

NATIONAL RETAIL PROPERTIES, INC.

Form 10-Q

August 04, 2011

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from            to

Commission File Number 001-11290

**NATIONAL RETAIL PROPERTIES, INC.**

(Exact name of registrant as specified in its charter)

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**Maryland** **56-1431377**  
(State or other jurisdiction of **(I.R.S. Employer**  
**incorporation or organization)** **Identification No.)**  
**450 South Orange Avenue, Suite 900, Orlando, Florida 32801**  
**(Address of principal executive offices, including zip code)**  
**(407) 265-7348**  
**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) for 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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  Smaller reporting company

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

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

86,034,800 shares of common stock, \$0.01 par value, outstanding as of July 28, 2011.

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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements**

## NATIONAL RETAIL PROPERTIES, INC.

## and SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share data)

	June 30, 2011 (unaudited)	December 31, 2010
<b><u>ASSETS</u></b>		
Real estate, Investment Portfolio:		
Accounted for using the operating method, net of accumulated depreciation and amortization	\$ 2,603,827	\$ 2,519,950
Accounted for using the direct financing method	28,475	29,773
Real estate, Inventory Portfolio, held for sale	31,350	32,076
Investment in unconsolidated affiliate	4,423	4,515
Mortgages, notes and accrued interest receivable, net of allowance	32,402	30,331
Commercial mortgage residual interests	16,245	15,915
Cash and cash equivalents	3,588	2,048
Receivables, net of allowance of \$1,934 and \$1,750, respectively	2,424	3,403
Accrued rental income, net of allowance of \$4,364 and \$3,609, respectively	25,386	25,535
Debt costs, net of accumulated amortization of \$13,674 and \$11,198, respectively	9,669	9,366
Other assets	41,018	40,663
<b>Total assets</b>	<b>\$ 2,798,807</b>	<b>\$ 2,713,575</b>
<b><u>LIABILITIES AND EQUITY</u></b>		
Liabilities:		
Line of credit payable	\$ 219,200	\$ 161,000
Mortgages payable	23,728	24,269
Notes payable convertible, net of unamortized discount of \$8,967 and \$12,201, respectively	352,768	349,534
Notes payable, net of unamortized discount of \$1,017 and \$1,118, respectively	598,983	598,882
Accrued interest payable	7,285	7,342
Other liabilities	40,395	43,774
<b>Total liabilities</b>	<b>1,242,359</b>	<b>1,184,801</b>
Equity:		
Stockholders' equity:		
Preferred stock, \$0.01 par value. Authorized 15,000,000 shares		
Series C, 3,680,000 depositary shares issued and outstanding, at stated liquidation value of \$25 per share	92,000	92,000
Common stock, \$0.01 par value. Authorized 190,000,000 shares; 86,034,430 and 83,613,289 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	862	838
Excess stock, \$0.01 par value. Authorized 205,000,000 shares; none issued or outstanding		
Capital in excess of par value	1,487,290	1,429,750
Retained earnings (accumulated dividends in excess of earnings)	(21,922)	3,234
Accumulated other comprehensive income (loss)	(3,069)	1,661

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Total stockholders' equity of NNN	1,555,161	1,527,483
Noncontrolling interests	1,287	1,291
Total equity	1,556,448	1,528,774
Total liabilities and equity	\$ 2,798,807	\$ 2,713,575

See accompanying notes to condensed consolidated financial statements.

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## NATIONAL RETAIL PROPERTIES, INC.

## and SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(dollars in thousands, except per share data)

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
<b>Revenues:</b>				
Rental income from operating leases	\$ 58,154	\$ 52,106	\$ 115,494	\$ 104,025
Earned income from direct financing leases	713	755	1,473	1,519
Percentage rent	132	129	245	184
Real estate expense reimbursement from tenants	2,197	1,591	4,532	3,349
Interest and other income from real estate transactions	543	973	1,181	1,922
Interest income on commercial mortgage residual interests	777	858	1,544	1,907
	62,516	56,412	124,469	112,906
<b>Disposition of real estate, Inventory Portfolio:</b>				
Gross proceeds		5,600		5,600
Costs		(4,959)		(4,959)
Gain		641		641
<b>Retail operations:</b>				
Revenues	12,450	8,696	21,300	15,233
Operating expenses	(11,760)	(8,265)	(20,612)	(14,935)
Net	690	431	688	298
<b>Operating expenses:</b>				
General and administrative	6,568	5,775	13,226	11,372
Real estate	4,026	3,143	7,748	6,615
Depreciation and amortization	13,871	11,926	27,395	23,732
Impairment commercial mortgage residual interests valuation	267	165	396	3,848
	24,732	21,009	48,765	45,567
Earnings from operations	38,474	36,475	76,392	68,278
<b>Other expenses (revenues):</b>				
Interest and other income	(283)	(637)	(625)	(905)
Interest expense	17,512	16,034	35,174	32,024
	17,229	15,397	34,549	31,119

