

WELLS REAL ESTATE INVESTMENT TRUST II INC

Form 424B3

November 13, 2006

Table of Contents

**FILED PURSUANT TO**

**RULE 424 (B)(3)**

**REGISTRATION NO: 333-125643**

**WELLS REAL ESTATE INVESTMENT TRUST II, INC.**

**SUPPLEMENT NO. 5 DATED NOVEMBER 13, 2006**

**TO THE PROSPECTUS DATED APRIL 26, 2006**

This document supplements, and should be read in conjunction with, our prospectus dated April 26, 2006 relating to our offering of 475,000,000 shares of common stock, as supplemented by supplement no. 1 dated May 16, 2006, supplement no. 2 dated August 11, 2006, supplement no. 3 dated September 22, 2006 and supplement no. 4 dated November 1, 2006. Capitalized terms used in this supplement have the same meanings as set forth in the prospectus. The purpose of this supplement is to disclose:

the status of our public offerings;

information regarding our indebtedness;

information regarding a revision to suitability standards in Kansas;

risks related to our dependence on key personnel of our advisor;

the election of directors at our annual meeting;

Management's Discussion and Analysis of Financial Condition and Results of Operations similar to that filed in our Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed on November 8, 2006; and

our unaudited financial statements as of and for the three and nine months ended September 30, 2006.

**Status of Our Public Offerings**

We commenced our initial public offering of 785 million shares of common stock on December 1, 2003, which consisted of a 600 million-share primary offering and a 185 million-share offering under our dividend reinvestment plan. We stopped making offers under the primary offering on November 26, 2005. We raised gross offering proceeds of approximately \$2.0 billion from the sale of approximately 197.1 million shares in our initial public offering, including shares sold under the dividend reinvestment plan after the primary offering terminated.

On November 10, 2005, we commenced our follow-on offering of 300.6 million shares of common stock. Of these shares, we are offering 300 million shares in a primary offering and 0.6 million shares under our dividend reinvestment plan. On April 14, 2006, we amended the registration statements for our follow-on offering and our initial public offering in order to offer in a combined prospectus the 300.6 million shares registered under the follow-on offering and the 174.4 million unsold dividend reinvestment plan shares registered under the initial public offering. As of November 8, 2006, we had received gross offering proceeds of approximately \$739.3 million from the sale of approximately

## Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

73.9 million shares in our follow-on offering, including dividend reinvestment plan shares sold under the combined prospectus.

As of November 8, 2006, we had received aggregate gross offering proceeds of approximately \$2.7 billion from the sale of approximately 271.0 million shares in our public offerings. After incurring approximately \$54.0 million in acquisition fees, approximately \$253.5 million in selling commissions and dealer manager fees, approximately \$40.7 million in other organization and offering expenses, and funding common stock redemptions of approximately \$45.6 million pursuant to the share redemption program, as of November 8, 2006, we had raised aggregate net offering proceeds available for investment in properties of approximately \$2.3 billion, substantially all of which had been invested in real estate properties.

### **Indebtedness**

As of November 8, 2006, our leverage ratio, that is, the ratio of total debt to total purchase price of real estate assets plus cash and cash equivalents, was approximately 26%. As of November 8, 2006, total indebtedness was approximately \$834.4 million, which consisted of fixed-rate mortgages on certain properties of approximately \$560.5 million, approximately \$259.0 million outstanding under our \$400.0 million line of credit with Wachovia Bank, N.A. (the Wachovia Line of Credit ) and approximately \$14.9 million outstanding under our construction

## **Table of Contents**

line of credit. Based on the value of our borrowing-base properties, we had approximately \$128.5 million in remaining capacity under the Wachovia Line of Credit, of which approximately \$2.0 million was pledged in the form of letters of credit for future tenant improvements and leasing costs.

### **Revision to Suitability Standards in Kansas**

As of November 13, 2006, we will not sell shares to investors in Kansas unless they meet the following special suitability standards:

Investors must have either (1) a net worth of at least \$225,000, or (2) gross annual income of at least \$60,000 and a net worth of at least \$60,000.

Furthermore, it is recommended by the Office of the Kansas Securities Commissioner that Kansas investors not invest, in the aggregate, more than 10% of their liquid net worth in this and similar direct participation investments. Liquid net worth is defined as that portion of net worth, which consists of cash, cash equivalents and readily marketable securities.

For purposes of determining suitability of an investor, net worth in all cases should be calculated excluding the value of an investor's home, furnishings and automobiles. In the case of sales to fiduciary accounts, these suitability standards must be met by the fiduciary account, by the person who directly or indirectly supplied the funds for the purchase of the shares if such person is the fiduciary or by the beneficiary of the account.

Those selling shares on our behalf must make every reasonable effort to determine that the purchase of shares in this offering is a suitable and appropriate investment for each stockholder based on information provided by the stockholder regarding the stockholder's financial situation and investment objectives.

### **Risks Related to Our Dependence on Key Personnel of Wells Capital**

The following risk factor relates to our dependence on key personnel of Wells Capital and should be read together with the risk factors disclosed in the prospectus.

#### ***Our inability to retain the services of key personnel could cause our operations to suffer.***

We rely on Wells Capital, our advisor, and its affiliates for the day-to-day operation of our business. We believe that our success is significantly dependent upon the contributions of the key personnel of Wells Capital and its affiliates, including among others Leo F. Wells, III, Douglas P. Williams, and Randall D. Fretz, each of whom would be difficult to replace. Such key personnel dedicate attention to multiple programs sponsored by Wells Real Estate Funds, Inc. ( WREF ) and, as a result, experience conflicts of interest in allocating their time among us and other WREF-sponsored programs with which they are involved.

The charter of Wells Real Estate Investment Trust, Inc. ( Wells REIT ), a Wells-sponsored program, requires that it begin the process of liquidating its investments if its shares are not listed on a national securities exchange by January 30, 2008. If the board of directors of Wells REIT should decide to list its securities on a national securities exchange prior to January 30, 2008, Wells REIT might seek to become self-managed prior to listing due to the market's apparent preference for self-managed REITs. In so doing, Wells REIT might consider acquiring a portion of Wells Capital's business in an effort to become self-managed. In the event that Wells Real Estate Investment Trust, Inc. or another WREF-sponsored program were to sever ties with WREF, there is a risk that certain of these key personnel may cease their affiliation with us, Wells Capital, or its affiliates. In such event, we may be unable to find suitable replacement personnel, and our operating results could suffer as a result.

### **Election of Directors**

On July 19, 2006, we held our annual meeting of stockholders at The Atlanta Athletic Club in Duluth, Georgia. Our stockholders elected the following individuals to the board of directors: Leo Wells, III; Douglas Williams; Charles Brown; Richard Carpenter; Bud Carter; Donald Moss; Jack Pinkerton; Neil Strickland; and Wayne Woody. The board of directors also solicited proxies for the re-election of Walter W. Sessoms to the board. Mr. Sessoms passed away prior to the annual stockholders' meeting and his name was withdrawn. The board of directors has not made a decision to fill the vacancy on the board.



---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and notes thereto contained in this supplement no. 5, as well as our consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2005 included in the prospectus. This discussion contains forward-looking statements, which can be identified with the use of forward-looking terminology such as *may*, *will*, *intend* or similar words. Actual results may differ from those described in forward-looking statements. For a discussion of the factors that could cause actual results to differ from those anticipated, see *Risk Factors* in the prospectus and *Risks Related to Our Dependence on Key Personnel of Wells Capital* in this supplement.

We were formed on July 3, 2003. During 2004, we began acquiring real estate assets and receiving investor proceeds under our initial public offering of common stock. We continued receiving investor proceeds and investing in real estate assets through September 30, 2006. Thus, our results of operations for the three months and nine months ended September 30, 2006 and 2005, respectively, reflect growing operational revenues and expenses, fluctuating interest expense, and general and administrative expenses. The increased operational revenues and expenses result from acquiring real properties, while the fluctuations in interest expense arise from using varying levels of short-term and long-term debt financing for our acquisitions. Our general and administrative expenses have declined as a percentage of total revenues for the nine months ended September 30, 2006, as compared to the nine months ended September 30, 2005, commensurate with the operational growth of the enterprise.

**Liquidity and Capital Resources**

*Overview*

From January 2004 through September 2006, we raised significant funds through the sale of our common stock under our public offerings. We primarily used the proceeds from these sales of common stock, net of offering costs and other expenses, to acquire real properties and fund certain capital improvements identified at the time of acquisition. We anticipate receiving proceeds from the sale of our common stock under this offering in the future, and investing such proceeds in future acquisitions of real properties. We also anticipate receiving proceeds from the sale of our common stock under our dividend reinvestment plan in the future, and using a significant portion of such proceeds to fund redemptions of our common stock under our share redemption program. We expect that our primary source of future operating cash flows will be cash generated from the operations of the properties currently in our portfolio and those to be acquired in the future. The amount of future dividends to be paid to our stockholders will be largely dependent upon the amount of cash generated from our operating activities, our expectations of future cash flows, and our determination of near-term cash needs for capital improvements, tenant re-leasing, redemptions of our common stock, and debt repayments.

The competition to acquire high-quality commercial office properties remains high. Timing differences arise between acquiring properties and raising capital and between making operating payments and collecting operating receipts. Accordingly, we may periodically be required to borrow funds on a short-term basis to meet our dividend payment schedule. Our primary focus, however, is to continue to maintain the quality of our portfolio. Thus, in this intensely competitive environment, we may opt to lower the dividend rather than compromise that quality or accumulate significant borrowings to meet a dividend level higher than operating cash flow would support. We will continue to carefully monitor our cash flows and market conditions and their impact on our earnings and future dividend projections.

*Short-term Liquidity and Capital Resources*

During the nine months ended September 30, 2006, we generated net cash flows from operating activities of approximately \$102.1 million, which is primarily comprised of receipts for rental income, tenant reimbursements, hotel income, and interest and other income, partially offset by payments for operating costs, interest expense, asset and property management fees, and general and administrative expenses. Such net cash flows from operating activities were primarily used to pay dividends to stockholders of approximately \$100.6 million during the same period. We generated net cash flows from financing activities of approximately \$349.7 million during the nine months ended September 30, 2006, primarily as a result of raising proceeds from the sale of common stock under our public offerings, net of commissions, dealer-manager fees, and other offering costs of approximately \$567.7 million, reduced by net debt repayments and prepayment penalties of approximately \$92.0 million and redemptions of common stock of approximately \$24.4 million. Such net cash flows from financing activities and cash on hand were used primarily to invest approximately \$401.9 million in real estate and pay acquisition fees of approximately

## **Table of Contents**

\$14.7 million. We expect to utilize the residual cash balance of approximately \$72.9 million as of September 30, 2006 to satisfy current liabilities, pay future dividends, fund future acquisitions of real properties, or reduce indebtedness.

