Cole Credit Property Trust II Inc
Form 10-Q
August 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended June 30, 2012

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 000-51963

COLE CREDIT PROPERTY TRUST II, INC.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	20-1676382 (I.R.S. Employer Identification Number)
2325 East Camelback Road, Suite 1100 Phoenix, Arizona, 85016 (Address of principal executive offices; zip code)	(602) 778-8700 (Registrant’s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

As of August 13, 2012, there were 209,605,926 shares of common stock, par value $0.01, of Cole Credit Property Trust II, Inc. outstanding.

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PART I

FINANCIAL INFORMATION

The accompanying condensed consolidated unaudited interim financial statements as of and for the three and six months ended June 30, 2012 have been prepared by Cole Credit Property Trust II, Inc. (the "Company," "we," "us" or "our") pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements, and should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The financial statements herein should also be read in conjunction with the notes to the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Quarterly Report on Form 10-Q. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the operating results expected for the full year. The information furnished in our accompanying condensed consolidated unaudited balance sheets and condensed consolidated unaudited statements of operations, comprehensive income, stockholders' equity, and cash flows reflects all adjustments that are, in our opinion, necessary for a fair presentation of the aforementioned financial statements. Such adjustments are of a normal recurring nature.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. We caution readers not to place undue reliance on forward-looking statements, which reflect our management's view only as of the date of this Quarterly Report on Form 10-Q. We make no representation or warranty (expressed or implied) about the accuracy of any such forward-looking statements contained in the Quarterly Report on Form 10-Q. Additionally, we undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. The forward-looking statements should be read in light of the risk factors identified in the "Item 1A – Risk Factors" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED BALANCE SHEETS
(in thousands, except share and per share amounts)

	June 30, 2012	December 31, 2011
ASSETS		
Investment in real estate assets:		
Land	$863,088	$863,257
Building and improvements, less accumulated depreciation of $268,496 and $238,688, respectively	1,932,397	1,959,922
Real estate assets under direct financing leases, less unearned income of $12,398 and $13,342, respectively	35,482	35,999
Acquired intangible lease assets, less accumulated amortization of $143,969 and $128,544, respectively	307,431	323,298
Total investment in real estate assets, net	3,138,398	3,182,476
Investment in mortgage notes receivable, net	75,139	76,745
Total investment in real estate and mortgage assets, net	3,213,537	3,259,221
Cash and cash equivalents	27,392	53,205
Restricted cash	8,986	11,811
Investment in unconsolidated joint venture	21,686	22,334
Rents and tenant receivables, less allowance for doubtful accounts of $194 and $547, respectively	60,458	57,403
Prepaid expenses and other assets	3,245	3,739
Deferred financing costs, less accumulated amortization of $19,981 and $17,751, respectively	19,434	22,609
Total assets	$3,354,738	$3,430,322
LIABILITIES AND STOCKHOLDERS' EQUITY		
Notes payable and line of credit	$1,747,505	$1,767,591
Accounts payable and accrued expenses	18,496	16,100
Due to affiliates	1,319	1,069
Acquired below market lease intangibles, less accumulated amortization of $48,249 and $42,880, respectively	125,092	130,680
Distributions payable	10,766	11,157
Deferred rental income, derivative and other liabilities	13,260	17,530
Total liabilities	1,916,438	1,944,127
Commitments and contingencies		
Redeemable common stock	14,394	14,482
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.01 par value; 10,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $0.01 par value; 240,000,000 shares authorized, 210,137,757 and 210,151,692 shares issued and outstanding, respectively	2,101	2,101
Capital in excess of par value	1,883,140	1,882,971
Accumulated distributions in excess of earnings	(458,565)	(409,801)
Accumulated other comprehensive loss	(2,770)	(3,558)
Total stockholders' equity	1,423,906	1,471,713
Total liabilities and stockholders' equity	$3,354,738	$3,430,322

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Rental and other property income	$65,525	$62,853	$130,529	$123,836
Tenant reimbursement income	3,259	3,906	7,783	8,693
Earned income from direct financing leases	472	485	944	971
Interest income on mortgage notes receivable	1,548	1,611	3,113	3,232
Interest income on marketable securities	—	521	—	2,459
Total revenue	70,804	69,376	142,369	139,191
Expenses:				
General and administrative expenses	3,267	1,941	5,495	3,943
Property operating expenses	5,546	5,655	11,311	11,467
Property and asset management expenses	4,281	4,106	8,942	8,462
Acquisition related expenses	—	1,956	17	2,318
Depreciation	15,205	14,912	30,417	29,569
Amortization	7,328	7,077	14,310	14,474
Impairment of real estate assets	1,979	—	1,979	—
Total operating expenses	37,606	35,647	72,471	70,233
Operating income	33,198	33,729	69,898	68,958
Other income (expense):				
Equity in income of unconsolidated joint ventures and other income	412	368	540	536
Gain on sale of marketable securities	—	7,728	—	15,587
Interest expense	(26,855)	(26,898)	(53,880)	(53,419)
Total other expense	(26,443)	(18,802)	(53,340)	(37,296)
Net income	$6,755	$14,927	$16,558	$31,662
Weighted average number of common shares outstanding:				
Basic	210,142,692	209,586,828	210,159,439	209,430,055
Diluted	210,143,788	209,586,828	210,160,535	209,430,055
Net income per common share:				
Basic and diluted	$0.03	$0.07	$0.08	$0.15
Distributions declared per common share	$0.16	$0.16	$0.31	$0.31