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Earnings from continuing operations before income tax expense and equity in earnings of unconsolidated affiliate	21,245	21,078	41,843	37,159
Income tax expense	(210)	(223)	(191)	(327)
Equity in earnings of unconsolidated affiliate	104	108	213	214
Earnings from continuing operations	21,139	20,963	41,865	37,046
Earnings (loss) from discontinued operations (Note 7):				
Real estate, Investment Portfolio, net of income tax expense	(17)	566	(21)	641
Real estate, Inventory Portfolio, net of income tax expense	147	121	279	261
	130	687	258	902

See accompanying notes to condensed consolidated financial statements.

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## NATIONAL RETAIL PROPERTIES, INC.

## and SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS - CONTINUED

(dollars in thousands, except per share data)

(unaudited)

	Quarter Ended			
	2011	June 30, 2010	2011	Six Months Ended June 30, 2010
Earnings including noncontrolling interests	\$ 21,269	\$ 21,650	\$ 42,123	\$ 37,948
Loss (earnings) attributable to noncontrolling interests:				
Continuing operations	67	(489)	93	(346)
Discontinued operations	(33)	45	(93)	(31)
	34	(444)		(377)
Net earnings attributable to NNN	\$ 21,303	\$ 21,206	\$ 42,123	\$ 37,571
Net earnings attributable to NNN	\$ 21,303	\$ 21,206	\$ 42,123	\$ 37,571
Series C preferred stock dividends	(1,696)	(1,696)	(3,392)	(3,392)
Net earnings available to common stockholders	\$ 19,607	\$ 19,510	\$ 38,731	\$ 34,179
Net earnings per share of common stock:				
Basic:				
Continuing operations	\$ 0.23	\$ 0.22	\$ 0.46	\$ 0.40
Discontinued operations	0.00	0.01	0.00	0.01
Net earnings	\$ 0.23	\$ 0.23	\$ 0.46	\$ 0.41
Diluted:				
Continuing operations	\$ 0.23	\$ 0.22	\$ 0.46	\$ 0.40
Discontinued operations	0.00	0.01	0.00	0.01
Net earnings	\$ 0.23	\$ 0.23	\$ 0.46	\$ 0.41
Weighted average number of common shares outstanding:				
Basic	84,409,788	82,694,624	83,771,728	82,589,917
Diluted	84,725,968	82,825,423	84,271,352	82,717,975

See accompanying notes to condensed consolidated financial statements.





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## NATIONAL RETAIL PROPERTIES, INC.

## and SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

	Six Months Ended	
	2011	June 30, 2010
Cash flows from operating activities:		
Earnings including noncontrolling interests	\$ 42,123	\$ 37,948
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Performance incentive plan expense	3,297	2,712
Stock option expense tax effect		122
Depreciation and amortization	27,678	24,192
Impairment commercial mortgage residual interests valuation	396	3,848
Amortization of notes payable discount	3,335	3,130
Amortization of deferred interest rate hedges	(85)	(82)
Equity in earnings of unconsolidated affiliate	(213)	(214)
Distributions received from unconsolidated affiliate	286	286
Gain on disposition of real estate, Investment Portfolio	(30)	(377)
Gain on disposition of real estate, Inventory Portfolio	(102)	(941)
Income tax valuation allowance		265
Other	82	(67)
Change in operating assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Additions to real estate, Inventory Portfolio	(212)	(335)
Proceeds from disposition of real estate, Inventory Portfolio	1,058	42,817
Decrease in real estate leased to others using the direct financing method	802	753
Increase in work in process	(575)	(324)
Increase in mortgages, notes and accrued interest receivable	(88)	(39)
Decrease (increase) in receivables	998	(1,680)
Decrease (increase) in commercial mortgage residual interests	(127)	1,284
Decrease (increase) accrued rental income	149	(91)
Decrease (increase) in other assets	(19)	74
Decrease in accrued interest payable	(57)	(7)
Decrease in other liabilities	(1,631)	(3,167)
Increase in tax liability	794	216
Net cash provided by operating activities	77,859	110,323
Cash flows from investing activities:		
Proceeds from the disposition of real estate, Investment Portfolio	807	5,704
Additions to real estate, Investment Portfolio:		
Accounted for using the operating method	(111,673)	(23,003)
Accounted for using the direct financing method	(1,747)	
Increase in mortgages and notes receivable	(4,090)	(8,362)
Principal payments on mortgages and notes	2,107	9,358
Payment of lease costs	(672)	(686)