We intend to continue to generate capital from the sale of common stock under this offering and from third-party borrowings, and to use such capital primarily to fund future acquisitions of real estate. We expect that we will use a significant portion of the proceeds from sales under our dividend reinvestment plan to fund redemptions under the share redemption program. As of November 8, 2006, we held cash balances of approximately \$46.6 million and had outstanding borrowings under the Wachovia Line of Credit of approximately \$259.0 million. As of November 8, 2006, after consideration of a letter of credit pledged against the Wachovia Line of Credit, we had a remaining borrowing capacity of approximately \$126.5 million under the Wachovia Line of Credit. Accordingly, we believe that we have adequate capacity to continue to expand our portfolio and meet our future operating cash flow needs. We expect to use substantially all of our future operating cash flow, after payments for certain capital expenditures, to pay dividends to stockholders.

On September 5, 2006, our board of directors declared a daily dividend for stockholders of record from September 16, 2006 through December 15, 2006 in an amount equal to an annualized dividend of \$0.60 per share, which is consistent with the rate of dividends declared for each quarter of 2005 and the first three quarters of 2006 on a per share basis. Such dividend will be paid during December 2006.

### *Long-term Liquidity and Capital Resources*

We expect that our primary sources of capital over the long term will include proceeds from the sale of our common stock, proceeds from secured or unsecured borrowings from third-party lenders, and net cash flows from operations. We expect that our primary uses of capital will be for property acquisitions, either directly or through investments in joint ventures, tenant improvements, offering-related costs, operating expenses, including interest expense on any outstanding indebtedness, and dividends.

In determining how and when to allocate cash resources, we initially consider the source of the cash. We expect that substantially all future net operating cash flows, after payments for certain capital expenditures such as tenant improvements and leasing commissions, will be used to pay dividends. However, we may temporarily use other sources of cash, such as short-term borrowings, to fund dividends from time to time (see *Liquidity and Capital Resources Overview* above). We expect to use substantially all net cash flows generated from raising equity or debt financing to fund acquisitions, certain capital expenditures identified upon acquisition, the repayment of outstanding borrowings, and the redemption of shares under the share redemption program. If sufficient equity or debt capital is not available, our future investments in real estate will be lower.

To the extent that future cash flows provided by operations are lower due to lower returns on properties, future dividends paid may be lower as well. Our cash flow from operations depends significantly on market rents and our tenants' ability to make rental payments. We believe that the diversity of our tenant base and the concentration of creditworthy tenants in our portfolio help to mitigate the risk of a tenant defaulting on a lease. However, general economic downturns, or downturns in one or more of our core markets, could adversely impact the ability of our tenants to make lease payments and our ability to re-lease space on favorable terms when leases expire. In the event of either situation, our cash flow and consequently our ability to meet capital needs, could adversely affect our ability to pay dividends in the future.

**Table of Contents***Contractual Commitments and Contingencies*

As of September 30, 2006, our contractual obligations are as follows (in thousands):

| <b>Contractual Obligations</b>              | <b>Total</b>        | <b>Payments Due During the Years Ending December 31, Remainder</b> |                   |                  |                   |
|---|---------------------|--|-------------------|------------------|-------------------|
|   |                     | <b>of 2006</b>   | <b>2007-2008</b>  | <b>2009-2010</b> | <b>Thereafter</b> |
| Outstanding debt obligations <sup>(1)</sup> | \$ 743,689          | \$ 118   | \$ 303,274        | \$ 25,029        | \$ 415,268        |
| Capital lease obligations                   | 105,870             | 1,170  | 9,360             | 9,360            | 85,980            |
| Purchase obligations <sup>(2)</sup>         | 193,600             | 193,600  |                   |                  |                   |
| Operating lease obligations                 | 3,135               | 15   | 120               | 120              | 2,880             |
| <b>Total</b>                                | <b>\$ 1,046,294</b> | <b>\$ 194,903</b>  | <b>\$ 312,754</b> | <b>\$ 34,509</b> | <b>\$ 504,128</b> |

<sup>(1)</sup> Amounts include principal payments only. We made interest payments of \$26.3 million during the nine months ended September 30, 2006 and expect to pay interest in future periods on outstanding debt obligations based on the rates and terms disclosed in Note 4 to our consolidated financial statements for the year ended December 31, 2005 included in the prospectus and in Note 4 to our accompanying consolidated financial statements in this supplement.

<sup>(2)</sup> Represents a purchase commitment for the International Financial Tower, which was under contract at September 30, 2006. Refer to Note 8 of our accompanying consolidated financial statements in this supplement for further explanation.

**Results of Operations***Overview*

Our results of operations are not indicative of those expected in future periods, as we expect that rental income, tenant reimbursements, property operating costs, asset and property management fees, depreciation, amortization, and net income will increase in future periods as a result of owning the assets we acquired prior to and during the periods presented for an entire period and as a result of future acquisitions of real estate assets that are anticipated.

We commenced our initial public offering on December 1, 2003. Following the receipt and acceptance of subscriptions for the minimum offering of \$2,500,000 on January 22, 2004, we acquired 18 properties during the year ended December 31, 2004 and acquired 21 properties during the year ended December 31, 2005. During the nine months ended September 30, 2006, we acquired 7 properties and completed construction of the LakePointe 3 building, bringing our total portfolio to 47 properties as of September 30, 2006. Accordingly, the results of operations presented for the three months and nine months ended September 30, 2006 and 2005, respectively, are not directly comparable.

*Comparison of the three months ended September 30, 2005 versus the three months ended September 30, 2006*

Rental income and tenant reimbursements increased from approximately \$35.8 million and \$8.5 million, respectively, for the three months ended September 30, 2005 to approximately \$61.3 million and \$13.3 million, respectively, for the three months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Rental income and tenant reimbursements are expected to continue to increase in future periods, as compared to historical periods, as a result of owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of real estate assets.

Hotel income and hotel operating costs of approximately \$7.4 million and \$5.5 million, respectively, were recognized for the three months ended September 30, 2006 and reflect earnings on one hotel property located in Cleveland, Ohio, which we acquired during the fourth quarter of 2005.

## Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

Property operating costs and asset and property management fees increased from approximately \$13.1 million and \$3.5 million, respectively, for the three months ended September 30, 2005 to approximately \$22.3 million and \$6.4 million, respectively, for the three months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Property operating costs and asset and property management fees are expected to continue to increase in future periods, as compared to historical periods, due to owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of additional real estate assets.



## Table of Contents

Depreciation of real estate and amortization of related lease costs increased from approximately \$6.5 million and \$11.7 million, respectively, for the three months ended September 30, 2005 to approximately \$11.9 million and \$20.5 million, respectively, for the three months ended September 30, 2006, primarily due to the acquisition of properties during the last three months of 2005 and the first nine months of 2006. We expect depreciation and amortization to continue to increase in future periods, as compared to historical periods, due to future acquisitions of real estate assets.

General and administrative expenses increased from approximately \$1.5 million for the three months ended September 30, 2005 to approximately \$2.9 million for the three months ended September 30, 2006, primarily due to increases in salary expense reimbursements payable to Wells Capital and Wells Management as a result of increasing the size of our portfolio of real estate assets during the last three months of 2005 and the first nine months of 2006.

Lease termination expense of approximately \$1.8 million was recognized for the three months ended September 30, 2006 due to a noncash partial write-off of intangible lease assets resulting from an amendment to a lease agreement that reduced base rent in exchange for the removal of a lease termination option.

Interest expense increased from approximately \$5.5 million for the three months ended September 30, 2005 to approximately \$9.4 million for the three months ended September 30, 2006, primarily due to new mortgage notes and mortgage notes assumed in connection with property acquisitions, as well as an increase in average borrowings under our line of credit. There were no borrowings on the line of credit during the three months ended September 30, 2005 compared to average borrowings of approximately \$173.1 million during the three months ended September 30, 2006. Future levels of interest expense will vary primarily based on the amounts of future borrowings and the costs of borrowings. Future borrowings will be used primarily to fund future acquisitions of real estate or interests therein. Accordingly, the amounts of future borrowings and future interest expense will largely depend on the level of additional proceeds we raise in this offering and any future offerings, the opportunities to acquire real estate assets consistent with our investment objectives, and the timing of such future acquisitions.

Net income and net income per share decreased from approximately \$5.2 million and \$0.03, respectively, for the three months ended September 30, 2005 to approximately \$2.6 million and \$0.01, respectively, for the three months ended September 30, 2006, primarily as a result of the increases in lease termination expense and interest expense described above. We expect future real estate acquisitions to result in an increase in net income in future periods and expect future net income per share to fluctuate primarily based on the level of proceeds raised in this offering and any future offerings and the rate at which we are able to invest such proceeds in income-generating real estate assets.

### *Comparison of the nine months ended September 30, 2005 versus the nine months ended September 30, 2006*

Rental income and tenant reimbursements increased from approximately \$90.7 million and \$19.7 million, respectively, for the nine months ended September 30, 2005 to approximately \$176.1 million and \$40.7 million, respectively, for the nine months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Rental income and tenant reimbursements are expected to continue to increase in future periods, as compared to historical periods, as a result of owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of real estate assets.

Hotel income and hotel operating costs of approximately \$17.8 million and \$13.5 million, respectively, were recognized for the nine months ended September 30, 2006 and reflect earnings on one hotel property located in Cleveland, Ohio, which we acquired during the fourth quarter of 2005.

Property operating costs and asset and property management fees increased from approximately \$31.3 million and \$8.9 million, respectively, for the nine months ended September 30, 2005 to approximately \$65.3 million and \$18.4 million, respectively, for the nine months ended September 30, 2006, primarily as a result of the growth in the portfolio during the last three months of 2005 and the first nine months of 2006. Property operating costs and asset and property management fees are expected to continue to increase in future periods, as compared to historical periods, due to owning the assets acquired during the last three months of 2005 and the first nine months of 2006 for an entire period and future acquisitions of additional real estate assets.

Depreciation of real estate and amortization of related lease costs increased from approximately \$15.8 million and \$29.7 million, respectively, for the nine months ended September 30, 2005 to approximately \$33.8 million and

## **Table of Contents**

\$60.0 million, respectively, for the nine months ended September 30, 2006, primarily due to the acquisition of properties during the last three months of 2005 and the first nine months of 2006. We expect depreciation and amortization to continue to increase in future periods, as compared to historical periods, due to future acquisitions of real estate assets.

Lease termination expense of approximately \$1.8 million was recognized for the nine months ended September 30, 2006 due to a noncash partial write-off of intangible lease assets resulting from an amendment to a lease agreement that reduced base rent in exchange for the removal of a lease termination option.

General and administrative expenses increased from approximately \$6.1 million for the nine months ended September 30, 2005 to approximately \$8.8 million for the nine months ended September 30, 2006, primarily due to increases in salary expense reimbursements payable to Wells Capital and Wells Management as a result of increasing the size of our portfolio of real estate assets during the last three months of 2005 and the first nine months of 2006. General and administrative expenses as a percent of total revenues decreased from approximately 6% for the nine months ended September 30, 2005 to approximately 4% for the nine months ended September 30, 2006.

