

CapLease, Inc.
Form 10-Q
August 06, 2009

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

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 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

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

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

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

As of August 5, 2009, there were 49,424,190 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 June 30, 2009 (unaudited) and December 31, 2008

(Amounts in thousands, except share and per share amounts)	As Of June 30, 2009	As Of December 31, 2008
Assets		
Real estate investments, net	\$ 1,459,931	\$ 1,510,413
Loans held for investment, net	250,826	285,779
Commercial mortgage-backed securities	157,755	161,842
Cash and cash equivalents	17,026	8,439
Structuring fees receivable	1,486	1,863
Other assets	79,830	77,189
Total Assets	\$ 1,966,854	\$ 2,045,525
Liabilities and Equity		
Mortgages on real estate investments	\$ 950,836	\$ 972,324
Collateralized debt obligations	263,289	268,265
Credit facility	158,818	189,262
Secured term loan	119,221	123,719
Convertible senior notes	50,375	66,239
Other long-term debt	30,930	30,930
Total Debt Obligations	1,573,469	1,650,739
Intangible liabilities on real estate investments	48,009	49,277
Accounts payable, accrued expenses and other liabilities	21,029	19,879
Dividends and distributions payable	3,151	711
Total Liabilities	1,645,658	1,720,606
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, 1,400,000 shares issued and outstanding	33,657	33,657
Common stock, \$0.01 par value, 500,000,000 shares authorized, 48,651,990 and 47,391,790 shares issued and outstanding, respectively	487	474
Additional paid in capital	315,491	317,565
Accumulated other comprehensive (loss)	(29,768)	(28,118)
Total Stockholders' Equity	319,867	323,578
Non-controlling interest in consolidated subsidiaries	1,329	1,341

Total Equity	321,196	324,919
Total Liabilities and Equity	\$ 1,966,854	\$ 2,045,525

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries
Consolidated Statements of Operations
(Unaudited)

(Amounts in thousands, except per share amounts)	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2009	2008	2009	2008
Revenues:				
Rental revenue	\$ 33,890	\$ 33,875	\$ 67,751	\$ 67,753
Interest income from loans and securities	7,829	8,694	15,971	17,854
Property expense recoveries	2,688	2,844	5,716	5,604
Other revenue	156	217	363	407
Total revenues	44,563	45,630	89,801	91,618
Expenses:				
Interest expense	22,673	24,383	45,734	48,922
Property expenses	4,756	4,878	10,144	9,496
(Gain) loss on derivatives	-	(198)	-	1,862
Loss on investments	577	-	7,827	-
General and administrative expenses	2,636	3,248	5,154	6,244
General and administrative expenses-stock based compensation	515	627	1,020	1,061
Depreciation and amortization expense on real property	13,319	13,293	26,637	26,571
Loan processing expenses	77	70	156	127
Total expenses	44,553	46,301	96,672	94,283
Gain on extinguishment of debt	6,593	-	9,413	-
Income (loss) from continuing operations	6,603	(671)	2,542	(2,665)
Income from discontinued operations	83	135	196	274
Net income (loss) before non-controlling interest in consolidated subsidiaries	6,686	(536)	2,738	(2,391)
Non-controlling interest in consolidated subsidiaries	(20)	5	(4)	19
Net income (loss)	6,666	(531)	2,734	(2,372)
Dividends allocable to preferred shares	(711)	(711)	(1,422)	(1,422)
Net income (loss) allocable to common stockholders	\$ 5,955	\$ (1,242)	\$ 1,312	\$ (3,794)
Earnings per share:				
Net income (loss) per common share, basic and diluted	\$ 0.12	\$ (0.03)	\$ 0.03	\$ (0.09)
Weighted average number of common shares outstanding, basic and diluted	47,974	44,763	47,705	44,572
Dividends declared per common share	\$ 0.05	\$ 0.20	\$ 0.10	\$ 0.40
Dividends declared per preferred share	\$ 0.51	\$ 0.51	\$ 1.02	\$ 1.02

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries
Consolidated Statement of Changes in Equity
(Unaudited)
(in thousands)

	Stockholders' Equity							Total Equity
	Preferred Stock	Common Stock at Par	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Non-controlling Interest		
Balance at December 31, 2008	\$ 33,657	\$ 474	\$ 312,187	\$ (28,118)	\$ -	\$ 1,341	\$ 319,541	
Cumulative effect of adopting FSP 14-1	-	-	5,378	-	-	-	5,378	
Balance at December 31, 2008-as adjusted	33,657	474	317,565	(28,118)	-	1,341	324,919	
Incentive stock plan compensation expense	-	-	1,020	-	-	-	1,020	
Incentive stock plan grants issued	-	11	(11)	-	-	-	-	
Net income	-	-	-	-	2,734	-	2,734	
Non-controlling interest in consolidated subsidiaries	-	-	-	-	-	4	4	
Issuance of common stock	-	2	432	-	-	-	434	
Dividends declared-preferred	-	-	-	-	(1,422)	-	(1,422)	
Dividends declared-common	-	-	(3,515)	-	(1,312)	-	(4,827)	
Distributions declared-operating partnership units	-	-	-	-	-	(16)	(16)	
Amortization of unrealized loss on securities previously classified as available for sale	-	-	-	222	-	-	222	
Decrease in fair value of securities available for sale	-	-	-	(2,303)	-	-	(2,303)	
Reclassification of derivative items into earnings	-	-	-	431	-	-	431	
Balance at June 30, 2009	\$ 33,657	\$ 487	\$ 315,491	\$ (29,768)	\$ -	\$ 1,329	\$ 321,196	

See notes to consolidated financial statements.

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

	For the Six Months Ended June 30,	
	2009	2008
Operating activities		
Net income (loss)	\$ 2,734	\$ (2,372)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	26,944	27,032
Stock based compensation	1,020	1,061
Amortization of above and below market leases	688	718
Loss (gain) attributable to non-controlling interest in consolidated subsidiaries	4	(19)
Gain on extinguishment of debt	(9,413)	-
Loss on investments	7,827	-
Loss on derivatives	-	1,862
Straight-lining of rents	1,394	5,065
Amortization of discounts/premiums, and origination fees/costs, net	(231)	(192)
Amortization of debt issuance costs and fair market value of debt issued or assumed	1,818	1,212
Changes in operating assets and liabilities:		
Structuring fees receivable	378	349
Other assets	(5,882)	6,922
Accounts payable, accrued expenses and other liabilities	(1,590)	(2,540)
Deposits and escrows	1	(463)
Amounts due to servicer	-	(1)
Net cash provided by operating activities	25,692	38,634
Investing activities		
Proceeds from sale of loans	21,317	-
Additions to loans held for investment	(790)	-
Principal received from borrowers	9,537	3,071
Principal amortization on commercial mortgage-backed securities	2,150	1,832
Proceeds from sale of real estate investments	20,944	-
Real estate improvements, additions, rebates and construction in progress	(611)	1,205
Purchases of furniture, fixtures, equipment and leasehold improvements	(4)	(15)
Net cash provided by investing activities	52,543	6,093
Financing activities		
Repayments of repurchase agreement obligations	-	(232,867)
Borrowings from mortgages on real estate investments	766	688
Repayments of mortgages on real estate investments	(20,776)	(5,312)
Collateralized debt obligations repurchased	(2,881)	-
Borrowings from credit facility	-	210,392
Repayments on credit facility	(30,444)	(2,303)
Repayments on secured term loan	(4,499)	(2,845)
Convertible senior notes repurchased	(8,634)	-
Debt issuance costs	-	(1,783)
Escrows held with mortgage lender	212	600
Funds used in hedging and risk management activities	-	(5,458)

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Common stock issued, net of offering costs	434	912
Distributions to non-controlling interest	(8)	(105)
Dividends paid on common and preferred stock	(3,818)	(19,241)
Net cash used in financing activities	(69,648)	(57,322)
Net increase in cash and cash equivalents	8,587	(12,595)
Cash and cash equivalents at beginning of period	8,439	34,047
Cash and cash equivalents at end of period	\$ 17,026	\$ 21,452

See notes to consolidated financial statements.

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

	For the Six Months Ended June 30,	
	2009	2008
Supplemental disclosure of cash flow information		
Cash paid for interest expense (excluding capitalized interest)	\$ 44,382	\$ 47,951
Distributions declared but not paid	8	53
Dividends declared but not paid	3,144	9,684
Supplemental disclosure of noncash operating, investing and financing information		
Securities transferred to loans held for investment	–	\$ 24,453

See notes to consolidated financial statements.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts)

June 30, 2009 (unaudited)

1. Organization

CapLease, Inc. (“CapLease” and collectively with its majority-owned subsidiaries, the “Company”) is a diversified 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 expenses normally associated with the ownership of the property, 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 expenses when it determines it can sufficiently underwrite that exposure and isolate a predictable cash flow.

The Company has two complimentary business lines: owning single tenant properties and making first mortgage loans and other debt investments on single tenant properties.

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 99.6% 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 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 accounting principles generally accepted in the United States 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, 2008 and notes thereto, included in the Company’s Form 10-K filed with the SEC on March 6, 2009.

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. The Company accounts for properties that it intends to dispose of in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. All significant intercompany transactions, balances and accounts have been eliminated in

consolidation.

Accounting for Real Estate

Real estate is carried on the Company's Consolidated Balance Sheet at cost, net of accumulated depreciation and amortization. Depreciation is determined by the straight-line method over the remaining estimated economic useful lives of the properties. The Company generally depreciates buildings and building improvements over periods not exceeding 40 years. Direct costs incurred in acquiring properties are capitalized. Expenditures for maintenance and repairs 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, in accordance with SFAS No. 144. Upon determination of impairment, the Company would record a write-down of the asset, which would be charged to earnings. Significant judgment is required both in determining impairment and in estimating the resulting write-down, including an evaluation of factors such as the credit quality of the tenant, the anticipated cash flows of the property, based on current leases in place, and an estimate of what lease rents will be if the property is vacated coupled with an estimate of proceeds to be realized upon sale. However, these estimates are highly subjective and could differ materially from actual results. The Company recognized \$2,853 of impairment losses on long-lived assets during the six months ended June 30, 2009, related to an owned property sold in the second quarter of 2009. See Note 6. The Company recognized no impairment losses on long-lived assets during the three and six months ended June 30, 2008.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts)

June 30, 2009 (unaudited)

SFAS No. 144 also requires that long-lived assets and related liabilities that meet various criteria be classified as held for sale and presented separately in the Consolidated Balance Sheet. The operating results of these assets are reflected as discontinued operations in the Consolidated Statement of Operations. The Company reclassified the owned property it sold in the second quarter of 2009 as held for sale at March 31, 2009, and as a result the operating results from this property have been reclassified as discontinued operations. See Note 6.

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.

In accordance with SFAS No. 65, Accounting for Certain Mortgage Banking Activities, loans that the Company expects to sell, if any, are classified as held for sale and carried at lower of cost or market value. As of June 30, 2009, the Company had 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 under SFAS No. 5, Accounting for Contingencies, and an asset-specific component under SFAS No. 114, Accounting by Creditors for Impairments of a Loan. The general reserve component covers performing loans and in accordance with SFAS No. 5 provisions for loan losses are 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. As of June 30, 2009, the Company has a general loan loss reserve in accordance with SFAS No. 5 of \$500. See Note 4.

The asset-specific component of the loan loss impairment analysis is conducted in accordance with SFAS No. 114, and covers 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 market value of any collateral, and the amount and status of any senior debt. The Company's accounting policy is to continue to accrue interest income on specific impaired loans as long as it concludes it is likely to collect it. As of June 30, 2009, the Company had an asset-specific loan loss reserve of \$444 on a single impaired loan. See Note 4.

Commercial Mortgage-Backed Securities

The Company designates its commercial mortgage-backed securities and other real estate securities (“CMBS”) investments pursuant to SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. SFAS No. 115 creates two 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. Under SFAS 115, securities classified as held to maturity are presented at cost plus the amortization of any premiums or discounts. For a security transferred into the held to maturity category, the security is recorded at estimated fair value on the date of transfer, with any unrealized gain or loss amortized against the related fair value adjustment recorded as a component of Other Comprehensive Income (Loss) within Stockholders’ Equity 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.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts)

June 30, 2009 (unaudited)

In January 2008, the Company reclassified a total of 11 securities that are financed in its March 2005 collateralized debt obligation or in the December 2007 secured term loan transaction discussed at Note 9, from “available for sale” to “held to maturity,” as the Company has the positive intent and ability to hold all of those securities until maturity and the terms of the financings significantly restrict or prohibit a sale. As of the date of transfer, the unrealized loss on the securities reclassified as held to maturity included in Other Comprehensive Income (Loss) was \$(9,722). The Company classifies all of its other securities investments 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, and unrealized losses that in the judgment of management are “other-than-temporary” are charged against earnings as a loss on the Consolidated Statement of Operations. In estimating other-than-temporary impairment losses, management considers (1) the financial condition and near-term prospects of the underlying credit, (2) the intent and ability of the Company to retain its investment in the underlying credit for a period of time sufficient to allow for anticipated recovery in fair value and (3) the length of time and the extent to which the fair value has been below cost. The Company had losses on securities of \$133 charged to the Statement of Operations during each of the three and six months ended June 30, 2009. See Note 5. The Company had no losses on securities charged to the Statement of Operations during the three and six months ended June 30, 2008.

Deferred Origination Fees and Costs

In accordance with SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, 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.

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.

Revenue Recognition

Rental revenue on real estate is recognized in accordance with SFAS No. 13, Accounting for Leases. Rental revenue is recognized on a straight-line basis over the non-cancelable term of the lease unless another systematic and rational basis is more representative of the time pattern in which the use benefit is derived from the leased property. This includes the effects of rent steps and rent abatements under the leases.

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. 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.

CapLease, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Dollar amounts in thousands, except per share amounts)

June 30, 2009 (unaudited)

Earnings per Share

In accordance with SFAS No. 128, Earnings per Share, 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 4,903,928 and 5,390,473, respectively, for the three and six months ended June 30, 2009. For each of the 2008 periods, the number of weighted average common shares not included was 6,627,780.