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Other	402	(1,610)
Net cash used in investing activities	\$ (114,866)	\$ (18,599)

See accompanying notes to condensed consolidated financial statements.

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## NATIONAL RETAIL PROPERTIES, INC.

## and SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED

(dollars in thousands)

(unaudited)

	Six Months Ended June 30,	
	2011	2010
<b>Cash flows from financing activities:</b>		
Proceeds from line of credit payable	\$ 328,800	\$
Repayment of line of credit payable	(270,600)	
Payment of interest rate hedge	(5,300)	
Payment of debt costs	(2,920)	
Repayment of mortgages payable	(541)	(533)
Proceeds from issuance of common stock	56,391	11,832
Payment of Series C preferred stock dividends	(3,392)	(3,392)
Payment of common stock dividends	(63,887)	(62,174)
Noncontrolling interest contributions	41	11
Noncontrolling interest distributions	(45)	(861)
Net cash provided by (used in) financing activities	38,547	(55,117)
Net increase in cash and cash equivalents	1,540	36,607
Cash and cash equivalents at beginning of period	2,048	15,225
Cash and cash equivalents at end of period	\$ 3,588	\$ 51,832
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid, net of amount capitalized	\$ 33,230	\$ 31,054
Taxes paid (received)	\$ (487)	\$ 305
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Issued 139,351 and 392,474 shares of restricted and unrestricted common stock in 2011 and 2010, respectively, pursuant to NNN's performance incentive plan	\$ 3,407	\$ 7,490
Issued 4,623 and 5,372 shares of common stock in 2011 and 2010, respectively, to directors pursuant to NNN's performance incentive plan	\$ 118	\$ 118
Issued 13,879 and 12,528 shares of common stock in 2011 and 2010, respectively, pursuant to NNN's Deferred Director Fee Plan	\$ 245	\$ 186
Surrender of 4,494 shares of restricted stock in 2011	\$ 94	
Change in lease classification (direct financing lease to operating lease)	\$ 2,243	

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Change in other comprehensive income	\$ (4,730)	58
Mortgage receivable accepted in connection with real estate transactions	\$	\$ 5,950
Mortgages payable assumed in connection with real estate transactions	\$	\$ 5,432
Real estate acquired in connection with mortgage receivable foreclosure	\$	\$ 4,350

See accompanying notes to condensed consolidated financial statements.

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NATIONAL RETAIL PROPERTIES, INC.

and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011

(unaudited)

**Note 1 Organization and Summary of Significant Accounting Policies:**

**Organization and Nature of Business** National Retail Properties, Inc., a Maryland corporation, is a fully integrated real estate investment trust ( REIT ) formed in 1984. The term NNN or the Company refers to National Retail Properties, Inc. and all of its consolidated subsidiaries. NNN has elected to treat certain subsidiaries as taxable REIT subsidiaries. These taxable subsidiaries and their majority owned and controlled subsidiaries are collectively referred to as the TRS.

