NATIONAL RETAIL PROPERTIES, INC.
Form 10-K
February 22, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from _________ to _________.

Commission file number 001-11290

NATIONAL RETAIL PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland	56-1431377
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

450 South Orange Avenue, Suite 900

Orlando, Florida 32801

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: (407) 265-7348

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	*Name of exchange on which registered:*

Common Stock, $0.01 par value	New York Stock Exchange
7.375% Non-Voting Series C Preferred Stock, $0.01 par value	New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes *x* No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨

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

The aggregate market value of voting common stock held by non-affiliates of the registrant as of June 30, 2007 was $66,159,208.

The number of shares of common stock outstanding as of February 14, 2008 was 72,534,884.

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DOCUMENTS INCORPORATED BY REFERENCE:

Registrant incorporates by reference into Part III (Items 10, 11, 12, 13 and 14) of this Annual Report on Form 10-K portions of National Retail Properties, Inc. s definitive Proxy Statement for the 2008 Annual Meeting of Stockholders to be filed with the Securities Exchange Commission pursuant to Regulation 14A. The definitive Proxy Statement will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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PART I

Unless the context otherwise requires, references in this Annual Report on Form 10-K to the terms registrant or NNN or the Company refer to National Retail Properties, Inc. and its [consolidated] subsidiaries, including taxable real estate investment trust (REIT) subsidiaries and their majority owned and controlled subsidiaries (collectively the TRS).

Statements contained in this annual report on Form 10-K, including the documents that are incorporated by reference, that are not historical facts are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Also, when NNN uses any of the words anticipate, assume, believe, estimate, expect, intend, or similar expressions, NNN is n forward-looking statements. Although management believes that the expectations reflected in such forward-looking statements are based upon present expectations and reasonable assumptions, NNN s actual results could differ materially from those set forth in the forward-looking statements. Certain factors that could cause actual results or events to differ materially from those NNN anticipates or projects are described in Item 1A. Risk Factors of this Annual Report on Form 10-K.

Given these uncertainties, readers are cautioned not to place undue reliance on such statements, which speak only as of the date of this Annual Report on Form 10-K or any document incorporated herein by reference. NNN undertakes no obligation to publicly release any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date of this Annual Report on Form 10-K.

Item 1. Business

The Company

NNN, a Maryland corporation, is a fully integrated REIT formed in 1984. NNN s operations are divided into two primary business segments: (i) investment assets, including real estate assets and mortgages and notes receivable (including structured finance) (collectively, Investment Assets), and (ii) inventory real estate assets (Inventory Assets). The Investment Assets are operated through National Retail Properties, Inc. and its wholly owned subsidiaries. The Inventory Assets are held in the TRS.

Real Estate Assets

NNN acquires, owns, invests in, manages and develops properties that are leased primarily to retail tenants under long-term net leases (Investment Properties or Investment Portfolio). As of December 31, 2007, NNN owned 908 Investment Properties, with an aggregate leasable area of 10,610,000 square feet, located in 44 states. Approximately 98 percent of NNN s Investment Portfolio was leased at December 31, 2007. The TRS, directly and indirectly, through investment interests, acquires and/or develops real estate primarily for the purpose of resale (Inventory Properties or Inventory Portfolio). As of December 31, 2007, the TRS owned 56 Inventory Properties.

Mortgages and Notes Receivable

Mortgages are loans secured by real estate, real estate securities or other assets. As of December 31, 2007, these receivables totaled $49,336,000.

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Structured finance agreements are typically loans secured by a borrower s pledge of ownership interests in the entity that owns or leases the real estate and/or other acceptable collateral such as fixtures, equipment or cash. These agreements are sometimes subordinated to senior loans secured by first mortgages encumbering the underlying real estate. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans. As of December 31, 2007, the structured finance agreements had an outstanding principal balance of $14,359,000.