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	$6,755	$14,927	$16,558	$31,662
Other comprehensive income (loss):				
Unrealized loss on marketable securities	—	—	—	(1,713)
Reclassification of previous unrealized gain on marketable securities into net income	—	(6,906)	—	(14,654)
Unrealized gain (loss) on interest rate swaps	573	(955)	788	(697)
Total other comprehensive income (loss)	573	(7,861)	788	(17,064)
Comprehensive income	$7,328	$7,066	$17,346	$14,598

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands, except share amounts)

	Common Stock		Capital in Excess of Par Value	Accumulated Distributions in Excess of Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Number of Shares	Par Value				
Balance, January 1, 2012	210,151,692	$2,101	$1,882,971	$(409,801)	$(3,558)	$1,471,713
Issuance of common stock	3,098,850	31	28,943	—	—	28,974
Distributions to investors	—	—	—	(65,322)	—	(65,322)
Redemptions of common stock	(3,112,785)	(31)	(28,862)	—	—	(28,893)
Changes in redeemable common stock	—	—	88	—	—	88
Comprehensive income	—	—	—	16,558	788	17,346
Balance, June 30, 2012	210,137,757	$2,101	$1,883,140	$(458,565)	$(2,770)	$1,423,906

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

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COLE CREDIT PROPERTY TRUST II, INC.
CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	$16,558	$31,662
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	30,417	29,569
Amortization of intangible lease assets and below market lease intangibles, net	10,944	11,292
Amortization of deferred financing costs	3,458	3,380
Amortization of premiums on mortgage notes receivable	358	349
Accretion of discount on marketable securities	—	(846)
Amortization of fair value adjustments of mortgage notes payable assumed	949	939
Bad debt expense	55	(92)
Impairment of real estate assets	1,979	—
Equity in income of unconsolidated joint ventures	(467)	(390)
Return on investment from unconsolidated joint ventures	467	465
Property condemnation gain	(55)	(92)
Gain on sale of marketable securities	—	(15,587)
Changes in assets and liabilities:		
Rents and tenant receivables	(3,110)	(4,858)
Prepaid expenses and other assets	1,509	1,886
Accounts payable and accrued expenses	1,199	1,683
Due to affiliates, deferred rental income and other liabilities	(3,312)	(4,843)
Net cash provided by operating activities	60,949	54,517
Cash flows from investing activities:		
Investment in real estate and related assets and other capital expenditures	(4,249)	(94,143)
Proceeds from sale of marketable securities	—	82,061
Principal repayments from mortgage notes receivable and real estate assets under direct financing leases	1,765	1,614
Return of investment from unconsolidated joint ventures	648	1,248
Refund of property escrow deposits	—	1,090
Payment of property escrow deposits	—	(1,290)
Proceeds from easement of real estate assets	75	247
Change in restricted cash	2,825	(2,464)
Net cash provided by (used in) investing activities	1,064	(11,637)
Cash flows from financing activities:		
Redemptions of common stock	(28,893)	(24,120)
Distributions to investors	(36,739)	(35,290)
Proceeds from notes payable, line of credit and repurchase agreement	77,000	140,796
Repayment of notes payable, line of credit and repurchase agreement	(98,035)	(147,187)
Payment of loan deposits	(1,015)	—
Deferred financing costs paid	(144)	(1,404)
Net cash used in financing activities	(87,826)	(67,205)
Net decrease in cash and cash equivalents	(25,813)	(24,325)
Cash and cash equivalents, beginning of period	53,205	45,791
Cash and cash equivalents, end of period	$27,392	$21,466

The accompanying notes are an integral part of these condensed consolidated unaudited financial statements.

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COLE CREDIT PROPERTY TRUST II, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS
June 30, 2012

NOTE 1 — ORGANIZATION AND BUSINESS

Cole Credit Property Trust II, Inc. (the “Company”) is a Maryland corporation formed on September 29, 2004, that has elected to be taxed, and currently qualifies, as a real estate investment trust (“REIT”) for federal income tax purposes. Substantially all of the Company’s business is conducted through Cole Operating Partnership II, LP (“Cole OP II”), a Delaware limited partnership. The Company is the sole general partner of and owns a 99.99% partnership interest in Cole OP II. Cole REIT Advisors II, LLC (“Cole Advisors II”), the advisor to the Company, is the sole limited partner and owner of an insignificant noncontrolling partnership interest of less than 0.01% of Cole OP II.