Interest expense increased from approximately \$16.7 million for the nine months ended September 30, 2005 to approximately \$30.8 million for the nine months ended September 30, 2006, primarily due to new mortgage notes and mortgage notes assumed in connection with property acquisitions, as well as an increase in average borrowings under our line of credit. Average borrowings under our line of credit increased from approximately \$13.2 million during the first nine months of 2005 to \$202.3 million during the first nine months of 2006. Future levels of interest expense will vary primarily based on the amounts of future borrowings and the costs of borrowings. Future borrowings will be used primarily to fund future acquisitions of real estate or interests therein. Accordingly, the amounts of future borrowings and future interest expense will largely depend on the level of additional proceeds we raise in this offering and any future offerings, the opportunities to acquire real estate assets consistent with our investment objectives, and the timing of such future acquisitions.

We recognized a loss on early extinguishment of debt of approximately \$1.1 million during the nine months ended September 30, 2006 in connection with prepaying the University Circle Buildings mortgage note in January 2006. The loss resulted from a prepayment penalty of approximately \$5.7 million and a write-off of approximately \$0.6 million in deferred financing costs, partially offset by a write-off of the unamortized fair value adjustment to debt of approximately \$5.2 million.

Net income and net income per share decreased from approximately \$7.5 million and \$0.06, respectively, for the nine months ended September 30, 2005 to approximately \$5.8 million and \$0.03, respectively, for the nine months ended September 30, 2006, primarily as a result of the loss on early extinguishment of debt, the lease termination expense, and the increase in interest expense described above. We expect future real estate acquisitions to result in an increase in net income in future periods and expect future net income per share to fluctuate primarily based on the level of proceeds raised in this offering and any future offerings and the rate at which we are able to invest such proceeds in income-generating real estate assets.

## **Funds From Operations**

Funds from operations ( FFO ) is a non-GAAP financial measure and should not be viewed as an alternative measurement of our operating performance to net income. We believe that FFO is a beneficial indicator of the performance of equity REITs. Specifically, FFO calculations exclude factors such as depreciation and amortization of real estate assets and gains or losses from sales of operating real estate assets. As such factors can vary among owners of identical assets in similar conditions based on historical cost accounting and useful-life estimates, FFO may provide a valuable comparison of operating performance between periods and with other REITs. Management believes that accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. As a result, we believe that the use of FFO, together with the required GAAP presentation, provides a more complete understanding of our performance relative to our competitors and a more informed and appropriate basis on which to make decisions involving operating, financing, and investing activities. We calculate FFO in accordance with the current National Association of Real Estate Investment Trust ( NAREIT ) definition. However, other REITs may not define FFO in accordance with the NAREIT definition, or may interpret the current NAREIT definition differently than we do.

**Table of Contents**

As presented below, FFO is adjusted to exclude the impact of certain noncash items, such as depreciation, amortization, and gains on the sale of real estate assets. Reconciliations of net income to FFO are presented below (in thousands):

|                                     | For the Three Months Ended |                    | For the Nine Months Ended |                    |
|-------------------------------------|----------------------------|--------------------|---------------------------|--------------------|
|                                     | September 30, 2006         | September 30, 2005 | September 30, 2006        | September 30, 2005 |
| Net income                          | \$ 2,637                   | \$ 5,246           | \$ 5,842                  | \$ 7,484           |
| Add:                                |                            |                    |                           |                    |
| Depreciation of real assets         | 11,937                     | 6,542              | 33,846                    | 15,773             |
| Amortization of lease-related costs | 20,475                     | 11,655             | 59,988                    | 29,659             |
| <b>FFO</b>                          | <b>\$ 35,049</b>           | <b>\$ 23,443</b>   | <b>\$ 99,676</b>          | <b>\$ 52,916</b>   |
| Weighted-average shares outstanding | 247,285                    | 161,770            | 226,983                   | 123,903            |

Set forth below is additional information related to certain cash and noncash items included in or excluded from net income above, which may be helpful in assessing our operating results. In addition, cash flows generated from FFO may be used to fund all or a portion of certain capitalizable items that are excluded from FFO, such as capitalized interest, tenant improvements, building improvements, and deferred lease costs. Please see the accompanying consolidated statements of cash flows for detail of our operating, investing, and financing cash activities.

*Noncash Items Included in Net Income:*

Straight-line rental revenue of approximately \$5.1 million and \$4.4 million was recognized for the three months ended September 30, 2006 and 2005, respectively, and approximately \$16.1 million and \$9.9 million was recognized for the nine months ended September 30, 2006 and 2005, respectively;

Amortization of above-market and below-market in-place leases was recognized as net decreases to rental income of approximately \$2.8 million and \$0.8 million for the three months ended September 30, 2006 and 2005, respectively, and approximately \$8.5 million and \$2.5 million for the nine months ended September 30, 2006 and 2005, respectively;

Amortization of deferred financing costs of approximately \$0.2 million and \$0.2 million was recognized as interest expense for the three months ended September 30, 2006 and 2005, respectively, and approximately \$0.7 million and \$1.2 million was recognized as interest expense for the nine months ended September 30, 2006 and 2005, respectively;

Approximately \$1.1 million was recognized as a loss on early extinguishment of debt for the nine months ended September 30, 2006 in connection with prepayment of the University Circle Buildings mortgage note during January 2006 resulting from a prepayment penalty of \$5.7 million and a write-off of \$0.6 million in deferred financing costs, partially offset by a write-off of the unamortized fair value adjustment to debt of approximately \$5.2 million; and

Approximately \$1.8 million was recognized as lease termination expense for the three months and nine months ended September 30, 2006 due to a noncash partial write-off of intangible lease assets resulting from an amendment to a lease agreement that reduced base rent in exchange for the removal of a lease termination option.

*Cash Item Excluded from Net Income:*

Master lease proceeds relating to previous acquisitions of approximately \$5.7 million and \$8.2 million were collected during the three months ended September 30, 2006 and 2005, respectively, and approximately \$6.0 million and \$15.1 million were collected during the nine months ended September 30, 2006 and 2005, respectively. Master lease proceeds are recorded as an adjustment to the basis of real

## **Table of Contents**

estate assets during the period acquired and, accordingly, are not included in net income or FFO. We consider master lease proceeds when determining cash available for dividends to our stockholders.

### **Election as a REIT**

We have elected to be taxed as a REIT under the Code, as amended, and have operated as such beginning with our taxable year ended December 31, 2003. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our adjusted taxable income, as defined in the Code, to our stockholders, computed without regard to the dividends-paid deduction and by excluding our net capital gain. As a REIT, we generally will not be subject to federal income tax on income that we distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we will then be subject to federal income taxes on our taxable income for that year and for the four years following the year during which qualification is lost, unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. However, we believe that we are organized and operate in such a manner as to qualify for treatment as a REIT for federal income tax purposes.

On October 4, 2005, we created Wells TRS II, LLC ( Wells TRS ), a wholly owned subsidiary organized as a Delaware limited liability company, which owns, among other things, an interest in a full-service hotel. We have elected to treat Wells TRS as a taxable REIT subsidiary. We may perform additional, non-customary services for tenants of buildings that we own through Wells TRS, including any real estate or non-real estate related services; however, any earnings related to such services are subject to federal and state income taxes. In addition, in order for us to continue to qualify as a REIT, our investments in taxable REIT subsidiaries cannot exceed 20% of the value of our total assets. Wells TRS had net operating income on an income tax basis for the three months and nine months ended September 30, 2006. The related deferred tax liability as of September 30, 2006 is included in accounts payable, accrued expense, and accrued capital expenditures, and the related deferred tax asset as of December 31, 2005 is included in prepaid and other assets in the accompanying consolidated balance sheets. The related income tax expense for the three months and nine months ended September 30, 2006 is included in the accompanying consolidated statements of income.

No provision for federal income taxes has been made in our accompanying consolidated financial statements, other than the provision relating to Wells TRS, as we made distributions in excess of taxable income for the periods presented. We are subject to certain state and local taxes related to property operations in certain locations, which have been provided for in our accompanying consolidated financial statements.

### **Inflation**

We are exposed to inflation risk, as income from long-term leases is the primary source of our cash flows from operations. There are provisions in the majority of our tenant leases that are intended to protect us from, and mitigate the risk of, the impact of inflation. These provisions include rent steps, reimbursement billings for operating expense pass-through charges, real estate tax and insurance reimbursements on a per-square-foot basis, or in some cases, annual reimbursement of operating expenses above a certain per-square-foot allowance. However, due to the long-term nature of the leases, the leases may not re-set frequently enough to fully cover inflation.

### **Application of Critical Accounting Policies**

Our accounting policies have been established to conform with GAAP. The preparation of financial statements in conformity with GAAP requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied, thus resulting in a different presentation of the financial statements. Additionally, other companies may utilize different estimates that may impact comparability of our results of operations to those of companies in similar businesses.

**Table of Contents***Investment in Real Estate Assets*

We are required to make subjective assessments as to the useful lives of our depreciable assets. We consider the period of future benefit of the asset to determine the appropriate useful lives. These assessments have a direct impact on net income. The estimated useful lives of our assets by class are as follows:

|                         |  |
|-------------------------|--|
| Buildings               | 40 years                               |
| Building improvements   | 5-25 years                             |
| Tenant improvements     | Shorter of economic life or lease term |
| Intangible lease assets | Lease term                             |

*Allocation of Purchase Price of Acquired Assets*

Upon the acquisition of real properties, we allocate the purchase price of properties to acquired tangible assets, consisting of land and building, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases and the value of in-place leases, based in each case on our estimate of their fair values.

The fair values of the tangible assets of an acquired property (which includes land and building) are determined by valuing the property as if it were vacant, and the as-if-vacant value is then allocated to land and building based on our determination of the relative fair value of these assets. We determine the as-if-vacant fair value of a property using methods similar to those used by independent appraisers. Factors we consider in performing these analyses include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases, including leasing commissions and other related costs. In estimating carrying costs, we include real estate taxes, insurance, and other operating expenses during the expected lease-up periods based on current market conditions.

The fair values of above-market and below-market in-place leases are recorded based on the present value (using a discount rate that reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) our estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining terms of the leases. The capitalized above-market and below-market lease values are recorded as intangible lease assets or liabilities and amortized as an adjustment to rental income over the remaining terms of the respective leases.

The fair values of in-place leases include direct costs associated with obtaining a new tenant, opportunity costs associated with lost rentals that are avoided by acquiring an in-place lease, and tenant relationships. Direct costs associated with obtaining a new tenant include commissions, tenant improvements, and other direct costs and are estimated based on our consideration of current market costs to execute a similar lease. These direct costs are included in deferred lease costs in the accompanying consolidated balance sheets and are amortized to expense over the remaining terms of the respective leases. The value of opportunity costs is calculated using the contractual amounts to be paid pursuant to the in-place leases over a market absorption period for a similar lease. Customer relationships are valued based on expected renewal of a lease or the likelihood of obtaining a particular tenant for other locations. These lease intangibles are included in intangible lease assets in the accompanying consolidated balance sheets and are amortized to expense over the remaining terms of the respective leases.