Investment in Unconsolidated Affiliate

Crow Holdings. In September 2007, NNN entered into a joint venture, NNN Retail Properties Fund I LLC (the NNN Crow JV I), with an affiliate of Crow Holdings Realty Partners IV, L.P. NNN Crow JV I plans to acquire from unrelated third parties up to $220,000,000 of real estate assets leased to convenience store operators.

Competition

NNN generally competes with numerous other REITs, commercial developers, real estate limited partnerships and other investors, including but not limited to, insurance companies, pension funds and financial institutions, that own, manage, finance or develop retail and net leased properties.

Employees

As of January 31, 2008, NNN employed 72 full-time associates including executive and administrative personnel.

NNN s executive offices are located at 450 S. Orange Avenue, Suite 900, Orlando, Florida 32801, and its telephone number is (407) 265-7348. NNN has an Internet website at www.nnnreit.com where NNN s filings with the Securities and Exchange Commission can be downloaded free of charge. The common shares of National Retail Properties, Inc. are traded on the New York Stock Exchange (NYSE), under the ticker symbol NNN.

Business Strategies and Policies

The following is a discussion of NNN s operating strategy and certain of its investment, financing and other policies. These strategies and policies have been set by management and/or the Board of Directors and, in general, may be amended or revised from time to time by management and/or the Board of Directors without a vote of NNN s stockholders.

Operating Strategies

NNN s strategy is to invest primarily in retail real estate that is typically located along high-traffic commercial corridors near areas of commercial and residential density. Management believes that these types of properties, when leased to national or regional retailers generally pursuant to triple-net leases, provide attractive opportunities for a stable current return and the potential for increased current returns and capital appreciation. Triple-net leases typically require the tenant to pay property operating expenses such as real estate taxes, assessments and other government charges, insurance, utilities, and repairs and maintenance. Initial lease terms are generally 15 to 20 years.

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In some cases, NNN s investment in real estate is in the form of mortgages, structured finance investments or other loans which may be secured by real estate, a borrower s pledge of ownership interests in the entity that owns the real estate or other assets. These investments may be subordinated to senior loans secured by other loans encumbering the underlying real estate or assets. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans.

NNN holds investment real estate assets until it determines that the sale of such a property is advantageous in view of NNN s investment objectives. In deciding whether to sell a real estate investment asset, NNN may consider factors such as potential capital appreciation, net cash flow, tenant credit quality, market lease rates, potential use of sale proceeds and federal income tax considerations.

NNN acquires and/or develops inventory real estate assets primarily for the purpose of resale.

NNN s management team considers certain key indicators to evaluate the financial condition and operating performance of NNN. The key indicators for NNN may include items such as: the composition of NNN s Investment Portfolio (such as tenant, geographic and industry classification diversification), the occupancy rate of NNN s Investment Portfolio, certain financial performance ratios, profitability measures and industry trends compared to that of NNN.

The operating strategies employed by NNN have allowed it to increase dividends paid per common share for 18 consecutive years.

Investment in Real Estate or Interests in Real Estate

NNN s management believes that attractive acquisition opportunities for retail properties will continue to be available and that NNN is well suited to take advantage of these opportunities because of its access to capital markets, ability to underwrite and acquire properties, and because of management s experience in seeking out, identifying and evaluating potential acquisitions.

In evaluating a particular acquisition, management may consider a variety of factors, including:

- the location, visibility and accessibility of the property,
- the geographic area and demographic characteristics of the community, as well as the local real estate market, including potential for growth and existing or potential competing properties or retailers,
- the size of the property,
- the purchase price,
- the non-financial terms of the proposed acquisition,
- the availability of funds or other consideration for the proposed acquisition and the cost thereof,
- the compatibility of the property with NNN s existing portfolio,
- the potential for, and current extent of, any environmental problems,

the quality of construction and design and the current physical condition of the property,

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- the financial and other characteristics of the existing tenant,
- the tenant s business plan, operating history and management team,
- the tenant s industry,
- the terms of any existing leases, and
- the rent to be paid by the tenant.