As of June 30, 2012, the Company owned 753 properties comprising 21.2 million rentable square feet of single and multi-tenant retail and commercial space located in 45 states and the U.S. Virgin Islands. As of June 30, 2012, the rentable space at these properties was 96% leased. As of June 30, 2012, the Company also owned 69 mortgage notes receivable secured by 43 restaurant properties and 26 single-tenant retail properties, each of which is subject to a net lease. Through an unconsolidated joint venture, the Company also had a non-controlling majority interest in a 386,000 square foot multi-tenant retail building in Independence, Missouri as of June 30, 2012.

The Company ceased offering shares of common stock in its initial primary offering (the “Initial Offering”) on May 22, 2007, and ceased offering shares of common stock in its follow-on offering (the “Follow-on Offering”) on January 2, 2009. The Company continues to issue shares of common stock under its distribution reinvestment plan (the “DRIP Offering”, and collectively with the Initial Offering and the Follow-on Offering, the “Offerings”). As of June 30, 2012, the Company had issued approximately 228.2 million shares of common stock in its Offerings for aggregate gross proceeds of $2.3 billion (including proceeds from the issuance of shares pursuant to the DRIP Offering of $233.2 million), before share redemptions of $163.7 million. As of June 30, 2012, the Company had incurred an aggregate of $188.3 million in offering costs, selling commissions, and dealer manager fees in the Offerings.

The Company's stock is not currently listed on a national securities exchange. The Company may seek to list its common stock for trading on a national securities exchange only if a majority of its independent directors believes listing would be in the best interest of its stockholders. The Company disclosed in its prospectus a targeted liquidity event by May 22, 2017 and in the event it does not obtain listing prior to such date, its charter requires that it either (1) seek stockholder approval of an extension or elimination of this listing deadline; or (2) seek stockholder approval to adopt a plan of liquidation. If neither proposal is approved, the Company may continue to operate as before. The Company is actively exploring options to successfully exit its portfolio. The potential exit strategies the Company is evaluating include, but are not limited to, a sale of the Company or all or a portion of its portfolio, a merger or other business combination, or a listing of the Company's stock on a national securities exchange. However, the Company has not yet finalized a plan for, or had, a liquidity event.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The condensed consolidated unaudited financial statements of the Company have been prepared in accordance with the rules and regulations of the SEC, including the instructions to Form 10-Q and Article 10 of Regulation S-X, and do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the statements for the interim periods presented include all adjustments, which are of a normal and recurring nature, necessary for a fair presentation of the results for such periods. Results for these interim periods are not necessarily indicative of full year results. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited consolidated financial statements as of and for the year ended December 31, 2011, and related notes thereto set forth in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

The condensed consolidated unaudited financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

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The Company evaluates its relationships and investments to determine if it has variable interests. A variable interest is an investment or other interest that will absorb portions of an entity's expected losses or receive portions of the entity's expected residual returns. If the Company determines that it has a variable interest in an entity, it evaluates whether such interest is in a variable interest entity ("VIE"). A VIE is broadly defined as an entity where either (1) the equity investors as a group, if any, lack the power through voting or similar rights to direct the activities of an entity that most significantly impact the entity's economic performance or (2) the equity investment at risk is insufficient to finance that entity's activities without additional subordinated financial support. The Company consolidates any VIEs when it is determined to be the primary beneficiary of the VIE's operations.

A variable interest holder is considered to be the primary beneficiary of a VIE if it has the power to direct the activities of a VIE that most significantly impact the entity's economic performance and has the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the VIE. The Company qualitatively assesses whether it is (or is not) the primary beneficiary of a VIE. Consideration of various factors include, but are not limited to, the Company's ability to direct the activities that most significantly impact the entity's economic performance, its form of ownership interest, its representation on the entity's governing body, the size and seniority of its investment, its ability and the rights of other investors to participate in policy making decisions and to replace the manager of and/or liquidate the entity.

The Company continually evaluates the need to consolidate joint ventures based on standards set forth in GAAP. In determining whether the Company has a controlling interest in a joint venture and the requirement to consolidate the accounts of that entity, management considers factors such as ownership interest, power to make decisions and contractual and substantive participating rights of the partners/members as well as whether the entity is a VIE for which the Company is the primary beneficiary. The Company has no relationship, investment or other interests in entities that are or were required to be consolidated because the Company has no variable interests in an entity that qualifies as a VIE.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Valuation of Real Estate and Related Assets

The Company continually monitors events and changes in circumstances that could indicate that the carrying amounts of its real estate and related assets may not be recoverable. Impairment indicators that the Company considers include, but are not limited to, bankruptcy or other credit concerns of a property's major tenant, such as a history of late payments, rental concessions, and other factors, a significant decrease in a property's revenues due to lease terminations, vacancies, co-tenancy clauses, reduced lease rates or other circumstances. When indicators of potential impairment are present, the Company assesses the recoverability of the assets by determining whether the carrying amount of the assets will be recovered through the undiscounted future cash flows expected from the use of the assets and their eventual disposition. In the event that such expected undiscounted future cash flows do not exceed the carrying amount, the Company will adjust the real estate and related assets to their respective fair values and recognize an impairment loss. Generally, fair value is determined using a discounted cash flow analysis and recent comparable sales transactions.