Estimates of the fair values of the tangible and intangible assets require us to estimate market lease rates, property operating expenses, carrying costs during lease-up periods, discount rates, market absorption periods, and the number of years the property is held for investment. The use of inappropriate estimates would result in an incorrect assessment of our purchase price allocations, which would impact the amount of our reported net income.

*Valuation of Real Estate Assets*

We continually monitor events and changes in circumstances that could indicate that the carrying amounts of the real estate and related intangible assets of both operating properties and properties under construction, in which we have an ownership interest, either directly or through investments in joint ventures, may not be recoverable. When indicators of potential impairment are present that suggest that the carrying amounts of real estate and related intangible assets may not be recoverable, we assess the recoverability of these assets by determining whether the carrying value will be recovered through the undiscounted future operating cash flows expected from the use of the asset and its eventual disposition. In the event that such expected undiscounted future cash flows do not exceed the carrying value, we decrease the carrying value of the real estate and related intangible assets to the estimated fair



## **Table of Contents**

values, as defined by Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and recognize an impairment loss. Estimated fair values are calculated based on the following information, in order of preference, dependent upon availability: (i) recently quoted market prices, (ii) market prices for comparable properties, or (iii) the present value of undiscounted cash flows, including estimated salvage value. We have determined that there has been no impairment in the carrying value of our real estate assets during the nine months ended September 30, 2006 and 2005.

Projections of expected future operating cash flows require that we estimate future market rental income amounts subsequent to the expiration of current lease agreements, property operating expenses, the number of months it takes to re-lease the property, and the number of years the property is held for investment, among other factors. The subjectivity of assumptions used in the future cash flow analysis, including discount rates, could result in an incorrect assessment of the property's fair value and could result in the misstatement of the carrying value of our real estate and related intangible assets and net income.

## **Related-Party Transactions and Agreements**

We have entered into agreements with our advisor, Wells Capital, and its affiliates, whereby we pay certain fees and reimbursements to Wells Capital or its affiliates, for acquisition fees, commissions, dealer-manager fees, asset and property management fees, construction fees, reimbursement of organizational and offering costs, and reimbursement of operating costs. See Note 7 to our accompanying consolidated financial statements included herein for a discussion of the various related-party transactions, agreements, and fees.

## **Commitments and Contingencies**

We are subject to certain commitments and contingencies with regard to certain transactions. Refer to Note 8 of our accompanying consolidated financial statements in this supplement for further explanation. Examples of such commitments and contingencies include:

Take-Out Agreements;

Property under contract;

Commitments under existing lease agreements; and

Litigation.



**Table of Contents**

**INDEX OF FINANCIAL STATEMENTS**

|   | <b>Page</b> |
|---|-------------|
| <b>Consolidated Financial Statements</b>  |             |
| <b>Wells Real Estate Investment Trust II, Inc. September 30, 2006</b>   |             |
| <u>Consolidated Balance Sheets as of September 30, 2006 (unaudited) and December 31, 2005</u>   | F-2         |
| <u>Consolidated Statements of Income for the Three Months Ended September 30, 2006 (unaudited) and 2005 (unaudited) and the Nine Months Ended September 30, 2006 (unaudited) and 2005 (unaudited)</u> | F-3         |
| <u>Consolidated Statements of Stockholders' Equity for the Year Ended December 31, 2005 and the Nine Months Ended September 30, 2006 (unaudited)</u>  | F-4         |
| <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2006 (unaudited) and 2005 (unaudited)</u>  | F-5         |
| <u>Condensed Notes to Consolidated Financial Statements (unaudited)</u>   | F-6         |

**Table of Contents****WELLS REAL ESTATE INVESTMENT TRUST II, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

|   | (Unaudited)         |                     |
|---|---------------------|---------------------|
|   | September 30,       | December 31,        |
|   | 2006                | 2005                |
| <b>Assets:</b>  |                     |                     |
| Real estate assets, at cost:  |                     |                     |
| Land  | \$ 332,570          | \$ 277,097          |
| Buildings and improvements, less accumulated depreciation of \$65,807 and \$31,961 as of September 30, 2006 and December 31, 2005, respectively                                       | 1,797,446           | 1,589,689           |
| Intangible lease assets, less accumulated amortization of \$89,839 and \$43,538 as of September 30, 2006 and December 31, 2005, respectively  | 415,679             | 390,001             |
| Construction in progress  | 1,085               | 6,040               |
| <b>Total real estate assets</b>   | <b>2,546,780</b>    | <b>2,262,827</b>    |
| Cash and cash equivalents   | 72,948              | 35,352              |
| Tenant receivables, net of allowance for doubtful accounts of \$1,358 and \$735 as of September 30, 2006 and December 31, 2005, respectively  | 47,687              | 27,887              |
| Prepaid expenses and other assets   | 41,949              | 44,033              |
| Deferred financing costs, less accumulated amortization of \$1,278 and \$614 as of September 30, 2006 and December 31, 2005, respectively   | 2,791               | 3,231               |
| Deferred lease costs, less accumulated amortization of \$43,250 and \$20,929 as of September 30, 2006 and December 31, 2005, respectively   | 285,004             | 237,553             |
| Investment in bonds   | 78,000              | 78,000              |
| <b>Total assets</b>   | <b>\$ 3,075,159</b> | <b>\$ 2,688,883</b> |
| <b>Liabilities:</b>   |                     |                     |
| Line of credit and notes payable  | \$ 743,689          | \$ 832,402          |
| Accounts payable, accrued expenses, and accrued capital expenditures  | 32,258              | 31,694              |
| Due to affiliates   | 2,866               | 8,220               |
| Dividends payable   | 6,310               | 5,142               |
| Deferred income   | 8,458               | 8,387               |
| Intangible lease liabilities, less accumulated amortization of \$8,172 and \$3,894 as of September 30, 2006 and December 31, 2005, respectively                                       | 93,172              | 62,560              |
| Obligations under capital leases  | 78,000              | 78,000              |
| <b>Total liabilities</b>  | <b>964,753</b>      | <b>1,026,405</b>    |
| <b>Commitments and Contingencies</b>  |                     |                     |
| <b>Minority Interest</b>  | <b>3,203</b>        | <b>2,724</b>        |
| <b>Redeemable Common Stock</b>  | <b>33,156</b>       |                     |
| <b>Stockholders' Equity:</b>  |                     |                     |
| Common stock, \$0.01 par value; 900,000,000 shares authorized; 258,275,700 and 197,403,280 shares issued and outstanding as of September 30, 2006 and December 31, 2005, respectively | 2,583               | 1,974               |
| Additional paid-in capital  | 2,296,001           | 1,752,162           |
| Cumulative distributions in excess of earnings  | (190,269)           | (94,382)            |

Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

|   |                  |              |
|---|------------------|--------------|
| Redeemable common stock   | (33,156)         |              |
| Other comprehensive loss  | (1,112)          |              |
| <b>Total stockholders' equity</b>   | <b>2,074,047</b> | 1,659,754    |
| Total liabilities, minority interest, redeemable common stock, and stockholders' equity | \$ 3,075,159     | \$ 2,688,883 |

*See accompanying notes.*

F-2

**Table of Contents****WELLS REAL ESTATE INVESTMENT TRUST II, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

|   | (Unaudited)           |           | (Unaudited)           |           |
|---|-----------------------|-----------|-----------------------|-----------|
|   | Three Months Ended    |           | Nine Months Ended     |           |
|   | September 30,<br>2006 | 2005      | September 30,<br>2006 | 2005      |
| <b>Revenues:</b>  |                       |           |                       |           |
| Rental income   | \$ 61,260             | \$ 35,795 | \$ 176,076            | \$ 90,675 |
| Tenant reimbursements   | 13,287                | 8,538     | 40,657                | 19,683    |
| Hotel income  | 7,426                 |           | 17,811                |           |
|   | <b>81,973</b>         | 44,333    | <b>234,544</b>        | 110,358   |
| <b>Expenses:</b>  |                       |           |                       |           |
| Property operating costs  | 22,266                | 13,122    | 65,272                | 31,259    |
| Hotel operating costs   | 5,483                 |           | 13,479                |           |
| Asset and property management fees:                                 |                       |           |                       |           |
| Related-party   | 5,170                 | 2,882     | 14,806                | 7,159     |
| Other   | 1,183                 | 635       | 3,560                 | 1,741     |
| Depreciation  | 11,937                | 6,542     | 33,846                | 15,773    |
| Amortization  | 20,475                | 11,655    | 59,988                | 29,659    |
| Lease termination expense   | 1,814                 |           | 1,814                 |           |
| General and administrative  | 2,919                 | 1,523     | 8,807                 | 6,134     |
|   | <b>71,247</b>         | 36,359    | <b>201,572</b>        | 91,725    |
| <b>Real estate operating income</b>                                 | <b>10,726</b>         | 7,974     | <b>32,972</b>         | 18,633    |
| <b>Other income (expense):</b>                                      |                       |           |                       |           |
| Interest expense  | (9,415)               | (5,478)   | (30,755)              | (16,667)  |
| Loss on early extinguishment of debt                                |                       |           | (1,115)               |           |
| Interest and other income   | 1,818                 | 2,833     | 5,559                 | 5,707     |
|   | <b>(7,597)</b>        | (2,645)   | <b>(26,311)</b>       | (10,960)  |
| <b>Income before minority interest and income tax expense</b>       | <b>3,129</b>          | 5,329     | <b>6,661</b>          | 7,673     |
| <b>Minority interest in earnings of consolidated entities</b>       | <b>(204)</b>          | (83)      | <b>(580)</b>          | (189)     |
| <b>Income before income tax expense</b>                             | <b>2,925</b>          | 5,246     | <b>6,081</b>          | 7,484     |
| <b>Income tax expense</b>   | <b>(288)</b>          |           | <b>(239)</b>          |           |
| <b>Net income</b>   | <b>\$ 2,637</b>       | \$ 5,246  | <b>\$ 5,842</b>       | \$ 7,484  |
| <b>Per share information basic and diluted:</b>                     |                       |           |                       |           |
| <b>Net income available to common stockholders</b>                  | <b>\$ 0.01</b>        | \$ 0.03   | <b>\$ 0.03</b>        | \$ 0.06   |
| <b>Weighted-average common shares outstanding basic and diluted</b> | <b>247,285</b>        | 161,770   | <b>226,983</b>        | 123,903   |

*See accompanying notes.*



Table of Contents

WELLS REAL ESTATE INVESTMENT TRUST II, INC.  
 CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY  
 FOR THE YEAR ENDED DECEMBER 31, 2005  
 AND THE NINE MONTHS ENDED SEPTEMBER 30, 2006 (UNAUDITED)