The following summarizes the Company's EPS computations for the three and six months ended June 30, 2009 and June 30, 2008 (in thousands, except per share amounts):

	For the three months ended June 30,		For the six months ended June 30,	
	2009	2008	2009	2008
Net income (loss) allocable to common stockholders	\$ 5,955	\$ (1,242)	\$ 1,312	\$ (3,794)
Weighted average number of common shares outstanding, basic and diluted	47,974	44,763	47,705	44,572
Income (loss) per share, basic and diluted	\$ 0.12	\$ (0.03)	\$ 0.03	\$ (0.09)
Non-vested shares included in weighted average number of shares outstanding above	1,812	935	1,812	935

Recently Issued Accounting Pronouncements

In April 2009, the FASB issued Staff Position FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. The FSP amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, and APB Opinion No. 28, Interim Financial Reporting, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The FSP is effective for the Company on June 30, 2009. The Company's adoption of this FSP on June 30, 2009 did not have a material effect on its financial position or results of operations, although it did result in some additional footnote disclosures in the Company's Form 10-Q filings. See Note 7.

In April 2009, the FASB issued FSP Issue No. FAS No. 115-2 and FAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The FSP amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP is effective for the Company on June 30, 2009. The

Company considered the guidance provided by this FSP in its determination of impairment as of June 30, 2009, and the impact was not material.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (“SFAS No. 165”), which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. SFAS No. 165 is effective for the Company on June 30, 2009. The Company’s adoption of SFAS No. 165 on June 30, 2009 did not have a material effect on its financial condition or results of operations. The Company has performed an evaluation of subsequent events through August 6, 2009, which is the date the financial statements were issued.

CapLease, Inc. and Subsidiaries
 Notes to Consolidated Financial Statements
 (Dollar amounts in thousands, except per share amounts)

June 30, 2009 (unaudited)

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets — an amendment of FASB Statement No. 140 (“SFAS No. 166”), which requires additional information regarding transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. SFAS No. 166 eliminates the concept of a “qualifying special-purpose entity,” changes the requirements for derecognizing financial assets, and requires additional disclosures. SFAS No. 166 is effective for the Company on January 1, 2010. The Company is currently evaluating the impact that the adoption of SFAS No. 166 will have on its financial condition and results of operations.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (“SFAS No. 167”), which modifies how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. SFAS No. 167 clarifies that the determination of whether a company is required to consolidate an entity is based on, among other things, an entity’s purpose and design and a company’s ability to direct the activities of the entity that most significantly impact the entity’s economic performance. SFAS No. 167 requires an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity. SFAS No. 167 also requires additional disclosures about a company’s involvement in variable interest entities and any significant changes in risk exposure due to that involvement. SFAS No. 167 is effective for the Company on January 1, 2010. The Company is currently evaluating the impact that the adoption of SFAS No. 167 will have on its financial condition and results of operations.

In June 2009, the FASB approved the FASB Accounting Standards Codification (“Codification”) as the single source of authoritative nongovernmental U.S. GAAP to be launched on July 1, 2009. The Codification does not change current U.S. GAAP, but is intended to simplify user access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place. All existing accounting standard documents will be superseded and all other accounting literature not included in the Codification will be considered nonauthoritative. The Codification is effective for the Company on September 30, 2009. The Codification will not have an impact on the Company’s financial condition or results of operations. However, because the Codification completely replaces existing standards, it will affect the way U.S. GAAP is referenced within 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 on real estate investments consisted of the following at June 30, 2009 and December 31, 2008:

	Jun 30, 2009 Unaudited	Dec 31, 2008
Real estate investments, at cost:		
Land	\$ 190,571	\$ 192,321
Building and improvements	1,260,153	1,278,025

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Intangible assets under SFAS 141	181,833	186,568
Less: Accumulated depreciation and amortization	(172,626)	(146,501)
Real estate investments, net	\$ 1,459,931	\$ 1,510,413
Intangible liabilities on real estate investments:		
Intangible liabilities under SFAS 141	\$ 56,000	\$ 56,000
Less: Accumulated amortization	(7,991)	(6,723)
Intangible liabilities on real estate investments, net	\$ 48,009	\$ 49,277

The Company did not complete any new real estate acquisitions during the three months ended June 30, 2009, or the three months ended June 30, 2008. The Company did, however, sell one owned real property during the quarter ended June 30, 2009. See Note 6.

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The impact on rental revenue of the straight-line rent adjustment under SFAS No. 13 is recorded on the Company's Consolidated Balance Sheet through accrued rental income and deferred rental income. Amounts for accrued rental income and deferred rental income as of June 30, 2009 and December 31, 2008, were as follows:

	Jun 30, 2009 Unaudited	Dec 31, 2008
Accrued Rental Income	\$ 34,927	\$ 35,883
Deferred Rental Income	3,810	1,072

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, accrued expenses and other liabilities" on the Company's Consolidated Balance Sheet. See Note 10.

Depreciation expense and amortization of intangible assets and liabilities on real estate investments for the three and six months ended June 30, 2009 and June 30, 2008, were as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2009	2008	2009	2008
Depreciation on real estate (included in depreciation and amortization expense)	\$ 8,217	\$ 8,197	\$ 16,431	\$ 16,396
Amortization of in-place leases (included in depreciation and amortization expense)	5,103	5,096	10,205	10,174
Amortization of above-market leases (included as a reduction of rental revenue)	962	967	1,924	1,924
Amortization of below-market leases (included as a component of rental revenue)	634	634	1,268	1,267

As of June 30, 2009, the Company's weighted average amortization period on intangible assets was 8.0 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 June 30, 2009 was as follows:

	Intangible Assets	Intangible Liabilities
6 Months Ending December 31, 2009	\$ 10,310	\$ 1,268
2010	19,893	2,535
2011	19,181	2,535
2012	14,763	2,535

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2013	9,091	2,400
Thereafter	40,128	36,736
	\$ 113,366	\$ 48,009

Substantially all of the Company's owned properties are pledged as collateral to the Company's lender that has provided financing on the property. The Company's strategy is to own and finance on a long-term basis each property through a separate and distinct single 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 9.

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4. Loans Held for Investment

Loans held for investment at June 30, 2009 and December 31, 2008, are summarized in the following table. These investments consist predominantly of mortgage loans on properties subject to leases to high credit quality tenants. As of June 30, 2009, the weighted average credit rating of the underlying tenants was BBB+ from Standard & Poor's. Except as described below, as of June 30, 2009, none of the Company's loans held for investment were on non-accrual status or past due 90 days or more.

	Jun 30, 2009 Unaudited	Dec 31, 2008
Principal	\$ 253,407	\$ 283,912
(Discount) Premium	(1,167)	3,151
Cost basis	252,240	287,063
Allowance for loan losses	(944)	(500)
Carrying amount of loans	251,296	286,563
Deferred origination fees, net	(470)	(784)
Total	\$ 250,826	\$ 285,779

A majority participation interest in a loan investment was reclassified to "Assets held for sale" at March 31, 2009, and sold during the quarter ended June 30, 2009. See Note 6.

As of June 30, 2009, the Company has a general loan loss reserve in accordance with SFAS No. 5 of \$500, reflecting management's estimate of losses that have probably occurred in its mortgage loan portfolio.

At each of June 30, 2009 and December 31, 2008, the Company's loan investments carried interest rates ranging from 5.28% to 10.00%. At June 30, 2009 and December 31, 2008, the weighted average effective interest rate on the Company's loan investments, as measured against its cost basis, was 6.83% and 6.80%, respectively.

From time to time, the Company makes mezzanine loan and other investments. These investments are typically shorter-term in nature and are often subordinate to other financing. As of June 30, 2009, the carry value of these investments aggregated \$1,650, and are included in the table above.

As of June 30, 2009, the Company classified two loan investments each of which experienced a payment default in 2008 as impaired in accordance with SFAS No. 114. One of those loan investments was amended during 2009 at which time the borrower made a net principal repayment of \$4,272, the loan maturity was extended until October 2009 and certain other loan modifications were made. Both loans have been placed on non-accrual status with interest income accounted for on a cost-recovery basis. The Company performed an impairment analysis for each of these loans as of June 30, 2009, and concluded to record a loss reserve of \$444 on one of the two loans, in order to reflect its current estimate of the value of the collateral underlying the loan.

The following tables summarize certain financial information with respect to the Company's impaired loans:

Average carrying amount

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Borrower	Carrying Amount		For the three months ended June 30,		For the six months ended June 30,	
	6/30/2009	12/31/2008	2009	2008	2009	2008
Eden Hylan Seaview LLC	\$ 650	\$ 650	\$ 650	\$ 650	\$ 650	\$ 650
West End Mortgage Finance Fund I L.P.	1,000	6,154	1,299	6,654	2,961	6,654

Borrower	Interest Income Recognized					
	For the three months ended June 30,2009			For the six months ended June 30,2009		
	Accrual	Cash		Accrual	Cash	
Eden Hylan Seaview LLC	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
West End Mortgage Finance Fund I L.P.	-	-	-	115	115	-

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The above table includes interest income only for the period the loan was classified as impaired. The loans were not classified as impaired during the 2008 periods.

5. Commercial Mortgage-Backed Securities and Structuring Fees Receivable

The following is a summary of the Company's securities investments at June 30, 2009:

Description	Number of Securities	Face Value	Carry Value	Amortized Cost	Fair Value	Gross Unrecognized Gain	Gross Unrecognized Loss
Held to Maturity	11	\$ 154,651	\$ 139,453	\$ 149,664	\$ 81,327	\$ -	\$ (68,337)
Available For Sale							
Sale	9	45,936	18,302	32,786	18,303	-	(14,483)
Total	20	\$ 200,587	\$ 157,755	\$ 182,450	\$ 99,630	\$ -	\$ (82,820)

A detailed schedule of the Company's securities investments at June 30, 2009 follows:

	Jun 30, 2009 Unaudited
BSCMS 1999 CLF1, Class E (rated CCC) Face Amount	Available For Sale \$ 3,326
BSCMS 1999 CLF1, Class F (not rated) Face Amount	Available For Sale 251
CMLBC 2001-CMLB-1, Class H (rated B-) Face Amount	Available For Sale 11,907
CMLBC 2001-CMLB-1, Class J (rated D) Face Amount	Available For Sale 6,383
NLFC 1999-LTL-1, Class X (IO) (rated AAA) Carry Value	Available For Sale 5,379
WBCMT 2004-C15 180E (rated B) Face Amount	Available For Sale 8,000
BACMS 2002-2, Class V-1 (7-Eleven, Inc.) (rated A) Face Amount	Available For Sale 530
BACMS 2002-2, Class V-2 (Sterling Jewelers) (not rated) Face Amount	Available For Sale 810
Yahoo, Inc. (rated BBB-) Face Amount	Available For Sale 9,350
BACM 2006-4, Class H (rated BBB+) Face Amount	Held To Maturity 8,000
CALFS 1997-CTL1, Class D (rated B-) Face Amount	Held To Maturity 6,000
CMLBC 2001-CMLB-1, Class E (rated BBB+) Face Amount	Held To Maturity 9,526
CMLBC 2001-CMLB-1, Class G (rated BB-) Face Amount	Held To Maturity 9,526
NLFC 1999-LTL-1, Class E (rated BB) Face Amount	Held To Maturity 11,081
WBCMT 2004-C15 180D (rated B+) Face Amount	Held To Maturity 15,000
WBCMT 2006-C27, Class C (rated AA-) Face Amount	Held To Maturity 11,000
CVS Corporation (rated BBB+) Face Amount	Held To Maturity 18,335
Koninklijke Ahold, N.V. 7.82% Jan 2020 (rated BBB) Face Amount	Held To Maturity 8,283
Lucent 6.70% due 9/1/2020 (rated B+) Face Amount	Held To Maturity 35,754
Yahoo, Inc. (rated BBB-) Face Amount	Held To Maturity 22,145
Unearned Discount	(18,136)
Cost Basis	182,450

Net unrealized gain (loss) on securities	(24,695)
Total	\$ 157,755

All credit ratings in the above table are as of June 30, 2009.

During the three and six months ended June 30, 2009, the Company recognized impairment losses on securities investments of \$133 and \$133, respectively. The losses are included in "Loss on investments" in the Company's Consolidated Statement of Operations and were recorded on one CMBS investment: BSCMS Class E. These losses represent management's determination that other-than-temporary declines in the fair value of the security below its cost basis had occurred. The loss reflects management's estimate of expected losses from underlying credits in the collateral pool (including Circuit City Stores, Inc.). The loss estimate is highly subjective and reflects a variety of assumptions, including estimates of the likelihood of default and lease rejection given the credit characteristics of the tenant, and estimates of appraised values and/or stressed collateral values and potential bankruptcy claim recoveries.

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Unrealized gains and losses on securities at June 30, 2009 and December 31, 2008, included as a component of Other Comprehensive Income (Loss) on the Company's Consolidated Balance Sheet, consisted of the following:

	Jun 30, 2009 Unaudited	Dec 31, 2008
Unrealized gains on securities previously available for sale	\$ 826	\$ 900
Unrealized losses on securities previously available for sale	(11,038)	(10,117)
Unrealized gains on securities available for sale	-	1
Unrealized losses on securities available for sale	(14,483)	(13,397)

The following table summarizes the Company's securities in an unrealized loss position as of June 30, 2009.

	Aggregate Fair Value	Aggregate Unrealized Loss	Number of Securities
In unrealized loss position less than 12 months	\$ 23,434	\$ 7,863	3
In unrealized loss position 12 or more months	75,169	74,958	13

The collateral backing our securities investments is primarily net lease loan assets and loss experience on the assets has historically been de minimis. Credit ratings on the 13 securities in a continuous unrealized loss position for more than 12 months range from AAA to D with a weighted average of BBB- and those securities have a weighted average maturity of approximately 9.8 years. The Company believes that none of the unrealized losses on investment securities are other than temporary because substantially all of the unrealized losses relate to market interest rate changes, and the Company has both the intent and the ability to hold these securities for a period of time sufficient to allow for a full recovery in fair value. In addition, management considers the underlying credits to be financially sound and believes the Company will receive all contractual principal and interest related to these investments.