The Company continually monitors certain properties for which it has identified impairment indicators. As of June 30, 2012, the Company had seven properties with an aggregate book value of $53.1 million for which it had assessed the recoverability of the carrying amounts. For six of these properties, the undiscounted future cash flows expected as a result of the use of the real estate and related assets and the eventual disposition of the assets continued to exceed their carrying amount as of June 30, 2012. Should the conditions related to any of these, or any of the Company's other properties change, the underlying assumptions used to determine the expected undiscounted future cash flows may change and adversely affect the recoverability of the respective real estate and related assets' carrying amounts. The Company identified one property during the three and six months ended June 30, 2012 with impairment indicators for which the undiscounted future cash flows expected as a result of the use and eventual disposition of the real estate and related assets was less than the carrying value of the property. As a result, the Company reduced the carrying value of the real estate and related assets to their estimated fair value by recognizing an impairment loss of $2.0 million during the three and six months ended June 30, 2012. No impairment losses were recorded during the three and six months ended June 30, 2011.

When developing estimates of expected future cash flows, the Company makes certain assumptions regarding future market rental income amounts subsequent to the expiration of current lease agreements, property operating expenses, terminal capitalization and discount rates, the expected number of months it takes to re-lease the property, required tenant improvements and the number of years the property will be held for investment. The use of alternative assumptions in estimating expected future cash flows could result in a different determination of the property's expected future cash flows and a different conclusion regarding the existence of an impairment, the extent of such loss, if any, as well as the fair value of the real estate and related assets.

When a real estate asset is identified by the Company as held for sale, the Company ceases depreciation and amortization of the assets related to the property and estimates the fair value, net of selling costs. If, in management's opinion, the fair value, net of selling costs, of the asset is less than the carrying amount of the asset, an adjustment to the carrying amount would be recorded to reflect the estimated fair value of the property, net of selling costs. There were no assets identified as held for sale as of June 30, 2012 or December 31, 2011.

Concentration of Credit Risk

As of June 30, 2012, the Company had cash on deposit, including restricted cash, in four financial institutions, all of which had deposits in excess of federally insured levels totaling $14.8 million; however, the Company has not experienced any losses in such accounts. The Company limits significant cash investments to accounts held by financial institutions with high credit standing; therefore, the Company believes it is not exposed to any significant credit risk on its cash deposits.

Investment in Unconsolidated Joint Venture

Investment in unconsolidated joint venture as of June 30, 2012 consists of the Company's non-controlling majority interest in a joint venture that owns a multi-tenant property in Independence, Missouri. As of June 30, 2012, the aggregate carrying amount of assets held within the unconsolidated joint venture was $58.6 million and the face value of the non-recourse mortgage note payable was $33.8 million. As of December 31, 2011, the aggregate carrying value of assets held within the unconsolidated joint venture was $59.3 million and the face value of the non-recourse mortgage note payable was $34.1 million.

The Company accounts for the unconsolidated joint venture using the equity method of accounting as the Company has the ability to exercise significant influence, but not control, over operating and financial policies of these investments. The equity method of accounting requires the investment to be initially recorded at cost and subsequently adjusted for the Company's share of equity in the joint venture's earnings and distributions. The Company is required to determine whether an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of its investment in the joint venture. If an event or change in circumstance has occurred, the Company is required to evaluate the joint venture for potential impairment and determine if the carrying amount of its investment exceeds its fair value. An impairment charge is recorded when an impairment is deemed to be other than temporary. To determine whether impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until the carrying amount is fully recovered. The evaluation of an investment in a joint venture for potential impairment requires the Company's management to exercise significant judgment and to make certain assumptions. The use of different judgments and assumptions could result in different conclusions. No impairment indicators were identified and no impairment losses were recorded related to the unconsolidated joint venture for the six months ended June 30, 2012 or 2011. The Company recognizes gains or losses on the sale of interests in joint ventures to the extent the economic substance of the transaction is a sale.

New Accounting Pronouncements

In June 2011, the U.S. Financial Accounting Standards Board issued Accounting Standards Update 2011-05, Presentation of Comprehensive Income, which requires the presentation of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. The Company elected to present two separate but consecutive statements herein.

NOTE 3 — FAIR VALUE MEASUREMENTS

GAAP defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. GAAP emphasizes that fair value is intended to be a market-based measurement, as opposed to a transaction-specific measurement.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, various techniques and assumptions can be used to estimate the fair value. Assets and liabilities are measured using inputs from three levels of the fair value hierarchy, as follows:

Level 1 – Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. An active market is defined as a market in which transactions for the assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active (markets with few transactions), inputs other than quoted prices that are observable for the asset or liability (i.e. interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data correlation or other means (market corroborated inputs).

Level 3 – Unobservable inputs, which are only used to the extent that observable inputs are not available, reflect the Company’s assumptions about the pricing of an asset or liability.