NNN's operations are divided into two primary business segments: (i) investment assets, including real estate assets, mortgages and notes receivable and commercial mortgage residual interests (collectively, Investment Assets ), and (ii) inventory real estate assets ( Inventory Assets ). NNN acquires, owns, invests in, and develops properties that are leased primarily to retail tenants under long-term net leases and primarily held for investment ( Investment Properties or Investment Portfolio ). NNN's Investment Portfolio consisted of the following:

	June 30, 2011
<b>Investment Portfolio:</b>	
Total properties (including retail operations)	1,248
Gross leasable area (square feet)	13,623
States	46

The Inventory Assets typically represent direct and indirect investment interests in real estate assets acquired or developed primarily for the purpose of selling the real estate ( Inventory Properties or Inventory Portfolio ). NNN owned 16 Inventory Properties at June 30, 2011.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America. The unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. Operating results for the quarter and six months ended June 30, 2011, may not be indicative of the results that may be expected for the year ending December 31, 2011. Amounts as of December 31, 2010, included in the condensed consolidated financial statements have been derived from the audited consolidated financial statements as of that date. The unaudited condensed consolidated financial statements, included herein, should be read in conjunction with the consolidated financial statements and notes thereto as well as Management's Discussion and Analysis of Financial Condition and Results of Operations in NNN's Form 10-K for the year ended December 31, 2010.

**Principles of Consolidation** NNN's condensed consolidated financial statements include the accounts of each of the respective majority owned and controlled affiliates, including transactions whereby NNN has been determined to be the primary beneficiary in accordance with the Financial Accounting Standards Board ( FASB ) guidance included in *Consolidation*. All significant intercompany account balances and transactions have been eliminated.

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**Investment in an Unconsolidated Affiliate** NNN accounts for its investment in an unconsolidated affiliate under the equity method of accounting.

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

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

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

**Goodwill** Goodwill arises from business combinations and represents the excess of the cost of an acquired entity over the net fair value amounts that were assigned to the assets acquired and the liabilities assumed. In accordance with the FASB guidance included in *Goodwill*, NNN performs impairment testing on goodwill by comparing fair value to carrying amount annually.

**Other Comprehensive Income** The components for the change in other comprehensive income (loss) consisted of the following (dollars in thousands):

	Six Months Ended June 30, 2011
Balance at beginning of period	\$ 1,661
Amortization of interest rate hedges	(85)
Fair value treasury locks	(5,218)
Unrealized gain commercial mortgage residual interests	599
Stock value adjustment	(26)
Balance at end of period	\$ (3,069)

NNN's total comprehensive income consisted of the following (dollars in thousands):

	Quarter Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Net earnings	\$ 21,303	\$ 21,206	\$ 42,123	\$ 37,571
Other comprehensive income (loss)	(6,391)	(18)	(4,730)	32
Comprehensive income including noncontrolling interests	14,912	21,188	37,393	37,603
Comprehensive (income) loss attributable to noncontrolling interests		(73)		26
Comprehensive income attributable to NNN	\$ 14,912	\$ 21,115	\$ 37,393	\$ 37,629

**Earnings Per Share** Earnings per share have been computed pursuant to the FASB guidance included in *Earnings Per Share*. Effective January 1, 2009, the guidance requires classification of the Company's unvested restricted share units which contain rights to receive nonforfeitable dividends, as participating securities requiring the two-class method of computing earnings per share. Under the two-class method, earnings per common share are computed by dividing the sum of distributed earnings to common stockholders and undistributed earnings allocated to common





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stockholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities based on the weighted average shares outstanding during the period.

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

	Quarter Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
<b>Basic and Diluted Earnings:</b>				
Net earnings attributable to NNN	\$ 21,303	\$ 21,206	\$ 42,123	\$ 37,571
Less: Series C preferred stock dividends	(1,696)	(1,696)	(3,392)	(3,392)
Net earnings available to NNN's common stockholders	19,607	19,510	38,731	34,179
Less: Earnings attributable to unvested restricted shares	(152)	(92)	(286)	(144)
Net earnings used in basic earnings per share	19,455	19,418	38,445	34,035
<b>Reallocated undistributed income</b>				
Net earnings used in diluted earnings per share	\$ 19,455	\$ 19,418	\$ 38,445	\$ 34,035
<b>Basic and Diluted Weighted Average Shares Outstanding:</b>				
Weighted average number of shares outstanding	85,309,082	83,344,447	84,635,929	83,149,908
Less: contingent shares	(251,826)		(251,826)	
Less: unvested restricted stock	(647,468)	(649,823)	(612,375)	(559,991)
Weighted average number of shares outstanding used in basic earnings per share	84,409,788	82,694,624	83,771,728	82,589,917
<b>Effects of dilutive securities:</b>				
Common stock options	3,162	3,866	3,305	4,151
Convertible debt	160,006		346,699	
Directors' deferred fee plan	153,012	126,933	149,620	123,907
Weighted average number of shares outstanding used in diluted earnings per share	84,725,968	82,825,423	84,271,352	82,717,975

The potential dilutive shares related to certain convertible notes payable were not included in computing earnings per common share for the quarter and six months ended June 30, 2011 and 2010 because their effects would be antidilutive.

