CapLease, Inc.
Form 10-Q
May 06, 2011

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 March 31, 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 001-32039

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

Maryland (State or Other Jurisdiction of Incorporation or Organization)	52-2414533 (I.R.S. Employer Identification No.)
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 ¨

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

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

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

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

As of May 6, 2011, there were 68,055,665 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 March 31, 2011 (unaudited) and December 31, 2010

(Amounts in thousands, except share and per share amounts)	As Of March 31, 2011	As Of December 31, 2010
Assets		
Real estate investments, net	$1,391,613	$ 1,398,399
Loans held for investment, net	207,032	210,040
Commercial mortgage-backed securities	121,470	145,965
Cash and cash equivalents	33,506	32,742
Structuring fees receivable	309	326
Other assets	99,997	82,799
Total Assets	$1,853,927	$ 1,870,271
Liabilities and Equity		
Mortgages on real estate investments	$923,984	$ 928,429
Collateralized debt obligations	251,804	254,210
Credit agreement	101,105	105,345
Secured term loan	97,434	101,880
Convertible senior notes	34,068	33,926
Other long-term debt	30,930	30,930
Total Debt Obligations	1,439,325	1,454,720
Intangible liabilities on real estate investments	36,858	37,405
Accounts payable, accrued expenses and other liabilities	25,846	21,134
Dividends and distributions payable	5,401	5,373
Total Liabilities	1,507,430	1,518,632
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, 3,204,900 shares issued and outstanding	73,880	73,880
Common stock, $0.01 par value, 500,000,000 shares authorized, 57,905,665 and 57,471,268 shares issued and outstanding, respectively	580	576
Additional paid in capital	290,220	296,232
Accumulated other comprehensive loss	(19,331)	(20,216)
Total Stockholders' Equity	345,349	350,472
Non-controlling interest in consolidated subsidiaries	1,148	1,167
Total Equity	346,497	351,639
Total Liabilities and Equity	$1,853,927	$ 1,870,271

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 March 31, 2011	2010
Revenues:		
Rental revenue	$32,178	$31,527
Interest income from loans and securities	6,428	6,968
Property expense recoveries	3,353	3,012
Other revenue	283	202
Total revenues	42,242	41,709
Expenses:		
Interest expense	20,453	21,727
Property expenses	6,913	6,367
Loss on investments	490	–
General and administrative expenses	2,833	2,964
General and administrative expenses-stock based compensation	672	554
Depreciation and amortization expense on real property	12,330	12,065
Loan processing expenses	66	77
Total expenses	43,757	43,754
Loss on extinguishment of debt	–	(96)
Loss from continuing operations	(1,515)	(2,141)
Income from discontinued operations	–	38
Net loss before non-controlling interest in consolidated subsidiaries	(1,515)	(2,103)
Non-controlling interest in consolidated subsidiaries	9	8
Net loss	(1,506)	(2,095)
Dividends allocable to preferred shares	(1,627)	(741)
Net loss allocable to common stockholders	$(3,133)	$(2,836)
Earnings per share:		
Net loss per common share, basic and diluted	$(0.05)	$(0.05)
Weighted average number of common shares outstanding, basic and diluted	57,537	53,051
Dividends declared per common share	$0.07	$0.06
Dividends declared per preferred share	$0.51	$0.51

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)	Non-controlling Interest	Total Equity
Balance at December 31, 2010	$ 73,880	$ 576	$ 296,232	$ (20,216)	$ 1,167	$ 351,639
Incentive stock plan compensation expense	–	–	672	–	–	672
Incentive stock plan grants issued and forfeited	–	4	(4)	–	–	–
Net loss	–	–	(1,506)	–	–	(1,506)
Non-controlling interest in consolidated subsidiaries	–	–	–	–	(9)	(9)
Issuance of common stock	–	–	219	–	–	219
Dividends declared-preferred	–	–	(1,627)	–	–	(1,627)
Dividends declared-common	–	–	(3,766)	–	–	(3,766)
Distributions declared-operating partnership units	–	–	–	–	(10)	(10)
Amortization of unrealized loss on securities previously classified as available for sale	–	–	–	150	–	150
Increase in fair value of securities available for sale	–	–	–	585	–	585
Reclassification of derivative items into earnings	–	–	–	150	–	150
Balance at March 31, 2011	$ 73,880	$ 580	$ 290,220	$ (19,331)	$ 1,148	$ 346,497