During the three and six months ended June 30, 2012, real estate assets with a carrying amount of $3.8 million related to one property were deemed to be impaired and their carrying values were reduced to their estimated fair value of $1.8 million, resulting in an impairment charge of $2.0 million, which is included in impairment of real estate assets on the condensed consolidated unaudited statement of operations for the three and six months ended June 30, 2012. A summary of such real estate assets measured at fair value on a non-recurring basis during the three and six months ended June 30, 2012 is as follows (in thousands):

	Balance as of June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Description:					
Investment in real estate assets	$ 1,751	$ —	$ —	$ 1,751	$ 1,979

During the year ended December 31, 2011, there were no real estate assets measured at fair value on a non-recurring basis.

The Company's estimated fair value was primarily based upon a discounted cash flow analysis and an estimated sales price provided by a third party broker. The discounted cash flow analysis was comprised of unobservable inputs, including internally prepared probability-weighted cash flow estimates, which included estimated future market rental income, property operating expenses, the expected number of months to re-lease the property and estimated tenant improvements, which are all considered Level 3 inputs. In addition, the discounted cash flow analysis utilized observable discount rates and terminal capitalization rates, which were based on available information obtained from third-party service provider reports, which are considered Level 2 inputs.

The following describes the methods the Company uses to estimate the fair value of the Company’s financial assets and liabilities:

Cash and cash equivalents and restricted cash – The Company considers the carrying values of these financial assets to approximate fair value because of the short period of time between their origination and their expected realization.

Mortgage notes receivable – The fair value is estimated by discounting the expected cash flows on the notes at rates at which management believes similar loans would be made as of June 30, 2012 and December 31, 2011. The estimated fair value of these notes was $86.6 million and $85.3 million as of June 30, 2012 and December 31, 2011, respectively, as compared to the carrying value of $75.1 million and $76.7 million as of June 30, 2012 and December 31, 2011, respectively. The fair value of the Company’s mortgage notes receivable is estimated using Level 2 inputs.

Notes payable and line of credit – The fair value is estimated by discounting the expected cash flows based on estimated borrowing rates available to the Company as of June 30, 2012 and December 31, 2011. The estimated fair value of the notes payable and line of credit was $1.8 billion as of June 30, 2012 and December 31, 2011, respectively, as compared to the carrying value of $1.7 billion and $1.8 billion, as of as June 30, 2012 and December 31, 2011, respectively. The fair value of the Company’s notes payable and line of credit is estimated using Level 2 inputs.

Derivative Instruments – The Company’s derivative instruments represent interest rate swaps. All derivative instruments are carried at fair value and are valued using Level 2 inputs. The fair value of these instruments is determined using interest rate market pricing models. The Company includes the impact of credit valuation adjustments on derivative instruments measured at fair value.

Considerable judgment is necessary to develop estimated fair values of financial assets and liabilities. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize, or be liable for, on disposition of the financial assets and liabilities. As of June 30, 2012, there have been no transfers of financial assets or liabilities between levels.

In accordance with the fair value hierarchy described above, the following table shows the fair value of the Company’s financial liabilities that are required to be measured at fair value on a recurring basis as of June 30, 2012 and December 31, 2011(in thousands):

	Balance as of June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swaps	$2,770	$ —	$2,770	$—

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swaps	$3,558	$ —	$3,558	$—

The following table shows a reconciliation of the change in fair value of the Company’s financial assets and liabilities with significant unobservable inputs (Level 3) for the six months ended June 30, 2012 and 2011 (in thousands):

	Six Months Ended June 30,	
	2012	2011
Balance at beginning of period	$—	$81,995
Total gains or losses		
Realized gain included in earnings	—	15,587
Reclassification of previous unrealized gain out of other comprehensive income	—	(14,654)
Unrealized loss included in other comprehensive income	—	(1,713)
Purchases, issuances, settlements, sales and accretion		
Purchases	—	—
Issuances	—	—
Settlements	—	(82,061)
Accretion of discount included in earnings	—	846
Balance at end of period	$—	$—

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COLE CREDIT PROPERTY TRUST II, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS - (Continued)
June 30, 2012

NOTE 4 — INVESTMENT IN DIRECT FINANCING LEASES

The components of investment in direct financing leases as of June 30, 2012 and December 31, 2011 were as follows (in thousands):

	June 30, 2012	December 31, 2011
Minimum lease payments receivable	$20,026	$21,487
Estimated residual value of leased assets	27,854	27,854
Unearned income	(12,398)	(13,342)
Total	$35,482	$35,999

NOTE 5 — REAL ESTATE ACQUISITIONS

2012 Property Acquisitions

The Company made no property acquisitions during the six months ended June 30, 2012.

2011 Property Acquisitions

During the six months ended June 30, 2011, the Company acquired a 100% interest in 24 commercial properties for an aggregate purchase price of $76.9 million (the "2011 Acquisitions"). The Company purchased the 2011 Acquisitions with a combination of proceeds from the DRIP Offering, cash flows from operations and net proceeds from borrowings. The Company allocated the purchase price of the 2011 Acquisitions to the fair value of the assets acquired and liabilities assumed. The following table summarizes the purchase price allocation (in thousands):

	June 30, 2011
Land	$23,208
Building and improvements	41,879
Acquired in-place leases	11,450
Acquired above-market leases	805
Acquired below-market leases	(444)
Total purchase price	$76,898

The Company recorded revenue for the three and six months ended June 30, 2011 of $1.3 million and $1.4 million, respectively, and a net loss for the three and six months ended June 30, 2011 of $1.0 million and $1.2 million, respectively, related to the 2011 Acquisitions. In addition, the Company recorded $2.0 million and $2.3 million of acquisition related expenses for the three and six months ended June 30, 2011, respectively.

