NATIONAL RETAIL PROPERTIES, INC.
Form 10-K
February 21, 2007
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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, 2006

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	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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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, 2006 was $1,144,188,520.

The number of shares of common stock outstanding as of February 14, 2007 was 60,272,926.

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DOCUMENTS INCORPORATED BY REFERENCE:

Registrant incorporates by reference portions of the National Retail Properties, Inc. Proxy Statement for the 2007 Annual Meeting of Stockholders (Items 10, 11, 12, 13 and 14 of Part III).

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PART I

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 the Company uses any of the words anticipate, assume, believe, estimate, expect, intend, or similar expressions, t Company is making forward-looking statements. Although management believes that the expectations reflected in such forward-looking statements are based upon present expectations and reasonable assumptions, the Company 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 the Company 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. The Company 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

National Retail Properties, Inc. (formerly known as Commercial Net Lease Realty, Inc.), a Maryland corporation, is a fully integrated real estate investment trust (REIT) formed in 1984. The terms Registrant or Company refer to National Retail Properties, Inc. and its majority owned and controlled subsidiaries. These subsidiaries include the wholly owned qualified REIT subsidiaries of National Retail Properties, Inc., as well as the taxable REIT subsidiaries and their majority owned and controlled subsidiaries (the NNN TRS). Effective May 1, 2006, Commercial Net Lease Realty, Inc. changed its name to National Retail Properties, Inc.

The Company s operations are divided into two primary business segments: (i) investment assets, including real estate assets, structured finance investments (included in mortgages and notes receivable on the consolidated balance sheets) and mortgage residual interests (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 qualified REIT subsidiaries. The Inventory Assets are operated through the NNN TRS.

Real Estate Assets

The Company 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, 2006, the Company owned 710 Investment Properties, with an aggregate leasable area of 9,341,000 square feet, located in 44 states. Approximately 98 percent of the Company s Investment Portfolio was leased at December 31, 2006. The NNN TRS, directly and indirectly, through investment interests, owns real estate primarily for the purpose of selling the real estate (Inventory Properties or Inventory Portfolio). As of December 31, 2006, the NNN TRS owned 97 Inventory Properties.

Structured Finance Investments

Structured finance agreements (included in mortgages, notes and accrued interest receivable on the consolidated balance sheets) are typically loans secured by a borrower s pledge of ownership interests in the entity that owns the real estate. These agreements are typically 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, 2006, the structured finance agreements had an outstanding principal balance of $13,917,000.

Mortgage Residual Interests

Orange Avenue Mortgage Investments, Inc. (OAMI), a majority owned and consolidated subsidiary of the Company, holds the mortgage residual interests (Residuals) from seven commercial real estate loan securitizations. Each of the Residuals is reported at its market value based upon a third party valuation, with unrealized gains and losses reported as other comprehensive income in stockholders equity. Losses that are considered other than temporary are reported through earnings. The Residuals had an estimated fair value of $31,512,000 at December 31, 2006.

NNN TRS

Prior to January 1, 2005, the Company held a 98.7 percent, non-controlling and non-voting interest in Commercial Net Lease Realty Services, Inc. and its majority owned and controlled subsidiaries (collectively, Services). Kevin B. Habicht, an officer and director of the Company, James M. Seneff, Jr. and Gary M. Ralston, each a former officer and director of the Company, (collectively, the Services Investors), owned the remaining 1.3 percent interest, which represented 100 percent of the voting interest in Services. Effective January 1, 2005, the Company acquired the remaining 1.3 percent interest in Services, increasing the Company s ownership in Services to 100 percent. Effective November 1, 2005, Commercial Net Lease Realty Services, Inc. merged into National Retail Properties, Inc. CNLRS Exchange I, Inc., a taxable REIT subsidiary (TRS), became the TRS holding company for the Company s development and exchange activities. Effective October 2, 2006, CNLRS Exchange I, Inc. changed its name to NNN TRS, Inc.

Competition

The Company 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 December 31, 2006, the Company employed 68 full-time associates including executive and administrative personnel.

The Company s executive offices are located at 450 S. Orange Avenue, Suite 900, Orlando, Florida 32801, and its telephone number is (407) 265-7348. The Company has an Internet website at www.nnnreit.com where the Company s filings with the Securities and Exchange Commission can be downloaded free of charge.

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Business Strategies and Policies

The following is a discussion of the Company 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 the Company s stockholders.

Operating Strategies

The Company 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 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.

In some cases, the Company s investment in real estate is in the form of structured finance investments, which are typically loans secured by a borrower s pledge of ownership interests in the entity that owns the real estate. These agreements are typically 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.

Additionally, the Company may provide mortgage loans which are typically secured by a specific real estate asset owned by the borrower.

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

The Company acquires and develops inventory real estate assets primarily for the purpose of resale.

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

Investment in Real Estate or Interests in Real Estate

The Company s management believes that attractive acquisition opportunities for retail properties will continue to be available and that the Company is suited to take advantage of these opportunities because of its access to capital markets, ability to underwrite and acquire properties, either for cash or securities, 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 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;

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- 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 fit of the property with the Company 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;
- the financial and other characteristics of the existing tenant;
- the tenant s business plan, operating history and management team;
- the tenant s industry; and
- the terms of any existing leases.

The Company 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 the Company 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, Mortgage Residual Interests, and Securities of or Interests in Persons Engaged in Real Estate Activities

While the Company s current portfolio of, and its business objectives primarily emphasize, equity investments in retail properties, the Company may invest in (i) a wide variety of retail properties or other property and tenant types, (ii) mortgages, participating or convertible mortgages, deeds of trust, mortgage residual interests and other types of real estate interests, or (iii) 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, the Company from time to time has made investments in mortgage loans or held mortgages on properties the Company sold and has made structured finance investments (as discussed above), which are typically loans secured by a pledge of ownership interests in the borrowers (or their subsidiaries) that own the underlying real estate.

Financing Strategy

The Company 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. The Company 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.

The Company typically funds its short-term liquidity requirements including investments in additional retail properties with cash from its $300,000,000 unsecured revolving credit facility (Credit Facility). As of December 31, 2006, $28,000,000 was outstanding and approximately $272,000,000 was available for future borrowings under the Credit Facility, excluding undrawn letters of credit totaling $5,159,000.

For the year ended December 31, 2006, the Company s ratio of total indebtedness to total gross assets (before accumulated depreciation) was approximately 41 percent and the secured indebtedness to total gross assets was approximately three percent. The total debt to total market capitalization was approximately 35 percent. Certain financial agreements to which the Company is a party contain covenants that limit the Company s ability to incur debt under certain circumstances.

