CapLease, Inc.
Form 10-Q
November 09, 2012

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 September 30, 2012

OR

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

For the transition period from to

Commission file number 001-32039

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 (Address of Principal Executive Offices)	10018 (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 x No o

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 x No o

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

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

As of November 8, 2012, there were 66,766,965 shares of common stock of CapLease, Inc., $0.01 par value per share, outstanding (“Common Stock”).

CapLease, Inc.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CapLease, Inc. and Subsidiaries
Consolidated Balance Sheets
As of September 30, 2012 (unaudited) and December 31, 2011

(Amounts in thousands, except share and per share amounts)	As Of September 30, 2012	As Of December 31, 2011
Assets		
Real estate investments, net	$1,457,284	$1,401,526
Loans held for investment, net	28,569	33,139
Commercial mortgage-backed securities	59,904	59,435
Cash and cash equivalents	40,192	71,160
Other assets	89,018	76,363
Total Assets	$1,674,967	$1,641,623
Liabilities and Equity		
Mortgages on real estate investments	$986,629	$972,924
Credit agreements	48,097	70,668
Secured term loan	76,100	88,142
Convertible senior notes	35,007	34,522
Other long-term debt	30,930	30,930
Total Debt Obligations	1,176,763	1,197,186
Intangible liabilities on real estate investments	33,579	35,219
Accounts payable and other liabilities	28,055	17,371
Dividends and distributions payable	7,532	5,946
Total Liabilities	1,245,929	1,255,722
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value, 100,000,000 shares authorized:		
Series A cumulative redeemable preferred, liquidation preference $25.00 per share, 3,401,107 and 3,204,900 shares issued and outstanding, respectively	78,649	73,880
Series B cumulative redeemable preferred, liquidation preference $25.00 per share, 2,140,913 and 0 shares issued and outstanding, respectively	51,800	–
Common stock, $0.01 par value, 500,000,000 shares authorized, 66,766,965 and 66,275,535 shares issued and outstanding, respectively	668	663
Additional paid in capital	300,522	321,303
Accumulated other comprehensive loss	(3,653)	(11,051)
Total Stockholders' Equity	427,986	384,795
Non-controlling interest in consolidated subsidiaries	1,052	1,106
Total Equity	429,038	385,901
Total Liabilities and Equity	$1,674,967	$1,641,623

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 September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
Revenues:				
Rental revenue	$35,137	$32,362	$101,815	$95,302
Interest income from loans and securities	1,921	4,774	6,026	17,386
Tenant reimbursements	4,552	3,574	11,939	10,072
Other revenue	182	156	693	601
Total revenues	41,792	40,866	120,473	123,361
Expenses:				
Interest expense	16,723	19,147	50,666	59,197
Property expenses	7,209	6,600	20,242	19,174
General and administrative expenses	2,754	2,558	8,604	8,050
General and administrative expenses-stock based compensation	830	796	2,441	2,264
Depreciation and amortization expense on real property	12,166	11,676	35,878	34,538
Other expenses	930	38	962	167
Total expenses	40,612	40,815	118,793	123,390
Other gains (losses):				
Gain on investments, net	300	3,861	1,009	648
Gain (loss) on extinguishment of debt, net	–	(3,698)	11,012	(3,698)
Total other gains (losses)	300	163	12,021	(3,050)
Income (loss) from continuing operations	1,480	214	13,701	(3,079)
Discontinued operations:				
Loss from discontinued operations	(6)	(727)	(1,372)	(2,188)
Gain (loss) on investments	–	1,426	(15,229)	1,426
Provision for loss on property investment	–	(14,119)	–	(14,119)
Total discontinued operations	(6)	(13,420)	(16,601)	(14,881)
Net income (loss) before non-controlling interest in consolidated subsidiaries	1,474	(13,206)	(2,900)	(17,960)
Non-controlling interest in consolidated subsidiaries	5	36	23	55
Net income (loss)	1,479	(13,170)	(2,877)	(17,905)
Dividends allocable to preferred shares	(2,731)	(1,627)	(6,812)	(4,882)
Net loss allocable to common stockholders	$(1,252)	$(14,797)	$(9,689)	$(22,787)
Income (loss) per common share, basic and diluted:				
Income (loss) from continuing operations	$(0.02)	$(0.02)	$0.10	$(0.12)
Loss from discontinued operations	$–	$(0.20)	$(0.25)	$(0.23)
Net loss per common share, basic and diluted	$(0.02)	$(0.22)	$(0.15)	$(0.35)
	66,767	67,615	66,616	64,238