2011 Other Investment in Real Estate

During the six months ended June 30, 2011, the Company paid a tenant improvement allowance of $12.0 million for an expansion and improvements to an existing property, including the conversion of an existing warehouse into office space and the construction of a parking area, for which the Company will receive additional rents. Such costs were capitalized to buildings and improvements and will be depreciated over their estimated useful life.

COLE CREDIT PROPERTY TRUST II, INC.

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS - (Continued)

June 30, 2012

NOTE 6 — INVESTMENT IN MORTGAGE NOTES RECEIVABLE

As of June 30, 2012, the Company owned 69 mortgage notes receivable, which were secured by 43 restaurant properties and 26 single-tenant retail properties (each, a “Mortgage Note”, and collectively, the “Mortgage Notes”). As of June 30, 2012, the Mortgage Notes balance of $75.1 million consisted of the face amount of the Mortgage Notes of $69.3 million, a $6.9 million premium, $2.0 million of acquisition costs, and was net of accumulated amortization of premium and acquisition costs of $3.1 million. As of December 31, 2011, the Mortgage Notes balance of $76.7 million consisted of the face amount of the Mortgage Notes of $70.6 million, a $6.9 million premium, $2.0 million of acquisition costs, and was net of accumulated amortization of premium and acquisition costs of $2.8 million. The premium and acquisition costs are amortized into interest income over the term of each Mortgage Note using the effective interest rate method. The Mortgage Notes mature on various dates from August 1, 2020 to January 1, 2021. Interest and principal are due each month at interest rates ranging from 8.60% to 10.47% per annum with a weighted average interest rate of 9.89%. There were no amounts past due as of June 30, 2012.

The Company evaluates the collectability of both interest and principal on each Mortgage Note to determine whether it is collectible, primarily through the evaluation of credit quality indicators, such as underlying collateral and payment history. No impairment losses were recorded related to the Mortgage Notes for the six months ended June 30, 2012 or 2011. In addition, no allowances for uncollectability were recorded related to the Mortgage Notes as of June 30, 2012 or December 31, 2011.

NOTE 7 — MARKETABLE SECURITIES

During the six months ended June 30, 2011, the Company sold all six of its investments in commercial mortgage backed securities (“CMBS”) for $82.1 million, and realized a gain on the sale of $15.6 million. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. The Company had no investments in CMBS as of June 30, 2012.

NOTE 8 — DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

In the normal course of business, the Company uses certain types of derivative instruments for the purpose of managing or hedging its interest rate risks. The following table summarizes the notional amount and fair value of the Company’s derivative instruments (in thousands):

Derivatives designated as hedging instruments	Balance Sheet Location	Notional Amount	Interest Rate	Effective Date	Maturity Date	Fair Value of Liability June 30, 2012	Fair Value of Liability December 31, 2011
Interest Rate Swap	Deferred rental income, derivative and other liabilities	$31,781	6.2%	11/04/2008	10/31/2012	$(359)	$ (869)
Interest Rate Swap	Deferred rental income, derivative and other liabilities	14,847	6.2%	06/12/2009	06/11/2012	—	(172)
Interest Rate Swap	Deferred rental income, derivative and other liabilities	7,037	5.8%	02/20/2009	03/01/2016	(512)	(497)
Interest Rate Swap	Deferred rental income, derivative and other liabilities	30,000	6.0%	11/24/2009	10/16/2012	(124)	(310)
Interest Rate Swap	Deferred rental income, derivative	111,111	4.9%	02/28/2011	11/30/2013	(1,460)	(1,558)

	and other liabilities						
Interest Rate Swap	Deferred rental income, derivative and other liabilities	38,250	3.5%	09/26/2011	09/26/2014	(315)	(152)
		$233,026				$(2,770)	$ (3,558)

Additional disclosures related to the fair value of the Company’s derivative instruments are included in Note 3 to these condensed consolidated unaudited financial statements. The notional amount under the agreements is an indication of the extent of the Company’s involvement in each instrument, but does not represent exposure to credit, interest rate or market risks.

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Accounting for changes in the fair value of a derivative instrument depends on the intended use and designation of the derivative instrument. The Company designated the interest rate swaps as cash flow hedges, to hedge the variability of the anticipated cash flows on its variable rate notes payable. The change in fair value of the effective portion of the derivative instruments that are designated as hedges is recorded in other comprehensive income or loss.

The following table summarizes the unrealized gains and losses on the Company's derivative instruments and hedging activities (in thousands):

	Amount of Gain (Loss) Recognized in Other Comprehensive Income			
	Three Months Ended June 30,		Six Months Ended June 30,	
Derivatives in Cash Flow Hedging Relationships	2012	2011	2012	2011
Interest Rate Swaps [(1)]	$573	$(956)	$788	$(697)

(1) There were no portions of the change in the fair value of the interest rate swap agreements that were considered ineffective during the six months ended June 30, 2012 or 2011. No previously effective portions of losses that were recorded in accumulated other comprehensive loss during the term of the hedging relationship were reclassified into earnings during the six months ended June 30, 2012 or 2011.