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	For the Three Months Ended March 31,	
	2011	2010
Operating activities		
Net loss	$(1,506)	$(2,095)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	12,306	12,102
Stock based compensation	672	554
Amortization of above and below market leases	419	416
Loss attributable to non-controlling interest in consolidated subsidiaries	(9)	(8)
Loss on extinguishment of debt	–	96
Loss on investments	490	–
Straight-lining of rents	11,674	10,372
Amortization of discounts/premiums, and origination fees/costs, net	(133)	(133)
Amortization of debt issuance costs, leasing commissions and fair market value of debt issued or assumed	617	882
Changes in operating assets and liabilities:		
Structuring fees receivable	17	202
Other assets	(7,803)	(6,169)
Accounts payable, accrued expenses and other liabilities	(1,746)	(321)
Net cash provided by operating activities	14,998	15,898
Investing activities		
Principal received from borrowers	3,021	2,729
Proceeds from sale of securities	22,540	–
Repayments of commercial mortgage-backed securities	2,321	1,719
Proceeds from sale of real estate investments	–	3,410
Real estate improvements, additions and construction in progress	(6,417)	(45)
Leasing commission costs	(60)	–
Purchases of furniture, fixtures, equipment and leasehold improvements	(2)	(7)
Net cash provided by investing activities	21,403	7,806
Financing activities		
Borrowings from mortgages on real estate investments	468	421
Repayments of mortgages on real estate investments	(4,679)	(3,702)
Funds held by trustee of CDO pending distribution	(15,171)	(355)
Repayments of collateralized debt obligations	(2,416)	(2,095)
Repayments on credit agreement	(4,239)	(14,101)
Repayments on secured term loan	(4,446)	(3,755)
Convertible senior notes repurchased	–	(2,400)
Common stock issued, net of offering costs	219	23,479
Preferred stock issued, net of offering costs	–	40,146
Distributions to non-controlling interest	(10)	(9)
Dividends paid on common and preferred stock	(5,363)	(3,813)
Net cash (used in) provided by financing activities	(35,637)	33,816
Net increase in cash and cash equivalents	764	57,520

Cash and cash equivalents at beginning of period	32,742	38,546
Cash and cash equivalents at end of period	$33,506	$96,066

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries
Consolidated Statements of Cash Flows – continued
(Unaudited)
(in thousands)

	For the Three Months Ended March 31,	
	2011	2010
Supplemental disclosure of cash flow information		
Cash paid for interest expense	$18,522	$19,255
Cash paid for income taxes	–	201
Distributions declared but not paid	10	10
Dividends declared but not paid	5,391	5,056

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)

March 31, 2011 (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 invests primarily in single tenant commercial real estate assets 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 continues to be opportunistic and 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 primary business line is and it expects will continue to be the ownership of single tenant properties. The Company also has a portfolio of first mortgage loans and other debt investments on single tenant properties and may continue to make such debt investments from time to time on an opportunistic basis in the 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 99.7% 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, 2010 and notes thereto, included in the Company's Form 10-K filed with the SEC on February 18, 2011.

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 CapLease and its majority-owned subsidiaries. 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.

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 has allocated the purchase price of its owned properties to the following based on estimated fair values on the acquisition date: land (no depreciation), building and improvements (depreciated over periods not exceeding 40 years), above-market leases (amortized as a reduction of base rental revenue over the remaining term of the respective lease), below-market leases (amortized as an increase to base rental revenue over the remaining initial term plus the term of any below-market renewal options of the respective lease), and in-place leases (amortized as a component of depreciation and amortization expense over the remaining initial term of the respective lease). 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 6 below.

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

March 31, 2011 (unaudited)

Direct costs incurred in acquiring completed properties that meet the classification of a business for accounting purposes are charged to operations as incurred. Expenditures for maintenance and repairs of owned properties are 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 an 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 did not recognize any impairment losses on long-lived assets during either of the quarters ended March 31, 2011 or March 31, 2010.

Assets and liabilities of properties that meet various held for sale criteria, including whether 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.

Development Activities

Project costs and expenses 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 costs capitalized to construction in progress are transferred to (i) land and (ii) buildings and improvements.

Loan Investments

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

From time to time, the Company may determine to sell a loan in which case it must reclassify the asset as held for sale. Loans held for sale are carried at lower of cost or estimated fair value. As of March 31, 2011, the Company has not classified any of its loans as held for sale.

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 March 31, 2011, the Company has a general loan loss reserve of $500. See Note 4.

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

March 31, 2011 (unaudited)

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 March 31, 2011, the Company had an asset-specific loan loss reserve of $444 on a single impaired loan. See Note 4.

Commercial Mortgage-Backed Securities

GAAP creates two accounting classifications that are relevant with respect to the Company's securities investments:

- "Held to maturity" are those securities that the Company has the positive intent and ability to hold until maturity. All of the Company's securities classified as held to maturity were transferred to this classification (from "available for sale" classification) in January 2008. For a security transferred into the held to maturity category, the security is recorded at estimated fair value on the date of transfer. A fair market value adjustment is also recorded as a component of Other Comprehensive Income (Loss) within Stockholders' Equity for the amount of the unrealized gain or loss on the security on the date of the transfer. The unrealized gain or loss on the security is then amortized against the related fair value adjustment over the expected term of the security using the effective interest method.

- "Available for sale" are those securities that the Company does not hold for the purpose of selling in the near-term, but may dispose of prior to maturity. They are presented 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.