The Company 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 the Company.

The organizational documents of the Company do not limit the absolute amount or percentage of indebtedness that the Company may incur. Additionally, the Company may change its financing strategy at any time. The Company 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 the Company s strategies or policies described above may be changed at any time by the Company without notice to or a vote of the Company s stockholders.

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, the Company s business, financial condition or results of operations could be adversely affected.

Loss of revenues from tenants would reduce the Company s cash flow.

The Company s five largest tenants accounted for an aggregate of approximately 23 percent of the Company s annual base rent as of December 31, 2006. The default, financial distress or bankruptcy of one or more of the Company s tenants could cause substantial vacancies among the Company s Investment Portfolio. Vacancies reduce the Company s revenues until the Company 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, the Company 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 the Company s annual base rent is heavily concentrated in a specific industry classification and in specific geographic locations.

As of December 31, 2006, an aggregate of approximately 33 percent of the Company 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, 2006, an aggregate of approximately 36 percent of the Company 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 the Company s financial results.

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

Factors beyond the Company s control affect the Company s performance and value. Changes in national, regional and local economic and market conditions may affect the Company s economic performance and the value of the Company s real estate assets. Local real estate market conditions may include excess supply and intense competition for tenants, including competition based on rental rates and attractiveness and location of the property.

In addition, other factors may adversely affect the performance and value of the Company s properties, including (i) changes in laws and governmental regulations, including those governing usage, zoning and taxes; (ii) changes in interest rates; and (iii) the availability of financing.

The Company s real estate investments are illiquid.

Because real estate investments are relatively illiquid, the Company 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 the Company s financial condition.

The Company may be subject to unknown environmental liabilities.

The Company 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 the Company 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 the Company intends to acquire real estate where contamination or potential contamination exists, the Company generally requires the seller or tenant to (i) remediate the problem, (ii) indemnify the Company for environmental liabilities, or (iii) agree to other arrangements deemed appropriate by the Company to address environmental conditions at the property.

The Company has 25 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, the Company may have to cover the costs of remediation, fines or other environmental liabilities at these and other properties. The Company 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 the Company to liability. The Company 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 the Company, (ii) the Company 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.

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

The Company cannot assure that it will be able to implement its investment strategies successfully. Additionally, the Company 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 the Company expects to invest in markets other than the ones in which its current properties are located or which may be leased to tenants other than those to which the Company has historically leased properties, the Company will also be subject to the risks associated with investment in new markets or with new tenants that may be relatively unfamiliar to the Company s management team.

The Company 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 the Company 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 delay or eliminate proceeds or cash flows the Company expects from these projects, which could have an adverse effect on the Company s financial condition.

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

The Company may be unable to sell properties targeted for disposition (including its Inventory Properties) at a profit if interest rates increase, or adverse market conditions exist, thereby, rendering the Company unable to sell these properties.

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

As of December 31, 2006, the Residuals had a carrying value of $31,512,000. The value of these Residuals is based on delinquency, loan loss, prepayment and interest rate assumptions made by the Company 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 the Company s earnings, could decline.

The Company may suffer a loss in the event of a default or bankruptcy of a structured finance loan borrower.

If a borrower defaults on a structured finance loan and does not have sufficient assets to satisfy the loan, the Company may suffer a loss of principal and interest. In the event of the bankruptcy of a borrower, the Company 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 the Company s loans may be subordinate to other debt of a borrower. The structured finance agreements are typically loans secured by a borrower s pledge of its ownership interests in the entity that owns the real estate. These agreements are typically 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, 2006, the structured finance investments had an outstanding principal balance of $13,917,000. If a borrower defaults on the debt senior to the Company s loan, or in the event of the bankruptcy of a borrower, the Company s loan will be satisfied only after the borrower s senior creditors claims are satisfied. Where debt senior to the Company s loans exists, the presence of intercreditor arrangements may limit the Company s ability to amend loan documents, assign the loans, accept prepayments, exercise remedies and control decisions made in bankruptcy proceedings relating to borrowers.

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Bankruptcy proceedings and litigation can significantly increase the time needed for the Company to acquire underlying collateral in the event of a default, during which time the collateral may decline in value. In addition, there are significant costs and delays associated with the foreclosure process.

Certain provisions of the leases or structured finance loan agreements may be unenforceable.

The Company s rights and obligations with respect to its leases or structured finance loans are governed by written agreements. A court could determine that one or more provisions of an agreement are unenforceable, such as a particular remedy, a loan prepayment provision or a provision governing the Company s security interest in the underlying collateral of a borrower. The Company could be adversely impacted if this were to happen with respect to an asset or group of assets.

Property ownership through joint ventures and partnerships could limit the Company s control of those investments.

Joint ventures or partnerships involve risks not otherwise present for direct investments by the Company. It is possible that the Company s co-venturers or partners may have different interests or goals than the Company at any time and they may take actions contrary to the Company s requests, policies or objectives, including the Company s policy with respect to maintaining its qualification as a REIT. Other risks of joint venture investments include impasses on decisions, because no single co-venturer or partner has full control over the joint venture or partnership.

Competition with numerous other REITs, commercial developers, real estate limited partnerships and other investors may impede the Company s ability to grow.

The Company may not be in a position or have the opportunity in the future to make suitable property acquisitions on advantageous terms due to competition for such properties with others engaged in real estate investment activities. The Company s inability to successfully acquire new properties may affect the Company s ability to achieve anticipated return on investment, which could have an adverse effect on its results of operations.

Uninsured losses may adversely affect the Company s ability to pay outstanding indebtedness.

The Company s properties are generally covered by comprehensive liability, fire, flood, extended coverage and business interruption insurance. The Company believes that the insurance carried on its properties is adequate in accordance with industry standards. There are, however, types of losses (such as from hurricanes, wars or earthquakes) which may be uninsurable, or the cost of insuring against these losses may not be economically justifiable. If an uninsured loss occurs, the Company could lose both the invested capital in and anticipated revenues from the property. In that event, the Company s cash flow could be reduced.

Terrorist attacks, such as the attacks that occurred in New York City and Washington, D.C., on September 11, 2001, and other acts of violence or war may affect the markets in which the Company operates and the Company s results of operations.

Terrorist attacks may negatively affect the Company s operations. There can be no assurance that there will not be further terrorist attacks against the United States or United States businesses. These attacks may directly impact the Company s physical facilities or the businesses of the Company s tenants.

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Also, the United States has been engaged in armed conflict, which could have an impact on the Company s tenants. The consequences of armed conflict are unpredictable, and the Company may not be able to foresee events that could have an adverse effect on its business.