(in thousands, except per share amounts)

|   | Common Stock   |                 | Additional<br>Paid-In<br>Capital | Cumulative<br>Distributions<br>in Excess of<br>Earnings | Redeemable<br>Common<br>Stock | Other<br>Comprehensive<br>Loss | Total<br>Stockholders<br>Equity |
|---|----------------|-----------------|----------------------------------|---|-------------------------------|--------------------------------|---------------------------------|
|   | Shares         | Amount          |                                  |   |                               |                                |                                 |
| <b>Balance, December 31, 2004</b>   | 79,132         | \$ 791          | \$ 699,463                       | \$ (23,139)   | \$                            | \$                             | \$ 677,115                      |
| Issuance of common stock  | 119,875        | 1,199           | 1,197,555                        |   |                               |                                | 1,198,754                       |
| Redemptions of common stock   | (1,604)        | (16)            | (15,304)                         |   |                               |                                | (15,320)                        |
| Dividends (\$0.60 per share)  |                |                 |                                  | (83,764)  |                               |                                | (83,764)                        |
| Commissions and discounts on stock sales<br>and related dealer-manager fees |                |                 | (113,017)                        |   |                               |                                | (113,017)                       |
| Other offering costs  |                |                 | (16,535)                         |   |                               |                                | (16,535)                        |
| Net income  |                |                 |                                  | 12,521  |                               |                                | 12,521                          |
| <b>Balance, December 31, 2005</b>   | 197,403        | 1,974           | 1,752,162                        | (94,382)  |                               |                                | 1,659,754                       |
| <b>Issuance of common stock</b>   | <b>63,430</b>  | <b>634</b>      | <b>633,666</b>                   |   |                               |                                | <b>634,300</b>                  |
| <b>Redemptions of common stock</b>  | <b>(2,557)</b> | <b>(25)</b>     | <b>(24,407)</b>                  |   |                               |                                | <b>(24,432)</b>                 |
| <b>Redeemable common stock</b>  |                |                 |                                  |   | <b>(33,156)</b>               |                                | <b>(33,156)</b>                 |
| <b>Dividends (\$0.45 per share)</b>   |                |                 |                                  | <b>(101,729)</b>  |                               |                                | <b>(101,729)</b>                |
| Commissions and discounts on stock sales<br>and related dealer-manager fees |                |                 | (57,113)                         |   |                               |                                | (57,113)                        |
| Other offering costs  |                |                 | (8,307)                          |   |                               |                                | (8,307)                         |
| <b>Components of comprehensive income:</b>                                  |                |                 |                                  |   |                               |                                |                                 |
| <b>Net income</b>   |                |                 |                                  | <b>5,842</b>  |                               |                                | <b>5,842</b>                    |
| <b>Loss on interest rate swap</b>   |                |                 |                                  |   |                               | <b>(1,112)</b>                 | <b>(1,112)</b>                  |
| <b>Comprehensive income</b>   |                |                 |                                  |   |                               |                                | <b>4,730</b>                    |
| <b>Balance, September 30, 2006</b>  | <b>258,276</b> | <b>\$ 2,583</b> | <b>\$ 2,296,001</b>              | <b>\$ (190,269)</b>                                     | <b>\$ (33,156)</b>            | <b>\$ (1,112)</b>              | <b>\$ 2,074,047</b>             |

*See accompanying notes.*

**Table of Contents****WELLS REAL ESTATE INVESTMENT TRUST II, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

|   | (unaudited)       |                   |
|---|-------------------|-------------------|
|   | Nine Months Ended |                   |
|   | September 30,     |                   |
|   | 2006              | 2005              |
| <b>Cash Flows from Operating Activities:</b>  |                   |                   |
| Net income  | \$ 5,842          | \$ 7,484          |
| Adjustments to reconcile net income to net cash provided by operating activities:           |                   |                   |
| Depreciation  | 33,846            | 15,773            |
| Other amortization  | 68,582            | 32,180            |
| Amortization of deferred financing costs and fair market value adjustments on notes payable | 1,354             | 1,633             |
| Loss on early extinguishment of debt  | 1,115             |                   |
| Lease termination expense   | 1,814             |                   |
| Minority interest in earnings of consolidated entities                                      | 580               | 189               |
| Changes in assets and liabilities:  |                   |                   |
| Increase in tenant receivables, net   | (19,330)          | (10,938)          |
| Decrease (increase) in prepaid expenses and other assets                                    | 3,161             | (6,251)           |
| Increase in accounts payable and accrued expenses   | 7,169             | 1,144             |
| Decrease in due to affiliates   | (2,079)           | (77)              |
| Increase in deferred income   | 71                | 3,319             |
| Net cash provided by operating activities   | 102,125           | 44,456            |
| <b>Cash Flows from Investing Activities:</b>  |                   |                   |
| Investment in real estate and earnest money paid  | (401,916)         | (712,591)         |
| Proceeds from master leases   | 6,040             | 15,094            |
| Acquisition fees paid   | (14,677)          | (22,832)          |
| Deferred lease costs paid   | (3,708)           | (2,214)           |
| Net cash used in investing activities   | (414,261)         | (722,543)         |
| <b>Cash Flows from Financing Activities:</b>  |                   |                   |
| Deferred financing costs paid   | (840)             | (3,437)           |
| Proceeds from line of credit and notes payable  | 450,654           | 347,887           |
| Repayments of line of credit and notes payable  | (536,934)         | (336,406)         |
| Prepayment penalty on early extinguishment of debt  | (5,734)           |                   |
| Distributions paid to minority interest partners  | (101)             | (160)             |
| Issuance of common stock  | 630,463           | 971,221           |
| Redemptions of common stock   | (24,424)          | (10,399)          |
| Dividends paid to stockholders  | (100,561)         | (53,184)          |
| Commissions on stock sales and related dealer-manager fees paid                             | (52,571)          | (89,692)          |
| Other offering costs paid   | (10,220)          | (16,605)          |
| Net cash provided by financing activities   | 349,732           | 809,225           |
| <b>Net increase in cash and cash equivalents</b>  | <b>37,596</b>     | <b>131,138</b>    |
| <b>Cash and cash equivalents, beginning of period</b>                                       | <b>35,352</b>     | <b>20,876</b>     |
| <b>Cash and cash equivalents, end of period</b>   | <b>\$ 72,948</b>  | <b>\$ 152,014</b> |

*See accompanying notes.*

F-5



**Table of Contents**

**WELLS REAL ESTATE INVESTMENT TRUST II, INC.**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2006**

**(unaudited)**

**1. Organization**

Wells Real Estate Investment Trust II, Inc. ( Wells REIT II ) is a Maryland corporation that has elected to be taxed as a real estate investment trust ( REIT ) for federal income tax purposes. Wells REIT II engages in the acquisition and ownership of commercial real estate properties throughout the United States, including properties that are under construction, are newly constructed, or have operating histories. Wells REIT II was incorporated on July 3, 2003 and commenced operations on January 22, 2004. Wells REIT II conducts business primarily through Wells Operating Partnership II, L.P. ( Wells OP II ), a Delaware limited partnership. Wells REIT II is the sole general partner of Wells OP II and controls the operations of Wells OP II. Wells REIT II owns more than 99.9% of the equity interests in Wells OP II. Wells Capital, Inc. ( Wells Capital ), the external advisor to Wells REIT II, is the sole limited partner of Wells OP II. Wells OP II acquires, develops, owns, leases, and operates real properties directly, through wholly owned subsidiaries or through joint ventures. References to Wells REIT II herein shall include Wells REIT II, all subsidiaries of Wells REIT II, including consolidated joint ventures, Wells OP II, and Wells OP II s subsidiaries. See Note 7 for a discussion of the advisory services provided by Wells Capital.

As of September 30, 2006, Wells REIT II owned interests in 45 office properties, one industrial building, and one hotel, comprising approximately 13.6 million square feet of rentable space located in 17 states and the District of Columbia. Forty-one of the properties are wholly owned and six are owned through consolidated joint ventures. As of September 30, 2006, the office and industrial properties were approximately 97% leased.

On December 1, 2003, Wells REIT II commenced its initial public offering of up to 785.0 million shares of common stock, of which 185.0 million shares were reserved for issuance through Wells REIT II s dividend reinvestment plan, pursuant to a Registration Statement filed on Form S-11 under the Securities Act of 1933. Except for continuing to offer shares for sale through its dividend reinvestment plan, Wells REIT II stopped offering shares for sale under its initial public offering on November 26, 2005. Wells REIT II raised gross offering proceeds of approximately \$2.0 billion from the sale of approximately 197.1 million shares under its initial public offering, including shares sold under the dividend reinvestment plan after the primary offering terminated. On November 10, 2005, Wells REIT II commenced a follow-on offering of up to 300.6 million shares of common stock, of which 0.6 million shares were reserved for issuance under Wells REIT II s dividend reinvestment plan, pursuant to a Registration Statement filed on Form S-11 under the Securities Act of 1933. On April 14, 2006, Wells REIT II amended the aforementioned registration statements to offer in a combined prospectus the 300.6 million shares registered under the follow-on offering and 174.4 million unsold shares related to the dividend reinvestment plan and registered under the initial public offering. As of September 30, 2006, Wells REIT II had raised gross offering proceeds of approximately \$654.1 million from the sale of approximately 65.4 million shares under the follow-on offering, including dividend reinvestment plan shares sold under the combined prospectus.

Wells REIT II has raised gross offering proceeds from the sale of common stock under the initial public offering and follow-on offering of approximately \$2.6 billion. After deductions from such gross offering proceeds for payments of acquisition fees of approximately \$52.3 million, selling commissions and dealer-manager fees of approximately \$245.4 million, other organization and offering expenses of approximately \$40.7 million, and common stock redemptions of approximately \$42.3 million under the share redemption program, Wells REIT II had received aggregate net offering proceeds of approximately \$2.2 billion as of September 30, 2006. Substantially all of Wells REIT II s net offering proceeds have been invested in real properties.

Wells REIT II s stock is not listed on a public securities exchange. However, Wells REIT II s charter requires that, in the event that Wells REIT II s stock is not listed on a national securities exchange by October 2015, Wells REIT II must either seek stockholder approval of an extension or amendment of this listing deadline or stockholder approval to begin liquidating investments and distributing the resulting proceeds to the stockholders. In the event that Wells REIT II seeks stockholder approval for an extension or amendment to this listing date and does not obtain it, Wells REIT II will then be required to seek stockholder approval to liquidate. In this circumstance, if Wells REIT II seeks and does not obtain approval to liquidate, Wells REIT II will not be required to list or liquidate and could continue to operate indefinitely as an unlisted company



---

## **Table of Contents**

### **2. Summary of Significant Accounting Policies**

#### *Basis of Presentation*

The consolidated financial statements of Wells REIT II have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ( SEC ), including the instructions to Form 10-Q and Article 10 of Regulation S-X, and do not include all of the information and footnotes required by U.S. generally accepted accounting principles ( GAAP ) for complete financial statements. In the opinion of management, the statements for these unaudited interim periods presented include all adjustments, which are of a normal and recurring nature, necessary for a fair and consistent presentation of the results for such periods. Results for these interim periods are not necessarily indicative of a full year's results. Wells REIT II's consolidated financial statements include the accounts of Wells REIT II, Wells OP II, and a variable interest entity in which Wells REIT II is the primary beneficiary. For further information, refer to the financial statements and footnotes for the year ended December 31, 2005 included in Wells REIT II's prospectus dated April 26, 2006.