Weighted average number of common shares outstanding, basic and diluted				
Dividends declared per common share	$0.070	$0.065	$0.20	$0.195
Dividends declared per preferred A share	$0.508	$0.508	$1.523	$1.523
Dividends declared per preferred B share	$0.523	$–	$1.024	$–

See notes to consolidated financial statements.

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CapLease, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

(Amounts in thousands)	For the Three Months Ended September 30, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2012	For the Nine Months Ended September 30, 2011
Net income (loss) before non-controlling interest in consolidated subsidiaries	$1,474	$(13,206)	$(2,900)	$(17,960)
Other comprehensive income:				
Amortization of unrealized loss on securities previously classified as available for sale	–	–	–	150
Increase (decrease) in fair value of securities available for sale	919	13,194	7,376	5,595
Reclassification of derivative items into earnings	40	2,391	22	3,544
Other comprehensive income	959	15,585	7,398	9,289
Comprehensive income (loss)	2,433	2,379	4,498	(8,671)
Comprehensive (income) loss attributable to non-controlling interests	(10)	(6)	(11)	21
Comprehensive income (loss) attributable to CapLease, Inc.	$2,423	$2,373	$4,487	$(8,650)

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, 2011	$73,880	$663	$321,303	$ (11,051)	$–	$ 1,106	$385,901
Incentive stock plan compensation expense	–	–	2,441	–	–	–	2,441
Incentive stock plan grants issued and forfeited	–	5	(5)	–	–	–	–
Net loss	–	–	(2,877)	–	–	–	(2,877)
Non-controlling interest in consolidated subsidiaries	–	–	–	–	–	(23)	(23)
Issuance of preferred stock	56,569	–	–	–		–	56,569
Dividends declared-preferred	–	–	(6,986)	–	–	–	(6,986)
Dividends declared-common	–	–	(13,354)	–	–	–	(13,354)
Distributions declared-operating partnership units	–	–	–	–	–	(31)	(31)
Increase in fair value of securities available for sale	–	–	–	7,376	–	–	7,376
Reclassification of derivative items into earnings	–	–	–	22	–	–	22
Balance at September 30, 2012	$130,449	$668	$300,522	$ (3,653)	$–	$ 1,052	$429,038

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	For the Nine Months Ended September 30, 2012	2011
Operating activities		
Net income (loss)	$(2,877)	$(17,905)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	36,434	37,240
Stock based compensation	2,441	2,264
Amortization of above and below market leases	(612)	1,258
Loss (gain) on investments, net	14,220	(2,074)
Provision for loss on property investment	–	14,119
(Gain) loss on extinguishment of debt, net	(11,012)	3,698
Non-controlling interest in consolidated subsidiaries	(23)	(55)
Straight-lining of rents	11,261	3,271
Amortization of discounts/premiums, and origination fees/costs, net	(331)	(419)
Amortization of debt issuance costs, leasing commissions and fair market value of debt issued or assumed	1,921	1,789
Changes in operating assets and liabilities:		
Other assets	(14,364)	(4,434)
Accounts payable and other liabilities	6,230	614
Deposits and escrows	1	45
Net cash provided by operating activities	43,289	39,411
Investing activities		
Proceeds from sale or prepayments of loans	–	86,946
Principal received from borrowers	5,401	8,525
Proceeds from sale of securities	3,744	31,285
Repayments of commercial mortgage-backed securities	3,671	3,409
Proceeds from sale of real estate investments	9,611	5,171
Purchases of real estate investments	(88,397)	(9,576)
Real estate improvements, additions and construction in progress	(29,465)	(14,386)
Proceeds from sale of CDO, net of liabilities assumed	–	22,273
Leasing commission costs	(3,601)	(118)
Deposits on potential equity investments	(3,000)	(600)
Return of deposits on potential equity investments	3,000	550
Purchases of furniture, fixtures, equipment and leasehold improvements	(16)	(11)
Net cash (used in) provided by investing activities	(99,052)	133,468
Financing activities		
Borrowings from mortgages on real estate investments	68,580	19,318
Repayments of mortgages on real estate investments	(43,506)	(15,653)
Funds held by trustee of CDO pending distribution	–	3,757
Repayments of collateralized debt obligations	–	(105,266)
Collateralized debt obligations repurchased	–	(1,605)
Borrowings from credit agreements	78,056	–
Repayments on credit agreements	(100,627)	(33,858)
Repayments on secured term loan	(12,042)	(10,530)
Debt issuance costs	(3,451)	(829)