The Company classifies its securities investments that are financed in its March 2005 collateralized debt obligation or in the December 2007 secured term loan transaction discussed at Note 8, as "held to maturity," and all other securities investments, including those financed within the credit agreement discussed at Note 8, as "available for sale."

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 is charged to earnings as other-than-temporary impairment. Otherwise, impairment losses on the security must be further analyzed for separation into two categories: (i) credit losses and (ii) losses due to factors other than credit. The portion which is considered credit loss is charged to earnings as other-than-temporary impairment. The portion which is due to other factors is not charged to earnings. Also, if the security is classified as available for sale, the non-credit portion of the impairment loss is charged to other comprehensive income (loss), a component of equity on the Company's Consolidated Balance Sheet.

In estimating credit or other-than-temporary impairment losses, management considers a variety of factors including (1) the financial condition and near-term prospects of the credit, including credit rating of the security and the underlying tenant and an estimate of the likelihood, amount and expected timing of any default, (2) whether the Company expects to hold the investment for a period of time sufficient to allow for anticipated recovery in fair value, (3) the length of time and the extent to which the fair value has been below cost, (4) current market conditions, (5) expected cash flows from the underlying collateral and an estimate of underlying collateral values, and (6) subordination levels within the securitization pool. These estimates are highly subjective and could differ materially from actual results. The Company had no other-than-temporary impairment losses on securities charged to the Statement of Operations during each of the quarters ended March 31, 2011 and March 31, 2010.

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

March 31, 2011 (unaudited)

Deferred Fees and Costs

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

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.

If the Company employs risk management transactions, they will be treated as cash flow hedges under applicable accounting guidance as long as they have been designated and qualify as such, which basically means so long as the Company has satisfied a variety of technical accounting requirements, such as hedge documentation requirements and initial and subsequent quarterly hedge effectiveness tests. If the cash flow hedge criteria are met, the transactions are marked to fair value at each reporting date and recorded as an asset or liability, depending on the Company's rights or obligations under the applicable contract. The effective portion of the Company's realized and unrealized gains and losses on such transactions are treated as a component of "Other Comprehensive Income (Loss)" on the Company's Consolidated Balance Sheet and are not reported as a component of current income or loss on the Company's Consolidated Statement of Operations. The effective portion of the Company's realized gains and losses, which generally represent the net payments the Company makes or receives on the interest rate swaps, are then reclassified and amortized as part of interest expense on the Company's Consolidated Statement of Operations beginning at issuance of the related debt and continuing over the expected term of such debt.

If cash flow hedge criteria are not met or the hedge is deemed ineffective, some or all of the realized and unrealized gains and losses on such transactions are treated as a component of current income or loss on the Company's Consolidated Statement of Operations.

If the Company employs risk management transactions, no assurance can be made that the Company will satisfy the cash flow hedge requirements and as to the portion of the Company's gains and losses that will be deemed effective under applicable accounting guidance. Changes in management's initial assumptions regarding any proposed debt issuance (e.g., timing and the amount and type of debt) and changes in the shape of the swap curve (which represents the market's expectations for future LIBOR rates) are among the factors that could cause the Company to include a greater portion of its gains and losses from the associated risk management transactions as current income or loss.

Cash and Cash Equivalents

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

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

March 31, 2011 (unaudited)

Revenue Recognition

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

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

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

Income Taxes

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

Earnings per Share

As required by GAAP, the Company presents both basic and diluted earnings per share ("EPS"). Basic EPS excludes dilution and is computed by dividing net income (loss) allocable to common stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, where such exercise or conversion would result in a lower EPS amount. 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 the three months ended March 31, 2011, and 4,597,676 for the three months ended March 31, 2010.

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

March 31, 2011 (unaudited)
The following summarizes the Company's EPS computations for the three months ended March 31, 2011 and March 31, 2010 (in thousands, except per share amounts):

	For the three months ended March 31,	
	2011	2010
Net (loss) income allocable to common stockholders	$ (3,133)	$ (2,836)
Weighted average number of common shares outstanding, basic and diluted	57,537	53,051
(Loss) income per share, basic and diluted	$ (0.05)	$ (0.05)
Non-vested shares included in weighted average number of shares outstanding above	1,617	1,740

Recently Issued Accounting Pronouncements

In July 2010, the Financial Accounting Standards Board ("FASB") issued new accounting guidance ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which amends various sections of FASB Accounting Codification Statement ("ASC") 310-10 and outlines specific disclosures that will be required for the allowance for credit losses and all finance receivables. Finance receivables includes loans, lease receivables and other arrangements with a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset on an entity's statement of financial position. The amendment requires companies to provide disaggregated levels of disclosure by portfolio segment and class to enable users of the financial statement to understand the nature of credit risk, how the risk is analyzed in determining the related allowance for credit losses and changes to the allowance during the reporting period. The required disclosures under this amendment as of the end of a reporting period are effective for the Company's December 31, 2010 reporting period and disclosures regarding activities during a reporting period are effective for the Company's March 31, 2011 interim reporting period. The Company's adoption of this ASU did not have a material effect on the Company's consolidated financial statements.