#### *Redeemable Common Stock*

As of September 30, 2006, Wells REIT II's share redemption program provided that Ordinary Redemptions (those that do not occur within two years of death or qualifying disability) and those sought upon qualifying disability during any calendar year are limited to those that can be funded with proceeds raised in the current calendar year from Wells REIT II's dividend reinvestment plan. Although Wells REIT II is under no obligation to redeem any shares to the extent that total redemptions would exceed the foregoing limit, the board of directors of Wells REIT II has reserved the right to redeem additional shares upon the death of stockholders. See Note 5 for a discussion of the limits on redemption.

As the use of proceeds raised in the current calendar year from the dividend reinvestment plan is outside the control of Wells REIT II, those proceeds are considered to be temporary equity under Accounting Series Release No. 268, *Presentation in Financial Statements of Redeemable Preferred Stock*. Therefore, Wells REIT II has included an amount equal to proceeds from shares issued through Wells REIT II's dividend reinvestment plan in the current calendar year, less the amount of redemptions previously funded with such proceeds, as redeemable common stock in the accompanying consolidated financial statements as of September 30, 2006.

Wells REIT II's redeemable common shares are contingently redeemable at the option of the holder until such shares are tendered for redemption. Accordingly, pursuant to Statement of Financial Accounting Standard ( SFAS ) No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* ( SFAS 150 ), Wells REIT II reclassifies such obligations from temporary equity to a liability based upon their respective settlement values upon being tendered for redemption. As of September 30, 2006 and December 31, 2005, shares tendered for redemption and not yet redeemed of approximately \$8,000 and \$0, respectively, are included in accounts payable, accrued expenses, and accrued capital expenditures in the accompanying consolidated balance sheets.

#### *Interest Rate Swap Agreements*

Wells REIT II has entered into interest rate swap agreements to hedge its exposure to changing interest rates on variable rate debt instruments. Wells REIT II accounts for interest rate swap agreements in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Accordingly, the fair value of all interest rate swap agreements are included in either prepaid expenses and other assets or accounts payable, accrued expenses, and accrued capital expenditures in the consolidated balance sheets. The change in fair value of the effective portion of an interest rate swap agreement that is designated as a hedge is recorded as other comprehensive income (loss) in the consolidated statement of stockholders' equity. All other changes in fair values of interest rate swap agreements are recorded as other income (expense) in the accompanying consolidated statements of income. Net amounts received or paid under interest rate swap agreements are recorded as adjustments to interest expense as incurred.

#### *Revenue Recognition - Hotel Operations*

Wells REIT II owns an interest in a full-service hotel. Revenues derived from the operations of the hotel include, but are not limited to, revenues from rental of rooms, food and beverage sales, telephone usage, and other service revenues. Revenue is recognized when rooms are occupied, when services have been performed, and when products are delivered.

## **Table of Contents**

### *Income Taxes*

Wells REIT II has elected to be taxed as a REIT under the Internal Revenue Code of 1986 (the Code), as amended, and has operated as such beginning with its taxable year ended December 31, 2003. To qualify as a REIT, Wells REIT II must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of its adjusted taxable income, as defined in the Code, to its stockholders. As a REIT, Wells REIT II generally is not subject to income tax on income it distributes to stockholders. Wells REIT II is subject to certain state and local taxes related to the operations of properties in certain locations, which have been provided for in the accompanying consolidated financial statements.

On October 4, 2005, Wells REIT II created Wells TRS II, LLC (Wells TRS), a wholly owned subsidiary organized as a Delaware limited liability company, which owns, among other things, an interest in a full-service hotel. Wells REIT II has elected to treat Wells TRS as a taxable REIT subsidiary. Wells REIT II may perform additional, non-customary services for tenants of buildings owned by Wells REIT II through Wells TRS, including any real estate or non-real estate related services; however, any earnings related to such services are subject to federal and state income taxes. In addition, for Wells REIT II to continue to qualify as a REIT, Wells REIT II's investments in taxable REIT subsidiaries cannot exceed 20% of the value of the total assets of Wells REIT II. Deferred tax assets and liabilities are established for temporary differences between the financial reporting basis and the tax basis of assets and liabilities at the enacted rates expected to be in effect when the temporary differences reverse.

### *Reclassifications*

Certain prior period amounts have been reclassified to conform with the current period financial statement presentation.

### *Recent Accounting Pronouncements*

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, (FIN 48), which clarifies the relevant criteria and approach for the recognition, derecognition, and measurement of uncertain tax positions. FIN 48 will be effective for Wells REIT II beginning January 1, 2007. Wells REIT II is currently assessing the provisions and evaluating the financial statement impact of FIN 48 on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures required for fair value measurements under GAAP. SFAS 157 emphasizes that fair value is a market-based measurement, as opposed to a transaction-specific measurement. SFAS 157 will be effective for Wells REIT II beginning January 1, 2008. Wells REIT II is currently assessing the provisions and evaluating the financial impact of SFAS 157 on its consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB No. 108), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB No. 108 is effective for fiscal years ending after November 15, 2006, and will be effective for Wells REIT II beginning December 31, 2006. Wells REIT II does not believe the adoption of such guidance will have an impact on its consolidated financial statements.

## **Table of Contents**

### **3. Real Estate Acquisitions**

#### *Summary*

As of September 30, 2006, Wells REIT II owned interests in 47 properties as a result of acquiring 18 properties during the year ended December 31, 2004, acquiring 21 properties during the year ended December 31, 2005, acquiring 2 properties and completing construction of the LakePointe 3 building during the second quarter of 2006, and acquiring 5 properties during the third quarter of 2006.

#### *263 Shuman Boulevard Building Acquisition*

On July 20, 2006, Wells REIT II purchased a five-story office building containing approximately 354,000 rentable square feet (the 263 Shuman Boulevard Building ) located on an approximate 15.2-acre parcel of land at 263 Shuman Boulevard in Naperville, Illinois, for a purchase price of approximately \$55.3 million, exclusive of closing costs. The 263 Shuman Boulevard Building, which was constructed in 1986, is entirely leased to OfficeMax Incorporated.

#### *11950 Corporate Boulevard Building Acquisition*

On August 9, 2006, Wells REIT II purchased a four-story office building containing approximately 227,000 rentable square feet (the 11950 Corporate Boulevard Building ) located on an approximate 13.2-acre parcel of land at 11950 Corporate Boulevard in Orlando, Florida, for a purchase price of approximately \$44.0 million, exclusive of closing costs. The 11950 Corporate Boulevard Building, which was constructed in 2001, is entirely leased to Siemens Westinghouse Power Corporation.

#### *Edgewater Corporate Center Building Acquisition*

On September 6, 2006, Wells REIT II purchased a five-story office building containing approximately 180,000 rentable square feet (the Edgewater Corporate Center Building previously referred to as the Decision One Building ) located on an approximate 10.5-acre parcel of land at 3023 HSBC Way in Lancaster, South Carolina, for a purchase price of approximately \$35.5 million, exclusive of closing costs. The Edgewater Corporate Center Building, which was constructed in 2006, is entirely leased to Decision One Mortgage Company, LLC.

#### *4300 Centreway Place Building Acquisition*

On September 19, 2006, Wells REIT II purchased a three-story office building containing approximately 139,000 rentable square feet (the 4300 Centreway Place Building ) located on an approximate 9.2-acre parcel of land at 4300 Centreway Place in Arlington, Texas, for a purchase price of approximately \$19.3 million, exclusive of closing costs. The 4300 Centreway Place Building, which was constructed in 1998, is entirely leased to Aetna Life Insurance Company.

#### *80 Park Plaza Building Acquisition*

On September 21, 2006, Wells REIT II purchased a 26-story office building containing approximately 1.0 million rentable square feet (the 80 Park Plaza Building ) located on an approximate 2.8-acre parcel of land at 1135-1155 Raymond Boulevard in Newark, New Jersey, for a purchase price of approximately \$147.5 million, exclusive of closing costs. The 80 Park Plaza Building, which was constructed in 1979, is entirely leased to Public Service Electric and Gas Company.

**Table of Contents****4. Line of Credit and Notes Payable**

As of September 30, 2006 and December 31, 2005, Wells REIT II had the following indebtedness outstanding (in thousands):

| Facility   | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Line of credit                                     | \$ 173,000            | \$ 214,000           |
| 100 East Pratt Street Building mortgage note       | 105,000               | 105,000              |
| Wildwood Buildings mortgage note                   | 90,000                | 90,000               |
| 5 Houston Center Building mortgage note            | 90,000                | 90,000               |
| One West Fourth Street Building mortgage note      | 48,733                | 49,662               |
| 800 North Frederick Building mortgage note         | 46,400                | 46,400               |
| 80 Park Plaza Building mortgage note               | 45,900                |                      |
| SanTan Corporate Center mortgage note              | 39,000                |                      |
| Highland Landmark Building mortgage note           | 30,840                | 30,840               |
| 9 Technology Drive Building mortgage note          | 23,800                | 23,800               |
| One and Four Robbins Road Buildings mortgage note  | 23,000                | 23,000               |
| LakePointe 3 construction loan                     | 14,842                | 6,476                |
| Key Center Complex mortgage notes                  | 13,174                | 12,571               |
| University Circle Buildings mortgage note          |                       | 122,932              |
| Finley Road and Opus Place Buildings mortgage note |                       | 17,721               |
| <br>Total indebtedness                             | <br>\$ 743,689        | <br>\$ 832,402       |

During the three months ended September 30, 2006, Wells REIT II engaged in the following significant activities with respect to its line of credit and notes payable:

The line of credit represents a \$400.0 million unsecured revolving financing facility (the Wachovia Line of Credit ) with a syndicate of banks led by Wachovia Bank, N.A., which expires May 9, 2008. During August 2006, Wells REIT II pledged approximately \$2.0 million of its borrowing capacity under the Wachovia Line of Credit to a letter of credit for future tenant improvements. As of September 30, 2006, after consideration of the letter of credit, Wells REIT II had remaining borrowing capacity of up to approximately \$212.5 million under the Wachovia Line of Credit. During the three months ended September 30, 2006, Wells REIT II received net proceeds of \$89.0 million under the Wachovia Line of Credit.