More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the United States and worldwide financial markets and economies. They also could result in, or cause a deepening of, economic recession in the United States or abroad. Any of these occurrences could have a significant adverse impact on the Company s financial condition or results of operations.

Vacant properties or bankrupt tenants could adversely affect the Company.

As of December 31, 2006, the Company owned nine vacant, unleased Investment Properties, which accounted for approximately two percent of the total gross leasable area of the Company s Investment Portfolio and four unleased land parcels. The Company is actively marketing these properties for sale or lease but may not be able to sell or lease these properties on favorable terms or at all. The lost revenues and increased property expenses resulting from the rejection by any bankrupt tenant of any of their respective leases with the Company could have a material adverse effect on the liquidity and results of operations of the Company if the Company is unable to re-lease the Investment Properties at comparable rental rates and in a timely manner. Less than one percent of the total gross leasable area of the Company s Investment Portfolio is leased to one tenant that has filed a voluntary petition for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. As a result, the tenant has the right to reject or affirm its lease with the Company.

The amount of debt the Company has and the restrictions imposed by that debt could adversely affect the Company s business and financial condition.

As of December 31, 2006, the Company had total mortgage debt and secured notes payable outstanding of approximately $60,392,000, total unsecured notes payable of $662,304,000 and $28,000,000 outstanding on the Credit Facility. The Company s organizational documents do not limit the level or amount of debt that it may incur. If the Company incurs additional indebtedness and permits a higher degree of leverage, debt service requirements would increase and could adversely affect the Company s financial condition and results of operations, as well as the Company s ability to pay principal and interest on the outstanding indebtedness or dividends to its stockholders. In addition, increased leverage could increase the risk that the Company may default on its debt obligations. The Credit Facility contains financial covenants that could limit the amount of distributions to the Company s common and preferred stockholders.

The amount of debt outstanding at any time could have important consequences to the Company s stockholders. For example, it could:

- require the Company to dedicate a substantial portion of its cash flow from operations to payments on Company debt, thereby reducing funds available for operations, real estate investments and other appropriate business opportunities that may arise in the future;
- limit the Company s ability to obtain any additional financing it may need in the future for working capital, debt refinancing, capital expenditures, real estate investments, development or other general corporate purposes;
- make it difficult to satisfy the Company s debt service requirements;

- limit the Company s ability to pay dividends on its outstanding common and preferred stock;
- require the Company to dedicate increased amounts of cash flow from operations to payments on its variable rate, unhedged debt if interest rates rise;
- limit the Company s flexibility in planning for, or reacting to, changes in its business and the factors that affect the profitability of its business; and
- limit the Company s flexibility in conducting its business, which may place the Company at a disadvantage compared to competitors with less debt or debt with less restrictive terms.

The Company s ability to make scheduled payments of principal or interest on its debt, or to refinance such debt will depend primarily on its future performance, which to a certain extent is subject to the creditworthiness of its tenants, competition, as well as economic, financial, and other factors beyond its control. There can be no assurance that the Company s business will continue to generate sufficient cash flow from operations in the future to service its debt or meet its other cash needs. If the Company is unable to generate this cash flow from its business, it may be required to refinance all or a portion of its existing debt, sell assets or obtain additional financing to meet its debt obligations and other cash needs.

The Company cannot assure you that any such refinancing, sale of assets or additional financing would be possible on terms and conditions, including but not limited to the interest rate, which the Company would find acceptable.

The Company is obligated to comply with financial and other covenants in its debt that could restrict its operating activities, and the failure to comply with such covenants could result in defaults that accelerate the payment under its debt.

The Company s unsecured debt contains various restrictive covenants which include, among others, provisions restricting the Company s ability to:

- incur or guarantee additional debt;
- make certain distributions, investments and other restricted payments, including dividend payments on its outstanding common and preferred stock;
- limit the ability of restricted subsidiaries to make payments to the Company;
- enter into transactions with certain affiliates;
- create certain liens; and
- consolidate, merge or sell the Company s assets.

The Company s secured debt generally contains customary covenants, including, among others, provisions:

- relating to the maintenance of the property securing the debt;

restricting its ability to sell, assign or further encumber the properties securing the debt;

restricting its ability to incur additional debt;

restricting its ability to amend or modify existing leases; and

relating to certain prepayment restrictions.

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The Company s ability to meet some of the covenants in its debt, including covenants related to the condition of the property or payment of real estate taxes, may be dependent on the performance by the Company s tenants under their leases.

In addition, certain covenants in the Company s debt, including its Credit Facility, require the Company and its subsidiaries, among other things, to:

- maintain certain maximum leverage ratios;
- maintain certain minimum interest and debt service coverage ratios;
- limit dividends declared and paid to the Company s common and preferred stockholders; and
- limit investments in certain types of assets.

The Company s failure to qualify as a real estate investment trust for federal income tax purposes could result in significant tax liability.

The Company intends to operate in a manner that will allow the Company to continue to qualify as a real estate investment trust (REIT). The Company believes it has been organized as, and its past and present operations qualify the Company as a REIT. However, the IRS could successfully assert that the Company is not qualified as such. In addition, the Company may not remain qualified as a REIT in the future. Qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which there are only limited judicial or administrative interpretations and involves the determination of various factual matters and circumstances not entirely within the Company s control.

If the Company fails to qualify as a REIT, it would not be allowed a deduction for dividends paid to stockholders in computing taxable income and would become subject to federal income tax at regular corporate rates. In this event, the Company could be subject to potentially significant tax liabilities. Unless entitled to relief under certain statutory provisions, the Company would also be disqualified from treatment as a REIT for the four taxable years following the year during which the qualification was lost. Even if the Company maintains its REIT status, the Company may be subject to certain federal, state and local taxes on its income and property.

Compliance with REIT requirements, including distribution requirements, may limit the Company s flexibility and negatively affect the Company s operating decisions.

To maintain its status as a REIT for U.S. federal income tax purposes, the Company must meet certain requirements, on an on-going basis, including requirements regarding its sources of income, the nature and diversification of its assets, the amounts the Company distributes to its stockholders and the ownership of its shares. The Company may also be required to make distributions to its stockholders when it does not have funds readily available for distribution or at times when the Company s funds are otherwise needed to fund capital expenditures or to fund debt service requirements. The Company generally will not be subject to federal income taxes on amounts distributed to stockholders, providing it distributes 100 percent of its REIT taxable income and meets certain other requirements for qualifying as a REIT. For each of the years in the three-year period ended December 31, 2006, the Company believes it has qualified as a REIT. Notwithstanding the Company s qualification for taxation as a REIT, the Company is subject to certain state taxes on its income and real estate.

Item 1B. Unresolved Staff Comments.