NNN intends to engage in future investment activities in a manner that is consistent with the maintenance of its status as a REIT for federal income tax purposes and that will not make NNN an investment company under the Investment Company Act of 1940, as amended. Equity investments in acquired properties may be subject to existing mortgage financings and other indebtedness or to new indebtedness which may be incurred in connection with acquiring or refinancing these investments.

Investments in Real Estate Mortgages, Commercial Mortgage Residual Interests, and Securities of or Interests in Persons Engaged in Real Estate Activities

While NNN s primary business objectives and current portfolio ownership primarily emphasize retail properties, NNN may invest in (i) a wide variety of property and tenant types, (ii) leases, mortgages, commercial mortgage residual interests and other types of real estate interests, (iii) loans secured by collateral related to business operations of an owned or leased property, or (iv) securities of other REITs, other entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities. For example, NNN from time to time has made investments in mortgage loans or held mortgages on properties that NNN has sold and has made structured finance investments and other loans related to properties acquired or sold.

Financing Strategy

NNN s financing objective is to manage its capital structure effectively in order to provide sufficient capital to execute its operating strategies while servicing its debt requirements and providing value to its stockholders. NNN generally utilizes debt and equity security offerings, bank borrowings, the sale of properties, and to a lesser extent, internally generated funds to meet its capital needs.

NNN typically funds its short-term liquidity requirements including investments in additional retail properties with cash from its $400,000,000 unsecured revolving credit facility (Credit Facility). As of December 31, 2007, $129,800,000 was outstanding and approximately $270,200,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling $2,685,000.

For the year ended December 31, 2007, NNN s ratio of total indebtedness to total gross assets (before accumulated depreciation) was approximately 43 percent and the secured indebtedness to total gross assets was approximately one percent. The total debt to total market capitalization was approximately 39 percent. Certain financial agreements to which NNN is a party contain covenants that limit NNN s ability to incur debt under certain circumstances.

NNN anticipates it will be able to obtain additional financing for short-term and long-term liquidity requirements as further described in *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation Liquidity.* However, there can be no assurance that additional financing or capital will be available, or that the terms will be acceptable or advantageous to NNN.

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The organizational documents of NNN do not limit the absolute amount or percentage of indebtedness that NNN may incur. Additionally, NNN may change its financing strategy at any time. NNN has not engaged in trading, underwriting or agency distribution or sale of securities of other issues and does not intend to do so.

Strategies and Policy Changes

Any of NNN s strategies or policies described above may be changed at any time by NNN without notice to or a vote of NNN s stockholders.

Investment Properties

As of December 31, 2007, NNN owned 908 Investment Properties with an aggregate gross leasable area of 10,610,000 square feet, located in 44 states. Approximately 98 percent of the gross leasable area was leased at December 31, 2007. Reference is made to the Schedule of Real Estate and Accumulated Depreciation and Amortization filed with this report for a listing of NNN s Investment Properties and their respective carrying costs.

The following table summarizes NNN s Investment Properties as of December 31, 2007 (in thousands):

	Size(1)			Cost(2)		
	High	Low	Average	High	Low	Average
Land	2,223	7	115	$ 10,197	$ 25	$ 1,078
Building	135	1	12	13,874	44	1,440

(1) Approximate square feet.
(2) Costs vary depending upon size and local demographic factors.

In connection with the development of 27 Investment Properties, NNN has agreed to fund construction commitments (including land costs) of $71,883,000, of which $44,561,000 has been funded as of December 31, 2007.

During 2006, NNN disposed of the properties leased to the United States of America which had accounted for more than 10 percent of NNN's total rental income in 2005. As of December 31, 2007, NNN does not have any one tenant that accounts for ten percent or more of its rental income.