At June 30, 2009 and December 31, 2008, the weighted average effective interest rate (yield to maturity on adjusted cost basis) on securities was approximately 7.5% and 7.5%, respectively.

The Company had no sales of securities during each of the six months ended June 30, 2009 and June 30, 2008.

Structuring fees receivable of \$1,486 and \$1,863 at June 30, 2009 and December 31, 2008, 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. Assets Sold and Discontinued Operations

During April 2009, the Company sold the OSHA technological laboratory facility in Sandy, Utah leased to the United States Government. In connection with the sale of this property, the Company recognized a loss of \$2,853 during the quarter ended March 31, 2009. The loss was included in "Loss on investments" in the Company's Consolidated Statement of Operations. In accordance with SFAS No. 144, operating results from this property are reflected as

discontinued operations in the Company's Consolidated Statement of Operations.

During April 2009, the Company sold a majority participation interest in a long-term mortgage loan on a property in Framingham, Massachusetts backed by a Lowe's Companies Inc. lease. During the quarter ended March 31, 2009, the Company recorded a loss of \$4,397 in connection with the sale of this loan. The loss was included in "Loss on investments" in the Company's Consolidated Statement of Operations.

7. Fair Value

SFAS No. 107, Disclosure about Fair Value of Financial Instruments ("SFAS No. 107"), requires disclosure of fair value information about all of the Company's financial instruments, whether or not these instruments are measured at fair value on the Company's Consolidated Balance Sheet. Until June 30, 2009, SFAS No. 107 required these disclosures be included solely in the Company's annual financial statements. As of June 30, 2009, the Company adopted Staff Position FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, which now requires disclosures about the fair value of financial instruments be included in financial statements for interim reporting periods, as well as annual financial statements.

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For purposes of SFAS No. 107, substantially all of the Company's assets and liabilities other than its owned property investments are classified as financial instruments.

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 June 30, 2009 and December 31, 2008 are as follows:

	Carrying Amount		Notional Amount		Estimated Fair Value	
	6/30/2009	12/31/2008	6/30/2009	12/31/2008	6/30/2009	12/31/2008
Assets:						
Loans held for investment	\$ 251,296	\$ 286,563	\$ 253,407	\$ 283,912	\$ 220,174	\$ 262,647
Commercial mortgage-backed securities	157,755	161,842	200,587	202,382	99,630	119,083
Structuring fees receivable	1,486	1,863	N/A	N/A	1,486	1,863
Liabilities:						
Mortgages on real estate investments	\$ 950,836	\$ 972,325	\$ 946,081	\$ 966,091	\$ 852,302	\$ 936,668
Collateralized debt obligations	263,289	268,265	263,500	268,500	142,924	116,592
Credit facility	158,818	189,262	158,818	189,262	158,818	189,262
Secured term loan	119,221	123,719	119,221	123,719	72,223	62,010
Convertible senior notes	50,375	66,239	53,944	71,760	32,760	28,329
Other long-term debt	30,930	30,930	30,930	30,930	15,873	11,152

The fair values indicated above are indicative of the interest rate and credit spread environment as of June 30, 2009 and December 31, 2008, respectively, and may not take into consideration the effects of subsequent interest rate, credit spread fluctuations, or changes in the ratings of the tenant obligors under 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 are determined in most cases primarily by reference to index pricing. Management may also estimate fair value based on credit characteristics and term of the security, market yields on securities with similar credit ratings, and collateral values. Management has obtained broker quotes, but believes that in most cases the broker quotes reflect expected pricing for distressed trades in inactive and dislocated markets, rather than actual prices in orderly transactions. Management has ultimately determined the fair values recorded in the financial statements based on a variety of factors.

Structuring fees receivable—The fair value of structuring fees receivable is estimated with a discounted cash flow analysis, utilized scheduled cash flows and discount rates estimated by management to approximate those that a

willing buyer and seller might use.

Credit facility—Management believes that the stated interest rate (which floats based on short-term interest rates) approximate 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 FSP No. 14-1. 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.

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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.

The Company adopted Statement No. 157, Fair Value Measurements (“SFAS No. 157”), on January 1, 2008. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 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. Under existing accounting pronouncements, the Company measures its securities available for sale and any derivative assets and liabilities at fair value.

SFAS No. 157 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 June 30, 2009, the Company has classified none 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 June 30, 2009, the Company has classified one of its securities available for sale as Level 2. For that security which is backed by a single corporate tenant, the Company has determined fair value based on a broker quotation for a similar security.
- Level 3 – Instruments that have little to no pricing observability as of the reported date. These financial instruments do not have two-way markets and are measured using management’s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation. Instruments in this category generally include assets and liabilities for which there is little, if any, current market activity. As of June 30, 2009, the Company has classified all but one of its securities available for sale as Level 3, due to the lack of current market activity. The Company believes that it may be appropriate to transfer the securities to Level 2 in subsequent periods if market activity returns to normalized levels and observable inputs become available. The fair values of the securities are determined in most cases primarily by reference to index pricing. With respect to one security, management has estimated fair value based on credit characteristics and term of the security, market yields on securities with similar credit ratings, and collateral values. Management has obtained broker quotes, but believes that in most cases the broker quotes reflect expected pricing for distressed trades in inactive and dislocated markets, rather than actual prices in orderly transactions. Management has ultimately determined the fair values recorded in the financial statements based on a variety of factors.

The table below presents the fair value of the Company’s securities available for sale as of June 30, 2009, aggregated by the level in the fair value hierarchy within which those measurements fall. As of June 30, 2009, the Company had no derivative assets or liabilities.

Significant Balance at

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	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	June 30,2009
Assets				
Securities available for sale	\$	– \$	7,488 \$	10,815 \$ 18,303

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The following table summarizes the change in the fair value for Level 3 items for the three and six months ended June 30, 2009:

	Three months ended June 30, 2009 (unaudited)	Six months ended June 30, 2009 (unaudited)
Securities available for sale		
Beginning balance	\$ 12,475	\$ 13,483
Gains (losses) included in net income (loss)	(133)	(133)
Gains (losses) included in other comprehensive income	(1,329)	(2,105)
Amortization included in interest income	(65)	(124)
Settlements or repayments	(133)	(306)
Transfers in (out) of Level 3	-	-
Ending balance	\$ 10,815	\$ 10,815

8. Other Assets

Other assets as of June 30, 2009 and December 31, 2008, consisted of the following:

	Jun 30, 2009 Unaudited	Dec 31, 2008
Receivables and accrued interest	\$ 8,734	\$ 10,024
Prepaid expenses and deposits	1,705	1,198
Reserve accounts	14,876	12,889
Escrow held with mortgage lender	-	212
Funds with CDO trustee pending distribution or reinvestment	8,697	3,947
Restricted cash	161	44
Amounts held by servicer	165	356
Accrued rental income	34,927	35,883
Debt issuance costs, net	8,485	10,404
Investment in statutory trust	930	930
Other	1,150	1,302
Total	\$ 79,830	\$ 77,189

9. Debt Obligations

Credit Agreement

During April 2008, the Company (through its wholly-owned subsidiary Caplease Debt Funding, LP) entered into a credit agreement with Wachovia Bank, N.A. Pursuant to the credit agreement, Wachovia Bank agreed to make an aggregate of \$250,000 of term and revolving credit loans available to the Company. The Company drew a \$210,392 term loan upon closing of the credit agreement and may make draws of revolving credit loans from time to time

during the agreement term to finance commercial real estate assets that are approved by Wachovia Bank in its discretion.

On December 31, 2008, Wells Fargo & Company acquired Wachovia Bank, N.A., through a merger of Wachovia Bank's parent company, Wachovia Corporation, with and into Wells Fargo & Company.

The credit agreement is for a term of two years with a one-year extension option at the Company's option provided it meets certain conditions (including reducing the Company's borrowings to \$135,000 by the scheduled maturity date in April 2010). The Company can prepay its borrowings under the facility in whole or in part at any time (subject to a \$1,000 minimum) without any penalty or premium. Subject to certain exceptions, the Company is required to use a portion of its future debt or equity issuances to prepay borrowings under the facility. The Company is required to pay interest on its borrowings at prevailing short-term rates (30-day LIBOR) plus a pricing spread ranging from 200 to 250 basis points. As of June 30, 2009, the Company's weighted average effective financing rate on the credit agreement was 3.50%.

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In connection with the financing transaction, the Company and Wachovia also agreed to consolidate their existing lending arrangements into this facility and, as a result, the Company's prior \$250,000 repurchase agreement and a \$30,000 revolving loan agreement (the "Revolver"), were terminated. The Company's borrowings under the facility are secured by the same collateral that previously secured its obligations under the repurchase agreement and Revolver, which includes 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 Wachovia 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, Wachovia may require the Company to prepay a portion of its borrowings, provided that Wachovia 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 is required to comply with the following financial covenants under the credit agreement: minimum liquidity (as defined in the agreement) of at least \$8,000, and minimum consolidated tangible net worth (as defined in the agreement) of at least \$180,000 plus 75% of the aggregate net proceeds from equity offerings or capital contributions after September 22, 2004.

Amounts related to the Company's credit agreement as of June 30, 2009 and December 31, 2008, were as follows:

	At June 30, 2009		At December 31, 2008	
	Borrowings (unaudited)	Collateral Carry Value (unaudited)	Borrowings	Collateral Carry Value
Credit Agreement				
Loans held for investment	\$ 34,066	\$ 51,533	\$ 55,434	\$ 78,071
Intercompany mortgage loans and investments in CapLease				
CDO	113,331	138,417	119,119	145,816
Commercial mortgage-backed securities	11,421	16,956	14,709	19,390
Owned property	–	41,316	–	44,398
Total	\$ 158,818	\$ 248,222	\$ 189,262	\$ 287,675

The following interest rates apply with respect to the Company's credit agreement and repurchase agreement borrowings for the three and six months ended June 30, 2009 and June 30, 2008:

	For the three months ended June 30,		For the six months ended June 30,	
	2009 unaudited	2008 unaudited	2009 unaudited	2008 unaudited
Weighted average effecting financing rate	3.74%	5.03%	3.76%	4.65%
30-Day LIBOR rate	0.44%	2.70%	0.44%	3.10%

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Mortgage Notes on Real Estate Investments

The Company has financed most of its owned real properties with third party mortgage debt. The Company's mortgage notes payable are summarized in the following table:

Property Level Debt - Fixed Rate	Jun 30, 2009		Dec 31, 2008		Coupon	Effective Financing Rate (1)	Maturity
	Face (unaudited)	Carry Value (unaudited)	Face	Carry Value			
Abbott Laboratories, Waukegan, IL	\$ 15,020	\$ 15,020	\$ 15,120	\$ 15,120	5.11%	5.16%	Aug 2015
Aetna Life Insurance Company, Fresno, CA	16,043	16,043	16,043	16,043	5.63%	5.68%	Dec 2016
Allstate Insurance Company, Charlotte, NC	20,105	20,105	20,209	20,209	5.68%	5.71%	Jan 2016
Allstate Insurance Company, Roanoke, VA	21,404	21,404	21,516	21,516	5.68%	5.76%	Jan 2016
AmeriCredit Corp., Arlington, TX	27,916	27,613	28,148	27,828	5.28%	5.51%	Sep 2017
AMVESCAP PLC, Denver, CO	43,700	43,700	43,700	43,700	6.03%	6.08%	Jul 2016
Aon Corporation, Glenview, IL	62,970	62,970	63,613	63,613	5.23%	5.75%	Nov 2014
Bunge North America, Inc., Fort Worth, TX	6,262	6,262	6,262	6,262	5.45%	5.55%	May 2017
Cadbury Schweppes Plc, Whippany, NJ	34,188	34,188	34,491	34,491	5.26%	5.34%	Mar 2015
Capital One Financial Corporation, Plano, TX	20,459	20,459	20,630	20,630	5.24%	5.29%	May 2013
Choice Hotels International, Inc., Silver Spring, MD	29,592	29,592	30,080	30,080	5.30%	5.34%	May 2013
County of Yolo, California, Woodland, CA	10,332	10,332	10,332	10,332	5.68%	5.75%	Feb 2017
Farmers Group, Inc., Simi Valley, CA	25,620	25,620	25,620	25,620	5.81%	5.85%	Jan 2017
Farmers New World Life Insurance Company, Mercer	30,200	30,200	30,200	30,200	5.69%	5.72%	Jan 2016

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Island, WA							
ITT Industries, Inc., Herndon, VA	41,112	41,112	41,301	41,301	5.33%	5.40%	Jun 2015
Johnson Controls, Inc., Largo, FL	16,200	16,200	16,200	16,200	5.48%	5.52%	Jan 2017
Koninklijke Ahold, N.V., Levittown, PA	14,344	14,344	14,441	14,441	6.05%	6.11%	Jul 2016
Lowes Companies, Inc., Aliso Viejo, CA	42,125	42,125	42,125	42,125	5.10%	5.37%	Jul 2015
Nestle Holdings, Inc., Breinigsville, PA; Fort Wayne, IN; and Lathrop, CA	117,000	117,000	117,000	117,000	6.32%	5.65%	Aug 2012
Omnicom Group, Inc., Irving, TX	13,222	13,222	13,361	13,361	5.24%	5.30%	May 2013
Pearson Plc., Lawrence, KS	16,025	16,025	16,025	16,025	5.84%	5.95%	May 2016
T-Mobile USA, Inc., Nashville, TN	10,885	10,885	10,885	10,885	5.59%	5.69%	Dec 2016
The Travelers Corporation, Hartford, CT	12,744	13,348	15,074	15,950	9.80%	5.53%	Sep 2011
The Travelers Corporation, Hartford, CT	14,691	15,748	13,925	15,159	10.76%	7.67%	Oct 2011
Tiffany & Co., Parsippany, NJ	58,400	58,400	58,400	58,400	5.33%	5.34%	Oct 2015
Time Warner Entertainment Company, L.P., Milwaukee, WI	17,500	17,500	17,500	17,500	5.55%	5.59%	Dec 2016
TJX Companies, Inc., Philadelphia, PA	70,521	70,521	70,805	70,805	5.57%	5.59%	Mar 2016
United States Government (DEA), Birmingham, AL	11,280	11,280	11,280	11,280	5.23%	5.42%	Sep 2015
United States Government (EPA), Kansas City, KS	20,246	23,214	20,245	23,328	7.57%	5.74%	Oct 2022
United States Government (FBI), Albany, NY	10,137	10,137	10,137	10,137	5.50%	5.68%	Nov 2016
United States Government (FBI), Birmingham, AL	18,800	18,800	18,800	18,800	5.23%	5.31%	Sep 2015
United States Government (NIH), N. Bethesda, MD	61,630	61,630	62,322	62,322	5.32%	5.56%	Sep 2015
United States Government (OSHA), Sandy, UT	–	–	14,470	15,361	6.28%	5.52%	Jan 2024

United States Government (SSA), Austin, TX	5,391	5,391	5,391	5,391	5.23%	5.46% Sep 2015
United States Government (VA), Ponce, PR	5,592	5,782	5,867	6,078	7.30%	6.41% Apr 2016
Walgreen Co., Pennsauken, NJ	1,558	1,645	1,636	1,733	7.65%	6.04% Oct 2016
Walgreen Co., Portsmouth, VA	2,867	3,019	2,937	3,098	7.20%	6.18% Jul 2018
Total	\$ 946,081	\$ 950,836	\$ 966,091	\$ 972,324		

(1) The effective rate is the Company's approximate borrowing cost, including the effect of hedge gains or losses and other deferred financing costs associated with the related borrowing.

