Lease Real Estate Properties

We generally classify net leases into the following four categories:

	Bondable Net Lease	Triple Net Lease	Double Net Lease	Modified Gross Lease
Tenant Responsibility	• Tenant is responsible for all aspects of the property and its operation during the lease term.	• Tenant is responsible for all aspects of the property and its operation during the lease term.	• Tenant is responsible for all aspects of the property and its operation during the lease term, except that the landlord has the obligation with respect to certain capital expenditures on the property, such as replacement obligations for roof, structure and parking.	• Landlord is responsible for most property related expenses during the lease term, but cost of most of those expenses is passed through to the tenant pursuant to the lease.
Termination Right	• Tenant can only terminate the lease upon a condemnation, in which case the tenant must offer to purchase the property for at least the then outstanding unpaid principal balance of the loan, plus accrued interest	• Tenant may have a right to terminate the lease or abate rent due to a casualty (usually in the last few years) or to condemnation of a portion or all of the property.	• Tenant may have a right to terminate the lease or abate rent due to a casualty or condemnation or due to the landlord's failure to perform its obligations under the lease.	• Tenant may have a right to terminate the lease or abate rent due to a casualty or condemnation or due to the landlord's failure to perform its obligations under the lease.

When we refer to a net lease property, we mean a real estate property that is leased to a commercial tenant under a net lease.

As of December 31, 2004, we had the following number of asset investments in each net lease category:

		By Segment	
	Total	Lending Investments	Operating Net Lease Real Estate
Bondable net leases	13	13	—
Triple net leases	16	13	3

Double net leases	26	23	3
Modified gross leases	2	—	2
	57	49	8

Our Property Acquisition Activity

Our real property acquisitions, all of which have been made since the closing of our initial public offering, have been primarily in properties subject to net leases that fall into one of the above four categories, but also include investments in a limited number of leased properties (one as of December 31, 2004) where we bear the financial risk of operating the property. While our focus continues to be on net lease properties, we expect to make select additional investments in properties where we bear such financial risk in the future. Our investment underwriting on property acquisitions is based on the credit of the underlying tenant and the related lease term and other lease provisions, as well as:

- the location and type of property (e.g., office or retail);
- vacancy rates and trends in vacancy rates and demand in the property's market;

· an analysis of the rental rates within the market;

· an analysis of sales prices in the market; and

· demographics in the property's market.

Our Loan Origination Activity

Our loan origination activity has historically and we expect will continue to be primarily focused on properties subject to bondable net leases, triple net leases and double net leases. When we refer to a net lease loan, we mean a mortgage loan made to an owner of a commercial property leased to a tenant under a net lease described in the prior sentence. A net lease loan is secured by a first mortgage on a commercial real property subject to a long-term net lease to a tenant, and by a collateral assignment of the lease and all rents due under the lease. Under a net lease loan, the principal credit underlying the loan is the credit of the tenant rather than the credit of the borrower or the liquidation value of the applicable real estate.

Our net lease loan products generally offer commercial real property owners greater loan proceeds than a traditional commercial real estate lender because our underwriting and due diligence process focuses on the value of the cash flow stream generated by the underlying net lease rather than the value of the real property. We may use the specialized lease enhancement mechanisms that we helped to develop to substantially mitigate the risk of a potential interruption in the rental stream due to real estate related events so that triple-net and double-net leases can be evaluated as if they were bondable net leases. Our lease enhancement mechanisms consist primarily of an integrated set of specialized insurance policies, loan documents and various borrower and expense reserve accounts. The specialized insurance policies are generally non-cancelable for the term of the lease, are written for the benefit of the holder of the mortgage and have been designed to protect against risks such as rent abatement or lease termination as a result of a casualty or condemnation event under the underlying net lease.

A properly structured net lease investment and net lease with appropriate lease enhancements can be expected to receive a rating from one or more of the rating agencies equivalent to the unsecured debt rating of the underlying tenant. The expected receipt of that rating improves our ability to finance the loan on a long-term basis through a CDO.