Leases. Although there are variations in the specific terms of the leases, the following is a summary of the general structure of NNN's leases. Generally, the leases of the Investment Properties provide for initial terms of 15 to 20 years. As of December 31, 2007, the weighted average remaining lease term was approximately 13 years. The Investment Properties are generally leased under net leases pursuant to which the tenant typically will bear responsibility for substantially all property costs and expenses associated with ongoing maintenance and operation, including utilities, property taxes and insurance. In addition, the majority of NNN's leases provide that the tenant is responsible for roof and structural repairs. The leases of the Investment Properties provide for annual base rental payments (payable in monthly installments) ranging from $11,000 to $1,800,000 (average of $217,000). Tenant leases generally provide for limited increases in rent as a result of fixed increases, increases in the consumer price index, and/or increases in the tenant s sales volume.

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Generally, the Investment Property leases provide the tenant with one or more multi-year renewal options subject to generally the same terms and conditions as the initial lease. Some of the leases also provide that in the event NNN wishes to sell the Investment Property subject to that lease, NNN first must offer the lessee the right to purchase the Investment Property on the same terms and conditions as any offer which NNN intends to accept for the sale of the Investment Property.

Certain Investment Properties have leases that provide the tenant with a purchase option to acquire the Investment Property from NNN. The purchase price calculations are generally stated in the lease agreement or are based on current market value.

The following table summarizes the lease expirations of NNN s Investment Portfolio as of December 31, 2007:

	% of Annual Base Rent[1]	# of Properties	Gross Leasable Area[2]		% of Annual Base Rent[1]	# of Properties	Gross Leasable Area[2]
2008	0.7%	14	258,000	2014	5.0%	31	509,000
2009	1.8%	24	458,000	2015	2.9%	20	469,000
2010	3.1%	38	401,000	2016	2.3%	16	262,000
2011	2.3%	21	336,000	2017	4.9%	27	674,000
2012	4.0%	35	563,000	2018	4.3%	33	505,000
2013	4.3%	32	687,000	Thereafter	64.4%	601	5,233,000

(1) Based on annualized base rent for all leases in place as of December 31, 2007.

(2) Approximate square feet.

The following table summarizes the diversification of trade of NNN s Investment Portfolio based on the top 10 lines of trade:

		% of Annual Base Rent[1]		
	Top 10 Lines of Trade	2007	2006	2005
1.	Convenience Stores	23.9%	16.3%	12.1%
2.	Restaurants Full Service	10.3%	12.1%	6.6%
3.	Drug Stores	5.0%	8.3%	10.0%
4.	Automotive Parts	4.9%	1.6%	0.1%
5.	Books	4.4%	5.7%	5.8%
6.	Consumer Electronics	4.3%	5.6%	5.9%
7.	Theaters	4.2%	-	-
8.	Car Washes	4.0%	-	-
9.	Sporting Goods	3.9%	7.3%	7.4%
10.	Restaurants Limited Service	3.7%	4.7%	3.0%
	Other	31.4%	38.4%	49.1%
		100.0%	100.0%	100.0%

(1) Based on annualized base rent for all leases in place as of December 31, of the respective year.

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The following table summarizes the diversification by state of NNN s Investment Portfolio as of December 31, 2007:

	State	# of Properties	% of Annual Base Rent[(1)]
1.	Texas	201	20.2%
2.	Florida	84	11.3%
3.	North Carolina	62	6.8%
4.	Illinois	38	6.6%
5.	Georgia	48	5.3%
6.	Pennsylvania	80	4.7%
7.	Indiana	36	3.7%
8.	Colorado	15	3.4%
9.	Ohio	28	3.4%
10.	Missouri	19	3.0%
	Other	297	31.6%
		908	100.0%

(1) Based on annualized base rent for all leases in place as of December 31, 2007.

Mortgages and Notes Receivable

As of December 31, 2007 and 2006, NNN held mortgages and notes receivables with an aggregate principal balance of $51,556,000 and $17,227,000, respectively. The mortgages and notes receivables bear interest rates ranging from 7.00% to 12.00% with maturity dates ranging from May 2008 through October 2028.