The Company has agreements with each of its derivative counterparties that contain a provision whereby, if the Company defaults on certain of its unsecured indebtedness, then the Company could also be declared in default on its derivative obligations resulting in an acceleration of payment. In addition, the Company is exposed to credit risk in the event of non-performance by its derivative counterparties. The Company believes it mitigates its credit risk by entering into agreements with credit-worthy counterparties. The Company records credit risk valuation adjustments on its interest rate swaps based on the respective credit quality of the Company and the counterparty. As of both June 30, 2012 and 2011, there were no termination events or events of default related to the interest rate swaps.

NOTE 9 — NOTES PAYABLE, LINE OF CREDIT AND REPURCHASE AGREEMENT

As of June 30, 2012, the Company had $1.7 billion of debt outstanding, consisting of (1) $1.4 billion in fixed rate mortgage loans (the "Fixed Rate Debt"), (2) $4.3 million in variable rate mortgage loans (the "Variable Rate Debt") and (3) $316.1 million outstanding under a senior unsecured line of credit entered into on December 17, 2010 (the "Credit Facility"). The aggregate balance of gross real estate assets, net of gross intangible lease liabilities, securing the Fixed Rate Debt and the Variable Rate Debt, was $2.5 billion as of June 30, 2012. Additionally, the aggregate balance of gross real estate assets that are part of the Credit Facility's unencumbered borrowing base was $635.4 million. The combined weighted average interest rate was 5.56% and the weighted average years to maturity was 3.82 years as of June 30, 2012.

The Credit Facility and certain notes payable contain customary affirmative, negative and financial covenants, including requirements for minimum net worth and debt service coverage ratios, in addition to limits on the Company's overall leverage ratios and Variable Rate Debt. These agreements also include usual and customary events of default and remedies for facilities of this nature. Based on the Company's analysis and review of its results of operations and financial condition, the Company believes it was in compliance with the covenants of the Credit Facility and such notes payable as of June 30, 2012.

Notes Payable

The Fixed Rate Debt has annual interest rates ranging from 3.52% to 7.22%, with a weighted average annual interest rate of 5.85%, and various maturity dates ranging from August, 2012 through August, 2031. The Variable Rate Debt has an annual interest rate of LIBOR plus 275 basis points, and matures in September, 2014. The notes payable are secured by properties in the portfolio and their related tenant leases, as well as other real estate related assets on which the debt was placed. During the six months ended June 30, 2012, the Company repaid $44.0 million of fixed rate debt, including monthly principal payments on amortizing loans.

Line of Credit

The Credit Facility provides for up to $350.0 million of unsecured borrowings and allows the Company to borrow up to $238.9 million in revolving loans (the “Revolving Loans”) and $111.1 million in a term loan (the “Term Loan”). The Credit Facility matures on December 17, 2013.

During the six months ended June 30, 2012, the Company borrowed $77.0 million and repaid $54.0 million under the Credit Facility. As of June 30, 2012, the Company had $111.1 million outstanding under the Term Loan and an additional $205.0 million in Revolving Loans outstanding. Additionally, the Company has established a letter of credit in the amount of $476,000 from the Credit Facility lenders to support an escrow agreement relating to a certain property with that property's lender. This letter of credit reduces the amount of borrowings available under the Credit Facility. The Company executed an interest rate swap agreement on February 24, 2011, which fixed LIBOR for amounts outstanding under the Term Loan to 1.44%. The all-in rate for the Term Loan includes a spread of 275 to 400 basis points, as determined by the leverage ratio of the Company, which was equal to a spread of 350 basis points as of June 30, 2012. Revolving Loans outstanding as of June 30, 2012 bore interest at a weighted average interest rate of 3.93%.

Repurchase Agreement

Prior to the sale of the Company's investment in CMBS, the CMBS were pledged as collateral to a bank under a repurchase agreement (the "Repurchase Agreement"), which provided secured borrowings. As of June 30, 2012, there were no amounts outstanding or available under the Repurchase Agreement. During the six months ended June 30, 2011, the Company borrowed $10.7 million under the Repurchase Agreement and repaid the total amount outstanding of $65.0 million in connection with the sale of all the Company's investments in CMBS.

NOTE 10 — SUPPLEMENTAL CASH FLOW DISCLOSURES

Supplemental cash flow disclosures for the six months ended June 30, 2012 and 2011 are as follows (in thousands):

	Six Months Ended June 30,	
	2012	2011
Supplemental Disclosures of Non-Cash Investing and Financing Activities		
Distributions declared and unpaid	$10,766	$10,772
Common stock issued through the DRIP Offering	$28,974	$29,947
Net unrealized loss on marketable securities	$—	$(1,713)
Reclassification of unrealized gain on marketable securities into net income	$—	$14,654
Net unrealized gain (loss) on interest rate swaps	$788	$(697)
Accrued capital expenditures	$1,138	$57
Accrued deferred financing costs	$139	$—
Supplemental Cash Flow Disclosures:		
Interest paid	$49,803	$49,085

NOTE 11 — COMMITMENTS AND CONTINGENCIES

Litigation

In the ordinary course of business, the Company may become subject to litigation or claims. The Company is not aware of any pending legal proceedings of which the outcome is reasonably possible to have a material effect on its results of operations, financial condition or liquidity.