Market Opportunity

We believe that there is a significant market opportunity to earn attractive risk-adjusted returns in the net lease market. We estimate that the total amount of net lease transactions in the United States that would meet our general criteria is approximately $15 billion to $25 billion per year. Corporations and many other users of real estate utilize single tenant properties for a variety of purposes, including office buildings for corporate headquarters and regional operations, industrial facilities for the storage and distribution of goods, and freestanding retail stores such as major discount stores, drug stores and home improvement stores.

Investment yields on high credit quality net lease assets have traditionally exceeded those on comparably rated unsecured bonds (based on our experience in financing these assets since 1996). We believe that these two investments are comparable as they are each subject to the same credit risk (the failure of the underlying tenant or bond issuer). In addition, we believe high credit quality net lease investments present a lower overall risk than unsecured bonds. Our loan investments generally require three distinct triggering events before our cash flows from the investment are interrupted.

Trigger Number 1: Bankruptcy or default of the underlying tenant.

Trigger Number 2: Tenant rejects the underlying lease.

- Provisions of the U.S. Bankruptcy Code permit the tenant in a Chapter 11 bankruptcy reorganization to assume or reject the lease.

Trigger Number 3: Borrower/owner of the property does not meet its obligations to pay the loan.

- The borrower/owner may desire to protect its interest in the property (e.g., if the property value exceeds the loan amount or for other strategic reasons).

In addition, if these three triggers occur, we have a mortgage on the property which permits us to foreclose and sell or re-lease the property.

Our real property purchases generally require the first two triggers (but not the third), and if both occur, we, as owner of the property, can sell or re-lease the property.

Corporate Structure

We conduct substantially all of our business operations through our operating partnership, Caplease, LP (the successor-in-interest to Capital Lease Funding, LLC). We own the sole limited partnership interest of Caplease, LP and our wholly-owned subsidiary, CLF OP General Partner LLC, is the sole general partner. We conduct activities that we believe could jeopardize our REIT status, such as our gain-on-sale business, through our taxable REIT subsidiary, Caplease Services Corp. As of December 31, 2004, our company was organized as follows:

Business Segments

Beginning with this annual report on Form 10-K, we have begun reporting our results through two operating segments:

- lending investments; and
- operating net lease real estate.

Our 2004 revenues attributable to each segment and segment profit, along with a reconciliation of these amounts to our total revenue and net income, are as follows:

	Lending Investments	Operating Net Lease Real Estate	Corporate/ Unallocated	Total
		(in thousands)		
Total revenue	$ 14,045	$ 6,356	$ 603	$ 21,004
Net income (loss)	10,476	2,150	(11,266)	1,360

Our lending investments business includes our loan business as well as our investments in structured interests and structuring fees receivable.

For fiscal years 2002 and 2003, we were only in the net lease lending business, and all of our revenues and net income were allocated to that segment. See note 18 to our consolidated financial statements.

During 2004, Aon Corporation accounted for approximately $4.2 million, or 20.0%, of our total revenues. As we continue to add assets to our balance sheet and as those assets and existing assets begin to generate income, we expect revenues from our lease with Aon to generate a smaller percentage of our total revenues. Any financial difficulty or bankruptcy resulting in nonpayment or delay of rental payments and other amounts due under our lease with Aon Corporation could have a material adverse effect on our cash flows and operating results.

Our Competitive Strengths

Experienced management team. Our chief executive officer, Paul H. McDowell, our president, William R. Pollert, and our senior vice president, chief financial officer and treasurer, Shawn P. Seale, founded the predecessor to our company in 1994 and have since managed our business. Our chairman, Lewis S. Ranieri, joined us in 1995 in connection with an investment in our company by Hyperion Partners II L.P. Over the years, we have added key senior management personnel, including our senior vice president and chief investment officer, Robert C. Blanz, in 1999, who has significant rating agency experience as a former executive with Standard & Poor’s.