Structured finance agreements are typically loans secured by a borrower s pledge of its ownership interest in the entity that owns or leases the real estate and/or other acceptable collateral such as fixtures, equipment or cash. These agreements are sometimes subordinated to senior loans secured by first mortgages encumbering the underlying real estate. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans.

In 2007 and 2006, NNN made structured finance investments of $12,376,000 and $16,477,000, respectively. As of December 31, 2007, the structured finance investments bear a weighted average interest rate of 11.26% per annum, of which 9.78% is payable monthly and the remaining 1.48% accrues and is due at maturity. The principal balance of each structured finance investment is due in full at maturity, which ranges between January 2009 and March 2010. The structured finance investments are secured by the borrowers pledge of their respective membership interests in the entities which own the respective real estate. As of December 31, 2007 and 2006, the outstanding principal balance of the structured finance investments was $14,359,000 and $13,917,000, respectively.

Commercial Mortgage Residual Interests

Orange Avenue Mortgage Investments, Inc. (OAMI), a majority owned and consolidated subsidiary of NNN, holds the residual interests (Residuals) from seven commercial real estate loan securitizations. Each of the Residuals is reported at fair value based upon an independent valuation; unrealized gains or losses are reported as other comprehensive income in stockholders equity, and other than temporary losses as a result of a change in timing or amount of estimated cash flows are recorded as an other than temporary valuation impairment. The Residuals had an estimated fair value of $24,340,000 at December 31, 2007.

Inventory Assets

The TRS develops Inventory Properties (Development Properties or Development Portfolio) as well as acquires existing Inventory Properties (Exchange Properties or Exchange Portfolio). NNN's Inventory Portfolio is held with the intent to sell the properties to purchasers who are looking for replacement like-kind exchange property or to other purchasers with different investment objectives. As of December 31, 2007, the TRS owned 23 Development Properties (eight completed, nine under construction and six land parcels) and 33 Exchange Properties. Reference is made to the Schedule of Real Estate and Accumulated Depreciation and Amortization filed with this report for a listing of the Inventory Properties and their respective carrying costs.

The following table summarizes the eight completed Development Properties and 33 Exchange Properties as of December 31, 2007 (in thousands):

	Size[1]			Cost[2]		
	High	Low	Average	High	Low	Average
Completed Development Properties:						
Land	1,255	47	378	$ 8,959	$ 244	$ 172
Building	125	8	34	37,007	1,635	9,212
Exchange Properties:						
Land	294	11	64	$ 3,665	$ 121	$ 1,403
Building	47	2	15	4,785	184	2,033

(1) Approximate square feet.

(2) Costs vary depending upon size and local demographic factors.

Under Construction. In connection with the development of nine Inventory Properties by the TRS, NNN has agreed to fund total construction commitments (including land costs) of $24,097,000, of which $17,125,000 has been funded as of December 31, 2007.

Governmental Regulations Affecting Properties

Property Environmental Considerations. NNN may acquire a property that contains some level of contamination or potential contamination exists, subject to a determination of the level of risk and potential cost of remediation. Investments in real property create a potential for substantial environmental liability on the part of the owner of such property from the presence or discharge of hazardous substances on the property, regardless of fault. As a part of its acquisition due diligence process, NNN generally obtains an environmental site assessment for each property. In such cases where NNN intends to acquire real estate where contamination or potential contamination exists, NNN generally requires the seller or tenant to (i) remediate the problem, (ii) indemnify NNN for environmental liabilities, or (iii) agree to other arrangements deemed appropriate by NNN to address environmental conditions at the property.

NNN has 70 Investment Properties currently under some level of environmental remediation. In general, the seller, the tenant or an adjacent land owner is responsible for the cost of the environmental remediation for each of these Investment Properties.