The mortgage notes are non-recourse to the Company subject to limited non-recourse exceptions and are secured by the respective properties and an assignment of the relevant leases on the properties. See Note 3 regarding the separate and distinct nature of the Company's SPEs. The Company's book value before accumulated depreciation and amortization on owned property investments encumbered with mortgage debt aggregated \$1,431,169 at June 30, 2009, and \$1,455,527 at December 31, 2008.

Collateralized Debt Obligations

During March 2005, the Company issued a collateralized debt obligation, or CDO. The CDO is an entirely fixed rate on-balance sheet financing. The Company aggregated approximately \$300,000 of assets and then transferred these assets into a wholly-owned securitization vehicle, and issued \$285,000 face amount of multi-class notes and \$15,000 of preferred equity through the securitization vehicle. The assets serve as collateral for the Company's obligations under the notes. The securitization vehicle is an SPE, with its business limited to the issuance of the notes and the preferred equity, the acquisition of the collateral and certain other related matters. The net amount of the debt the Company issued was \$268,130, inclusive of a \$370 discount to face, as the Company retained the three most junior note classes aggregating a face amount of \$16,500 and the full \$15,000 of preferred equity. Each of the five note classes of the CDO was and continues to be rated investment grade. Through October 2009, the Company expects to reinvest principal repayments on the underlying assets into qualifying replacement collateral. The CDO notes have a stated maturity in January 2040, but are expected to mature in January 2015 when they become subject to an auction call procedure. The Company's weighted average effective financing rate (inclusive of original issue discount and debt issuance and hedge costs) on its CDO is approximately 5.69%. The CDO debt is non-recourse to the Company but is secured by the collateral assets. The following table summarizes the assets posted as CDO collateral as of June 30, 2009.

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	Carry Value
Loans held for investment	\$ 155,898
Intercompany mortgage loans on CapLease properties	45,150
Commercial mortgage-backed securities	81,757
Total	\$ 282,805

During the quarter ended June 30, 2009, the Company repurchased \$5,000 of the Class A CDO notes at a price of \$2,825, plus accrued interest, or a 43.5% discount from the face of the notes. The Company recorded a gain on extinguishment of the CDO debt in the quarter ended June 30, 2009 of \$2,012.

Secured Term Loan

During December 2007, the Company completed a \$129,521 secured term loan with KBC Bank, N.V. Upon closing of the financing, the Company pledged approximately \$163,145 principal amount of collateral to secure its obligations under the loan. The interest coupon on the loan is fixed at 5.81% annually until the loan matures in January 2018. The Company's effective financing rate on the loan is 6.02% annually (inclusive of hedge and closing costs). The loan is non-recourse to the Company, subject to limited non-recourse exceptions. The following table summarizes the assets pledged as collateral for the Company's obligations under the loan as of June 30, 2009.

	Carry Value
Loans held for investment	\$ 42,715
Intercompany mortgage loans on CapLease properties	49,389
Commercial mortgage-backed securities	57,696
Total	\$ 149,800

Convertible Senior Notes

During October 2007, CapLease issued \$75,000 principal amount of 7.50% convertible senior notes due 2027. The notes represent general unsecured obligations of CapLease and rank equally in right of payment with all of its other existing and future obligations that are unsecured and unsubordinated. The notes are jointly and severally, fully and unconditionally guaranteed, on a senior unsecured basis by four of CapLease's subsidiaries, Caplease, LP, Caplease Debt Funding, LP, Caplease Services Corp. and Caplease Credit LLC.

The Company adopted FSP No. 14-1, reflecting new rules that retrospectively change the accounting for the convertible senior notes, as of January 1, 2009. The adoption of FSP No. 14-1 affected the accounting for the Company's convertible senior notes by requiring the initial proceeds from their sale to be allocated between a liability component and an equity component in a manner that results in interest expense on the liability component at the Company's estimated nonconvertible debt borrowing rate on the date of issue.

During December 2008, the Company agreed to repurchase \$8,740 of the convertible senior notes at a price of \$3,269, plus accrued interest on the notes, or a 62.6% discount from the face amount of the notes. The repurchase of a total of \$3,240 of notes was closed in December at a price of \$1,179. Inclusive of the impact of FSP No. 14-1, the Company recorded a gain on extinguishment of debt of \$1,713 in the year ended December 31, 2008. The repurchase of the remaining \$5,500 was closed in January at a price of \$2,090. The Company recorded a gain on extinguishment of

debt in the quarter ended March 31, 2009 of \$2,821, also inclusive of the impact of FSP No. 14-1.

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During the quarter ended June 30, 2009, the Company repurchased \$12,316 of the convertible senior notes at a price of \$6,512, plus accrued interest on the notes, or a 47.1% discount from the face of the notes. The Company recorded a gain on extinguishment of the convertible senior notes in the quarter ended June 30, 2009 of \$4,581, inclusive of the impact of FSP No. 14-1.

The notes bear interest at an annual fixed rate of 7.50% and will mature on October 1, 2027, unless earlier converted, redeemed or repurchased. The Company's effective financing rate on the notes, which includes the effect of the offering discount and expenses of the transaction, is approximately 8.26%. The Company's effective interest rate on the liability component of the instrument as measured under FSP No. 14-1 was 10.91% at June 30, 2009.

Holder may require CapLease to repurchase their notes, in whole or in part, on October 1, 2012, October 1, 2017 and October 1, 2022, for a cash price equal to 100% of the principal amount of the notes to be repurchased, plus any accrued and unpaid interest.

Trust Preferred Securities

In December 2005, the Operating Partnership issued \$30,000 in aggregate principal amount of fixed/floating rate preferred securities through its wholly-owned subsidiary, Caplease Statutory Trust I. The trust preferred securities represent an unsecured subordinated recourse debt obligation of the Company and require quarterly interest payments calculated at a fixed interest rate equal to 7.68% per annum through January 30, 2016, and subsequently at a variable interest rate equal to LIBOR plus 2.60% per annum. The securities must be redeemed on January 30, 2036, and may be redeemed, in whole or in part, at par, at the Company's option, beginning on January 30, 2011. The Company's effective financing rate on the trust preferred securities, inclusive of deferred issuance costs, is approximately 8.30% per annum.

Scheduled principal amortization and balloon payments for all of the Company's outstanding debt obligations as of June 30, 2009, for the next five years and thereafter are as follows:

	Scheduled Amortization	Balloon Payments	Total
6 Months Ending December 31, 2009	\$ 21,637	\$ -	\$ 21,637
2010	54,522	145,799	200,321
2011	41,120	18,861	59,981
2012	41,096	170,944	212,040
2013	40,362	54,984	95,346
Thereafter	113,630	870,514	984,144
	\$ 312,367	\$ 1,261,102	\$ 1,573,469

10. Accounts payable, accrued expenses and other liabilities

Accounts payable, accrued expenses and other liabilities as of June 30, 2009 and December 31, 2008 consisted of the following:

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	Jun 30, 2009	Dec 31, 2008
	Unaudited	
Accounts payable and other liabilities	\$ 1,029	\$ 1,458
Accrued interest	7,553	8,571
Accrued expenses	4,273	4,862
Deferred rental income	3,810	1,072
Unearned rental income	4,364	3,916
Total	\$ 21,029	\$ 19,879

11. Risk Management Transactions

As part of its financing strategy, the Company may use interest rate swap transactions to manage its exposure to interest rate fluctuations on assets not yet financed with long-term fixed rate debt. As of June 30, 2009, the Company had no open interest rate swap positions.

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During most of 2008, the Company had a single open interest rate swap, intended to manage the Company's exposure to interest rate movements for a planned long-term financing of assets financed on its interim financing facility with Wachovia Bank. During November 2008, the Company closed the swap as a result of unprecedented credit market dislocations and associated declines in the 10-Year Treasury and other benchmark market interest rates.

The Company had net (expense) income from derivatives of \$198 and \$(1,862) for the three and six months ended June 30, 2008, related to hedge ineffectiveness on the interest rate swap position that was closed in November 2008. This loss is included in "(Gain) loss on derivatives" on the Company's Consolidated Statements of Operations.

As of June 30, 2009, the Company had \$5,074 of net realized losses on derivatives deferred on the Company's Consolidated Balance Sheet as a component of Accumulated Other Comprehensive Income (Loss). Within the next twelve months, the Company estimates that \$629 of net losses currently held within Accumulated Other Comprehensive Income (Loss) will be reclassified to earnings as additional interest expense.

The Company classifies the cash flows from derivatives as a financing activity on the Consolidated Statements of Cash Flows.

12. Commitments and Contingencies

The Company is involved from time to time in litigation arising in the ordinary course of business. The Company is not currently involved in any matter which management believes will have a material adverse effect on the Company's business, results of operations or financial condition. However, periodic settlements and/or professional or other fees and expenses related to any matter could have an adverse impact on our results of operations in the quarterly or annual period in which they are recognized.

As an owner of commercial real estate, the Company is subject to potential environmental costs. At June 30, 2009, the Company was not aware of any environmental concerns that would have a material adverse effect on the Company's business, results of operations or financial condition.

13. Stockholders' Equity

Stock Issuances

CapLease's authorized capital stock consists of 500,000,000 shares of common stock, par value \$0.01 per share, and 100,000,000 shares of preferred stock, par value \$0.01 per share. As of June 30, 2009, CapLease had issued and outstanding 48,651,990 shares of common stock, and 1,400,000 shares of 8.125% Series A cumulative redeemable preferred stock.

During the quarter ended June 30, 2009, CapLease issued an aggregate of 152,600 shares of common stock through at the market public sales at an average price of \$2.98 per share, for net proceeds of \$441.

CapLease did not issue any shares of common stock through its dividend reinvestment and stock purchase during the six months ended June 30, 2009. During the six months ended June 30, 2008, CapLease issued 121,280 shares of common stock through its dividend reinvestment and stock purchase plan at an average price of \$7.84 per share.

During the six months ended June 30, 2009, CapLease issued 1,107,600 shares of common stock to its executive officers, directors and other employees pursuant to the Company's stock incentive plan, including 531,805 shares in March 2009 and 575,795 shares in June 2009 after CapLease's stockholders approved amendments to the plan increasing the number of shares authorized. During March 2008, CapLease issued 393,950 shares of common stock to its executive officers, other employees and directors pursuant to the Company's stock incentive plan. As of June 30, 2009, the Company had awarded 2,898,795 shares of common stock under the stock plan, all in the form of stock awards to executive officers, other employees and directors of the Company (see Note 14 below).

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Dividends

The following table summarizes the dividend history on shares of CapLease common stock for the periods indicated.

Quarter Ended	Record Date	Payment Date	Dividend Per Share	Total Amount
12/31/2007	12/31/2007	1/15/2008	\$ 0.20	\$ 8,870
3/31/2008	3/31/2008	4/15/2008	0.20	8,949
6/30/2008	6/30/2008	7/15/2008	0.20	8,973
9/30/2008	9/30/2008	10/15/2008	0.20	9,475
3/31/2009	3/31/2009	4/15/2009	0.05	2,396
6/30/2009	6/30/2009	7/15/2009	0.05	2,433

The Company did not declare a dividend on CapLease common stock during the fourth quarter of 2008.

The following table summarizes the dividend history on shares of CapLease Series A preferred stock for the periods indicated.

Quarter Ended	Record Date	Payment Date	Dividend Per Share	Total Amount
12/31/2007	12/31/2007	1/15/2008	\$ 0.5078125	\$ 711
3/31/2008	3/31/2008	4/15/2008	0.5078125	711
6/30/2008	6/30/2008	7/15/2008	0.5078125	711
9/30/2008	9/30/2008	10/15/2008	0.5078125	711
12/31/2008	12/31/2008	1/15/2009	0.5078125	711
3/31/2009	3/31/2009	4/15/2009	0.5078125	711
6/30/2009	6/30/2009	7/15/2009	0.5078125	711

14. Stock Based Compensation

The Company adopted a stock incentive plan for its employees and directors during March 2004 in connection with its initial public offering. On June 16, 2009, CapLease's stockholders approved amendments to the stock incentive plan which, among other things, increased by 2,800,000 shares, to 5,123,000 shares, the number of shares authorized under the plan. As of June 30, 2009, the Company had awarded 2,898,795 shares of common stock under the stock plan, all in the form of stock awards to executive officers, other employees and directors of the Company. The Company has not awarded any options, stock appreciation rights or other stock based compensation under the stock plan.