Market expertise. We have recognized expertise in the net lease marketplace and the specialized lease enhancement mechanisms that we helped to develop are now market standard. These lease enhancement mechanisms are discussed in detail above and are designed to mitigate or eliminate the risks associated with the termination or abatement of rent under a net lease for reasons other than the bankruptcy of the underlying tenant. We have worked extensively with Moody’s and Standard & Poor’s to develop rating criteria for net lease financing, and we continue to provide ongoing advice and assistance to these rating agencies on net lease financing issues.

Origination and underwriting capabilities. We have an experienced in-house team of originators and underwriters that originate, structure, underwrite and close our transactions. In addition, we have developed an extensive national network of borrowers, tenants, mortgage brokers, investment sale brokers, lenders, institutional investors and other market participants that helps us to identify and originate a variety of net lease financing and investment opportunities. We also have an in-depth understanding of the real estate and credit risks unique to net lease financing and investment. Prior to funding, we subject each investment we make to a comprehensive due diligence review and the approval of our investment committee. Our investment committee consists of six of our key employees. We also have an investment oversight committee of our board of directors that approves our investments in excess of $50.0 million.

Securitization expertise. We have substantial experience in securitizing net lease assets. Prior to our initial public offering, we generally structured outright sales of pools of our loans to securitization vehicles, commonly referred to as “gain-on-sale” securitizations. In addition to traditional mortgage debt, we now intend to finance our assets over the long-term through CDOs. We completed our first CDO financing in March 2005. A CDO is a form of securitization that is treated as a “financing” for tax and accounting purposes. In a CDO, we retain ownership of the securitized assets through a trust or other bankruptcy remote subsidiary and finance those assets with long-term fixed-rate debt. We seek to match the generally fixed payments on our long-term assets with long-term fixed rate debt, such that changes in prevailing interest rates, credit spreads and the credit quality of the tenant during the term of the debt obligation will not increase our financing costs for those assets. We expect this match-funded strategy to reduce our refinancing risk and to allow us to earn consistent returns on our investments.

Financing relationships. We benefit from our relationships with major financial institutions, including Wachovia Bank, N.A., a significant investor in, and secured warehouse lender to, our company. We currently may borrow up to $250.0 million under our repurchase agreement with Wachovia, provided certain conditions are met. Our relationship with Wachovia has also allowed us to obtain competitive pricing on our long-term traditional mortgage debt financings of property acquisitions.

Our Strategy

Our principal business objective is to generate attractive risk-adjusted investment returns by investing in a broad range of assets. We plan to achieve our objective by focusing on the following core business strategies:

Expanding Net Lease Lending Business. We intend to continue to build on our strong market presence and expanding borrower base to grow origination volume of our existing net lease loan products. Our existing loan products include:

Long-Term Credit Tenant Loans. We offer traditional long-dated fully amortizing (or nearly fully amortizing) or insured balloon loans secured by first mortgages on properties subject to long-term net leases, primarily to investment grade tenants. This product enables a borrower to receive the highest proceeds that a property's rent payments will support. We expect this type of loan to continue to be our primary loan product. As of December 31, 2004, our portfolio contained $167.8 million of long-term credit tenant loans.

10-Year Credit Tenant Loans. For loans secured by net leases to lower investment grade tenants or near investment grade tenants, or shorter-term leases, we have developed a 10-year credit tenant loan product, for which we have received a United States patent. These loans are bifurcated into two notes, a real estate and a corporate credit note. Both notes are secured by a first mortgage on the underlying real property and an assignment of the lease and payments under the lease. The following summarizes the characteristics of the two notes:

Real Estate Note	**Corporate Credit Note**
· 70 to 75% of loan amount	· 15 to 20% of loan amount
· Senior claim on real estate	· Junior claim on real estate
· Junior claim on rents in bankruptcy	· Senior claim on rents in bankruptcy
· 10-year term, balloon at maturity	· 10-year term, fully amortizing
• Significant debt service coverage and loan-to-value ratio	• Provides diversity and favorable yield when placed in a CDO

We typically sell the real estate note to a CMBS conduit promptly following origination, and retain the corporate credit note in our portfolio. As of December 31, 2004, our portfolio contained $13.8 million of corporate credit notes.