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Americans with Disabilities Act of 1990. The Investment and Inventory Properties, as commercial facilities, are required to comply with Title III of the Americans with Disabilities Act of 1990 (the ADA). Investigation of a property may reveal non-compliance with the ADA. The tenants will typically have primary responsibility for complying with the ADA, but NNN may incur costs if the tenant does not comply. As of February 15, 2008, NNN has not been notified by any governmental authority of, nor is NNN s management aware of, any non-compliance with the ADA that NNN s management believes would have a material adverse effect on its business, financial condition or results of operations.

Other Regulations. State and local fire, life-safety and similar requirements regulate the use of NNN s Investment and Inventory Properties. The leases generally require that each tenant will have primary responsibility for complying with regulations, but failure to comply could result in fines by governmental authorities, awards of damages to private litigants, or restrictions on the ability to conduct business on such properties.

Item 1A. Risk Factors.

Carefully consider the following risks and all of the other information set forth in this Annual Report on Form 10-K, including the consolidated financial statements and the notes thereto. If any of the events or developments described below were actually to occur, NNN s business, financial condition or results of operations could be adversely affected.

Loss of revenues from tenants would reduce NNN s cash flow.

NNN s five largest tenants accounted for an aggregate of approximately 25 percent of NNN s annual base rent as of December 31, 2007. The default, financial distress or bankruptcy of one or more of NNN s tenants could cause substantial vacancies among NNN s Investment Portfolio. Vacancies reduce NNN s revenues until NNN is able to re-lease the affected properties and could decrease the ultimate sale value of each such vacant property. Upon the expiration of the leases that are currently in place, NNN may not be able to re-lease a vacant property at a comparable lease rate or without incurring additional expenditures in connection with such re-leasing.

A significant portion of the source of NNN s annual base rent is heavily concentrated in a specific industry classification and in specific geographic locations.

As of December 31, 2007, an aggregate of approximately 38 percent of NNN s annual base rent is generated from two retail lines of trade, convenience stores and restaurants, each representing more than 10 percent. In addition, as of December 31, 2007, an aggregate of approximately 32 percent of NNN s annual base rent is generated from properties in Texas and Florida, each representing more than 10 percent. Any financial hardship and/or changes in these industries or states could have an adverse effect on NNN s financial results.

There are a number of risks inherent in owning real estate and indirect interests in real estate.

NNN s economic performance and the value of its real estate assets are subject to the risk that if NNN s properties do not generate revenues sufficient to meet its operating expenses, including debt service, NNN s cash flow and ability to pay distributions to its shareholders will be adversely affected. As a real estate company, NNN is susceptible to the following real estate industry risks, which are beyond its control:

- changes in national, regional and local economic conditions and outlook,

- decreases in consumer spending and retail sales,

- economic downturns in the areas where NNN s properties are located,
- adverse changes in local real estate market conditions, such as an oversupply, reduction in demand or intense competition for tenants,
- changes in tenant preferences that reduce the attractiveness of NNN s properties to tenants,
- zoning, regulatory restrictions, or change in taxes, and
- changes in interest rates or availability of financing.

All of these factors could result in decreases in market rental rates and increases in vacancy rates, which could adversely affect NNN s results of operations.

NNN s real estate investments are illiquid.

Because real estate investments are relatively illiquid, NNN s ability to adjust the portfolio promptly in response to economic or other conditions is limited. Certain significant expenditures generally do not change in response to economic or other conditions, including: (i) debt service (if any), (ii) real estate taxes, and (iii) operating and maintenance costs. This combination of variable revenue and relatively fixed expenditures may result, under certain market conditions, in reduced income from investment. Such reduction in investment income could have an adverse effect on NNN s financial condition.

NNN may be subject to known or unknown environmental liabilities.

NNN may acquire a property that contains some level of contamination or potential contamination exists, subject to a determination of the level of risk and potential cost of remediation. Investments in real property create a potential for substantial environmental liability on the part of the owner of such property from the presence or discharge of hazardous substances on the property, regardless of fault. It is NNN's policy, as a part of its acquisition due diligence process, generally to obtain an environmental site assessment for each property. In such cases that NNN intends to acquire real estate where contamination or potential contamination exists, NNN generally requires the seller or tenant to (i) remediate the problem, (ii) indemnify NNN for environmental liabilities, or (iii) agree to other arrangements deemed appropriate by NNN to address environmental conditions at the property.