None.

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Item 2. Properties

Investment Properties

As of December 31, 2006, the Company owned 710 Investment Properties with an aggregate gross leasable area of 9,341,000 square feet, located in 44 states. Approximately 98 percent of the gross leasable area was leased at December 31, 2006. Reference is made to the Schedule of Real Estate and Accumulated Depreciation and Amortization filed with this report for a listing of the Company s Investment Properties and their respective carrying costs.

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

The following table summarizes the Company s Investment Properties as of December 31, 2006 (dollars in thousands):

	Size [1]			Cost [2]		
	High	Low	Average	High	Low	Average
Land	2,223,000	7,000	112,000	$ 10,197	$ 25	$ 1,001
Building	135,000	1,000	14,000	13,877	44	1,352

[1] Approximate square feet.
[2] Costs vary depending upon size and local demographic factors.

In connection with the development of 11 Investment Properties, the Company has agreed to fund construction commitments (including land costs) of $35,020,000, of which $17,845,000 has been funded as of December 31, 2006.

Leases. Although there are variations in the specific terms of the leases, the following is a summary of the general structure of the Company s leases. Generally, the leases of the Investment Properties owned by the Company provide for initial terms of 10 to 20 years. As of December 31, 2006, the weighted average remaining lease term was approximately 12 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 the Company 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 $1,635,000 (average of $210,000). 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.

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 the Company wishes to sell the Investment Property subject to that lease, the Company first must offer the lessee the right to purchase the Investment Property on the same terms and conditions as any offer which the Company intends to accept for the sale of the Investment Property.

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

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The following table summarizes the lease expirations of the Company s Investment Portfolio as of December 31, 2006 (dollars in thousands):

	% of Total[1]	# of Properties	Gross Leasable Area[2]		% of Total[1]	# of Properties	Gross Leasable Area[2]
2007	1.2%	13	206,000	2013	5.6%	30	690,000
2008	1.8%	22	406,000	2014	7.3%	39	591,000
2009	2.6%	25	490,000	2015	4.6%	22	621,000
2010	3.9%	36	383,000	2016	4.2%	22	508,000
2011	3.8%	23	439,000	2017	7.2%	28	808,000
2012	4.6%	30	531,000	Thereafter	53.2%	407	3,500,000

(1) Based on annualized base rent for all leases in place as of December 31, 2006.
(2) Approximate square feet.

The following table summarizes the diversification of trade of the Company s Investment Portfolio based on the top 10 lines of trade as of December 31, 2006 (dollars in thousands):

	Top 10 Lines of Trade	2006[1]	2005[1]	2004[1]
1.	Convenience Stores	16.3%	12.1%	0.7%
2.	Restaurants Full Service	12.1%	6.6%	6.7%
3.	Drug Stores	8.3%	10.0%	11.5%
4.	Sporting Goods	7.3%	7.4%	7.8%
5.	Books	5.7%	5.8%	6.9%
6.	Grocery	5.7%	6.3%	7.7%
7.	Consumer Electronics	5.6%	5.9%	7.1%
8.	Restaurants Limited Service	4.7%	3.0%	3.1%
9.	Furniture	4.2%	4.7%	5.0%
10.	Office Supplies	4.1%	4.4%	5.2%
	Other	26.0%	33.8%	38.3%
		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.

The following table summarizes the diversification by state of the Company s Investment Portfolio as of December 31, 2006:

State	# of Properties	% of Annual Base Rent[1]
1. Texas	149	22.2%
2. Florida	77	13.4%
3. Pennsylvania	77	5.4%
4. Georgia	37	5.1%

5.	Virginia	19	3.9%
6.	California	18	3.7%
7.	Tennessee	19	3.5%
8.	Illinois	22	3.4%
9.	Missouri	14	3.3%
10.	Ohio	23	3.0%
	Other	255	33.1%
		710	100.0%

(1) Based on annualized base rent for all leases in place as of December 31, 2006.

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Structured Finance Investments

Structured finance agreements (included in mortgages, notes and accrued interest receivable on the consolidated balance sheets) are typically loans secured by a borrower s pledge of its ownership interest in the entity that owns the real estate. These agreements are typically 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 2006 and 2005, the Company made structured finance investments of $16,477,000 and $5,988,000, respectively. As of December 31, 2006, the structured finance investments bear a weighted average interest rate of 13.3% per annum, of which 10.1% is payable monthly and the remaining 3.2% accrues and is due at maturity. The principal balance of each structured finance investment is due in full at maturity, which range between November 2007 and January 2009. The structured finance investments are secured by the borrowers pledge of their respective membership interests in the subsidiaries which own the respective real estate. As of December 31, 2006 and 2005, the outstanding principal balance of the structured finance investments was $13,917,000 and $27,805,000, respectively.

Mortgage Residual Interests

OAMI, a majority owned and consolidated subsidiary of the Company holds the residual interests from seven commercial real estate loan securitizations. Each of the Residuals is recorded at fair value based upon a third party valuation, with adjustments subsequent to the initial acquisition of the Company s interest in OAMI recorded through earnings. The Residuals had a fair value of $31,512,000 at December 31, 2006.

Inventory Assets

The NNN TRS develops Inventory Properties (Development Properties or Development Portfolio) as well as acquires existing Inventory Properties (Exchange Properties or Exchange Portfolio). The Company 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, 2006, NNN TRS owned 29 Development Properties (11 completed, five under construction and 13 land parcels) and 68 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 11 completed Development Properties and 68 Exchange Properties as of December 31, 2006 (dollars in thousands):

	Size [1]			Cost [2]		
	High	Low	Average	High	Low	Average
Completed Development Properties:						
Land	527,000	42,000	205,000	$ 6,149	$ 387	$ 1,598
Building	71,000	5,000	20,000	10,852	112	3,492
Exchange Properties:						
Land	396,000	8,000	45,000	2,927	59	606
Building	50,000	2,000	5,000	8,905	74	955

[1] Approximate square feet.

[2] Costs vary depending upon size and local demographic factors.

Under Construction. In connection with the development of five Inventory Properties by the NNN TRS, the Company has agreed to fund total construction commitments (including land costs) of $36,728,000, of which $27,263,000 has been funded as of December 31, 2006.

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Governmental Regulations Affecting Properties

Property Environmental Considerations. The Company 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 the Company 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 the Company intends to acquire real estate where contamination or potential contamination exists, the Company generally requires the seller or tenant to (i) remediate the problem, (ii) indemnify the Company for environmental liabilities, or (iii) agree to other arrangements deemed appropriate by the Company to address environmental conditions at the property.

The Company has 25 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.