A summary of the Company's activity under the stock plan from January 1, 2008 through the six months ended June 30, 2009, is presented below:

	Number of Shares
Stock Awards at January 1, 2008	1,397,245
	393,950(1)

Granted During the Year Ended December 31,
2008

Stock Awards at January 1, 2009	1,791,195
Granted During the Period Ended June 30, 2009	1,107,600(2)
Stock Awards at June 30, 2009	2,898,795

(1) Shares are scheduled to vest between March 2009 and March 2013, but will generally be forfeited if the recipient either terminates his employment with the Company or ceases to be a member of CapLease's Board of Directors at any time prior to the vesting date. Vesting of an aggregate of 196,725 shares is also subject to satisfaction of objective and subjective performance criteria, to be determined by CapLease's Compensation Committee.

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(2) Shares are scheduled to vest between March 2010 and March 2014, but will generally be forfeited if the recipient either terminates his employment with the Company or ceases to be a member of CapLease's Board of Directors at any time prior to the vesting date. Vesting of an aggregate of 523,565 shares is also subject to satisfaction of objective and subjective performance criteria, to be determined by CapLease's Compensation Committee.

A summary of the status of unvested shares from January 1, 2008 through the six months ended June 30, 2009, is presented below:

	Shares Awarded Under Plan	Shares Priced Under SFAS 123 and 123R	Weighted Average Fair Value
Nonvested at January 1, 2008	692,582	446,731	\$ 10.99
Current period awards	393,950	236,570	8.43
Prior period awards	N/A	79,799	8.43
Vested	(156,300)	(156,300)	11.00
Nonvested at January 1, 2009	930,232	606,800	9.66
Current period awards	1,107,600	688,741	2.23
Prior period awards	N/A	119,140	1.88
Vested	(225,642)	(225,642)	6.71
Nonvested at June 30, 2009	1,812,190	1,189,039	4.19

The Company uses the closing stock price on the grant date as its estimate of the fair value of the award.

As the immediately preceding table indicates, not all Company share awards have been valued for purposes of SFAS 123R, as the Company's stock awards include shares awarded with vesting dependent upon satisfaction of performance criteria and with the performance criteria on a portion of the shares to be determined in the future. "Prior period awards" represent share awards made in a prior period which have been valued for purposes of SFAS 123R in the current period when the CapLease Compensation Committee determined the performance criteria.

As of June 30, 2009, \$4,478 of unvested shares (fair value at the grant dates) is expected to be charged to the Company's Consolidated Statement of Operations ratably over the remaining vesting period (through March 2014). As of June 30, 2009, the grant date fair value for awards of 23,558 restricted shares made in 2006, 62,700 restricted shares made in 2007, 118,035 restricted shares made in 2008 and 418,852 restricted shares made in 2009, has not yet been determined because the grant date (as defined under SFAS 123R) has not yet occurred.

15. Other Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances, excluding those resulting from investments by and distributions to owners. For the Company's purposes, comprehensive income (loss) represents net income (loss), as presented in the Company's Consolidated Statements of Operations, adjusted for unrealized gains or losses on securities available for sale, unrealized gains or losses on derivatives designated as cash flow hedges, and realized gains and losses on derivatives designated as cash flow hedges (net of amortization of those realized gains and losses reclassified into

interest expense).

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The Company's comprehensive income (loss) for the three and six months ended June 30, 2009 and June 30, 2008 is summarized below:

	For the three months ended June 30,		For the six months ended June 30,	
	2009	2008	2009	2008
Net income (loss)	\$ 6,666	\$ (531)	\$ 2,734	\$ (2,372)
Increase (decrease) in fair value on securities available for sale	(2,694)	1,031	(2,303)	(3,005)
Amortization of unrealized loss on securities previously classified as available for sale	71	107	222	248
Increase (decrease) in fair value of derivatives	-	5,237	-	(12)
Reclassification of derivative items into earnings	265	(41)	431	2,175
Realized gain (loss) on derivatives	-	(932)	-	(1,231)
Comprehensive income (loss)	\$ 4,308	\$ 4,871	\$ 1,084	\$ (4,197)

SFAS No. 130, Reporting Comprehensive Income, divides comprehensive income (loss) into "net income (loss)" and "other comprehensive income (loss)." Other comprehensive income (loss) is defined as revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income (loss) but excluded from net income (loss). Other comprehensive income (loss) is a component of Stockholders' Equity and is shown on the Company's Consolidated Statement of Changes in Stockholders' Equity (fourth column). The following table summarizes the Company's Accumulated Other Comprehensive Income (Loss) as reported on the Consolidated Statement of Changes in Stockholders' Equity.

	Jun 30, 2009	Dec 31, 2008
Net unrealized losses on securities available for sale	\$ (14,483)	\$ (13,396)
Net unrealized losses on securities previously classified as available for sale	(10,212)	(9,217)
Net realized losses on derivatives	(5,073)	(5,505)
Accumulated other comprehensive loss	\$ (29,768)	\$ (28,118)

16. Non-Controlling Interests

The Company adopted SFAS No. 160 as of January 1, 2009. Under SFAS No. 160, the portion of the equity that the Company does not own in the Operating Partnership is now referred to as a non-controlling interest, rather than a minority interest.

During June 2006, the Operating Partnership issued 263,157 units of limited partnership to an unaffiliated third party. All of these units were issued in connection with the Company's acquisition of a property in June 2006 from the

third party. During June 2008, the units of limited partnership became redeemable by the holder, at its option, on the basis of one unit for either one share of CapLease common stock or cash equal to the fair market value of a share of common stock at the time of the redemption. The units of limited partnership do not have a liquidation preference. During September 2008, the non-controlling interest holder redeemed 107,131 units for the same number of shares of CapLease common stock. As of June 30, 2009, the Operating Partnership had issued and outstanding 156,026 units of limited partnership.

Cash distributions by the Operating Partnership are paid in the following priority: first, to the non-controlling interest holder until such holder receives the amount it would have received if the holder's units of limited partnership interest were converted to an equal number of shares of CapLease common stock, and then, to CapLease. Since July 2006, at the same time CapLease has paid a cash dividend to its common stockholders, the non-controlling interest holder has been paid a cash dividend of the same amount per limited partnership unit.

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17. Rental Income

The Company is the lessor to tenants under operating leases with expiration dates ranging from 2009 to 2026. The minimum rental amounts due under the leases are generally subject to scheduled fixed increases. The leases generally also require that the tenants pay for or reimburse the Company for the 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. Approximate future minimum rents to be received over the next five years and thereafter for non-cancelable operating leases in effect at June 30, 2009 are as follows:

6 Months Ending December 31, 2009	\$ 60,995
2010	118,059
2011	118,258
2012	117,098
2013	90,435
Thereafter	510,732
	\$ 1,015,577

18. Segment Reporting

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes the manner in which public businesses report information about operating segments in annual and interim financial reports issued to stockholders. SFAS No. 131 defines a segment as a component of an enterprise about which separate financial information is available and that is evaluated regularly to allocate resources and assess performance. The Company conducts its business through two segments: operating real estate (including its investments in owned properties) and lending investments (including its loan investments as well as its investments in securities). For segment reporting purposes, the Company does not allocate interest income on short-term investments or general and administrative expenses.

Selected results of operations by segment for the three months ended June 30, 2009 and June 30, 2008, are as follows:

	Corporate / Unallocated		Operating Real Estate		Lending Investments	
	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008
Total revenues	\$ 87	\$ 194	\$ 36,731	\$ 36,886	\$ 7,744	\$ 8,552
Total expenses	5,183	6,291	33,774	34,633	5,596	5,377
Gain on extinguishment of debt	6,593	—	—	—	—	—
Income (loss) from continuing operations	1,497	(6,098)	2,957	2,253	2,149	3,174
Total assets	38,319	46,728	1,515,801	1,594,492	412,734	465,373

Selected results of operations by segment for the six months ended June 30, 2009 and June 30, 2008, are as follows:

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	Corporate / Unallocated		Operating Real Estate		Lending Investments	
	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008
Total revenues	\$ 177	\$ 576	\$ 73,757	\$ 73,715	\$ 15,868	\$ 17,328
Total expenses	10,541	12,119	70,994	69,096	15,137	13,068
Gain on extinguishment of debt	9,413	—	—	—	—	—
Income (loss) from continuing operations	(951)	(11,542)	2,763	4,619	731	4,259
Total assets	38,319	46,728	1,515,801	1,594,492	412,734	465,373

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and the notes to those financial statements, included elsewhere in this filing.

General

We are a diversified REIT that invests primarily in single tenant commercial real estate assets subject to long-term leases to high credit quality tenants. We focus on properties that are subject to a net lease, or a lease that requires the tenant to pay all or substantially all expenses normally associated with the ownership of the property, such as utilities, real estate taxes, insurance and routine maintenance. We also continue to be opportunistic and have made and expect to continue to make investments in single tenant properties where the owner has exposure to property expenses when we determine we can sufficiently underwrite that exposure and isolate a predictable cash flow.

We have two complimentary business lines: owning single tenant properties and making first mortgage loans and other debt investments on single tenant properties.

The principal sources of our revenues are rental income on our owned real properties and interest income from our debt investments (loans and securities). The principal sources of our expenses are interest expense on our assets financed, depreciation expense on our real properties, general and administrative expenses and property expenses (net of expense recoveries).

Our primary business objective is to generate stable, long-term and attractive returns based on the spread between the yields generated by our assets and the cost of financing our portfolio. We rely on leverage to allow us to invest in a greater number of assets and enhance our asset returns. Our overall portfolio leverage as of June 30, 2009 was approximately 76.9%. We expect our leverage levels to decrease over time, as a result of one or more of the following factors: scheduled principal amortization on our debt, voluntary debt reduction, and lower leverage on new asset acquisitions. As a result of market conditions, we began to reduce our debt levels during 2008 and have begun and expect to continue to do so in 2009.

Our portfolio financing strategy is to finance our assets with long-term fixed rate debt as soon as practicable after we invest, generally on a secured, non-recourse basis. We seek to finance our assets with "match-funded" or substantially "match-funded" debt, meaning that we seek to obtain debt whose maturity matches as closely as possible the maturity of the asset financed. Through June 30, 2009, our long-term fixed rate asset financings have been in the form of traditional third party mortgage financings (on most of our owned real properties) and two term financings, including a secured term loan (completed in December 2007) and one CDO (completed in March 2005). For assets not yet financed with long-term fixed rate debt, we typically employ a hedging strategy to manage our exposure to changes in interest rates prior to the time we obtain long-term fixed rate financing. We enter into hedging transactions at the discretion of our management team, and we may determine that it is not in our company's best interests to hedge the interest rate risks with respect to certain expected long-term financings. We entered into such a period in the fourth quarter of 2008 when we removed our only open interest rate hedge.

We rely primarily on equity and debt capital to fund our portfolio growth. Through June 30, 2009, our primary capital issuances have been our initial public offering of common stock in March 2004 (net proceeds of \$221.8 million), a Series A preferred stock issuance in October 2005 (net proceeds of \$33.7 million), trust preferred debt issued in December 2005 (net proceeds of \$29.9 million), a follow-on common stock offering in each of May 2006 and May/June 2007 (net proceeds of \$57.3 million and \$104.8 million, respectively), and a \$75.0 million 7.50% convertible senior note offering in October 2007 (net proceeds of \$72.8 million).

Business Environment

Conditions within the United States credit markets in general and United States real estate credit markets in particular continue to experience historic levels of dislocation and stress that began in the summer of 2007. These conditions continue to impact us in a variety of ways, including by:

- making it difficult for us to price and finance new investment opportunities on attractive terms. As a result of market conditions, we have not been adding new asset investments to our investment portfolio.
- causing us to preserve our liquidity rather than make new investments due to the lack of debt or equity capital on attractive terms.
- causing a delay in the long-term fixed rate financing of the mortgage assets financed under our credit agreement with Wachovia Bank. We expect credit market conditions to continue to impact our ability to obtain long-term financing and, therefore, we cannot provide any assurance as to the timing or our ability to do so. Further, to the extent we continue to finance a portion of our portfolio through the credit agreement with Wachovia Bank, that agreement is recourse to all of our other assets, we will continue to be subject to potential margin calls from the lender (primarily for credit events related to the assets financed) and we will be subject to interest rate risk as the borrowings are priced at floating rates based on 30-day LIBOR, or the London Interbank Offered Rate.
 - causing us to sell selected assets to reduce debt and generate liquidity.

Widening credit spreads and limited market trading activity for real estate securities continue to result in depressed valuations on our real estate securities. If these conditions do not improve, we may be subject to impairment losses on our securities investments in the future, and these losses may be significant.

We do not know when market conditions will stabilize, if adverse conditions will intensify or the full extent to which the disruptions will affect us. If market instability persists or intensifies, the trends discussed above may continue and we may be impacted in a variety of additional ways. For example, we may experience challenges in refinancing debt as it matures or raising additional capital, margin calls on our Wachovia Bank credit agreement and impairment charges on our assets. If weak economic conditions continue and capital for commercial real estate remains scarce, certain collateral within our CDO may default, which could cause the CDO to fail to satisfy certain cash flow coverage tests, which would result in a redirection of the cash distributions payable to us from the CDO until the tests are back into compliance.

We have taken and may continue to take a variety of cash conservation measures such as asset sales, expense reductions and dividend adjustments to increase our liquidity levels until credit markets normalize. Credit market conditions have resulted in reduced trading activity and lower valuations for our securities, which could impact the amount at which and how quickly we could sell our assets if needed to generate liquidity. Our ability to sell collateral to generate liquidity could also be impacted by factors such as market conditions, the relative illiquidity of certain of our assets (i.e., our owned property and loan investments) and limitations on sale imposed pursuant to the debt financing terms of our assets.

Current economic conditions and the credit crisis may cause commercial real estate values and market rental rates to decline significantly. These declines could adversely impact us in a number of ways, including by causing us to record losses on our assets, reducing the proceeds we receive upon sale or refinance of our assets or adversely impacting our ability to re-let our owned properties.