Reclassifications

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

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

March 31, 2011 (unaudited)

3. Real Estate Investments

Real estate held for investment and related intangible liabilities on real estate investments consisted of the following at March 31, 2011 and December 31, 2010:

	Mar 31, 2011 Unaudited	Dec 31, 2010
Real estate investments:		
Land	$ 190,521	$ 190,521
Building and improvements	1,268,950	1,268,320
Construction in progress, land	951	951
Construction in progress, building and improvements	11,343	5,557
Intangible assets	183,543	183,543
Less: Accumulated depreciation and amortization	(263,695)	(250,493)
Real estate investments, net	$ 1,391,613	$ 1,398,399
Intangible liabilities on real estate investments:		
Intangible liabilities	$ 47,908	$ 47,908
Less: Accumulated amortization	(11,050)	(10,503)
Intangible liabilities on real estate investments, net	$ 36,858	$ 37,405

The Company did not make any real estate investments during the three months ended March 31, 2011, or the three months ended March 31, 2010.

Development Activities

In August 2010, the Company entered into a joint venture that is developing a warehouse/distribution building for Michelin North America, Inc. in Louisville, Kentucky with a construction budget of $8,391. The Company owns a 99% ownership interest in and will fund all of the construction costs associated with the project. Therefore, the Company consolidates the joint venture for financial accounting purposes.

Construction activity and funding of the project commenced during the third quarter of 2010 and the project is scheduled to be completed during May 2011.

The table below details the Company's construction in progress associated with the Michelin joint venture as of March 31, 2011. The information included in the table below represents management's estimates and expectations at March 31, 2011, 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)(1)	Construction in Progress at 3/31/11	Estimated Remaining Funding	Estimated Total Investment(2)	Estimated Completion Date
Louisville, Kentucky	Michelin North	Warehouse/ distribution	150,000	10	$ 5,101	$ 3,290	$ 8,391	May 2011

	America, Inc.

(1) The lease is scheduled to commence upon substantial completion of the building and the satisfaction of certain other conditions.

(2) Interest and fees the Company will earn during the construction period are expected to reduce the total investment to $8,069.

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 may be 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 March 31, 2011 and December 31, 2010, were as follows:

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	Mar 31, 2011 Unaudited	Dec 31, 2010
Accrued Rental Income	$ 34,287	$ 39,506
Deferred Rental Income	6,455	-

Accrued rental income is included in "Other assets" on the Company's Consolidated Balance Sheet. See Note 7. Deferred rental income is included in "Accounts payable, accrued expenses and other liabilities" on the Company's Consolidated Balance Sheet. See Note 9.

Depreciation and Amortization Expense

Depreciation expense and amortization of intangible assets and liabilities on real estate investments for the three months ended March 31, 2011 and March 31, 2010, were as follows:

	For the three months ended March 31,	
	2011	2010
Depreciation on real estate (included in depreciation and amortization expense)	$ 8,171	$ 8,031
Amortization of in-place leases (included in depreciation and amortization expense)	4,065	3,996
Amortization of above-market leases (included as a reduction of rental revenue)	966	962
Amortization of below-market leases (included as an increase to rental revenue)	547	547

As of March 31, 2011, the Company's weighted average amortization period on intangible assets was 7.4 years, and the weighted average amortization period on intangible liabilities was 25.9 years.

Scheduled amortization on existing intangible assets and liabilities on real estate investments as of March 31, 2011 was as follows:

	Intangible Assets	Intangible Liabilities
2011	$ 14,364	$ 1,640
2012	14,972	2,186
2013	9,300	2,051
2014	8,942	1,954
2015	8,283	1,678
Thereafter	24,686	27,350
Total	$ 80,547	$ 36,858

Owned Property Investment and Financing Strategy

Substantially 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. The Company's strategy is to own and finance on a long-term basis each property through a separate and distinct special purpose entity, or SPE, with each 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 8.

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Hartford, Connecticut Property

As of March 31, 2011, the Company performed an impairment analysis of its investment in the property in Hartford, Connecticut leased to Travelers Corporation. The Company concluded that no impairment loss was necessary as the estimated future cash flows from the investment are in excess of the Company’s carry value of the property of $18,740. The cash flows are based on estimates the Company believes to be reasonable and contemplate rent for the remaining lease term plus management’s estimates of future lease cash flows.

4. Loans Held for Investment

Loans held for investment at March 31, 2011 and December 31, 2010, are summarized in the following table. These investments consist predominantly of mortgage loans on properties subject to leases to investment grade tenants. As of March 31, 2011, the weighted average credit rating of the underlying tenants was BBB+ from Standard & Poor’s. Except as described below, as of March 31, 2011, none of the Company’s loans held for investment were on non-accrual status or past due 90 days or more.