Recapitalized Loans. From time to time, as part of our long-term credit tenant loan program, we identify existing loans where we can offer the borrower improved terms, typically by amending the underlying lease to a long-term lease and refinancing or replacing the existing loan. We expect to continue to identify these opportunities in the future. As of December 31, 2004, our portfolio contained $24.9 million of recapitalized loans.

Acquiring Real Properties Net Leased to Credit Tenants. Since our initial public offering, we have purchased net leased properties outright and have made this one of the core components of our business. In doing so, we have drawn on our extensive experience in the net lease business to evaluate tenant credit quality, lease structures and the commercial properties subject to net leases. When we reach our target borrowing level, we anticipate that net lease real estate will constitute approximately 40% to 60% of our assets in portfolio. Management has broad authority to modify this range without stockholder approval. As of December 31, 2004, our portfolio contained $194.5 million of purchased net leased real properties.

Acquiring Structured Interests in Net Lease Assets. We intend to continue to acquire structured interests in net lease assets from time to time. These investments may include CMBS or CDOs issued by our company or others, interest-only classes of CMBS and subordinate, mezzanine and equity interests in encumbered net lease assets. We do not have a policy that limits the amount or percentage we may invest in any asset or any type of asset. When we reach our target borrowing level, we anticipate that these types of real estate securities will constitute approximately 5% to 20% of our assets in portfolio. Management has broad authority to modify this range without stockholder approval. We believe we are well positioned to evaluate these investments due to our expertise with net lease assets. As of December 31, 2004, our portfolio contained $87.8 million of structured interest in net lease assets.

Selectively Developing Net Lease Properties. We have entered into arrangements with experienced real estate developers where we have the right to provide financing of construction and pre-construction costs for up to 20 Walgreen stores to be developed. We believe these investments will offer us the ability to capture above average returns with minimal capital invested and give us an advantage in making the permanent loan on the property, or purchasing our joint venture partner's interest at completion. Our investments have been and we expect will continue to be in the form of a subordinate loan and an equity interest in the owner and developer of the underlying project. As of December 31, 2004, we have funded loans on five properties for approximately $0.8 million.

Selectively Continuing Gain-on-Sale Transactions. On a limited and opportunistic basis, we intend to continue acquiring and promptly reselling net lease assets for an immediate gain. We will conduct this gain-on-sale business through a taxable REIT subsidiary. Since our initial public offering and through December 31, 2004, we have sold $25.4 million of assets for net gains of approximately $794,000 as part of our 10-year credit tenant loan program.

Leveraging. Our financing goal is to generate interest income from the loans we originate and rental income on the properties we own in excess of the interest costs on our financings. We intend to finance our assets on a long-term basis primarily through fixed-rate financings. We believe that the use of CDO structures and other term securitization structures, as well as traditional mortgage debt, will allow us to enhance returns on our assets, while reducing our exposure to interest rate fluctuations and refinancing risk, and allowing us to earn consistent returns on our investments. Overall, we expect our leverage to average 70% to 85% of our assets in portfolio.

Introducing Value-Added, Innovative Products. As we have done in the past with our 10-year credit tenant loan product, we intend to develop new financing products and identify investment opportunities. As part of our product development strategy, we seek to design products and financing structures to assist us in meeting the specific requirements of our borrowers and tenants earlier in the construction, acquisition and borrowing cycle as a means of expanding and better controlling our asset originations. We also look for ways to expand our existing products. For example, during 2004, we began offering floating rate bridge loans to our borrowers.