Common stock issued, net of offering costs	–	54,269
Common stock repurchased	–	(6,055)
Preferred stock issued, net of offering costs	56,569	–
Distributions to non-controlling interest	(30)	(30)
Dividends paid on common and preferred stock	(18,754)	(16,806)
Net cash provided by (used in) financing activities	24,795	(113,288)
Net (decrease) increase in cash and cash equivalents	(30,968)	59,591
Cash and cash equivalents at beginning of period	71,160	32,742
Cash and cash equivalents at end of period	$40,192	$92,333
Supplemental disclosure of cash flow information		
Cash paid for interest expense	$48,822	$58,580
Capitalized interest on development properties	443	–
Distributions declared but not paid	11	10
Dividends declared but not paid	7,521	5,948
Supplemental disclosure of noncash operating, investing and financing information		
Value of in-place leases and above-market leases acquired	$6,725	$–
Mortgage notes payable assumed on properties acquired	–	16,706
Mortgage note payable-notional amount repurchased	11,000	–
Collateralized debt obligations transferred on sale (notional)	–	152,950
Collateralized debt obligations reclassified to mortgages on real estate investments (notional)	–	30,718
Collateralized debt obligations reclassified to commercial mortgage-backed securities (fair value)	–	4,903

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)

September 30, 2012 (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. The Company focuses on properties that 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 also has made and expects to continue to make investments in single tenant properties where the owner has exposure to property operating expenses when it determines it can sufficiently underwrite that exposure and isolate a predictable cash flow.

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. That debt portfolio was reduced significantly during 2011 as a result of the Company's sale of the assets and associated liabilities comprising its collateralized debt obligation, or CDO, as well as the individual sale of certain other loans and securities. The remaining debt portfolio will continue to decrease over time as principal payments are received on the investments. While the focus of the Company's investment activity is expected to remain the ownership of real properties, the Company may continue to make debt investments from time to time on an opportunistic basis in the future.

We have invested in certain owned properties that are leased primarily but not exclusively by one tenant. We have 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. We expect these types of properties will continue to comprise a portion of our 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, 2011 and notes thereto, included in the Company's Form 10-K filed with the SEC on February 23, 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)

September 30, 2012 (unaudited)

2. 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 financial 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 7 below. The Company did not recognize any impairment losses on long-lived assets during the nine months ended September 30, 2012, although it did recognize a loss on sale of one real property during the nine months ended September 30, 2012. See Note 6. The Company recognized impairment losses of $14,119 on one long-lived asset located in Hartford, Connecticut during the nine months ended September 30, 2011. The foregoing loss is included a component of discontinued operations under the caption "Provision for loss on property investment" on the Company's Consolidated Statement of Operations. During December 2011, the Hartford, Connecticut property was transferred to the lender in full satisfaction of the related mortgage debt, and another $2,304 of losses on the property and gain on extinguishment of the related mortgage debt of $18,861 were recorded by the Company during the quarter ended December 31, 2011.

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 these properties 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.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

September 30, 2012 (unaudited)

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 7 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").