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 the Company may incur costs if the tenant does not comply. As of February 15, 2007, the Company has not been notified by any governmental authority of, nor is the Company s management aware of, any non-compliance with the ADA that the Company 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 the Company 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 3. Legal Proceedings

In the ordinary course of its business, the Company is a party to various legal actions that management believes is routine in nature and incidental to the operation of the business of the Company. Management believes that the outcome of these proceedings will not have a material adverse effect upon its operations, financial condition or liquidity.

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

None.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of the Company currently is traded on the New York Stock Exchange (NYSE) under the symbol NNN. Set forth below is a line graph comparing the cumulative total stockholder return on the Company s common stock, based on the market price of the common stock and assuming reinvestment of dividends (NNN), with the FTSE National Association of Real Estate Investment Trusts Equity Index (NAREIT) and the S&P 500 Index (S&P 500) for the five year period commencing December 31, 2001 and ending December 31, 2006. The graph assumes the investment of $100 on December 31, 2001.

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For each calendar quarter indicated, the following table reflects respective high, low and closing sales prices for the common stock as quoted by the NYSE and the dividends paid per share in each such period.

2006	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
High	$ 23.540	23.370	$ 22.460	$ 24.100	$ 24.100
Low	20.220	18.810	19.820	21.250	18.810
Close	23.300	19.950	21.600	22.950	22.950
Dividends paid per share	0.325	0.325	0.335	0.335	1.320
2005					
High	$ 20.880	$ 20.990	$ 21.650	$ 20.970	$ 21.650
Low	18.000	18.300	18.530	18.060	18.000
Close	18.450	20.470	20.000	20.370	20.370
Dividends paid per share	0.325	0.325	0.325	0.325	1.300

The following presents the characterizations for tax purposes of such common stock dividends for the years ended December 31:

	2006		2005	
Ordinary dividends	$ 1.151	87.18%	$ 1.068	82.19%
Qualified dividends	-	-	0.225	17.27%
Capital gain	0.150	11.38%	-	-
Unrecaptured Section 1250 Gain	0.019	1.44%	0.002	0.17%
Nontaxable distributions	-	-	0.005	0.37%
	$ 1.320	100.00%	$ 1.300	100.00%

The Company intends to pay regular quarterly dividends to its stockholders, although all future distributions will be declared and paid at the discretion of the board of directors and will depend upon cash generated by operating activities, the Company s financial condition, capital requirements, annual distribution requirements under the REIT provisions of the Internal Revenue Code of 1986, as amended, and such other factors as the board of directors deems relevant.

In February 2007 the Company paid dividends to its stockholders of $20,115,000 or $0.335 per share of common stock.

On February 15, 2007, there were 1,526 stockholders of record of common stock.

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Item 6. Selected Financial Data

Historical Financial Highlights

(dollars in thousands, except per share data)

	2006	2005	2004	2003	2002
Gross revenues[1]	$ 180,876	$ 151,831	$ 133,875	$ 112,073	$ 102,067
Earnings from continuing operations	73,538	44,083	38,216	30,653	28,098
Net earnings	182,505	89,400	64,934	53,473	48,058
Total assets	1,916,785	1,733,416	1,300,048	1,213,778	958,300
Total debt	776,737	861,045	524,241	467,419	386,912
Total equity	1,096,505	828,087	756,998	730,754	549,141
Cash dividends declared to:					
Common stockholders	76,035	69,018	66,272	55,473	51,178
Series A Preferred Stock stockholders	4,376	4,008	4,008	4,008	4,010
Series B Convertible Preferred Stock stockholders	419	1,675	1,675	502	-
Series C Redeemable Preferred Stock stockholders	923	-	-	-	-
Weighted average common shares:					
Basic	57,428,063	52,984,821	51,312,434	43,108,213	40,383,405
Diluted	58,079,875	54,640,143	51,742,518	43,896,800	40,588,957
Per share information:					
Earnings from continuing operations:					
Basic	1.18	0.72	0.63	0.61	0.60
Diluted	1.17	0.73	0.63	0.61	0.59
Net earnings:					
Basic	3.08	1.58	1.15	1.14	1.09
Diluted	3.05	1.56	1.15	1.13	1.09
Dividends declared to:					
Common stockholders	1.32	1.30	1.29	1.28	1.27
Series A Preferred Stock stockholders	2.45625	2.25	2.25	2.25	2.25
Series B Convertible Preferred Stock stockholders	41.875	167.50	167.50	50.25	-
Series C Redeemable Preferred Stock depositary stockholders	0.250955	-	-	-	-
Other data:					
Cash flows provided by (used in):					
Operating activities	18,561	30,930	85,800	54,215	111,589
Investing activities	(106,984)	(242,487)	(69,963)	(256,870)	(15,142)
Financing activities	81,864	217,844	(19,225)	205,965	(101,654)
Funds from operations diluted[2]	97,121	81,803	73,065	61,749	54,595

(1) Gross revenues include revenues from the Company s continuing and discontinued operations. The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and broadens the presentation of discontinued operations in the income statement to include a component of an entity. Accordingly, the results of operations related to these certain properties that have been classified as held for sale or have been disposed of subsequent to December 31, 2001, the effective date of SFAS No. 144, have been reclassified as earnings from discontinued operations.

(2) The National Association of Real Estate Investment Trusts (NAREIT) developed FFO as a relative non-GAAP financial measure of performance of a REIT in order to recognize that income-producing real estate historically has

not depreciated on the basis determined under GAAP. FFO is defined by NAREIT and is used by the Company as follows: net earnings (computed in accordance with GAAP) plus depreciation and amortization of assets unique to the real estate industry, excluding gains (or including losses) on the disposition of real estate held for investment, and the Company s share of these items from the Company s unconsolidated partnerships.

FFO is generally considered by industry analysts to be the most appropriate measure of operating performance of real estate companies. FFO does not necessarily represent cash provided by operating activities in accordance with GAAP and should not be considered an alternative to net income as an indication of the Company s operating performance or to cash flow as a measure of liquidity or ability to make distributions. Management considers FFO an appropriate measure of operating performance of an equity REIT because it primarily excludes the assumption that the value of the real estate assets diminishes predictably over time, and because industry analysts have accepted it as an operating performance measure. The Company s computation of FFO may differ from the methodology for calculating FFO used by other equity REITs, and therefore, may not be comparable to such other REITs.