Maintaining Flexibility Through Portfolio Model. Since our initial public offering, we have pursued an on-balance sheet portfolio investment strategy, rather than an originate-and-sell strategy to provide us with greater flexibility in all areas of our business to finance and acquire net lease assets that meet our risk-adjusted return criteria.

In addition to the core strategies we have outlined above, over time we intend to grow our fee-based net lease financial advisory services whereby we advise participants in the net lease market, including developers, owners and tenants of, and institutional investors in, net lease assets. We intend to conduct our financial advisory business through a taxable REIT subsidiary. In the future, we intend to explore acting, either directly or through a taxable REIT subsidiary, as a primary servicer, subservicer or special servicer of our asset portfolio. By doing so, we believe we would be afforded greater control over the performance of our portfolio. We presently outsource the servicing of our net lease assets.

Portfolio

Our shift in strategy subsequent to our initial public offering allowed us to invest in net lease assets (including real properties) for the medium to long-term and we plan to continue to invest in these types of assets for investment by leveraging our existing portfolio and with additional funds from future capital raising activity and our operations.

When we discuss our assets in portfolio, we mean the following categories of assets which are included on our balance sheet:

	Balance as of 12/31/04 *(in thousands)*	
Owned Properties	$	194,541

Mortgage Loans		206,510(1)
Development Loans		837
Structured Interests		87,756
Structuring Fees		4,426
Total	$	494,070

(1) Reflects our carry value less deferred origination costs of $546.

Owned Properties.

The following is a tabular presentation of the properties that we own and related data as of December 31, 2004.

Tenant or Guarantor	Location	Ratings (S&P/Moody's)[1]	Business Category	Square Feet	Property Type	Purchase Date	Lease Maturity	(in thousands)[2] 2005 Estimated Annual Rent[3]	Purchase Price	Book Value as of 12/31/04
Abbott Laboratories	Columbus, OH	AA/A1	Office	111,776	Office	11/2004	10/2016	$ 893	$ 12,025	$ 12,013
Aon Corporation[4]	Glenview, IL	BBB+/Baa2	Office	416,209	Office	8/2004	4/2017	6,151	85,750	85,934
Baxter International, Inc.	Bloomington, IN	A-/Baa1	Office/Whse	125,500	Office/Whse	10/2004	9/2016	790	10,500	10,722
Bob's Stores, Corp.	Randolph, MA	A-/A3[5]	Retail	88,420	Retail Store	9/2004	1/2014	744	10,450	14,051
Choice Hotels International, Inc.[6]	Silver Spring, MD	BBB-/Baa3	Office	223,912	Office	11/2004	5/2013	4,587	43,500	45,475
Crozer-Keystone Health System	Ridley Park, PA	Private[7]	Medical Office	22,708	Office	8/2004	4/2019	397	4,477	5,139
Department of Veterans Affairs	Ponce, PR	Private[8]	Office	56,500	Office	11/2004	2/2015	1,300	13,600	13,620
Walgreen Co.	Pennsauken, NJ	A+/Aa3	Retail Drug	18,500	Retail Store	11/2004	10/2016	297	3,089	3,239
Walgreen Co.	Portsmouth, VA	A+/Aa3	Retail Drug	13,905	Retail Store	11/2004	7/2018	356	4,165	4,350
Totals								**$ 15,515**	**$ 187,556**	**$ 194,541**

(1) Ratings represent publicly available long-term corporate credit rating or long-term senior unsecured debt ratings as of December 31, 2004.

(2) All amounts are rounded to the nearest thousand. Sums may not equal totals due to rounding.

(3) Reflects annual rent due for 2005 under our lease with the tenant. Does not include expense recoveries or above or below market rent amortization adjustments required by Statement of Financial Accounting Standards No. 141.

(4) As of December 31, 2004, approximately 2% of the property was leased to one other tenant.

(5) Represents the credit rating of CVS Corporation, the guarantor of the lease. Bob's Stores, Corp. is a wholly-owned subsidiary of The TJX Companies, Inc.