On September 21, 2006, Wells REIT II obtained a \$45.9 million loan secured by the 80 Park Plaza Building (the 80 Park Plaza Building mortgage note ) in favor of Anglo Irish Bank, the proceeds of which were used to purchase the 80 Park Plaza Building (Note 3). The 80 Park Plaza Building mortgage note bears interest at LIBOR plus 130 basis points (approximately 6.63% per annum as of September 30, 2006) and matures in September 2016. Interest is due monthly; however, under the terms of the loan agreement, monthly debt service amounts are added to the outstanding balance of the note over the term. Wells REIT II may prepay the 80 Park Plaza Building mortgage note in full or in part at any time upon 15 days written notice subject to the payment of a cost maintenance fee, as defined by the loan agreement.

In connection with obtaining the 80 Park Plaza Building mortgage note, Wells REIT II entered into an interest rate swap agreement with Anglo Irish Bank. The interest rate swap agreement has an effective date of September 22, 2006 and terminates on September 21, 2016. Under the terms of the interest rate swap agreement, Wells REIT II will pay Anglo Irish Bank monthly interest at a fixed rate of 5.275% per annum and receive LIBOR-based monthly interest payments from Anglo Irish Bank. The interest rate swap effectively fixes Wells REIT II's interest rate on the 80 Park Plaza Building mortgage note at 6.575%.

On September 28, 2006, Wells REIT II entered into a \$39.0 million interest-only promissory note with Wachovia Bank, N.A. (the SanTan Corporate Center mortgage note ). The SanTan Corporate Center mortgage note is secured by the SanTan Corporate Center. The note matures on October 11, 2016 and bears interest at a fixed rate of 5.83% per annum. Wells REIT II may prepay the SanTan Corporate Center mortgage note at anytime upon at least 30 days written notice subject to certain prepayment penalties, as defined by the promissory note agreement.

Wells REIT II made interest payments, including amounts capitalized, of approximately \$26.3 million and \$11.4 million during the nine months ended September 30, 2006 and 2005, respectively. This excludes the \$5.7 million



## **Table of Contents**

prepayment penalty paid in January 2006 related to the University Circle Buildings mortgage note, which is included in loss on early extinguishment of debt in the accompanying consolidated statements of income.

### **5. Share Redemption Program**

The board of directors of Wells REIT II approved an amendment to the share redemption program ( SRP ), which became effective September 9, 2006. The amendment grants Wells REIT II discretion to redeem additional shares submitted for redemption upon the death of stockholders in excess of net proceeds raised in the current calendar year from Wells REIT II 's dividend reinvestment plan. The redemption limits set forth in the amended SRP are summarized below:

Wells REIT II will not make an Ordinary Redemption (those that do not occur within two years of death or qualifying disability) until one year after the issuance of the shares to be redeemed.

Wells REIT II will not redeem shares on any redemption date to the extent that such redemptions would cause the amount paid for Ordinary Redemptions since the beginning of the then-current calendar year to exceed 50% of the net proceeds from the sale of shares under Wells REIT II 's dividend reinvestment plan during such period.

Wells REIT II will limit Ordinary Redemptions and those upon the qualifying disability of a stockholder so that the aggregate of such redemptions during any calendar year do not exceed:

100% of the net proceeds from Wells REIT II 's dividend reinvestment plan during the calendar year or

5% of the weighted-average number of shares outstanding in the prior calendar year.

Although there is no limit under the SRP on the number of shares Wells REIT II may redeem upon the death of stockholders, Wells REIT II is under no obligation to redeem such shares to the extent such redemptions would cause total redemptions to exceed the two limits set forth immediately above.



**Table of Contents****6. Supplemental Disclosures of Noncash Activities**

Outlined below are significant noncash investing and financing transactions for the nine months ended September 30, 2006 and 2005 (in thousands):

|   | Nine Months Ended     |            |
|---|-----------------------|------------|
|   | September 30,<br>2006 | 2005       |
| Investment in real estate funded with other assets                            | \$ 3,368              | \$ 345     |
| Acquisition fees applied to real estate assets                                | \$ 11,781             | \$ 18,107  |
| Other assets assumed upon acquisition of properties                           | \$ 58                 | \$ 5,076   |
| Other liabilities assumed upon acquisition of properties                      | \$ 965                | \$ 8,459   |
| Loss on interest rate swap  | \$ 1,112              | \$         |
| Acquisition fees due to affiliate   | \$ 330                | \$ 351     |
| Accrued capital expenditures and deferred lease costs                         | \$ 5,087              | \$ 418     |
| Notes payable assumed upon acquisition of properties                          | \$                    | \$ 118,269 |
| Proceeds from note payable in escrow  | \$ 2,112              | \$ 23,913  |
| Fair market value adjustments to notes payable upon acquisition of properties | \$                    | \$ 5,458   |
| Write-off of fully amortized intangible assets and deferred lease costs       | \$ 4,239              | \$         |
| Write-off of fully amortized deferred financing costs                         | \$ 34                 | \$ 1,093   |
| Discounts applied to issuance of common stock                                 | \$ 3,837              | \$ 3,067   |
| Contributions from minority interest partners                                 | \$                    | \$ 1,300   |
| Redeemable common stock   | \$ 33,156             | \$ 17,739  |
| Accrued redemptions of common stock   | \$ 8                  | \$         |
| Dividends payable   | \$ 6,310              | \$ 4,265   |
| Commissions on stock sales and related dealer-manager fees due to affiliate   | \$ 789                | \$ 450     |
| Other offering costs due to affiliate   | \$ 834                | \$ 861     |

**7. Related-Party Transactions***Advisory Agreement*

## Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

On October 26, 2006, Wells REIT II renewed the advisory agreement (the Advisory Agreement ) with Wells Capital through October 20, 2007. The Advisory Agreement entitles Wells Capital to earn specified fees for certain services. The terms of the renewed Advisory Agreement are identical to the prior agreement. Either party may terminate the Advisory Agreement without cause or penalty upon providing 60 days written notice. If initiating termination of the Advisory Agreement, Wells REIT II would be obligated to pay all unpaid earned fees and reimbursements of expenses to Wells Capital.

Under the terms of the Advisory Agreement, Wells Capital receives the following fees and reimbursements:

Reimbursement of organization and offering costs paid by Wells Capital on behalf of Wells REIT II, not to exceed 2.0% of gross offering proceeds;

Acquisition fees of 2.0% of gross offering proceeds, subject to certain limitations; Wells REIT II also reimburses Wells Capital for expenses it pays to third parties in connection with acquisitions or potential acquisitions;

Monthly asset management fees equal to one-twelfth of 0.75% of the cost of (i) all properties of Wells REIT II and (ii) investments in joint ventures. The amount of these fees paid in any calendar quarter may not exceed 0.25% of the net asset value of those investments at each quarter-end after deducting debt used to acquire or refinance properties;

Reimbursement for all costs and expenses Wells Capital incurs in fulfilling its duties as the asset portfolio manager, including (i) wages and salaries and other employee-related expenses of Wells Capital's employees,

F-12

## Table of Contents

who perform a full range of real estate services for Wells REIT II, including management, administration, operations, and marketing, and are billed to Wells REIT II based on the amount of time spent on Wells REIT II by such personnel, provided that such expenses are not reimbursed if incurred in connection with services for which Wells Capital receives a disposition fee (described below) or an acquisition fee, and (ii) amounts paid for IRA custodial service costs allocated to Wells REIT II accounts;

For any property sold by Wells REIT II, a disposition fee equal to 1.0% of the sales price, with the limitation that the total real estate commissions (including such disposition fee) for any Wells REIT II property sold may not exceed the lesser of (i) 6.0% of the sales price of each property or (ii) the level of real estate commissions customarily charged in light of the size, type, and location of the property;

Incentive fee of 10% of net sales proceeds remaining after stockholders have received distributions equal to the sum of the stockholders' invested capital plus an 8% return of invested capital; and

Listing fee of 10% of the excess by which the market value of the stock plus dividends paid prior to listing exceeds the sum of 100% of the invested capital plus an 8% return on invested capital.

Per the terms of the Advisory Agreement, Wells REIT II is required to reimburse Wells Capital for certain organization and offering costs up to the lesser of actual expenses or 2% of gross equity raised. As of September 30, 2006, Wells REIT II has incurred and charged to additional paid-in capital cumulative other offering costs of approximately \$31.7 million related to the initial public offering and \$9.0 million related to the follow-on offering, which represents approximately 1.6% and 1.4% of cumulative gross proceeds raised by Wells REIT II under each offering, respectively.

### *Dealer-Manager Agreement*

Wells REIT II has executed a Dealer-Manager Agreement with Wells Investment Securities, Inc. ( "WIS" ), whereby WIS, an affiliate of Wells Capital, performs the dealer-manager function for Wells REIT II. For these services, WIS earns a commission of up to 7% of the gross offering proceeds from the sale of the shares of Wells REIT II, of which substantially all is re-allowed to participating broker dealers. Effective beginning in the fourth quarter of 2005, Wells REIT II no longer pays commissions on shares issued under its dividend reinvestment plan.

Additionally, Wells REIT II is required to pay WIS a dealer-manager fee of up to 2.5% of the gross offering proceeds from the sale of Wells REIT II's stock at the time the shares are sold. Under the dealer-manager agreement, up to 1.5% of the gross offering proceeds may be reallowed by WIS to participating broker dealers. Wells REIT II pays no dealer-manager fees on shares issued under its dividend reinvestment plan.

### *Property Management, Leasing, and Construction Agreement*

On November 24, 2004, Wells REIT II entered into a Master Property Management, Leasing, and Construction Agreement (the "Management Agreement") with Wells Management Company, Inc. ( "Wells Management" ), an affiliate of Wells Capital. In consideration for supervising the management, leasing, and construction of certain Wells REIT II properties, Wells REIT II pays the following fees to Wells Management in accordance with the terms of the Management Agreement:

Property management fees in an amount equal to a percentage negotiated for each property managed by Wells Management of the gross monthly income collected for that property for the preceding month;

Leasing commissions for new, renewal, or expansion leases entered into with respect to any property for which Wells Management serves as leasing agent equal to a percentage as negotiated for that property of the total base rental and operating expenses to be paid to Wells REIT II during the applicable term of the lease, provided, however, that no commission shall be payable as to any portion of such term beyond ten years;

Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

Initial lease-up fees for newly constructed properties under the agreement, generally equal to one month's rent;

Fees equal to a specified percentage of up to 5% of all construction build-out funded by Wells REIT II, given as a leasing concession, and overseen by Wells Management; and

F-13

**Table of Contents**

Other fees as negotiated with the addition of each specific property covered under the agreement.