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

Level 1 Valuation is based upon quoted prices in active markets for identical assets or liabilities.

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Level 2 Valuation is based upon inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include option pricing models, discounted cash flow models and similar techniques.

**New Accounting Pronouncements** In May 2011, the FASB amended its guidance on Fair Value Measurements, providing a consistent definition and measurement of fair value, as well as similar disclosure requirements between U.S. GAAP and International Financial Reporting Standards. The new guidance changes certain fair value measurement principles, clarifies the application of existing fair value measurement and expands the disclosure requirements, particularly for Level 3 fair value measurements. The new guidance will be effective for fiscal years beginning after December 1, 2011. The adoption of this guidance is not expected to have a material effect on the Company's condensed consolidated financial statements, but may require certain additional disclosures.

In June 2011, the FASB amended its guidance on the presentation of comprehensive income in financial statements. The new guidance requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions of this new guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. NNN is currently evaluating the provisions to determine the potential impact, if any, the adoption will have on its financial position and results of operations.

**Use of Estimates** Management of NNN has made a number of estimates and assumptions relating to the reporting of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Significant estimates include provision for impairment and allowances for certain assets, accruals, useful lives of assets and capitalization of costs. Actual results could differ from these estimates.

**Reclassification** Certain items in the prior year's consolidated financial statements and notes to consolidated financial statements have been reclassified to conform to the 2011 presentation.

**Note 2 Real Estate - Investment Portfolio:**

**Leases** The following outlines key information for NNN's Investment Property leases:

	June 30, 2011
Lease classification:	
Operating	1,213
Direct financing	16
Building portion direct financing / land portion operating	6
Weighted average remaining lease term	12 Years

The leases generally provide for limited increases in rent as a result of fixed increases, increases in the consumer price index, and/or increases in the tenant's sales volume. Generally, the tenant is also required to pay all property taxes and assessments, substantially maintain the interior and exterior of the building and carry property and liability insurance coverage. Certain of NNN's Investment Properties are subject to leases under which NNN retains responsibility for certain costs

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and expenses of the property. Generally, the leases of the Investment Properties provide the tenants with one or more multi-year renewal options subject to generally the same terms and conditions, including rent increases, consistent with the initial lease term.

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

	June 30, 2011	December 31, 2010
Land and improvements	\$ 1,159,787	\$ 1,122,243
Buildings and improvements	1,663,800	1,592,752
Leasehold interests	1,290	1,290
	2,824,877	2,716,285
Less accumulated depreciation and amortization	(246,348)	(222,921)
	2,578,529	2,493,364
Work in process	25,298	26,586
	\$ 2,603,827	\$ 2,519,950

NNN has remaining funding commitments as follows (dollars in thousands):

	Total Commitment <sup>(1)</sup>	June 30, 2011 Amount Funded	Remaining Commitment
Investment Portfolio	\$ 92,534	\$ 55,579	\$ 36,955

<sup>(1)</sup> Includes land and construction costs.

**Note 3 Commercial Mortgage Residual Interests:**

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

Due to changes in loan performance relating to the Residuals, the independent valuation adjusted certain of the valuation assumptions. The following table summarizes the key assumptions used in determining the value of the Residuals as of:

	June 30, 2011	December 31, 2010
Discount rate	25%	25%
Average life equivalent CPR speeds range	2.18% to 20.77% CPR	4.35% to 20.37% CPR
Foreclosures:		
Frequency curve default model	0.2% -14.7% range	0.1% -15.0% range
Loss severity of loans in foreclosure	20%	20%

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Yield:

LIBOR	Forward 3-month curve	Forward 3-month curve
Prime	Forward curve	Forward curve

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Unrealized gains	\$ 539	\$ 35	\$ 599	\$ 127
Other than temporary valuation impairment	\$ 267	\$ 165	\$ 396	\$ 3,848