(6) As of December 31, 2004, approximately 29% of the property was leased to six other tenants.

(7) The credit does not carry public ratings from S&P or Moody's. The credit's subsidiary had a Baa2 rating from Moody's as of December 31, 2004.

(8) The Department of Veterans Affairs has no public rating from S&P or Moody's. The Department of Veterans Affairs is an independent establishment of the executive branch of the United States government.

Mortgage Loans.

Our outstanding mortgage loans as of December 31, 2004 are summarized in the following table.

									(in thousands)[2]		
										As of 12/31/04	
Tenant or Guarantor	**Location**	**Ratings (S&P/ Moody's)[1]**	**Business Category**	**Square Feet**	**Property Type**	**Coupon**	**Lease Expiration**	**Loan Maturity**	**Original Principal Balance**	**Principal Balance**	**Book Value**
Long-Term Credit Tenant Loans											
Autozone, Inc.	Douglas, GA / Valdosta, GA[4]	BBB+/Baa2	Auto Parts Store	13,383	Retail Store	6.50%	6/2023 / 4/2024	11/2022	$ 2,108	$ 2,103	$ 2,10
Best Buy Co., Inc..	Chicago, IL	BBB-/Baa3	Retail	45,720	Retail Store	6.43%	3/2025	3/2025	17,609	17,609	17,60
City of Jasper, TX	Jasper, TX	NR/Baa3	Office	12,750	Office	7.00%	12/2024	11/2024	1,736	1,736	1,63
CVS Corporation	Asheville, NC	A-/A3	Retail Drug	10,880	Retail Store	6.53%	1/2026	1/2026	2,360	2,336	2,40
CVS Corporation	Athol, MA	A-/A3	Retail Drug	13,013	Retail Store	6.46%	1/2025	1/2025	1,502	1,501	1,50
CVS Corporation	Bangor, PA	A-/A3	Retail Drug	13,013	Retail Store	6.28%	1/2026	1/2026	2,521	2,472	2,43
CVS Corporation	Bluefield, WV	A-/A3	Retail Drug	10,125	Retail Store	8.00%	1/2021	1/2021	1,439	1,354	1,49
CVS Corporation	Oak Ridge, NC	A-/A3	Retail Drug	10,880	Retail Store	6.99%	1/2025	8/2024	3,243	3,224	3,22
CVS Corporation	Sunbury, PA	A-/A3	Retail Drug	10,125	Retail Store	7.50%	1/2021	1/2021	1,829	1,699	1,62
CVS Corporation	Washington, DC	A-/A3	Retail Drug	7,920	Retail Store	8.10%	1/2023	1/2023	2,781	2,569	2,70
Home Depot U.S.A., Inc.	Tullytown, PA	Private[3]	Retail	116,016	Retail Store	6.62%	1/2033	1/2033	8,447	8,444	8,44
Home Depot U.S.A., Inc.	Westminster, CO	Private[3]	Retail	107,400	Retail Store	7.50%	7/2018	5/2009	8,500	8,581	8,55
Kohl's Corporation	Chicago, IL	A-/A3	Retail	133,000	Retail Store	6.69%	9/2030	9/2030	48,270	48,270	48,27
Koninklijke Ahold n.v.	North Kingstown, RI	BB/Ba3	Retail Grocer	125,772	Retail Store	7.50%	11/2025	11/2025	6,794	6,693	6,67
Koninklijke Ahold n.v.	Tewksbury, MA	BB/Ba3	Retail Grocer	58,450	Retail Store	7.50%	1/2027	1/2027	6,625	6,572	6,56