	Mar 31, 2011 Unaudited	Dec 31, 2010
Principal	$ 211,028	$ 214,049
(Discount) Premium	(2,662)	(2,664)
Cost basis	208,366	211,385
Allowance for loan losses	(944)	(944)
Carrying amount of loans	207,422	210,441
Deferred origination fees, net	(390)	(401)
Total	$ 207,032	$ 210,040

As of each of March 31, 2011 and December 31, 2010, the Company’s loan investments carried interest rates ranging from 5.00% to 9.32%. At March 31, 2011 and December 31, 2010, the weighted average effective interest rate on the Company’s loan investments, as measured against its cost basis, was 6.7% and 6.7%, respectively.

The Company’s loan portfolio is comprised primarily of fully amortizing or nearly fully amortizing first mortgage loans on single tenant commercial real estate. 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:

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March 31, 2011 (unaudited)

	Carry Value	
Credit rating (1) (2)	3/31/11	12/31/10
Investment grade rating of A- or A3 and above	$ 39,498	$ 39,780
Investment grade rating of below A- or A3	111,947	113,001
Implied investment grade rating	37,860	38,285
Non-investment grade rating	17,629	18,887
Unrated	988	988
General loan loss reserve	(500)	(500)
	$ 207,422	$ 210,441

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

(2) The Company implies an investment grade credit rating for tenants that are not publicly rated by Standard & Poor’s or Moody’s but (i) are 100% owned by an investment grade parent, (ii) for which the Company has obtained a private investment grade rating from either Standard & Poor’s or Moody’s, or (iii) are governmental entity branches or units of another investment grade rated governmental entity.

As of March 31, 2011, 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.

As of March 31, 2011, the Company had one loan investment which is on non-accrual status and past due more than 90 days. The loan, which has remaining principal outstanding of $1,444, has been classified as impaired under applicable accounting guidance. The Company intends to account for any interest income it collects on the impaired loan on a cost-recovery basis. The Company performed an impairment analysis for the impaired loan as of March 31, 2011, and concluded that no loss reserve beyond a reserve of $444 recorded at June 30, 2009, was warranted.

The following tables summarize certain financial information with respect to the Company’s impaired loan:

	Carrying Amount		Average carrying amount For the three months ended March 31,	
Borrower	3/31/2011	12/31/2010	2011	2010
West End Mortgage Finance Fund I L.P.	$ 988	$ 988	$ 988	$ 1,000

	Interest Income Recognized			
	For the three months ended March 31,2011		For the three months ended March 31,2010	
Borrower	Accrual	Cash	Accrual	Cash
West End Mortgage Finance Fund I L.P.	$ -	$ -	$ -	$ -

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5. Commercial Mortgage-Backed Securities and Structuring Fees Receivable

The following is a summary of the Company's securities investments at March 31, 2011:

Description	Number of Securities	Face Value	Carry Value	Amortized Cost	Fair Value	Gross Unrecognized Gain	Gross Unrecognized Loss
Held to Maturity	15	$ 136,410	$ 115,226	$ 123,183	$ 103,004	$ 1,653	$ (21,832)
Available For Sale	6	26,714	6,244	13,616	6,244	-	(7,372)
Total	21	$ 163,124	$ 121,470	$ 136,799	$ 109,248	$ 1,653	$ (29,204)

A detailed schedule of the Company's securities investments at March 31, 2011 follows:

		Face Amount (1)		Cost Basis	
Description	Classification	Mar 31, 2011 Unaudited	Dec 31, 2010	Mar 31, 2011 Unaudited	Dec 31, 2010
BACMS 2002-2, Class V-1 (7-Eleven, Inc.) (rated AA-)	Available for Sale	$ 615	$ 602	$ 507	$ 493
BACMS 2002-2, Class V-2 (Sterling Jewelers) (not rated)	Available for Sale	939	920	757	735
BSCMS 1999 CLF1, Class E (rated D)	Available for Sale	2,585	3,326	–	–
CMLBC 2001-CMLB-1, Class H (rated B-)	Available for Sale	11,907	11,907	7,016	6,978
CMLBC 2001-CMLB-1, Class J (rated D)	Available for Sale	6,383	6,383	1,051	1,149
NLFC 1999-LTL-1, Class X (IO) (rated AAA)	Available for Sale	4,285	4,392	4,285	4,392
Certificated Mortgage Loan (with Alcatel-Lucent USA Inc. as tenant) (rated B)	Held to Maturity	33,504	34,722	33,928	35,172
Certificated Mortgage Loan (with CVS Corporation as tenant) (rated BBB+)	Held to Maturity	17,330	17,480	17,330	17,480
Certificated Mortgage Loan (with Koninklijke Ahold, N.V. as tenant) (rated BBB)	Held to Maturity	7,489	8,032	7,588	8,142
Certificated Mortgage Loan (with Yahoo! Inc. as tenant) (rated BBB-)	Held to Maturity	21,654	21,739	21,416	21,497
		8,000	8,000	281	400