The Company has earnings from discontinued operations in each of its segments, investment assets and inventory assets, real estate held for investment and real estate held for sale. All property dispositions from the Company s investment segment are classified as discontinued operations. In addition, certain properties in the Company s inventory segment that have generated revenues before disposition are classified as discontinued operations. These inventory properties have not historically been classified as discontinued operations, therefore, prior period comparable consolidated financial statements have been restated to include these properties in its earnings from discontinued operations. These adjustments resulted in a decrease in the Company s reported total revenues and total and per share earnings from continuing operations and an increase in the Company s earnings from discontinued operations. However, the Company s total and per share net earnings available to common stockholders is not affected.

The following table reconciles FFO to their most directly comparable GAAP measure, net earnings for the years ended December 31:

	2006	2005	2004	2003	2002
Reconciliation of funds from operations:					
Net earnings	$ 182,505	$ 89,400	$ 64,934	$ 53,473	$ 48,058
Real estate depreciation and amortization:					
Continuing operations	20,874	14,871	11,296	9,572	8,822
Discontinued operations	1,545	5,536	4,419	2,300	1,506
Partnership real estate depreciation	463	606	622	699	479
Partnership gain on sale of asset	(262)	-	-	-	-
Gain on disposition of equity investment	(11,373)	-	-	-	-
Gain on disposition of investment assets	(91,332)	(9,816)	(2,523)	(287)	(260)
Extraordinary gain	-	(14,786)	-	-	-
FFO	102,420	85,811	78,748	65,757	58,605
Series A Preferred Stock dividends	(4,376)	(4,008)	(4,008)	(4,008)	(4,010)
Series B Convertible Preferred Stock dividends	(419)	(1,675)	(1,675)	(502)	-
Series C Redeemable Preferred Stock dividends	(923)	-	-	-	-
FFO available to common stockholders basic	96,702	80,128	73,065	61,247	54,595
Series B Convertible Preferred Stock dividends, if dilutive	419	1,675	-	502	-
FFO available to common stockholders diluted	$ 97,121	$ 81,803	$ 73,065	$ 61,749	$ 54,595

For a discussion of material events affecting the comparability of the information reflected in the selected financial data, refer to Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis should be read in conjunction with Item 6. Selected Financial Data, and the consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K, and the forward-looking disclaimer language in italics before Item 1. Business.

National Retail Properties, Inc., a Maryland corporation, is a fully integrated real estate investment trust (REIT) formed in 1984. The terms Registrant or Company refer to National Retail Properties, Inc. and its majority owned and controlled subsidiaries. These subsidiaries include the wholly owned qualified REIT subsidiaries of National Retail Properties, Inc., as well as the taxable REIT subsidiaries and their majority owned and controlled subsidiaries (the NNN TRS). Effective May 1, 2006, Commercial Net Lease Realty, Inc. changed its name to National Retail Properties, Inc.

Overview

The Company s operations are divided into two primary business segments: (i) investment assets, including real estate assets, structured finance investments (included in mortgages, notes and accrued interest receivable on the consolidated balance sheets) and mortgage residual interests (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 qualified REIT subsidiaries. The Company 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). The Inventory Assets are operated through the NNN TRS. The NNN TRS, directly and indirectly, through investment interests, owns real estate primarily for the purpose of selling the real estate (Inventory Properties or Inventory Portfolio).

As of December 31, 2006, the Company owned 710 Investment Properties, with an aggregate leasable area of 9,341,000 square feet, located in 44 states. Approximately 98 percent of the Company s Investment Portfolio was leased at December 31, 2006. In addition to the Investment Properties, as of December 31, 2006, the Company had $13,917,000 and $31,512,000 in structured finance investments and mortgage residual interests, respectively. As of December 31, 2006, the NNN TRS owned 97 Inventory Properties.

As of October 31, 2005, the Inventory Assets were operated through Commercial Net Lease Realty Services, Inc. (Services) and its majority owned and controlled subsidiaries. Effective November 1, 2005, Services merged with and into National Retail Properties, Inc., and a former Services subsidiary, CNLRS Exchange I, Inc., became the holding company for the Company s development and exchange activities. Effective October 2, 2006, CNLRS Exchange I, Inc. changed its name to NNN TRS, Inc.

The NNN TRS, directly and indirectly, through investment interests, owns real estate primarily for the purpose of selling the real estate (Inventory Properties or Inventory Portfolio). The NNN TRS acquires and develops Inventory Properties (Development Properties or Development Portfolio) and also acquires existing Inventory Properties (Exchange Properties or Exchange Portfolio). As of December 31, 2006, the NNN TRS owned 29 Development Properties (11 completed inventory, five under construction and 13 land parcels) and 68 Exchange Properties.

The Company s management team focuses on certain key indicators to evaluate the financial condition and operating performance of the Company. The key indicators for the Company include items such

as: the composition of the Company s Investment Portfolio and structured finance investments (such as tenant, geographic and industry classification diversification), the occupancy rate of the Company s Investment Portfolio, certain financial performance ratios and profitability measures, industry trends and performance compared to that of the Company, and returns the Company receives on its invested capital.

The Company has recently increased its investments in the convenience store and restaurant sectors. Both of these sectors represent a large part of the freestanding retail property marketplace which the Company believes represents areas of attractive investment opportunity. Similarly, the Company has some geographic focus in Texas and Florida which the Company believes are areas of above average population growth which provide relatively strong investment opportunity for retailers and retail real estate investments.

Critical Accounting Policies and Estimates

The preparation of the Company s consolidated financial statements in conformance with accounting principles generally accepted in the United States of America requires management to make numerous estimates and judgments on assumptions that affect the reported amounts of assets, liabilities, revenues and expenses as well as other disclosures in our financial statements. On an ongoing basis, management evaluates its estimates and judgments. However, actual results may differ from these estimates and assumptions which in turn could have a material impact on the Company s financial statements. A summary of the Company s accounting policies and procedures are included in Note 1 of the Company s consolidated financial statements. Management believes the following critical accounting policies among others affect its more significant judgments and estimates used in the preparation of the Company s consolidated financial statements.

Real Estate Investment Portfolio. The Company records the acquisition of real estate at cost, including acquisition and closing costs. The cost of properties developed by the Company includes direct and indirect costs of construction, property taxes, interest and other miscellaneous costs incurred during the development period until the project is substantially complete and available for occupancy.

Purchase Accounting for Acquisition of Real Estate Subject to a Lease For acquisitions of real estate subject to a lease subsequent to June 30, 2001, the effective date of Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, (SFAS 141), the fair value of the real estate acquired is allocated to the acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, value of in-place leases value of tenant relationships, based in each case on their relative fair values.