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 September 30, 2012, 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 market yields 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.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

September 30, 2012 (unaudited)

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 nine months ended September 30, 2012, and as of September 30, 2012, the Company has not classified any of its loans as held for sale. During the nine months ended September 30, 2011, the Company significantly reduced the size of its loan investments portfolio through the sale of the assets and associated liabilities comprising its collateralized debt obligation, or CDO, as well as the individual sale of certain loan investments. See Note 6 below for a discussion of these and other sale transactions.

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 September 30, 2012, the Company has a general loan loss reserve of $500. See Note 4.

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 September 30, 2012, 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.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts; totals may not add due to rounding)

September 30, 2012 (unaudited)

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 nine months ended September 30, 2012. The Company had $48 of other-than-temporary impairment losses on securities charged to the Statement of Operations during the nine months ended September 30, 2011.

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” 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. Deferred fees and costs 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 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 expected future debt issuances. The Company is not currently a party to any risk management transactions. It has been party to risk management transactions in the past and these transactions 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 Statement of Operations. See Note 11.

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.

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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. 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 3,093,759 for each of the three and nine months ended September 30, 2012, and 3,093,759 for each of the three and nine months ended September 30, 2011.

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The following summarizes the Company's EPS computations for the three and nine months ended September 30, 2012 and September 30, 2011 (in thousands, except per share amounts):

	For the three months ended September 30, 2012	For the three months ended September 30, 2011	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011
Net loss allocable to common stockholders	$ (1,252)	$ (14,797)	$ (9,689)	$ (22,787)
Weighted average number of common shares outstanding, basic and diluted	66,767	67,615	66,616	64,238
Loss per share, basic and diluted	$ (0.02)	$ (0.22)	$ (0.15)	$ (0.35)
Non-vested shares included in weighted average number of shares outstanding above	1,520	1,617	1,520	1,617

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.

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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. This guidance requires new disclosures only, and will have no impact 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). Adoption of this guidance will not impact 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. Adoption of this guidance is not expected to impact 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.

3. Real Estate Investments

Real estate held for investment and related intangible liabilities consisted of the following at September 30, 2012 and December 31, 2011:

	Sep 30, 2012 Unaudited	Dec 31, 2011
Real estate investments:		
Land	$ 209,909	$ 203,184
Building and improvements	1,348,495	1,304,655
Construction in progress, land	5,742	2,345
Construction in progress, building and improvements	30,466	6,277

Intangible assets		162,719			165,963	
Less: Accumulated depreciation and amortization		(300,047	)		(280,898	)
Real estate investments, net	$	1,457,284		$	1,401,526	
Intangible liabilities on real estate investments:						
Intangible liabilities	$	47,908		$	47,908	
Less: Accumulated amortization		(14,329	)		(12,689	)
Intangible liabilities on real estate investments, net	$	33,579		$	35,219	

"Construction in progress, building and improvements" in the above table includes $443 of capitalized interest on development properties.

Except for the Vitamin Shoppe Industries development project described below, the Company did not make any real estate acquisitions during the quarter ended September 30, 2012. In addition to the Vitamin Shoppe development project, the Company also continued to fund the construction of the office building for Cimarex Energy Co. described below during the quarter ended September 30, 2012.

The Company sold one owned property investment (the vacant Johnston, Rhode Island property) during the nine months ended September 30, 2012. See Note 6.

Lease Extensions

During March 2012, the Company entered into a five year lease extension for the 1,045,153 square foot warehouse property located in Breinigsville, Pennsylvania and leased to a subsidiary of Nestlé Holdings, Inc. The lease extension commences January 1, 2013 and the rental rate is $4.40 per square foot increasing 3% per annum.

During April 2012, the Company entered into a five year lease extension for the 751,021 square foot warehouse property located in Lathrop, California with the current subtenant at the property, Del Monte Corporation. The lease extension commences January 1, 2013 and the rental rate is $3.32 per square foot increasing 2.5% per annum.

The Company has entered into two separate leases with the United States Government with respect to the approximately 191,000 square feet of space occupied by the National Institutes of Health at the office building located in North Bethesda, Maryland. Both leases were scheduled to mature in May 2012, but the tenant has remained in occupancy and has requested a lease extension for all such space for an additional 18 months (until November 30, 2013). The primary lease is administered by the General Services Administration (on behalf of the Government) and relates to approximately 164,000 square feet. Such lease has now been extended until November 30, 2013. The other lease is being administered by the National Institutes of Health and relates to approximately 27,000 square feet of space. That lease has now been extended until December 31, 2012, and the Company has been advised that the National Institutes of Health is in the process of obtaining approval of the General Services Administration to the full 18 month lease extension until November 30, 2013.