Current economic conditions have contributed to unexpected bankruptcies and rapid declines in financial condition at a number of companies, particularly in the retail and financial sectors. These conditions could cause one or more of the tenants to whom we have exposure to fail or default in their payment obligations, which could cause us to record material losses or a material reduction in our cash flows.

Application of Critical Accounting Policies

A summary of our critical accounting policies is included in our Annual Report on Form 10-K for the year ended December 31, 2008 in Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no significant changes to those policies during 2009.

Investment and Financing Activities

During each of the three months ended June 30, 2009, and June 30, 2008, we did not make any new portfolio investments. We also did not complete any new asset financings during these periods other than a credit agreement with Wachovia Bank in the 2008 period discussed below under "Liquidity and Capital Resources."

Business Segments

We conduct our business through two operating segments:

- operating real estate (including our investments in owned real properties); and
- lending investments (including our loan investments as well as our investments in securities).

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Selected results of operations by segment for the three months ended June 30, 2009 and June 30, 2008, are as follows (dollar amounts in thousands):

	Corporate / Unallocated		Operating Real Estate		Lending Investments	
	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008
Total revenues	\$ 87	\$ 194	\$ 36,731	\$ 36,886	\$ 7,744	\$ 8,552
Total expenses	5,183	6,291	33,774	34,633	5,596	5,377
Gain on extinguishment of debt	6,593	—	—	—	—	—
Income (loss) from continuing operations	1,497	(6,098)	2,957	2,253	2,149	3,174
Total assets	38,319	46,728	1,515,801	1,594,492	412,734	465,373

Selected results of operations by segment for the six months ended June 30, 2009 and June 30, 2008, are as follows (dollar amounts in thousands):

	Corporate / Unallocated		Operating Real Estate		Lending Investments	
	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008	Jun 30, 2009	Jun 30, 2008
Total revenues	\$ 177	\$ 576	\$ 73,757	\$ 73,715	\$ 15,868	\$ 17,328
Total expenses	10,541	12,119	70,994	69,096	15,137	13,068
Gain on extinguishment of debt	9,413	—	—	—	—	—
Income (loss) from continuing operations	(951)	(11,542)	2,763	4,619	731	4,259
Total assets	38,319	46,728	1,515,801	1,594,492	412,734	465,373

Comparison of the Quarter Ended June 30, 2009 to the Quarter Ended June 30, 2008

The following discussion compares our operating results for the quarter ended June 30, 2009 to the comparable period in 2008.

Revenue.

Total revenue decreased \$1.1 million, or 2%, to \$44.6 million. The decrease was primarily attributable to a decrease in interest income.

Rental revenue and property expense recoveries, in the aggregate, were largely unchanged from the prior year period, as we have not added any new owned property investments since the second quarter of 2007.

Interest income decreased \$0.9 million, or 10%, to \$7.8 million, primarily as a result of lower loan balances, lower cash balances and interest rates.

Expenses.

Total expenses decreased \$1.7 million, or 4%, to \$44.6 million. The decrease in expenses was primarily attributable to lower interest expense and general and administrative expenses, offset in part by investment losses in the 2009 period.

Interest expense decreased \$1.7 million, or 7%, to \$22.7 million, from \$24.4 million. The decrease in the 2009 period resulted primarily from \$1.1 million of lower interest expense on floating rate borrowings (resulting from lower borrowings and interest rates in the 2009 period), \$0.4 million of lower interest expense on convertible debt due to repurchases of the convertible debt and \$0.2 million of lower interest expense on property mortgages. The Company's average balance outstanding and effective financing rate under its floating rate borrowings was approximately \$166 million at 3.74% during the 2009 period (average 30-day LIBOR of 0.44%), compared with approximately \$214 million at 5.03% during the 2008 period (average 30-day LIBOR of 2.70%).

Property expenses decreased \$0.1 million, or 3%, to \$4.8 million, reflecting reduced expenses. The net amount of property expenses we incurred (net of expense recoveries) was basically unchanged from the 2008 period.

We had gain on derivatives of \$0.2 million in the 2008 period, compared with no hedge activity in the 2009 period. During the 2008 period, delays in our anticipated long-term financing caused a portion of our hedge activity to be reported as current income (loss) on our Consolidated Statement of Operations rather than deferred as a component of equity on our Consolidated Balance Sheet.

We had losses on investments on \$0.6 million in the 2009 period, including a \$0.4 million asset-specific loan loss. There were no losses on investments in the 2008 period. The 2009 losses are discussed at Notes 4 and 5 of the consolidated financial statements included in this Form 10-Q.

General and administrative expense decreased \$0.6 million, or 19%, to \$2.6 million, primarily reflecting higher legal expenses in the 2008 period related to our legal actions involving the real property we own in Johnston, Rhode Island.

General and administrative expense-stock based compensation decreased \$0.1 million, or 18%, to \$0.5 million, as the grant date value of 2009 awards was lower than in prior years. As of June 30, 2009, \$4.5 million of unvested shares (fair value at the grant dates) is expected to be charged to our Consolidated Statement of Operations ratably over the remaining vesting period (through March 2014). As of June 30, 2009, the grant date fair value for awards of 23,558 restricted shares made in 2006, 62,700 restricted shares made in 2007, 118,035 restricted shares made in 2008 and 418,852 restricted shares made in 2009, has not yet been determined because the grant date (as defined under SFAS 123R) has not yet occurred.

Depreciation and amortization expense on real property was basically unchanged from the 2008 period, as we have not added any new owned property investments since the second quarter of 2007.

Gain on extinguishment of debt.

We had \$6.6 million of non-cash gain on extinguishment of debt in the 2009 period, relating to the repurchase of \$12.3 million of our convertible senior notes and \$5 million of our CDO debt. See Note 9.

Net income (loss).

We had net income of \$6.7 million, compared to net loss of \$(0.5) million in the 2008 period, primarily as a result of the gain on extinguishment of debt and lower interest expense in the 2009 period. Net income allocable to common stockholders was \$6.0 million in the second quarter of 2009, reflecting dividends to preferred stockholders of \$0.7 million.

Comparison of the Six Months Ended June 30, 2009 to the Six Months Ended June 30, 2008

The following discussion compares our operating results for the six months ended June 30, 2009 to the comparable period in 2008.

Revenue.

Total revenue decreased \$1.8 million, or 2%, to \$89.8 million. The decrease was primarily attributable to a decrease in interest income.

Rental revenue and property expense recoveries, in the aggregate, was basically unchanged from the 2008 period.

Interest income decreased \$1.9 million, or 11%, to \$16.0 million, primarily as a result of lower loan balances, lower cash balances and interest rates and an unexpected payment we received on an interest only bond during the 2008 period.

Expenses.

Total expenses increased \$2.4 million, or 3%, to \$96.7 million. The increase in expenses was primarily attributable to the loss on investments in the 2009 period, offset in part by lower interest expense, the loss on derivatives in the 2008 period and lower general and administrative expenses.

Interest expense decreased \$3.2 million, or 7%, from \$48.9 million to \$45.7 million. The decrease in the 2009 period resulted primarily from \$2.1 million of lower interest expense on floating rate borrowings (resulting from lower borrowings and interest rates in the 2009 period), \$0.5 million of lower interest expense on convertible debt due to repurchases of the convertible debt and \$0.5 million of lower interest expense on property mortgages. The Company's average balance outstanding and effective financing rate under its floating rate borrowings was approximately \$176 million at 3.76% during the 2009 period (average 30-day LIBOR of 0.44%), compared with approximately \$222 million at 4.65% during the 2008 period (average 30-day LIBOR of 3.10%).

Depreciation and amortization expense on real property was basically unchanged from the 2008 period, as we have not added any new owned property investments since the second quarter of 2007.

Property expenses increased \$0.6 million, or 7%, to \$10.1 million, reflecting increased expenses including costs paid to one of our tenants and real estate taxes. The net amount of property expenses we incurred (net of expense recoveries) increased \$0.5 million from the 2008 period.

We had loss on derivatives of \$1.9 million in the 2008 period, compared with no hedge activity in the 2009 period. During the 2008 period, delays in our anticipated long-term financing caused a portion of our hedge activity to be reported as current income (loss) on our Consolidated Statement of Operations rather than deferred as a component of equity on our Consolidated Balance Sheet.

We had losses on investments of \$7.8 million in the 2009 period, including \$7.3 million of losses on two assets that were sold in the second quarter of 2009. The 2009 losses are discussed at Notes 4, 5 and 6 of the consolidated financial statements included in this Form 10-Q.

General and administrative expense decreased \$1.1 million, or 17%, to \$5.2 million, primarily reflecting higher legal expenses in the 2008 period.

General and administrative expense-stock based compensation was basically unchanged from the 2008 period, as an additional year of stock awards was offset by lower grant date values in the 2009 period.

Gain on extinguishment of debt.

We had \$9.4 million of non-cash gain on extinguishment of debt in the 2009 period, relating to the repurchase of our convertible senior notes and CDO debt.

Net income (loss).

We had net income of \$2.7 million, compared to net loss of \$(2.4) million in the 2008 period, primarily as a result of the gain on extinguishment of debt and lower interest expense in the 2009 period, offset in part by the loss on investments in the 2009 period. Net income allocable to common stockholders was \$1.3 million in the 2009 period, reflecting dividends to preferred stockholders of \$1.4 million.

Funds from Operations

Funds from operations, or FFO, is a non-GAAP financial measure. We believe FFO is a useful additional measure of our performance because it facilitates an understanding of our operating performance after adjustment for real estate depreciation, a non-cash expense which assumes that the value of real estate assets diminishes predictably over time. In addition, we believe that FFO provides useful information to the investment community about our financial performance as compared to other REITs, since FFO is generally recognized as an industry standard for measuring the operating performance of an equity REIT. FFO does not represent cash generated from operating activities in accordance with GAAP and is not indicative of cash available to fund cash needs. FFO should not be considered as an alternative to net income or earnings per share determined in accordance with GAAP as an indicator of our operating performance or as an alternative to cash flow as a measure of liquidity. Since all companies and analysts do not calculate FFO in a similar fashion, our calculation of FFO may not be comparable to similarly titled measures reported by other companies.

We calculate FFO in accordance with standards established by the National Association of Real Estate Investment Trusts (“NAREIT”) which defines FFO as net income (loss) (computed in accordance with GAAP) excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures.

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The following table reconciles our net loss allocable to common stockholders to FFO for the three and six months ended June 30, 2009 and June 30, 2008.

(Amounts in thousands, except per share amounts)	For the Three Months Ended June 30		For the Six Months Ended June 30	
	2009	2008	2009	2008
Net income (loss) allocable to common stockholders	\$ 5,955	\$ (1,242)	\$ 1,312	\$ (3,794)
Add (deduct):				
Non-controlling interest in consolidated subsidiaries	20	(5)	4	(19)
Depreciation and amortization expense on real property	13,319	13,293	26,637	26,571
Depreciation and amortization expense on discontinued operations	–	149	149	298
Funds from operations	\$ 19,294	\$ 12,195	\$ 28,102	\$ 23,056
Weighted average number of common shares outstanding, basic and diluted	47,974	44,763	47,705	44,572
Weighted average number of OP units outstanding	156	263	156	263
Weighted average number of common shares and OP units outstanding, diluted	48,130	45,026	47,861	44,835
Net income (loss) per common share, basic and diluted	\$ 0.12	\$ (0.03)	\$ 0.03	\$ (0.09)
Funds from operations per share	\$ 0.40	\$ 0.27	\$ 0.59	\$ 0.51

Liquidity and Capital Resources

We rely on leverage to allow us to invest in a greater number of assets and enhance our asset returns. Leverage also exposes us to a variety of risks which are discussed in more detail in our most recent Annual Report on Form 10-K under the heading “Risk Factors.” Our overall portfolio leverage as of June 30, 2009 was approximately 76.9%. We expect our leverage levels to decrease over time, as a result of one or more of the following factors: scheduled principal amortization on our debt, voluntary debt reduction, and lower leverage on new asset acquisitions. As a result of market conditions, we began to reduce our debt levels during 2008 and have begun and expect to continue to do so in 2009.

Our portfolio financing strategy is to finance our assets with long-term fixed rate debt as soon as practicable after we invest, generally on a secured, non-recourse basis. We seek to finance our assets with “match-funded” or substantially “match-funded” debt, meaning that we seek to obtain debt whose maturity matches as closely as possible the maturity of the asset financed. Through June 30, 2009, our long-term fixed rate asset financings have been in the form of traditional third party mortgage financings (on most of our owned real properties) and two term financings, including a secured term loan (completed in December 2007) and one CDO (completed in March 2005). As of June 30, 2009, we have financed on a long-term fixed rate basis an aggregate of approximately \$1.78 billion of assets in portfolio with third party mortgage debt of \$950.8 million and term financings of \$382.5 million.

As a REIT, we are required to distribute at least 90% of our taxable income to our stockholders on an annual basis, and we intend to distribute all or substantially all of our REIT taxable income in order to comply with the distribution requirements of the Code and to avoid federal income tax and the nondeductible excise tax. We declared a cash dividend of \$0.05 per share of common stock in each of the quarters ended March 31, 2009 and June 30, 2009. We also declared a cash dividend of \$0.5078125 per share of 8.125% Series A cumulative redeemable preferred stock in each of the quarters ended March 31, 2009 and June 30, 2009.

Short-Term Liquidity and Financing.

We expect that our short-term liquidity requirements will be met generally through our available cash and cash equivalents, cash provided by operations, and, to the extent we make new investments, through revolving loan borrowings under our credit agreement with Wachovia Bank discussed below. We expect that our short-term liquidity requirements will also be met through a portion of the proceeds from any issuances of debt and/or equity capital. Our ability to issue debt or equity capital is currently being adversely impacted by the factors discussed under “Business Environment” above. As of June 30, 2009, we had \$17.0 million in available cash and cash equivalents. As of August 5, 2009, we had \$24.0 million in available cash and cash equivalents.