*Related-Party Costs*

Pursuant to the terms of the agreements described above, Wells REIT II incurred the following related-party costs for the three months and nine months ended September 30, 2006 and 2005, respectively (in thousands):

|  | Three Months Ended |                    | Nine Months Ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| Commissions <sup>(1)</sup>                                       | \$ 13,598          | \$ 20,244          | \$ 41,256          | \$ 68,200          |
| Dealer-manager fees <sup>(1)</sup>                               | 5,264              | 7,230              | 15,857             | 24,357             |
| Asset management fees  | 4,940              | 2,775              | 14,345             | 7,043              |
| Acquisition fees <sup>(2)</sup>                                  | 4,181              | 5,758              | 12,610             | 19,424             |
| Reimbursements of organization and offering costs <sup>(1)</sup> | 2,381              | 2,429              | 8,307              | 13,706             |
| Administrative reimbursements                                    | 1,594              | 497                | 4,380              | 2,496              |
| Property management fees   | 230                | 107                | 461                | 116                |
| Construction fees  |                    |                    | 150                |                    |
|  | <b>\$ 32,188</b>   | <b>\$ 39,040</b>   | <b>\$ 97,366</b>   | <b>\$ 135,342</b>  |

<sup>(1)</sup> Commissions, dealer-manager fees, and reimbursements of organization and offering costs are charged against stockholders' equity in the accompanying consolidated balance sheets.

<sup>(2)</sup> Acquisition fees are capitalized as prepaid expenses and other assets in the accompanying consolidated balance sheets and are allocated to properties upon acquiring properties, or repaying debt used to finance property acquisitions, with investor proceeds.

Wells REIT II incurred no related-party disposition fees, incentive fees, listing fees, or leasing commissions during the three months or nine months ended September 30, 2006 or 2005, respectively.

*Due to Affiliates*

The detail of amounts due to affiliates is provided below as of September 30, 2006 and December 31, 2005 (in thousands):

|  | September 30,   | December 31,    |
|--|-----------------|-----------------|
|  | 2006            | 2005            |
| Other salary and administrative reimbursements due to Wells Capital and Wells Management | \$ 913          | \$ 906          |
| Organization and offering cost reimbursements due to Wells Capital                       | 834             | 2,747           |
| Commissions and dealer-manager fees due to WIS   | 789             | 84              |
| Acquisition fees due to Wells Capital  | 330             | 2,397           |
| Asset management fees due to Wells Capital   |                 | 2,086           |
|  | <b>\$ 2,866</b> | <b>\$ 8,220</b> |

*Economic Dependency*

## Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

Wells REIT II has engaged Wells Capital and its affiliates, Wells Management and WIS, to provide certain services that are essential to Wells REIT II, including asset management services, supervision of the management and leasing of some properties owned by Wells REIT II, asset acquisition and disposition services, the sale of shares of Wells REIT II's common stock, as well as other administrative responsibilities for Wells REIT II including accounting services, stockholder communications, and investor relations. As a result of these relationships, Wells REIT II is dependent upon Wells Capital, Wells Management, and WIS.

F-14

**Table of Contents**

Wells Capital, Wells Management, and WIS are all owned and controlled by Wells Real Estate Funds, Inc. ( WREF ). The operations of Wells Capital, Wells Management, and WIS represent substantially all of the business of WREF. Accordingly, Wells REIT II focuses on the financial condition of WREF when assessing the financial condition of Wells Capital, Wells Management, and WIS. In the event that WREF were to become unable to meet its obligations as they become due, Wells REIT II might be required to find alternative service providers.

Future net income generated by WREF will be largely dependent upon the amount of fees earned by Wells Capital and Wells Management based on, among other things, the level of investor proceeds raised and the volume of future acquisitions and dispositions of real estate assets by Wells REIT II and other WREF-sponsored programs. As of September 30, 2006, Wells REIT II believes that WREF is generating adequate cash flow from operations and has adequate liquidity available in the form of cash on hand and current receivables necessary to meet its current and future obligations as they become due.

**8. Commitments and Contingencies***Take-Out Agreements*

Wells Management has developed a program that involves the acquisition of income-producing commercial properties through a series of single-member limited liability companies for the purpose of facilitating the resale of co-tenancy interests in such real estate properties (the

Wells Section 1031 Program ) to persons seeking to reinvest the proceeds from a sale of real estate held for investment in another real estate investment in order to qualify for like-kind exchange treatment under Section 1031 of the Internal Revenue Code ( 1031 Participants ). Acquisitions of properties for the Wells Section 1031 Program are generally financed with a combination of permanent first mortgage financing and interim financing obtained from institutional lenders. Following the acquisition of a property, a subsidiary of Wells Management attempts to sell co-tenancy interests in such property to 1031 Participants. The proceeds from such sales are typically used to immediately repay the interim financing.

As of September 30, 2006, Wells REIT II had commitments outstanding under two Take-Out Purchase and Escrow Agreements (the Take-Out Agreements ) related to the Wells Section 1031 Program. Under the terms of the Take-Out Agreements, Wells REIT II receives a fee in exchange for committing to purchase any of the co-tenancy interests described above that remain unsold to 1031 Participants on the maturity date of the interim financing obtained to acquire the properties. In consideration for the exposure created under the Take-Out Agreements, Wells REIT II earned fees of approximately \$0.1 million and \$0.2 million for the three months ended September 30, 2006 and 2005, respectively, and approximately \$0.3 million and \$0.2 million for the nine months ended September 30, 2006 and 2005, respectively, which are included in interest and other income in the accompanying consolidated statements of income.

Information regarding the Take-Out Agreements outstanding as of September 30, 2006 is as follows (in thousands):

| Location of Property | Property          |                   | Initial<br>Maximum<br>Exposure | Remaining             | Additional<br>Fees<br>Earned<br>(1) |
|----------------------|-------------------|-------------------|--------------------------------|-----------------------|-------------------------------------|
|                      | Acquisition       | Obligation        |                                | Exposure at           |                                     |
|                      | Date              | End Date          |                                | September 30,<br>2006 |                                     |
| Lisle, IL            | December 14, 2005 | December 14, 2006 | \$ 12,080                      | \$ 7,369              | \$ 46                               |
| Bellevue, NE         | December 16, 2005 | December 16, 2006 | \$ 21,610                      | \$ 14,165             | \$ 77                               |

(1) Additional fees earned represent amounts earned by Wells REIT II during the third quarter of 2006 for extending the take-out period through the respective obligation end dates shown above.

*Property Under Contract*

On September 13, 2006, Wells REIT II entered into an agreement to acquire a 19-story office building containing approximately 630,000 rentable square feet located on an approximate 1.9-acre tract of land at 95 Christopher Columbus Drive in Jersey City, New Jersey (the

International Financial Tower ) for a total contract price of \$193.6 million, exclusive of closing costs. In connection with the execution of this agreement, Wells REIT II paid a deposit of \$4.0 million to an escrow agent, which is included in prepaid expenses and other assets in the accompanying consolidated balance sheets. On October 31, 2006, Wells REIT II purchased the International Financial Tower for a purchase

## Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

price of approximately \$193.6 million, exclusive of closing costs. The International Financial Tower, which was constructed in 1989, is leased to Pershing, LLC (approximately 75%), NTT Data USA, LLC (approximately 22%), and various other office and retail tenants (approximately 3%).

F-15



## **Table of Contents**

### *Commitments Under Existing Lease Agreements*

Certain lease agreements include provisions that, at the option of the tenant, may obligate Wells REIT II to expend capital to expand an existing property or provide other expenditures for the benefit of the tenant. As of September 30, 2006, no tenants have exercised such options that had not been materially satisfied.

### *Litigation*

Wells REIT II is from time to time a party to legal proceedings that arise in the ordinary course of its business. Wells REIT II is not currently involved in any legal proceedings of which the outcome is reasonably likely to have a material adverse effect on the results of operations or financial condition of Wells REIT II. Wells REIT II is not aware of any such legal proceedings contemplated by governmental authorities.

## **9. Subsequent Event**

### *Sale of Shares of Common Stock*

From October 1, 2006 through October 31, 2006, Wells REIT II raised approximately \$67.1 million through the issuance of approximately 6.7 million shares of common stock under its follow-on offering. As of October 31, 2006, approximately 227.9 million shares remained available for sale to the public under the follow-on offering, exclusive of shares available under Wells REIT II's dividend reinvestment plan.

**Table of Contents**

**SUPPLEMENTAL INFORMATION** The prospectus of Wells Real Estate Investment Trust II, Inc. consists of this sticker, the prospectus dated April 26, 2006, supplement no. 1 dated May 16, 2006, supplement no. 2 dated August 11, 2006, supplement no. 3 dated September 22, 2006, supplement no. 4 dated November 1, 2006 and supplement no. 5 dated November 13, 2006.

Supplement no. 1 includes:

the status of our ongoing public offerings;

the acquisition of two three-story office buildings containing approximately 268,000 rentable square feet located on a 16.4-acre parcel of land in Chandler, Arizona;

information regarding our indebtedness;

an amendment to our share redemption program;

Management's Discussion and Analysis of Financial Condition and Results of Operations similar to that filed in our Quarterly Report on Form 10-Q for the period ended March 31, 2006, filed on May 11, 2006; and

our unaudited financial statements as of and for the three months ended March 31, 2006.

Supplement no. 2 includes:

the status of our ongoing public offerings;

the acquisition of a five-story office building containing approximately 354,000 rentable square feet located on a 15.2-acre parcel of land in Naperville, Illinois;

the acquisition of a four-story office building containing approximately 227,000 rentable square feet located on a 13.2-acre parcel of land in Orlando, Florida;

information regarding our indebtedness;

an amendment to our share redemption program and entering into an insurance agreement that may help us fund redemptions under the program upon the death of stockholders;

Management's Discussion and Analysis of Financial Condition and Results of Operations similar to that filed in our Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed on August 10, 2006; and

## Edgar Filing: WELLS REAL ESTATE INVESTMENT TRUST II INC - Form 424B3

our unaudited financial statements as of and for the three and six months ended June 30, 2006.

Supplement no. 3 includes:

the status of our ongoing public offerings;

the acquisition of a five-story office building containing approximately 182,000 rentable square feet located on a 10.5-acre parcel of land in Lancaster, South Carolina;

the acquisition of a three-story office building containing approximately 139,000 rentable square feet located on a 9.2-acre parcel of land in Arlington, Texas;

the acquisition of a 26-story office building containing approximately 1.0 million rentable square feet located on a 2.8-acre parcel of land in Newark, New Jersey;

information regarding our indebtedness.

**Table of Contents**

Supplement no. 4 includes:

the status of our public offerings;

the acquisition of a 19-story office building containing approximately 630,000 rentable square feet located on a 1.9-acre parcel of land in Jersey City, New Jersey; and

information regarding our indebtedness.

Supplement no. 5 includes:

the status of our public offerings;

information regarding our indebtedness;

information regarding a revision to suitability standards in Kansas;

risks related to our dependence on key personnel of our advisor;

the election of directors at our annual meeting;

Management's Discussion and Analysis of Financial Condition and Results of Operations similar to that filed in our Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed on November 8, 2006; and

our unaudited financial statements as of and for the three and nine months ended September 30, 2006.