NNN has 70 Investment Properties currently under some level of environmental remediation. In general, the seller, the tenant or an adjacent land owner is responsible for the cost of the environmental remediation for each of these Investment Properties. In the event of a bankruptcy or other inability on the part of these parties to cover these costs, NNN may have to cover the costs of remediation, fines or other environmental liabilities at these and other properties. NNN may also own properties where required remediation has not begun or adverse environmental conditions have not yet been detected. This may require remediation or otherwise subject NNN to liability. NNN cannot assure that (i) it will not be required to undertake or pay for removal or remediation of any contamination of the properties currently or previously owned by NNN, (ii) NNN will not be subject to fines by governmental authorities or litigation, or (iii) the costs of such removal, remediation fines or litigation would not be material.

NNN may not be able to successfully execute its acquisition or development strategies.

NNN cannot assure that it will be able to implement its investment strategies successfully. Additionally, NNN cannot assure that its property portfolio will expand at all, or if it will expand at any specified rate or to any specified size. In addition, investment in additional real estate assets is subject to a number of risks. Because NNN expects to invest in markets other than the ones in which its current properties are located or properties which may be leased to tenants other than those to which

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NNN has historically leased properties, NNN will also be subject to the risks associated with investment in new markets or with new tenants that may be relatively unfamiliar to NNN s management team.

NNN s development activities are subject to without limitation, risks relating to the availability and timely receipt of zoning and other regulatory approvals, the cost and timely completion of construction (including risks from factors beyond NNN s control, such as weather or labor conditions or material shortages), the risk of finding tenants for the properties and the ability to obtain both construction and permanent financing on favorable terms. These risks could result in substantial unanticipated delays or expenses and, under certain circumstances, could prevent completion of development activities once undertaken or provide a tenant the opportunity to terminate a lease. Any of these situations may delay or eliminate proceeds or cash flows NNN expects from these projects, which could have an adverse effect on NNN s financial condition.

NNN may not be able to dispose of properties consistent with its operating strategy.

NNN may be unable to sell properties targeted for disposition (including its Inventory Properties) due to adverse market conditions. This may adversely affect, among other things, NNN s ability to sell under favorable terms, execute its operating strategy, achieve target earnings or returns, retire debt or pay dividends.

A change in the assumptions used to determine the value of commercial mortgage residual interests could adversely affect NNN s financial position.

As of December 31, 2007, the Residuals had a carrying value of $24,340,000. The value of these Residuals is based on discount rate, loan loss, prepayment speed and interest rate assumptions made by NNN to determine their value. If actual experience differs materially from these assumptions, the actual future cash flow could be less than expected and the value of the Residuals, as well as NNN s earnings, could decline.

NNN may suffer a loss in the event of a default or bankruptcy of a borrower.

If a borrower defaults on a mortgage, structured finance loan or other loan made by NNN, and does not have sufficient assets to satisfy the loan, NNN may suffer a loss of principal and interest. In the event of the bankruptcy of a borrower, NNN may not be able to recover against all of the assets of the borrower, or the assets of the borrower may not be sufficient to satisfy the balance due on the loan. In addition, certain of NNN s loans may be subordinate to other debt of a borrower. These investments are typically loans secured by a borrower s pledge of its ownership interests in the entity that owns the real estate or other assets. These agreements are typically subordinated to senior loans secured by other loans encumbering the underlying real estate or assets. Subordinated positions are generally subject to a higher risk of nonpayment of principal and interest than the more senior loans. As of December 31, 2007, mortgages and notes receivables had an outstanding principal balance of $51,556,000 and the structured finance investments had an outstanding principal balance of $