Real estate is generally leased to tenants on a net lease basis, whereby the tenant is responsible for all operating expenses relating to the property, including property taxes, insurance, maintenance and repairs. The leases are accounted for using either the operating or the direct financing method. Such methods are described below:

Operating method Leases accounted for using the operating method are recorded at the cost of the real estate. Revenue is recognized as rentals are earned and expenses (including depreciation) are charged to operations as incurred. Buildings are depreciated on the straight-line method over their estimated useful lives (generally 35 to 40 years). Leasehold interests are amortized on the straight-line method over the terms of their respective leases. When scheduled

rentals vary during the lease term, income is recognized on a straight-line basis so as to produce a constant periodic rent over the term of the lease. Accrued rental income is the aggregate difference between the scheduled rents which vary during the lease term and the income recognized on a straight-line basis.

Direct financing method Leases accounted for using the direct financing method are recorded at their net investment (which at the inception of the lease generally represents the cost of the property). Unearned income is deferred and amortized into income over the lease terms so as to produce a constant periodic rate of return on the Company s net investment in the leases.

Management periodically assesses its real estate for possible impairment whenever events or changes in circumstances indicate that the carrying value of the asset, including accrued rental income, may not be recoverable through operations. Management determines whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the residual value of the real estate, with the carrying cost of the individual asset. If an impairment is indicated, a loss will be recorded for the amount by which the carrying value of the asset exceeds its fair value.

Real Estate Inventory Portfolio. The NNN TRS acquires, develops and owns properties that it intends to sell. The properties that are classified as held for sale at any given time may consist of properties that have been acquired in the marketplace with the intent to sell and properties that have been, or are currently being, constructed by the NNN TRS. The NNN TRS records the acquisition of the real estate at cost, including the acquisition and closing costs. The cost of the real estate developed by the NNN TRS includes direct and indirect costs of construction, interest and other miscellaneous costs incurred during the development period until the project is substantially complete and available for occupancy. Real estate held for sale is not depreciated.

Mortgage Residual Interests, at Fair Value. Mortgage residual interests, classified as available for sale, are reported at their market values with unrealized gains and losses reported as other comprehensive income in stockholders equity. The mortgage residual interests were acquired in connection with the acquisition of 78.9 percent equity interest of OAMI. The Company recognizes the excess of all cash flows attributable to the mortgage residual interests estimated at the acquisition/transaction date over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. Losses are considered other than temporary valuation impairments if and when there has been a change in the timing or amount of estimated cash flows, exclusive of changes in interest rates, that leads to a loss in value. Certain of the mortgage residual interests have been pledged as security for notes payable.

Revenue Recognition. Rental revenues for non-development real estate assets are recognized when earned in accordance with SFAS 13, Accounting for Leases, based on the terms of the lease at the time of acquisition of the leased asset. Rental revenues for properties under construction commence upon completion of construction of the leased asset and delivery of the leased asset to the tenant.

Use of Estimates. Additional critical accounting policies of the Company include management s estimates and assumptions relating to the reporting of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Additional critical accounting policies include management s estimates of the useful lives used in calculating depreciation expense relating to the Company s real estate assets, the recoverability of the carrying

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value of long-lived assets, including the mortgage residual interests, the collectibility of receivables from tenants, including accrued rental income, and capitalized overhead relating to development projects. Actual results could differ from those estimates.

Results of Operations

Property Analysis Investment Portfolio

General. The following table summarizes the Company s Investment Portfolio as of December 31:

	2006	2005	2004
Investment Properties Owned:			
Number	710	524	362
Total gross leasable area (square feet)	9,341,000	9,227,000	8,542,000
Investment Properties Leased:			
Number	697	512	351
Total gross leasable area (square feet)	9,173,000	9,066,000	8,322,000
Percent of total gross leasable area	98%	98%	97%
Weighted average remaining lease term (years)	12	11	10

The following table summarizes the lease expirations of the Company s Investment Portfolio as of December 31, 2006.

	% of Total[1]	# of Properties	Gross Leasable Area[2]		% of Total[1]	# of Properties	Gross Leasable Area[2]
2007	1.2%	13	206,000	2013	5.6%	30	690,000
2008	1.8%	22	406,000	2014	7.3%	39	591,000
2009	2.6%	25	490,000	2015	4.6%	22	621,000
2010	3.9%	36	383,000	2016	4.2%	22	508,000
2011	3.8%	23	439,000	2017	7.2%	28	808,000
2012	4.6%	30	531,000	Thereafter	53.2%	407	3,500,000

(1) Based on the annualized base rent for all leases in place as of December 31, 2006.
(2) Approximate square feet.

The following table summarizes the diversification of the Company s Investment Portfolio based on the top 10 lines of trade as of December 31, 2006 (dollars in thousands):

	Top 10 Lines of Trade	2006[1]	2005[1]	2004[1]
1.	Convenience Stores	16.3%	12.1%	0.7%
2.	Restaurants Full Service	12.1%	6.6%	6.7%
3.	Drug Stores	8.3%	10.0%	11.5%
4.	Sporting Goods	7.3%	7.4%	7.8%
5.	Books	5.7%	5.8%	6.9%

6.	Grocery	5.7%	6.3%	7.7%
7.	Consumer Electronics	5.6%	5.9%	7.1%
8.	Restaurants Limited Service	4.7%	3.0%	3.1%
9.	Furniture	4.2%	4.7%	5.0%
10.	Office Supplies	4.1%	4.4%	5.2%
	Other	26.0%	33.8%	38.3%
		100.0%	100.0%	100.0%

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

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The following table shows the top 10 states in which the Company s Investment Properties are located in as of December 31, 2006 (dollars in thousands):

	State	Number of Properties	% of Annual Base Rent[1]
1.	Texas	149	22.2%
2.	Florida	77	13.4%
3.	Pennsylvania	77	5.4%
4.	Georgia	37	5.1%
5.	Virginia	19	3.9%
6.	California	18	3.7%
7.	Tennessee	19	3.5%
8.	Illinois	22	3.4%
9.	Missouri	14	3.3%
10.	Ohio	23	3.0%
	Other	255	33.1%
		710	100.0%

(1) Based on annualized base rent for all leases in place as of December 31, 2006.

Property Acquisitions. The following table summarizes the Investment Property acquisitions for each of the years ended December 31 (dollars in thousands):

	2006	2005	2004
Acquisitions:			
Number of Investment Properties	213	170	36
Gross leasable area (square feet)	1,130,000	1,150,000	825,000
Total dollars invested [1]	$ 371,898	$ 332,461	$ 139,303

(1) Includes dollars invested on projects currently under construction.