Koninklijke Ahold n.v.	Upper Darby, PA	BB/Ba3	Retail Grocer	54,800	Retail Store	7.29%	4/2024	4/2024	6,889	6,799	6,4
Lowe's Companies, Inc	Matamoras, PA	A+/A2	Retail	162,070	Retail Store	6.61%	5/2030	5/2030	7,208	7,196	7,1
National City Bank of the Midwest (f/k/a National City Bank of Michigan/Illinois)	Chicago, IL	A+/Aa3	Bank Branch	5,274	Bank Branch	5.89%	12/2024	12/2024	3,114	3,114	3,2
Neiman Marcus Group, Inc	Las Vegas, NV	BBB/Baa2	Retail	167,000	Retail Store	6.06%	11/2022	11/2021	8,267	7,900	8,6
United States Postal Service	Sammon Bay, AK	Private(6)	Post Office	2,080	Post Office	7.05%	10/2021	10/2021	1,015	986	1,0
University of Connecticut Health Center	Farmington, CT	AA/Aa3(7)	Medical	100,000	Medical Office	6.34%	11/2029	11/2024	22,800	22,752	23,6
Walgreen Co.	Dallas, TX(8)	A+/Aa3	Retail Drug	14,550	Retail Store	6.46%	12/2029	12/2029	2,718	2,718	2,7
									167,775	166,628	168,2

9

									(in thousands)[2]	As of 12/31/04		
Tenant or Guarantor	**Location**	**Ratings (S&P/ Moody's)[1]**	**Business Category**	**Square Feet**	**Property Type**	**Coupon**	**Lease Expiration**	**Loan Maturity**	**Original Principal Balance**	**Principal Balance**	**Book Value**	**Loan to Realty Value[3]**
Corporate Credit Notes												
Albertson's, Inc.	Los Angeles, CA	BBB/Baa2	Retail Drug	16,475	Retail Store	6.50%	7/2028	9/2013	437	398	354	85%
Albertson's, Inc.	Norwalk, CA	BBB/Baa2	Retail Drug	14,696	Retail Store	6.33%	12/2028	12/2013	470	436	430	76%
Best Buy Co., Inc	Olathe, KS	BBB-/Baa3	Retail - Elect.	48,744	Retail Store	5.40%	1/2018	6/2013	1,779	1,595	1,512	86%
Best Buy Co., Inc	Wichita Falls, TX	BBB-/Baa3	Retail - Elect.	30,038	Retail Store	6.15%	1/2017	11/2012	743	631	593	81%
CVS Corporation	Clemmons, NC	A-/A3	Retail Drug	10,880	Retail Store	5.54%	1/2022	1/2015	285	285	271	66%
CVS Corporation	Commerce, MI	A-/A3	Retail Drug	10,880	Retail Store	5.85%	4/2025	5/2013	501	448	429	89%
CVS Corporation	Garwood, NJ	A-/A3	Retail Drug	11,970	Retail Store	6.12%	6/2025	8/2013	879	791	764	87%
CVS Corporation	Kennett Square, PA	A-/A3	Retail Drug	12,150	Retail Store	6.40%	1/2025	10/2012	857	716	685	90%
CVS Corporation	Knox, IN	A-/A3	Retail Drug	10,125	Retail Store	7.60%	1/2024	12/2011	322	250	249	75%
CVS Corporation	Rockingham, NC	A-/A3	Retail Drug	10,125	Retail Store	6.12%	1/2025	10/2013	435	397	386	82%
CVS Corporation	Rutherford College, NC	A-/A3	Retail Drug	10,125	Retail Store	6.12%	1/2025	10/2013	346	321	312	83%
FedEx Ground Package System, Inc.	McCook, IL	Private[9]	Distribution/ Whse/Office	159,699	Distribution/ Whse/Office	5.89%	1/2019	2/2015	2,737	2,737	2,699	86%
FedEx Ground Package System, Inc.	Reno, NV	Private[9]	Distribution/ Whse/Office	106,396	Distribution/ Whse/Office	5.90%	9/2018	10/2014	1,374	1,357	1,341	81%
PerkinElmer, Inc.	Beltsville, MD	BB+/Ba2	Global Tech.	65,862	Light Industrial							