BACM 2006-4, Class H (rated CCC)	Held to Maturity				
Banc of America 2007-1, Class C (rated B)	Held to Maturity	500	500	179	173
CALFS 1997-CTL1, Class D (rated B-)	Held to Maturity	6,000	6,000	5,953	5,951
CMLBC 2001-CMLB-1, Class E (rated BBB+)	Held to Maturity	9,526	9,526	10,027	10,033
CMLBC 2001-CMLB-1, Class G (rated BB-)	Held to Maturity	9,526	9,526	8,961	8,953
JP Morgan 2006-LDP9, Class AJ (rated BB-)	Held to Maturity	200	200	101	99
NLFC 1999-LTL-1, Class E (rated BB)	Held to Maturity	11,081	11,081	5,985	5,926
Wachovia 2007-C30, Class AJ (rated B)	Held to Maturity	200	200	97	95
Wachovia 2007-C31, Class AJ (rated B+)	Held to Maturity	200	200	98	96
Wachovia 2007-C33, Class AJ (rated B+)	Held to Maturity	200	200	98	96
WBCMT 2006-C27, Class C (rated BB)	Held to Maturity	11,000	11,000	11,142	11,148
BSCMS 1999 CLF1, Class F (not rated)	N/A	–	251	–	–
WBCMT 2004-C15, Class 180ML-E (rated CCC)	N/A	–	8,000	–	8,008
WBCMT 2004-C15, Class 180ML-D (rated CCC+)	N/A	–	15,000	–	15,013
Total		$ 163,124	$ 189,187	$ 136,799	$ 162,029

(1) Reflects face amount, or, in the case of the NLFC 1999-LTL-1 Class X (IO) bond, amortized cost.

All credit ratings in the above table are as of March 31, 2011.

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During February 2011, the Company sold two of its commercial-mortgage backed securities investments. Both of the securities are secured by portions of the mortgage financing on the office building located at 180 Maiden Lane, New York, New York (WBCMT 2004-C15, Class 180ML-D and Class 180ML-E). The sale was executed primarily because the securities were beyond their original scheduled maturity date of November 2009 and the sale enabled the Company to realize a return of substantially all of the outstanding principal. The total of $23,000 face amount of securities were sold at a dollar price of $98 per $100 of face amount, and the Company recognized a loss on investment during the quarter ended March 31, 2011 of $490. The aggregate carrying amount of these securities was $22,236 as of December 31, 2010. The proceeds from the sale of the Class D bond (face amount of $15,000) will be utilized to reduce principal outstanding in the Company's CDO on the next scheduled CDO payment date in April 2011, and the proceeds from the sale of the Class E bond (face amount of $8,000) were utilized for general corporate purposes.

Unrealized gains and losses on securities at March 31, 2011 and December 31, 2010, included as a component of Other Comprehensive Income (Loss) on the Company's Consolidated Balance Sheet, consisted of the following:

	Mar 31, 2011 Unaudited	Dec 31, 2010
Unrealized gains on securities previously available for sale	$ 743	$ 750
Unrealized losses on securities previously available for sale	(8,700)	(8,857)
Unrealized losses on securities available for sale	(7,372)	(7,958)

The following table summarizes the Company's securities in an unrealized loss position as of March 31, 2011.

	Aggregate Fair Value	Aggregate Unrealized Loss	Number of Securities
In unrealized loss position 12 or more months	$ 80,559	$ 29,204	10

Credit ratings on the 10 securities in a continuous unrealized loss position for more than 12 months as of March 31, 2011, range from AAA to D with a weighted average of BB and those securities have a weighted average maturity of approximately 8.3 years. The Company believes that none of the unrealized losses on investment securities are other-than-temporary because management expects the Company will receive all contractual principal and interest related to these investments. In addition, the Company expects to hold these securities for a period of time sufficient to allow for a full recovery in fair value.

At March 31, 2011 and December 31, 2010, the weighted average effective interest rate (yield to maturity on adjusted cost basis) on securities was approximately 8.4% and 8.0%, respectively.

Structuring fees receivable of $309 and $326 at March 31, 2011 and December 31, 2010, respectively, represented fees earned by the Company in conjunction with the structuring and subsequent sale of certain net lease loans. Such fees are payable to the Company monthly without interest through March 2020 and, accordingly, have been discounted based on imputed interest rates estimated by management to approximate market. Structuring fees receivable are shown at their amortized cost.

6. Fair Value

The Company is required to disclose fair value information about all of its financial instruments (as defined under prevailing accounting guidance), whether or not these instruments are measured at fair value on the Company's Consolidated Balance Sheet. Under such guidance, substantially all of the Company's assets and liabilities other than its owned property investments are classified as financial instruments.

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The Company estimates that the fair values of cash and cash equivalents, other assets, accounts payable, accrued expenses and other liabilities, and dividends payable approximate their carrying values due to the short-term maturities of these items.