Development Activities

During August 2012, the Company agreed 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. The Company will fund all of the project costs from cash on hand and other sources of available liquidity.

During July 2011, the Company entered into a joint venture that is developing a 17 story office building primarily on a build-to-suit basis for Cimarex Energy Co. with an estimated total investment of $55,000. Construction activity and funding of the project commenced during the third quarter of 2011. The Company is obligated to fund and has funded approximately one-half of the costs of the project, with the other half of the project costs to be funded by Bank of Oklahoma (BOK) pursuant to a loan agreement it has entered into with the joint venture entity. As of September 30, 2012, BOK had advanced $6,240 to the joint venture pursuant to the loan agreement. See Note 9. The Company owns a 99% ownership interest in and consolidates the joint venture for financial accounting purposes.

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The table below details the Company's investment in the above development projects as of September 30, 2012. The information included in the table below represents management's estimates and expectations at September 30, 2012 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 9/30/12	Estimated Remaining Investment	Estimated Total Investment	Estimated Completion Date
Ashland, Virginia	Vitamin Shoppe Industries, Inc.	Warehouse	312,000	15 (1)	$ 4,478	$ 17,226	$ 21,698	Q2 2013
Tulsa, Oklahoma	Cimarex Energy Co.	Office Building	324,000	12 (2)	$ 34,350	$ 21,072 (3)	$ 55,000 (4)	Q1 2013

(1) The lease is in force and rent and the 15 year lease term will commence upon substantial completion of the building and the satisfaction of certain other conditions.

(2) The lease is in force and rent will commence as building floors are completed and delivered to the tenant and the 12 year lease term will commence upon completion and delivery of all building floors to the tenant.

(3) The Company has entered into a construction/term loan with BOK pursuant to which BOK will fund the remaining investment. Upon completion of construction, up to $31,000 is expected to have been funded from borrowings under the loan agreement with BOK. See Note 9.

(4) Interest and fees the Company will earn during the construction period are expected to reduce the total investment to $53,000.

The amount of the "Investment" as of September 30, 2012, includes capitalized interest of $443, including imputed interest on equity funded by the Company in accordance with GAAP of $6 for the Vitamin Shoppe property and $422 for the Cimarex property. The "Estimated Remaining Investment" and "Estimated Total Investment" are based on project budgets and/or purchase prices and therefore do not include any amounts of imputed interest under GAAP.

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 September 30, 2012 and December 31, 2011, were as follows:

	Sep 30, 2012	Dec 31, 2011

	Unaudited	
Accrued Rental Income	$ 34,575	$ 41,387
Deferred Rental Income	4,451	2

Accrued rental income is included in “Other assets” on the Company’s Consolidated Balance Sheet. See Note 8. Deferred rental income is included in “Accounts payable and other liabilities” on the Company’s Consolidated Balance Sheet. See Note 10.

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Depreciation and Amortization Expense

Depreciation expense and amortization of intangible assets and liabilities on real estate investments for the three and nine months ended September 30, 2012 and September 30, 2011, were as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Depreciation on real estate (included in depreciation and amortization expense)	$8,574	$7,965	$24,930	$23,427
Amortization of in-place leases (included in depreciation and amortization expense)	3,479	3,592	10,653	10,785
Amortization of above-market leases (included as a reduction of rental revenue)	319	361	1,027	1,082
Amortization of below-market leases (included as an increase to rental revenue)	547	547	1,640	1,640

As of September 30, 2012, the Company's weighted average amortization period on intangible assets was 7.7 years, and the weighted average amortization period on intangible liabilities was 25.3 years.