Property Dispositions. The following table summarizes the Investment Properties sold by the Company for each of the years ended December 31 (dollars in thousands):

	2006	2005	2004
Number of properties	30	12	20
Gross leasable area (square feet)	1,015,000	476,000	155,000
Net sales proceeds	319,361	40,377	32,544
Net gain	$ 91,332	$ 9,816	$ 2,523

Property Analysis Inventory Portfolio

General. The following summarizes the number of properties held for sale in the Company s Inventory Portfolio as of December 31:

	2006	2005	2004
Development Portfolio:			
Completed Inventory Properties	11	1	4
Properties under construction	5	12	7
Land parcels	13	4	4
	29	17	15
Exchange Portfolio:			
Inventory Properties	68	46	6
Total Inventory Properties	97	63	21

Property Acquisitions. The following table summarizes the property acquisitions and dollars invested in the Inventory Portfolio for each of the years ended December 31 (dollars in thousands):

	2006	2005	2004
Development Portfolio:			
Number of properties acquired	16	58	33
Dollars invested [(1)]	$ 82,524	$ 66,527	$ 48,318
Exchange Portfolio:			
Number of properties acquired	77	4	8
Dollars invested	$ 118,553	$ 10,714	$ 26,366
Total dollars invested	$ 201,077	$ 134,373	$ 76,647

(1) Includes dollars invested on projects currently under construction.

Property Dispositions. The following table summarizes the number of Inventory Properties sold and the corresponding gain recognized from the disposition of real estate held for sale included in earnings from continuing and discontinued operations for each of the years ended December 31 (dollars in thousands):

	2006		2005		2004	
	# of Properties	Gain	# of Properties	Gain	# of Properties	Gain
Development	9	$ 9,698	12	$ 18,065	16	$ 20,673
Exchange	55	3,892	16	2,641	8	1,912
Intercompany eliminations	-	190	-	921	-	817
Minority interest, Development	-	(4,114)	-	(5,999)	-	(6,422)
	64	$ 9,666	28	$ 15,628	24	$ 16,980

Business Combinations

Orange Avenue Mortgage Investments, Inc. On May 2, 2005, the Company exercised its option to acquire 78.9 percent of the common shares of OAMI for $9,379,000. In December 2004, OAMI sold its loan origination, securitization and servicing operations and the majority of its assets and liabilities to a third party, leaving OAMI with an interest in seven commercial real estate loan securitization residual interests. The loans in each of the securitizations are secured by first mortgages on commercial real estate and generally borrower personal guarantees. As a result of the option exercise, the Company has consolidated OAMI in its consolidated financial statements.

In accordance with SFAS No. 141, Business Combinations, (SFAS 141), the Company recorded the assets and liabilities of OAMI at fair value. The Company recognized an extraordinary gain of $14,786,000, equal to the excess fair value over the option price, as all assets acquired were financial assets and current assets.

Between June 2001 and July 2003, a wholly owned subsidiary of the Company, Net Lease Funding, Inc. (NLF), entered into five limited liability company agreements with OAMI to create five limited liability companies (collectively, the LLCs). Kevin B. Habicht, an officer and director of the Company is an officer, director and indirect stockholder of OAMI. Craig Macnab, an officer and director of the Company and Julian E. Whitehurst, an officer of the Company, are each an officer and director of OAMI. Each of the LLCs holds an interest in mortgage loans and is 100 percent equity financed. Prior to the acquisition of the 78.9 percent equity interest in OAMI, NLF held a non-voting

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and non-controlling interest in each of the LLCs ranging between 36.7 and 44.0 percent and accounted for its investment under the equity method of accounting.

As a result of the Company s acquisition of 78.9 percent equity interest in OAMI, the Company s interest in the LLCs is no longer accounted for as an equity investment and is now included as part of OAMI in the Company s consolidated financial statements. In addition, certain officers and directors of the Company own preferred shares of OAMI.

Prior to the acquisition of 78.9 percent equity interest in OAMI, the Company received $2,749,000 and $10,562,000 in distributions from the LLCs during the years ended December 31, 2005 and 2004, respectively. For the years ended December 31, 2005 and 2004, the Company recognized $1,467,000 and $5,042,000 of earnings, respectively, from the LLCs.

In connection with the independent valuations of the Residuals fair value, the Company reduced the carrying value of the Residuals to reflect such fair value at December 31, 2005. The reduction in the Residuals value that related to the Residuals acquired at the time of the option exercise was recorded as a purchase price allocation adjustment. The reduction in the Residuals value acquired at the time of the option exercise that related to the period subsequent to the option exercise, as well as the reduction in the value related to the portion of the Residuals owned by NLF, was recorded as an aggregate other than temporary valuation impairment of $8,779,000 and $2,382,000 for the years ended December 31, 2006 and 2005, respectively. Unrealized gains of $1,992,000 were recorded as other comprehensive income in the Statement of Stockholders Equity during the year ended December 31, 2006.

The Company merged certain of its wholly owned subsidiaries into National Retail Properties, Inc. and elected to convert OAMI to a REIT. As a result, effective January 1, 2005, OAMI was taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and related regulations. Upon making the REIT conversion, $3,453,000 of OAMI s tax liability was eliminated and recorded as an adjustment to the net assets acquired at the time of the option exercise. The remaining tax liability will be reduced over the next ten years in proportion to the reduction of the basis of the respective mortgage residual interests.

National Properties Corporation. On June 16, 2005, the Company acquired 100 percent of National Properties Corporation (NAPE), a publicly traded company, which owned 43 freestanding properties located in 12 states. Results of NAPE operations have been included in the consolidated financial statements since the date of acquisition. NAPE stockholders received 1,636,532 newly issued shares of the Company s common stock. In accordance with SFAS 141, the acquisition price of $32,199,000 was allocated to the assets acquired and liabilities assumed at their fair values.

Revenue from Continuing Operations Analysis

General. During the year ended December 31, 2006, the Company s rental income increased primarily due to the acquisition of Investment Properties (See Results of Operations Property Analysis Investment Portfolio Property Acquisitions). The Company anticipates any significant increase in rental income will continue to come primarily from additional property acquisitions.

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The following summarizes the Company s revenues from continuing operations for each of the years ended December 31 (dollars in thousands):

				Percent of Total			2006 Versus 2005	2005 Versus 2004
	2006	2005	2004	2006	2005	2004	Percent Increase (Decrease)	Percent Increase (Decrease)
Rental Income [1]	$ 134,196	$ 100,836	$ 84,546	89.0%	85.1%	88.9%	33.1%	19.3%
Real estate expense reimbursement from tenants	4,862	4,094	2,828	3.2%	3.5%	3.0%	18.8%	44.8%
Interest and other income from real estate transactions	4,462	6,143	7,695	3.0%	5.2%	8.1%	(27.4)%	(20.2)%
Interest income on mortgage residual interests								