

\$364MM Net Lease Portfolio Acquired

CapLease acquired a portfolio of 18, high quality, triple net leased real estate assets totaling 4.1 million square feet for \$364 million (including \$159.3 million of assumed debt). Among the properties acquired are 3 state-of-the-art warehouses leased to Nestlé USA, Inc., 11 Kroger grocery stores, two office buildings leased to a subsidiary of Qwest Communications, and the corporate headquarters building for Factory Mutual Insurance Company.

"Since going public in March '04, we have rapidly grown our portfolio of high quality real estate assets by investing at all levels of the capital structure of net leased and other single tenant properties—equity, debt, and mezzanine," noted Paul McDowell, CapLease's CEO.

"The acquisition of this portfolio is significant. It pushes our portfolio over the \$2 billion threshold—about 78% of which (over 10 million square feet) is owned properties. Further, it demonstrates the expertise of our origination team in sourcing, structuring and closing a complex portfolio of very high quality assets. Overall, our portfolio has a weighted average credit rating of single A (S&P), and our owned property portfolio has a weighted average remaining lease term of over 10 years," added Mr. McDowell.

This transaction is expected to be immediately accretive to CapLease's stockholders.

CapLease's Annual Report Available

To learn more about CapLease's investment strategy, growth and future plans, read a copy of our '06 Annual Report. For a copy, call Brad Cohen, Investor Relations, at 212-217-6393.

"Muddle Through" Economy Impacts RE Fundamentals

The "muddle through" economy we forecasted in our February newsletter appears to be becoming a reality as the year progresses. First quarter GDP growth was an anemic 2.3%, as low unemployment and rising wages enabled consumer spending to offset the drag of growing sub-prime mortgage defaults (foreclosures yet to come), a depressed housing market, weak capital goods expenditures, high gas prices and nagging inflation.

While the commercial real estate market remains robust, with cap rates unchanged from last year and capital readily available (although spreads have widened about 70bps for "BBB" CMBS since February), we are beginning to see some weakening in underlying real estate fundamentals.

For example, net absorption in the office sector was 9.1 million square feet nationally in the first quarter, but half of this absorption was in New York City and San Jose, CA. Net absorption was down due to weak demand in 28 of the 44 major office markets. As demand for office space weakens, tenants are finding it economic to move from older Class B and C buildings to new Class A buildings.

Given our economic outlook for the remainder of 2007, we don't expect the national office vacancy

rate to continue downward as it has over the last few years. Rather, we believe this rate will plateau at last year's 12%. With the exception of a few "hot" markets like New York City, rents are not expected to keep pace with rising operating costs, resulting in some NOI compression.

Industrial vacancies have edged up to approximately 9%, particularly in the Mid west, reflecting weak capital expenditures on the part of the auto and construction industries. Retail, on the other hand, continues to benefit from consumer spending, with vacancies flat at around 8% and rents trending higher.

While the weakening we are seeing in commercial real estate fundamentals is not likely to result in an immediate widening of cap rates, it does support our belief that values have peaked and cap rates may begin to widen later this year. Should inflation continue to exceed expectations and interest rates begin to move up, the weakening we are seeing in the fundamentals could cause cap rates to widen much faster than we expect. Given the recent trends, RE investors will be best served by focusing on quality—real estate and tenant quality, rather than attempting to maximize returns by investing in lesser quality real estate.

TICs: Is the Bloom Coming off the Rose?

Following the 2002 IRS approval of sponsored tenant-in-common structures (TICs) as 1031 replacement properties, TICs have become one of the hottest growth segments in the real estate market. As frothy real estate prices squeeze returns and investors and regulators take a second look at these investment vehicles, the question arises: Is the bloom coming off the rose?

The value of funds raised by TIC sponsors jumped from \$166 million in 2001 to more than \$3.7 billion in 2006. Attracted by fees sometimes exceeding 10%, the number of TIC sponsors increased from approximately 20 to more than 60 over the past year. While TIC growth has been impressive, it is unlikely to continue in 2007, for the following reasons:

- Real estate values are peaking and many TIC sponsors must raise capital before closing transactions. Less capitalized TICs have difficulty competing for prime real estate.
- Because many hedge funds are returning 12 to 15%, some sellers are paying the 15% capital gains tax rather than deferring taxes through investment in low-return TIC real estate.
- There is growing recognition of the real risks for

TIC investors. These include the new Democratic Congress' focus on closing tax loopholes – such as 1031 exchanges – that are perceived to be geared toward the rich; new IRS regulations that adversely affect TICs; and the TIC structure remaining untested by a down real estate market.

Given these challenges, we believe that the TIC industry is likely to face a shake-up during the next twelve to eighteen months. Weaker, less capitalized sponsors, or those lacking the experienced infrastructure to manage and operate their investments, will probably leave the market. While TIC volume is expected to remain in the \$3 to 3.5 billion range in 2007, the difference between the "have" and "have-not" TICs will become even more pronounced, as smaller, less capitalized TICs are forced to focus on lesser quality real estate in order to generate the returns necessary for attracting investors.

Planning to attend Vegas' ICSC?

Our deal team will be booth located at C1459-14th Avenue (same location, new address), ready to discuss your net lease deal. To schedule individual meetings, please call Samantha Ross at 212-217-6300.