During April 2008, we entered into a credit agreement with Wachovia Bank. Pursuant to the agreement, Wachovia Bank agreed to make an aggregate of \$250 million of term and revolving credit loans available to us. We drew a \$210.4 million term loan upon closing of the credit agreement and may make draws of revolving credit loans from time to time during the agreement term to finance commercial real estate assets that are approved by the Wachovia Bank in its discretion.

The credit agreement is for a term of two years with a one-year extension option at our option provided we meet certain conditions (including reducing our borrowings to \$135 million by the scheduled maturity date in April 2010). We can prepay our borrowings under the facility in whole or in part at any time (subject to a \$1 million minimum) without any penalty or premium. Subject to certain exceptions, we are required to use a portion of our future debt or equity issuances to prepay borrowings under the facility. We are required to pay interest on our borrowings at prevailing short-term rates (30-day LIBOR) plus a pricing spread ranging from 200 to 250 basis points.

In connection with the financing transaction, we also agreed to consolidate our existing lending arrangements with Wachovia Bank into this facility and, as a result, our prior \$250 million repurchase agreement and a \$30 million revolving loan agreement were terminated. Our borrowings under the facility are secured by the same collateral that previously secured our obligations under the repurchase agreement and \$30 million revolver, which includes a combination of first mortgage loan investments, intercompany mortgage loans on our owned property investments, commercial mortgage-backed securities and a first lien on our ownership interest in the real property located in Johnston, Rhode Island. Our obligations under the credit agreement are also fully recourse to all of our other assets. In the event Wachovia determines in its sole discretion that the value of our collateral assets has declined, including as a result of an underlying tenant credit rating downgrade or other adverse tenant-credit event, Wachovia may require us to prepay a portion of our borrowings, provided that Wachovia may not reduce the value of any of our collateral other than CMBS securities due to general credit spread or interest rate fluctuations. As of June 30, 2009, we had \$5.3 million borrowed against collateral classified as CMBS securities by Wachovia.

We are required to comply with the following financial covenants under the credit agreement: minimum liquidity (as defined in the agreement) of at least \$8 million, and minimum consolidated tangible net worth (as defined in the agreement) of at least \$180 million plus 75% of the aggregate net proceeds from equity offerings or capital contributions after September 22, 2004.

We had \$158.8 million outstanding as of June 30, 2009 under our Wachovia credit agreement, which borrowings were secured by loan investments with an aggregate carry value of \$51.5 million, intercompany mortgage loans and investments in our CDO with an aggregate carry value of \$138.4 million, CMBS investments with a carry value of \$17.0 million and a single owned property with a carry value of \$41.3 million.

Long-Term Liquidity and Financing.

We expect that our long-term liquidity requirements will be met generally through cash provided by operations, long-term fixed-rate financings on our asset investments and issuances of debt and equity capital. Our ability to obtain long-term financings and to issue debt or equity capital is currently being adversely impacted by the factors discussed under "Business Environment" above. We have begun and may continue to selectively sell assets to help us to meet our long-term liquidity needs. For example, during April 2009, we sold two assets for net consideration of \$42.2 million (inclusive of \$14.4 million of debt assumed by the buyer), and utilized \$24.8 million of the proceeds to repay indebtedness to Wachovia Bank under the credit agreement.

Our primary long-term liquidity requirement is repayment of our debt obligations. We estimate that we will need to generate \$5 to \$15 million of liquidity to extend our credit agreement with Wachovia until April 2011, and we expect to be able to do so through cash from operations and/or asset sales. If we are unable to extend the credit agreement, our financial condition and operating results could be materially adversely affected.

Through June 30, 2009, our primary capital issuances have been our initial public offering of common stock in March 2004 (net proceeds of \$221.8 million), a Series A preferred stock issuance in October 2005 (net proceeds of \$33.7 million), trust preferred debt issued in December 2005 (net proceeds of \$29.9 million), a follow-on common stock offering in each of May 2006 and May/June 2007 (net proceeds of \$57.3 million and \$104.8 million, respectively),

and a \$75.0 million 7.50% Convertible Senior Note offering in October 2007 (net proceeds of \$72.8 million). Through July 2009, we have repurchased \$22.6 million of the convertible senior notes at an aggregate price of \$10.7 million, or a 52.4% discount from the face amount of the notes.

In March 2007, we implemented a dividend reinvestment and direct stock purchase plan. The plan provides us with an additional source of equity capital. The plan allows interested stockholders to reinvest all or a portion of their cash dividends in shares of our common stock and to make monthly purchases of our common stock generally up to a maximum of \$10,000 (unless a higher amount is approved by us in our sole discretion). Shares purchased through the plan may be either (i) newly issued by us or (ii) purchased by the plan administrator in the open market, at our discretion. We did not issue any shares of common stock through the plan during the six months ended June 30, 2009. During the six months ended June 30, 2008, we issued 121,280 shares of common stock through the plan at an average price of \$7.84 per share. As of June 30, 2009, we have reserved an aggregate of 2,665,504 shares of common stock for future issuance pursuant to the dividend reinvestment and direct stock purchase plan. We are not currently issuing new shares through the plan, although we reserve the right to elect to do so in our sole discretion at any time in the future.

We sold an aggregate of 152,600 shares of common stock through at the market public sales in the quarter ended June 30, 2009. Brinson Patrick Securities Corporation acted as our agent for these sales pursuant to a sales agreement we entered into with them in August 2005 and received a sales commission of 3% on the sales. The shares were issued pursuant to our shelf registration statement. We raised net proceeds of approximately \$0.4 million and we used the proceeds to repurchase our outstanding debt.

We intend to continue to raise additional capital from time to time to enable us to continue to implement our strategy. Our ability to raise capital is influenced by market conditions, and we cannot assure you that conditions for raising capital will be favorable for us at any time. As of June 30, 2009, we have an effective shelf registration statement under which we can offer an aggregate of \$489.5 million of common stock, preferred stock and/or senior or subordinated debt securities from time to time, including an aggregate of 2,086,500 shares of common stock reserved for sale under the Brinson Patrick sales agreement.

Long-Term Mortgage Financings.

During the quarter ended June 30, 2009, we did not obtain any new mortgage financings.

Our mortgage financings are fixed rate financings. The notes typically mature over a long-term period of approximately ten years, and debt service is payable monthly. The notes are non-recourse to us subject to limited recourse exceptions and are secured by a mortgage on the property and an assignment of the underlying lease and rents on the property. The notes are often interest only for all or a portion of the note term, and thus require a balloon payment at maturity. Our ability to fund a balloon payment will be dependent upon our ability to refinance the debt and/or sell the related property. Market conditions will impact our ability to refinance debt and sell assets. See “Business Environment” above and “Item 1A—Risk Factors” in our most recent Annual Report on Form 10-K.

Term Financings.

In December 2007, we completed a \$129.5 million original principal balance secured term loan. Upon closing of the financing, we pledged approximately \$163.1 million principal amount of collateral to secure our obligations under the loan. The interest coupon on the loan is fixed at 5.81% annually until the loan matures in January 2018. Our effective financing rate on the loan is 6.02% annually (inclusive of hedge and closing costs). The loan is non-recourse to us, subject to limited non-recourse exceptions.

We also completed an entirely fixed rate CDO financing in March 2005. We aggregated approximately \$300 million of assets and then transferred these assets into a wholly-owned securitization vehicle, and issued \$285 million face amount of multi-class notes and \$15 million of preferred equity through the securitization vehicle. The assets serve as collateral for our obligations under the notes. The securitization vehicle is an SPE, with its business limited to the issuance of the notes and the preferred equity, the acquisition of the collateral and certain other matters related thereto. The net amount of the debt we issued was \$268.1 million, inclusive of a \$0.4 million discount to face, as we retained the three most junior note classes aggregating a face amount of \$16.5 million and the full \$15 million of preferred equity. Each of the five note classes of the CDO was and continues to be rated investment grade. Through October 2009, we expect to reinvest principal repayments on the underlying assets into qualifying replacement collateral. The CDO notes have a stated maturity in January 2040, but are expected to mature in January 2015 when the notes become subject to an auction call procedure. Our weighted average effective financing rate (inclusive of original issue discount and debt issuance and hedge costs) on our CDO is approximately 5.67%. Our CDO debt is non-recourse to us but is secured by the collateral assets. We repurchased \$5 million of our Class A CDO notes during the quarter ended June 30, 2009.

We entered into a \$250 million two year credit agreement with an option for an additional year with Wachovia Bank in April 2008. The agreement is a floating rate LIBOR based facility. At closing, we refinanced the assets previously financed on our short-term repurchase agreement into this facility. We intend to continue to pursue a variety of strategies for the assets financed on the facility, including obtaining long-term fixed rate financing when market conditions permit, pursuing selected asset sales, and retiring the debt on selected assets and holding the assets unlevered. We expect credit market conditions to impact our ability to achieve these objectives and, therefore, we cannot provide any assurance as to the timing or our ability to do so.

Statement of Cash Flows

Operating activities provided \$25.7 million of cash during the six months ended June 30, 2009, primarily driven by net income as adjusted by various non-cash gains, losses, income and charges of \$32.8 million, partially offset by increases in other assets of \$5.9 million. Operating activities provided \$38.6 million of cash during the six months ended June 30, 2008, primarily driven by net (loss) as adjusted by various non-cash gains, income and charges of \$33.8 million and decreases in other assets of \$6.9 million, partially offset by decreases in accounts payable, accrued expenses and other liabilities of \$2.5 million.

We recognize rental income on our owned properties on a straight line basis in accordance with SFAS 13. As of June 30, 2009, this has resulted in the Company accruing \$31.1 million, net, of rental income in excess of actual rents due under the various leases. During the six months ended June 30, 2009, actual rents due under the leases exceeded rents on a straight-line basis by \$1.4 million. We expect the impact of straight-lining of rents to fluctuate over time as contractual rents step up and actual rents due increase under the various leases and market conditions improve and we purchase additional properties. Certain of our owned properties are also subject to rents which pay semi-annually, rather than monthly, and this also impacts the quarter-to-quarter changes due to straight-lining of rents.

Investing activities provided \$52.5 million of cash during the six months ended June 30, 2009, which primarily resulted from net proceeds from the sale of loans of \$21.3 million, net proceeds from the sale of owned properties of \$20.9 million and net principal received on loans of \$9.5 million and securities of \$2.2 million. Investing activities provided \$6.1 million of cash during the six months ended June 30, 2008, which primarily resulted from principal received on loans of \$3.1 million and securities of \$1.8 million and a \$1.2 million purchase price adjustment we received on two properties we purchased in 2005.

Cash used in financing activities during the six months ended June 30, 2009 was \$69.6 million, which primarily resulted from net repayments of principal on debt of \$54.9 million (\$30.4 million on the Wachovia credit facility, \$20.0 million, net, on property mortgages, and \$4.5 million on the secured term loan with KBC Bank), \$11.5 million used to repurchase our convertible senior notes and collateralized debt obligations, and dividends and distributions paid of \$3.8 million. Cash used in financing activities during the six months ended June 30, 2008 was \$57.3 million, which primarily resulted from net repayments of principal on debt of \$32.2 million (net of \$24.8 million on the Wachovia repurchase agreement and credit facility, net of \$4.6 million on property mortgages and \$2.9 million on the secured term loan with KBC Bank), dividends and distributions paid of \$19.3 million, and cash deposited to collateralize an open hedge position of \$5.5 million.

See our consolidated statements of cash flows included in the historical consolidated financial statements included elsewhere in this filing for a reconciliation of our cash position for the periods described above.

Risk Management Transactions

Since our initial public offering, we have employed a hedging strategy to manage our exposure to interest rate fluctuations prior to the time we obtain long-term fixed rate financing for our assets. Our risk management activities during this period have consisted primarily of interest rate swaps, and we expect they will continue to consist primarily of interest rate swaps in the future, although we may utilize other instruments. We may determine that it is not in our company's best interests to hedge the interest rate risks with respect to certain expected long-term financings, particularly during periods of market dislocation. For example, we closed our only open interest rate swap position during November 2008 as a result of unprecedented credit market dislocations and associated declines in the 10-Year Treasury and other benchmark market interest rates.

In accordance with SFAS 133, the interest rate swaps are treated as cash flow hedges for accounting purposes to the extent that they have been designated and qualify as such. The effective portion of our realized and unrealized gains and losses on such transactions are treated as a component of "Other Comprehensive Income (Loss)" on our Consolidated Balance Sheet and are not reported as a component of current income or loss on our Consolidated Statement of Operations. The effective portion of our realized gains and losses, which generally represent the net payments we make or receive on the interest rate swaps, are then reclassified and amortized as part of interest expense on our Consolidated Statement of Operations beginning at issuance of the related debt and continuing over the expected term of such issuance.

To the extent the SFAS No. 133 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 our Consolidated Statement of Operations. No assurance can be made that we will continue to satisfy the cash flow hedge requirements of SFAS No. 133 and as to the portion of our gains and losses that will be deemed effective under SFAS No. 133. Changes in management's initial assumptions regarding the proposed debt issuance (e.g., timing and the amount and type of debt) and changes in the shape of the swap curve are among the factors that could cause us to include a greater portion of our gains and losses from the associated risk management transactions as current income or loss. When we closed our interest rate swap position in November 2008, we were required under SFAS No. 133 to charge the full amount of the realized loss on closing the swap of \$15.2 million, along with \$2.9 million of related losses previously deferred in Other Comprehensive Income/Loss on our Consolidated Balance Sheet, directly to our Consolidated Statement of Operations, as the hedge position no longer represented an effective cash flow hedge under SFAS No. 133.

We settle our derivative and other risk management transactions in cash. Therefore, upon settlement, we will pay or receive cash for the net amount due. These amounts could be material and could have a material impact (positive or negative) on our liquidity. Since April 2008, our counterparty has required that we deposit cash to collateralize substantially all amounts we may owe at settlement of an open hedge.