The carrying amounts and estimated fair values of the Company's other financial instruments at March 31, 2011 and December 31, 2010 are as follows:

	Carrying Amount		Notional Amount		Estimated Fair Value	
	3/31/2011	12/31/2010	3/31/2011	12/31/2010	3/31/2011	12/31/2010
Assets:						
Loans held for investment	$ 207,422	$ 210,441	$ 211,028	$ 214,049	$ 220,157	$ 223,099
Commercial mortgage-backed securities	121,470	145,965	163,124	189,187	109,248	127,164
Structuring fees receivable	309	326	N/A	N/A	309	326
Liabilities:						
Mortgages on real estate investments	$ 923,984	$ 928,429	$ 921,053	$ 925,264	$ 964,687	$ 979,570
Collateralized debt obligations	251,804	254,210	251,945	254,361	208,495	220,907
Credit agreement	101,105	105,345	101,105	105,345	101,105	105,345
Secured term loan	97,434	101,880	97,434	101,880	91,469	95,145
Convertible senior notes	34,068	33,926	35,009	35,009	35,001	35,004
Other long-term debt	30,930	30,930	30,930	30,930	29,192	28,095

The fair values indicated above are indicative of the interest rate and credit spread environment as of March 31, 2011 and December 31, 2010, respectively, and may not take into consideration the effects of subsequent interest rate, credit spread fluctuations, or changes in the ratings of the underlying tenants on the related leases. The methodologies used and key assumptions made to estimate fair values are as follows:

Loans held for investment—The fair value of the Company's fixed-rate loan portfolio is estimated with a discounted cash flow analysis, utilizing scheduled cash flows and discount rates estimated by management to approximate those that a willing buyer and seller might use.

Commercial mortgage-backed securities—The fair values of the securities reflect management's best estimate and require a considerable amount of judgment and assumptions. Management evaluates a variety of inputs and then estimates fair value based on those inputs. The primary inputs evaluated by management are broker quotations, collateral values, subordination levels, and liquidity of the security.

Structuring fees receivable—The fair value of structuring fees receivable is estimated with a discounted cash flow analysis, utilizing scheduled cash flows and discount rates estimated by management to approximate those that a willing buyer and seller might use.

Credit agreement—Management believes that the stated interest rate (which floats based on short-term interest rates) approximates market rates (when compared to similar credit facilities with similar credit risk). As such, the fair value of these obligations is estimated to be equal to the outstanding principal amount.

Mortgages on real estate investments, collateralized debt obligations and secured term loan —The fair value of mortgages payable on real estate investments, collateralized debt obligations and the secured term loan is estimated using a discounted cash flow analysis, based on management's estimates of market interest rates. For mortgages where the Company has an early prepayment right, management also considers the prepayment amount to evaluate the fair value.

Convertible senior notes —The carry value of convertible senior notes reflects the impact of accounting guidance for the notes adopted as of January 1, 2009. See Note 8. The fair value is estimated using a discounted cash flow analysis, based on management's estimates of market interest rates, and indications of market yields, where available.

Other long-term debt—The fair value of the Company's other long-term debt is estimated using a discounted cash flow analysis, based on management's estimates of market interest rates.

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On January 1, 2008, the Company adopted accounting guidance (codified at FASB ASC 820) that defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. The guidance does not impose any new requirements around which assets and liabilities are to be measured at fair value, and instead applies to asset and liability balances required or permitted to be measured at fair value under existing accounting pronouncements.

The guidance applies principally to the Company's securities classified as "available for sale," as that is the only asset or liability which the Company measures on a recurring basis at fair value.

FASB ASC 820 establishes a valuation hierarchy based on the transparency of inputs used in the valuation of an asset or liability. Classification is based on the lowest level of inputs that is significant to the fair value measurement. The valuation hierarchy contains three levels:

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities at the reporting date. As of March 31, 2011, the Company has not classified any of its securities available for sale as Level 1.

- Level 2 – Pricing inputs other than quoted prices included within Level 1 that are observable for substantially the full term of the asset or liability. Level 2 assets include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and inputs other than quoted prices that are observable, such as models or other valuation methodologies. As of March 31, 2011, the Company has not classified any of its securities available for sale as Level 2.

- Level 3 – Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. These valuations require a considerable amount of judgment and assumptions. As of March 31, 2011, the Company has classified all of its securities available for sale as Level 3. Management evaluates a variety of inputs and then estimates fair value based on those inputs. The primary inputs evaluated by management are broker quotations (observable), collateral values (observable), subordination levels (observable), and liquidity of the security (unobservable). These inputs are the factors employed by management and to its knowledge other parties in determining where to price actual transactions. The Company's securities available for sale are unique in that in most cases the Company owns the entire bond class. As a result, the broker quotes obtained by the Company reflect expected pricing rather than actual trades and may also reflect distressed transactions in inactive markets. Therefore, the Company believes Level 3 is the appropriate classification in the fair value hierarchy for the Company's available for sale securities.

The table below presents the fair value of the Company's securities available for sale as of March 31, 2011, aggregated by the level in the fair value hierarchy within which those measurements fall.