**Note 4 Line of Credit Payable:**

In May 2011, NNN amended and restated its credit agreement increasing the borrowing capacity under its unsecured revolving credit facility from \$400,000,000 to \$450,000,000 and amending certain other terms under the former revolving credit facility (as the context requires, the previous and new revolving credit facility, the Credit Facility). The Credit Facility had a weighted average outstanding balance of \$191,099,000 and a weighted average interest rate of 3.3% during the six months ended June 30, 2011. The Credit Facility matures May 2015, with an option to extend maturity to May 2016. The Credit Facility bears interest at LIBOR plus 150 basis points; however, such interest rate may change pursuant to a tiered interest rate structure based on NNN's debt rating. The Credit Facility also includes an accordion feature for NNN to increase the facility size up to \$650,000,000. As of June 30, 2011, \$219,200,000 was outstanding and \$230,800,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling \$57,000.

**Note 5 Stockholders Equity:**

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

	Six Months Ended June 30,	
	2011	2010
Series C preferred stock <sup>(1)</sup> :		
Dividends	\$ 3,392	\$ 3,392
Per share	0.9218	0.9218
Common stock:		
Dividends	63,887	62,174
Per share	0.760	0.750

<sup>(1)</sup> The Series C preferred stock has no maturity date and will remain outstanding unless redeemed.

In July 2011, NNN declared a dividend of \$0.385 per share, which is payable in August 2011 to its common stockholders of record as of July 29, 2011.

In June 2009, NNN filed a shelf registration statement with the Securities and Exchange Commission for its Dividend Reinvestment and Stock Purchase Plan (DRIP). The following outlines the common stock issuances pursuant to the DRIP (dollars in thousands):

	Six Months Ended June 30,	
	2011	2010
Shares of common stock issued	2,284,335	561,107
Net proceeds	\$ 56,447	\$ 11,770



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**Note 6 Income Taxes:**

NNN has elected to be taxed as a REIT under the Internal Revenue Code ( Code ), commencing with its taxable year ended December 31, 1984. To qualify as a REIT, NNN must meet a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its REIT taxable income to its stockholders. NNN intends to adhere to these requirements and maintain its REIT status. As a REIT, NNN generally will not be subject to corporate level federal income tax on taxable income that it distributes currently to its stockholders. NNN may be subject to certain state and local taxes on its income and property, and to federal income and excise taxes on its undistributed taxable income, if any. The provision for federal income taxes in NNN's consolidated financial statements relates to its TRS operations and any potential taxable built-in gain. NNN did not have significant tax provisions or deferred income tax items during the periods reported hereunder.

In June 2006, the FASB issued guidance, which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB guidance included in *Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

NNN, in accordance with FASB guidance included in *Income Taxes*, has analyzed its various federal and state filing positions. NNN believes that its income tax filing positions and deductions are well documented and supported. Additionally, NNN believes that its accruals for tax liabilities are adequate. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to the FASB guidance. In addition, NNN did not record a cumulative effect adjustment related to the adoption of the FASB guidance.

NNN has had no increases or decreases in unrecognized tax benefits for current or prior years since adopting the guidance. Further, no interest or penalties have been included since no reserves were recorded and no significant increases or decreases are expected to occur within the next 12 months. When applicable, such interest and penalties will be recorded as non-operating expenses. The periods that remain open under federal statute are 2007 through 2011. NNN also files in many states with varying open years under statute.

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Real Estate Investment Portfolio NNN classified the revenues and expenses related to (i) all Investment Properties that were sold and leasehold interests which expired, and (ii) all Investment Properties that were held for sale as of June 30, 2011, as discontinued operations. The following is a summary of the earnings from discontinued operations from the Investment Portfolio (dollars in thousands):

	Quarter Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
<b>Revenues:</b>				
Rental income from operating leases	\$ 30	\$ 302	\$ 56	\$ 487
Real estate expense reimbursement from tenants	4	19	8	34
Interest and other income from real estate transactions	5	5	5	33
	39	326	69	554
<b>Operating expenses:</b>				
General and administrative				14
Real estate	53	39	108	123
Depreciation and amortization	4	59	9	139
	57	98	117	276
Earnings (loss) before gain on disposition of real estate and income tax expense	(18)	228	(48)	278
Gain on disposition of real estate	1	355	30	377
Income tax expense		(17)	(3)	(14)
Earnings (loss) from discontinued operations attributable to NNN	\$ (17)	\$ 566		