See Note 11 in our consolidated financial statements included in this Form 10-Q for additional discussion of our hedging and risk management transactions. As discussed above, we closed our only open hedge position during November 2008, and we had no open hedging and risk management transactions as of June 30, 2009.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

We may from time to time make written or oral forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements contained in our filings with the Securities and Exchange Commission and in our press releases and webcasts. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. In some cases, you can identify forward-looking statements by terms such as "anticipate," "believe," "could," "estimate," "expect," "intend," "plan," "potential," "should," "strategy," "will" and other words of similar meaning. The forward-looking statements are based on our beliefs, assumptions and expectations of future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us or are within our control. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, we are hereby identifying important factors that could cause actual results and outcomes to differ materially from those contained in any forward-looking statement made by or on our behalf. Such factors include, but are not limited to:

- our ability to make additional investments in a timely manner or on acceptable terms;
- current credit market dislocations and our ability to obtain long-term financing for our asset investments in a timely manner and on terms that are consistent with those we project when we invest in the asset;
- access to capital markets and capital market conditions;
- adverse changes in the financial condition of the tenants underlying our investments;
-

increases in our financing costs (including as a result of LIBOR rate increases), our general and administrative costs and/or our property expenses;

- changes in our industry, the industries of our tenants, interest rates or the general economy;
- impairments in the value of the collateral underlying our investments; and
 - the degree and nature of our competition.

These risks and uncertainties should be considered in evaluating any forward-looking statement we may make from time to time. Any forward-looking statement speaks only as of its date. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are qualified by the cautionary statements in this section. We undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date made.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk refers to the risk of loss from adverse changes in the level of one or more market prices, rate indices or other market factors. We are exposed to market risk primarily from changes in interest rates, credit spreads, tenant credit ratings and equity prices. We may attempt to mitigate certain of these risks by entering into hedge and other risk management transactions during the short-term and fixed-rate financings for the long-term. We seek to obtain long-term fixed rate financing as soon as practicable after we make an asset investment. There can be no assurance, however, that such mitigation strategies will be completely or even partially successful. The level of our exposure to market risk is subject to factors beyond our control, including political risk (including terrorism), monetary and tax policy, general economic conditions and a variety of other associated risks.

Interest Rate Exposure

We are exposed to interest rate risk in various aspects of our business. The most significant ways we can be impacted by interest rates are as follows: increases in the level of interest rates may impact our ability to add new assets, as spreads on assets we are targeting may compress (unless there is a corresponding increase in asset returns) and demand for our products may be adversely affected.

Also, to the extent we finance assets in our portfolio on our floating rate borrowing facilities, our net income from these fixed rate assets will decrease as interest rates rise (particularly LIBOR rates) and our borrowing cost increases. Our Wachovia Bank credit facility is currently our only floating rate borrowing facility. In addition, as interest rates rise, our anticipated cost to finance these assets on a long-term fixed rate basis may rise, causing our expected spread on these assets to be reduced. We may attempt to mitigate these risks by entering into risk management transactions that react in a manner that offsets our increased interest costs and by locking our long-term financing cost as soon as practicable after we commit to an asset. As a result of market conditions, we are not currently carrying an open interest rate hedge to manage our exposure to interest rate fluctuations for assets for which we may obtain long-term financing for in the future. Our decision to do so leaves us exposed to increases in long-term interest rates for those assets and, therefore, may make it more difficult or more costly to obtain long-term financing. As noted above, there can be no assurance that our mitigation strategies will be successful.

Furthermore, shifts in the U.S. Treasury yield curve, which represents the market's expectations of future interest rates, would also affect the yield required on our loans and real estate securities. Changes in the required yield would result in a higher or lower value for these assets. If the required market yields increase as a result of these interest rate changes, the value of our loans and real estate securities would decline relative to U.S. Treasuries. Conversely, if the required market yields decrease as a result of interest rate changes, the value of our loans and real estate securities would increase relative to U.S. Treasuries. These changes in the market value may affect the equity on our balance sheet or, if the value is less than our cost basis and we determine the losses to be other-than-temporary, our Statement of Operations through impairment losses on our loans or securities. These value changes may also affect our ability to borrow and access capital.

Credit Spread Curve Exposure

We are subject to credit spread risk in various aspects of our business. Credit spreads represent the portion of the required yield on an income investment attributable to credit quality. Credit spreads fluctuate over time as investor appetite for credit risk changes.

Changes in credit spreads can have many of the same impacts on us as a change in interest rates, or principally:

-

increases in credit spreads can result in spread compression on investments we target and, thus, a slowing of our new investment pace;

- increases in credit spreads can increase our anticipated cost to finance assets not yet financed with long-term fixed rate debt, causing our expected spread on these assets to be reduced; and
- increases in credit spreads can lower the value of our loans and securities as required yields on these assets increase.

Market conditions since the summer of 2007 have resulted in increases in credit spreads and generally lower fair valuations for our securities. If these conditions continue or persist, we may be required to record impairment losses on our securities, and these losses may be significant.

Tenant Credit Rating Exposure

Substantially all of our portfolio assets are subject to risks due to credit rating changes of the underlying tenant or tenants. Deterioration in the underlying tenant's credit rating can result in a lower value for the related asset, which could result in a reduction in the equity on our balance sheet or, if the value is less than our cost basis and we determine the loss to be other-than-temporary, an impairment loss on our Statement of Operations. In addition, declines in the credit rating of a particular tenant prior to our obtaining long-term fixed rate financing could result in a margin call by the related lender, and precipitous declines may significantly impede or eliminate our ability to finance the asset. We manage these risks by maintaining diversity among our credits and assessing our aggregate exposure to ratings classes, in particular lower rated classes. We also seek to lock or procure long-term financing on our assets as promptly as practicable after we commit to invest.

Equity Price Risk Exposure

We may seek to raise capital by sale of our common stock. Our ability to do so is dependent upon the market price of our common stock and general market conditions. Any sales we make may be dilutive to existing stockholders.

Fair Value

For certain of our financial instruments, fair values are not readily available since there are no active trading markets as characterized by current exchanges between willing parties. Accordingly, we derive or estimate fair values using various valuation techniques, such as computing the present value of estimated future cash flows using discount rates commensurate with the risks involved. However, the determination of estimated cash flows may be subjective and imprecise. Changes in assumptions or estimation methodologies can have a material affect on these estimated fair values. The fair values indicated below are indicative of the interest rate and credit spread environment as of June 30, 2009, and may not take into consideration the effects of subsequent interest rate or credit spread fluctuations, or changes in the ratings of the underlying tenants.

The following summarizes certain data regarding our interest rate sensitive instruments as of June 30, 2009:

	Carrying Amount	Notional Amount	Weighted Average Effective Interest / Financing Rate	Maturity Date	Fair Value
(dollars in thousands)					
Assets:					
Loans held for investment (1)	\$ 251,296	\$ 253,407	6.83%	Various	\$ 220,174
Commercial mortgage-backed securities (2)	157,755	200,587	7.47%	2009-2028	99,630
Structuring fees receivable	1,486	N/A	8.11%	2010-2020	1,486
Liabilities					
Mortgage notes payable (4)	\$ 950,836	\$ 946,081	5.63%	2011-2022	\$ 852,302

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Collateralized debt obligations					
(4)	263,289	263,500	5.69%	2015	142,924
Credit facility (3)	158,818	158,818	3.50%	2010	158,818
Secured term loan (4)	119,221	119,221	6.02%	2018	72,223
Convertible senior notes (5)	50,375	53,944	10.91%	2012	32,760
Other long-term debt (6)	30,930	30,930	8.30%	2016	15,873

- (1) This portfolio of loans bears interest at fixed rates. We have estimated the fair value of this portfolio of loans based on sales of loans with similar credit and structural characteristics where available, and management's estimate of fair values where comparable sales information is not available. The maturity dates for the loans range from 2009 through 2033.
- (2) Commercial mortgage-backed securities represent subordinate interests in securitizations, as well as pass-through certificates representing our pro rata investments in a pool of mortgage loans (collectively, CMBS). Structuring fees receivable represent cash flows receivable by us from the sale of loans to third-party purchasers. The notional values for the CMBS are shown at their respective face amounts. The fair values of CMBS are determined in most cases primarily by reference to index pricing. Management may also estimate fair value based on credit characteristics and term of the security, market yields on securities with similar credit ratings, and collateral values. Management has obtained broker quotes, but believes that in most cases the broker quotes reflect expected pricing for distressed trades in inactive and dislocated markets, rather than actual prices in orderly transactions. Management has ultimately determined the fair values recorded in the financial statements based on a variety of factors. Fair value for the structuring fees receivable is shown at our amortized cost for these items. For the CMBS, we expect to receive monthly interest coupon payments, and contractual principal payments as scheduled.
- (3) Our credit facility bears interest at floating rates, and we believe that for similar financial instruments with comparable credit risks, the effective rates approximate market value. Accordingly, the carrying amounts outstanding are believed to approximate fair value.
- (4) We estimate the fair value of mortgage notes on real estate investments, collateralized debt obligations and the secured term loan using a discounted cash flow analysis, based on our estimates of market interest rates. For mortgages where we have an early payment right, we also consider the prepayment amount to evaluate the fair value. The maturity date of the collateralized debt obligations reflects our expected maturity date in January 2015 and is used to compute the related fair value and weighted average effective interest rate.
- (5) The carry value and effective financing rate on the convertible senior notes reflect the impact of FSP No. 14-1. We estimate the fair value of our convertible senior notes using a discounted cash flow analysis, based upon management's estimates of market interest rates, and indications of market yields, where available. The maturity date of our convertible senior notes reflects our expected maturity date in October 2012 when the note investors have the right to require us to repurchase their notes for cash and is used to compute the related fair value and weighted average effective interest rate.
- (6) We estimate the fair value of our other long-term debt using a discounted cash flow analysis, based upon management's estimates of market interest rates. The maturity date of our other long-term debt reflects our expected maturity date in January 2016 and is used to compute the related fair value and weighted average effective interest rate.

Scheduled maturities of interest rate sensitive instruments as of June 30, 2009 are as follows:

	2009	2010	Expected Maturity Dates			Thereafter
			2011	2012	2013	
	(in thousands, notional amounts where appropriate, otherwise carrying amounts)					
Loans held for investment	\$ 7,519	\$ 11,682	\$ 12,907	\$ 13,641	\$ 10,806	\$ 196,852
	23,702	2,630	3,418	3,928	4,499	162,410

Commercial mortgage-backed securities						
Structuring fees receivable	393	767	72	79	86	89
Mortgages on real estate investments	7,025	15,382	35,929	131,486	69,445	691,569
Collateralized debt obligations	(21)	24,913	11,452	12,163	12,300	202,482
Credit facility	9,958	148,860				
Secured term loan	5,151	12,191	13,737	15,380	13,602	59,160
Convertible senior notes	(476)	(1,024)	(1,136)	53,011		
Other long-term debt	–	–	–	–	–	30,930

The above table includes regularly scheduled principal amortization payments. See Note 9 in our consolidated financial statements included in this Form 10-Q. We expect that the reinvestment feature of our CDO will enable us to reinvest about \$8 million of principal repaid on assets financed in the CDO into new assets in 2009, and we may apply this amount to assets financed on the credit facility. Negative amounts with respect to our convertible senior notes represent amortization of the equity component of the instrument as measured in accordance with FSP No. 14-1. Negative amounts shown with respect to our collateralized debt obligations represent amortization of original issue discount.

The expected maturity dates shown for loan investments, securities available for sale and structuring fees receivable are based on the contractual terms of the underlying assets. These assets, based on our current operating strategy, are held for investment. Our liabilities with respect to our repurchase agreement are short-term in nature and, accordingly, are listed in the current period. The material assumptions used to determine fair value are included in footnotes 1 through 7 in the immediately preceding table.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in Internal Controls

There has been no change in our internal control over financial reporting during the quarter ended June 30, 2009, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

There have been no material developments in the quarter ended June 30, 2009, to the legal proceedings to which we are a party as detailed in our Form 10-Q for the quarter ended March 31, 2009.

Item 1A. Risk Factors

See Item 1A of our Form 10-K for the fiscal year ended December 31, 2008 filed with the SEC on March 6, 2009.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

Our annual meeting of stockholders was held in New York, New York on June 16, 2009. 44,830,451 shares of common stock, or 93.5% of our outstanding shares as of the April 2, 2009 record date, were represented in person or by proxy.

The six directors listed below were elected to a one-year term expiring in 2010.

Number of Shares	
For	Withheld

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Paul H. McDowell	44,264,725	565,726
William R. Pollert	43,641,572	1,188,879
Michael E. Gagliardi	43,693,797	1,136,654
Stanley Kreitman	42,924,959	1,905,492
Jeffrey F. Rogatz	43,731,641	1,098,809
Howard A. Silver	44,001,891	828,560

Amendments to our 2004 Stock Incentive Plan were approved: 33,369,154 votes in favor, 2,964,690 votes against and 8,496,606 shares abstained (including 8,388,767 broker non-votes).

The appointment of McGladrey & Pullen LLP as independent registered public accounting firm was ratified: 44,546,570 votes in favor, 165,408 votes against and 118,469 shares abstained.

Item 5. Other Information

None.

Item 6. Exhibits

- 10.1 Amended and Restated CapLease, Inc. 2004 Stock Incentive Plan (Effective March 10, 2009) (incorporated herein by reference to Annex A to the Company's Definitive Proxy Statement filed with the SEC on April 17, 2009)
- 10.2 Form of Restricted Stock Award Agreement-Non-Employee Directors (incorporated herein by reference to Exhibit 10.2 to the registrant's Form 8-K filed with the SEC on June 16, 2009)
- 10.3 Form of Restricted Stock Award Agreement-Executive Officers (incorporated herein by reference to Exhibit 10.3 to the registrant's Form 8-K filed with the SEC on June 16, 2009)
- 12.1 Computation of ratio of earnings to fixed charges and ratio of earnings to combined fixed charges and preferred stock dividends
- 31.1 Certification of the Registrant's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Registrant's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of the Registrant's Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the Registrant's Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CAPLEASE, INC.

Registrant

Date: August 6, 2009

/s/ Paul H. McDowell

Paul H. McDowell

Chairman and Chief Executive Officer

Date: August 6, 2009

/s/ Shawn P. Seale

Shawn P. Seale

Senior Vice President, Chief Financial Officer
and Treasurer