	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at March 31,2011
Assets				

Securities available for sale	$	–	$	–	$	6,244	$	6,244

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The following table summarizes the change in the fair value for Level 3 items for the three months ended March 31, 2011 and March 31, 2010:

	Three months ended March 31,	
Securities available for sale	2011	2010
Beginning balance	$ 13,797	$ 13,044
Gains (losses) included in net income (loss):		
Included in interest income	78	75
Gains (losses) included in other comprehensive income	(168)	211
Purchases, sales, issuances and settlements (net)	(210)	(229)
Transfers in (out) of Level 3	(7,253)	–
Ending balance	$ 6,244	$ 13,101

7. Other Assets

Other assets as of March 31, 2011 and December 31, 2010, consisted of the following:

	Mar 31, 2011 Unaudited	Dec 31, 2010
Receivables and accrued interest	$ 8,146	$ 9,593
Prepaid expenses and deposits	1,570	2,197
Reserve accounts	26,471	15,598
Funds with CDO trustee pending distribution	19,868	4,697
Restricted cash	171	1,126
Amounts held by servicer	625	666
Accrued rental income	34,287	39,506
Debt issuance costs, net	5,543	5,999
Deferred leasing costs, net	1,733	1,767
Investment in statutory trust	930	930
Other	653	720
Total	$ 99,997	$ 82,799

8. Debt Obligations

Credit Agreement

The Company has financed certain of its portfolio assets pursuant to a credit agreement it entered into with Wells Fargo Bank, N.A. (as successor to Wachovia Bank, N.A.) in April 2008. The Company and Wells Fargo entered into an amendment and restatement of the credit agreement in July 2010, which, among other things:

- established a maximum revolving credit commitment of $140,000;
- extended the maturity date of the credit agreement to July 16, 2013, from April 28, 2011; and

- set the Company's interest rate on its borrowings at one-month LIBOR plus 275 basis points (an increase from one-month LIBOR plus 250 basis points at June 30, 2010).

Also in connection with the July 2010 amendment and restatement, the Company made a $13,419 principal payment to the lender and agreed to repay another $10,000 of principal in four equal quarterly installments beginning on October 1, 2010, the first three installments of which have been paid. The Company's outstanding borrowings under the agreement were $101,105 as of March 31, 2011.

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The agreement is a floating rate LIBOR based facility. As of March 31, 2011, the Company's effective financing rate on the credit agreement was 3.5%.

The Company's borrowings under the credit agreement are secured by a combination of first mortgage loan investments, intercompany mortgage loans on owned property investments, commercial mortgage backed securities and a first lien on the Company's ownership interest in the real property located in Johnston, Rhode Island. The Company's obligations under the credit agreement are also fully recourse to all of its other assets. In the event Wells Fargo determines in its sole discretion that the value of the Company's collateral assets has declined, including as a result of an underlying tenant credit rating downgrade or other adverse tenant-credit event, Wells Fargo may require the Company to prepay a portion of its borrowings, provided that Wells Fargo may not reduce the value of any of the Company's collateral other than CMBS securities due to general credit spread or interest rate fluctuations.

The Company may utilize the undrawn amount of the lender's revolving credit commitment to finance assets approved by the lender in its sole discretion at an advance rate of 60% of the asset's value (as determined by the lender). The Company drew $15,610 under the credit agreement during December 2010 to initially fund a portion of the purchase price for the Company's Cooper Tire and Rubber Company asset. Those borrowings were repaid in April 2011. See Note 19.

The Company is required to comply with the following financial covenants under the credit agreement: minimum liquidity (basically cash and cash equivalents) of at least $12,000, minimum consolidated tangible net worth (basically stockholders' equity before accumulated depreciation and amortization) of at least $360,000 plus 75% of the aggregate net proceeds from equity offerings or capital contributions after July 16, 2010, maximum corporate leverage (basically total liabilities divided by total assets before accumulated depreciation and amortization) of 80% and minimum interest coverage (basically EBITDA, or net income before income taxes, interest expense, depreciation and amortization, divided by interest expense) of 105%. As of March 31, 2011, the Company was in compliance with the above financial covenants.

Amounts related to the Company's credit agreement as of March 31, 2011 and December 31, 2010, were as follows:

	At March 31, 2011		At December 31, 2010	
Credit Agreement	Borrowings (unaudited)	Collateral Carry Value (unaudited)	Borrowings	Collateral Carry Value
Loans held for investment	$6,405	$11,157	$6,452	$11,195
Intercompany mortgage loans and investments in CapLease CDO	92,275	129,187	95,609	130,225
Commercial mortgage-backed securities	2,425	3,271	3,284	11,141
Owned property	–	26,483	–	26,812
Total	$101,105	$170,098	$105,345	$179,373

For the three months ended March 31, 2011 and March 31, 2010, the following interest rates applied with respect to the Company's credit agreement borrowings:

	For the three months ended March 31,	
	2011	2010