Scheduled amortization on existing intangible assets and liabilities on real estate investments as of September 30, 2012, was as follows:

	Intangible Assets	Intangible Liabilities
2012	$3,798	$547
2013	10,133	2,051
2014	9,776	1,954
2015	9,116	1,678
2016	7,530	1,614
Thereafter	22,743	25,736
Total	$63,096	$33,579

Owned Property Investment and Financing Strategy

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 9. Certain of the Company's owned properties are pledged to Wells Fargo Bank, N.A., as lender under the June 2012 revolving credit agreement described at Note 9, 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.

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4. Loans Held for Investment

Loans held for investment at September 30, 2012 and December 31, 2011, are summarized in the following table. These investments consist predominantly of mortgage loans on properties subject to leases to investment grade tenants. As of September 30, 2012, the weighted average credit rating of the underlying tenants was BBB from Standard & Poor's. As of September 30, 2012, none of the Company's loans held for investment were on non-accrual status or past due 90 days or more.

	Sep 30, 2012 Unaudited	Dec 31, 2011
Principal	$32,960	$37,622
Discount	(3,829)	(3,913)
Cost basis	29,131	33,709
Allowance for loan losses	(500)	(500)
Carrying amount of loans	28,631	33,209
Deferred origination fees, net	(62)	(70)
Total	$28,569	$33,139

As of each of September 30, 2012 and December 31, 2011, the Company's loan investments carried interest rates ranging from 5.28% to 9.32%. At September 30, 2012 and December 31, 2011, the weighted average effective interest rate on the Company's loan investments, as measured against its cost basis, was 7.0% and 7.3%, 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 typically 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.

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:

	Carry Value	
Credit rating (1)	9/30/12 (unaudited)	12/31/11
Investment grade rating of A- or A3 and above	$5,320	$16,664
Investment grade rating of below A- or A3	19,959	9,239
Non-investment grade rating	3,852	7,806
General loan loss reserve	(500)	(500)
	$28,631	$33,209

(1) Reflects the underlying tenant's or lease guarantor's actual or implied senior unsecured credit rating from S&P or equivalent rating if rated only by Moody's.

As of September 30, 2012, the Company has a general loan loss reserve of $500, reflecting management’s estimate of losses that have probably occurred in its mortgage loan portfolio. The loan loss reserve was established at December 31, 2008, and to date the Company has not had any actual losses charged against the allowance.

During the nine months ended September 30, 2012, the Company received net proceeds of $709 in satisfaction of the outstanding balance of its loan to a franchise lending joint venture. The amount received is included in “Gain on investments, net” in the Company’s Consolidated Statement of Operations. The Company previously recorded aggregate losses of $1,432 related to this investment, including $444 during the quarter ended June 30, 2009 and $988 during the quarter ended June 30, 2011.

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5. Commercial Mortgage-Backed Securities

As of September 30, 2012, the Company classifies all of its commercial mortgage-backed securities as "available for sale" for financial accounting purposes and carries those securities 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.

A detailed schedule of the Company's securities investments at September 30, 2012 follows:

	Face Amount (1)		Cost Basis		Fair Value	
Description	Sep 30, 2012 Unaudited	Dec 31, 2011	Sep 30, 2012 Unaudited	Dec 31, 2011	Sep 30, 2012 Unaudited	Dec 31, 2011
Certificated Mortgage Loan (with Alcatel-Lucent USA Inc. as tenant in Highlands Ranch, CO) (rated B)	$23,487	$24,527	$23,741	$24,818	$21,422	$20,648
Certificated Mortgage Loan (with CVS Corporation as tenant / multi-property) (rated BBB+)	16,382	16,867	16,382	16,867	18,586	17,410
Certificated Mortgage Loan (with Koninklijke Ahold, N.V. as tenant / multi-property) (rated BBB)	6,546	7,489	6,616	7,578	7,497	8,395
BACM 2006-4, Class H (rated D)	4,000	4,000	–	–	40	800
BACMS 2002-2, Class V-1 (7-Eleven, Inc.) (rated AA-)	699	656	606	555	607	555
BACMS 2002-2, Class V-2 (Sterling Jewelers) (not rated)	1,067	1,001	905	828	908	828
CALFS 1997-CTL1, Class D (rated B-)	2,704					