Environmental Matters

In connection with the ownership and operation of real estate, the Company potentially may be liable for costs and damages related to environmental matters. The Company owns certain properties that are subject to environmental remediation. In each case, the seller of the property, the tenant of the property and/or another third party has been identified as the responsible party for environmental remediation costs related to the respective property. Additionally, in connection with the purchase of certain of the properties, the respective sellers and/or tenants have indemnified the Company against future remediation costs. In addition, the Company carries environmental liability insurance on its properties that provides limited coverage for remediation liability and pollution liability for third-party bodily injury and property damage claims. The Company does not believe that the environmental matters identified at such properties is reasonably possible to have a material effect on its results of operations, financial condition or liquidity, nor is it aware of any environmental matters at other properties which it believes is reasonably possible to have a material effect on its results of operations, financial condition or liquidity.

NOTE 12 — RELATED-PARTY TRANSACTIONS AND ARRANGEMENTS

The Company has incurred commissions, fees and expenses payable to Cole Advisors II and its affiliates in connection with the Offerings, and has incurred and will continue to incur commissions, fees and expenses in connection with the acquisition, management and sale of the assets of the Company.

DRIP Offering

During the three and six months ended June 30, 2012 and 2011, the Company did not pay any amounts to Cole Advisors II for selling commissions, dealer manager fees, or other organization and offering expense reimbursements incurred in connection with the DRIP Offering.

Acquisitions and Operations

Cole Advisors II or its affiliates receive acquisition and advisory fees of up to 2.0% of the contract purchase price of each asset for the acquisition, development or construction of properties, and are reimbursed for acquisition expenses incurred in the process of acquiring properties, so long as the total acquisition fees and expenses relating to the transaction do not exceed 4.0% of the contract purchase price.

The Company paid, and expects to continue to pay, Cole Advisors II an annualized asset management fee of 0.25% of the aggregate asset value of the Company’s aggregate invested assets, as reasonably estimated by the Company’s board of directors. The Company also reimburses certain costs and expenses incurred by Cole Advisors II in providing asset management services.

The Company paid, and expects to continue to pay, Cole Realty Advisors, Inc. (“Cole Realty Advisors”), its property manager, which is an affiliate of its advisor, up to (1) 2.0% of gross revenues received from the Company’s single tenant properties and (2) 4.0% of gross revenues received from the Company’s multi-tenant properties, plus leasing commissions at prevailing market rates; provided however, that the aggregate of all property management and leasing fees paid to affiliates plus all payments to third parties do not exceed the amount that other nonaffiliated management and leasing companies generally charge for similar services in the same geographic location. Cole Realty Advisors may subcontract certain of its duties for a fee that may be less than the fee provided for in the property management agreement. The Company also reimburses Cole Realty Advisors’ costs of managing and leasing the properties.

The Company will reimburse Cole Advisors II for all expenses it paid or incurred in connection with the services provided to the Company, subject to the limitation that the Company will not reimburse Cole Advisors II for any amount by which its operating expenses (including the asset management fee) at the end of the four preceding fiscal quarters exceeds the greater of (1) 2% of average invested assets, or (2) 25% of net income other than any additions to reserves for depreciation, bad debts or other similar non-cash reserves and excluding any gain from the sale of assets for that period, unless the Company’s independent directors find that a higher level of expense is justified for that year based on unusual and non-recurring factors. The Company will not reimburse Cole Advisors II for personnel costs in connection with services for which Cole Advisors II receives acquisition fees and real estate commissions.

If Cole Advisors II provides services in connection with the origination or refinancing of any debt financing obtained by the Company that is used to acquire properties or to make other permitted investments, or that is assumed, directly or indirectly, in connection with the acquisition of properties, the Company will pay Cole Advisors II or its affiliates a financing coordination fee equal to 1.0% of the amount available under such financing; provided however, that Cole Advisors II or its affiliates shall not be entitled to a financing coordination fee in connection with the refinancing of any loan secured by any particular property that was previously subject to a refinancing in which Cole Advisors II or its affiliates received such a fee. Financing coordination fees payable from loan proceeds from permanent financing are paid to Cole Advisors II or its affiliates as the Company acquires and/or assumes such permanent financing.

The Company recorded fees and expense reimbursements as shown in the table below for services provided by Cole Advisors II and its affiliates related to the services described above during the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Acquisitions and Operations:				
Acquisition and advisory fees and expenses	$—	$1,380	$12	$1,823
Asset management fees and expenses	$2,305	$2,141	$4,598	$4,299
Property management and leasing fees and expenses	$1,894	$1,865	$4,197	$3,969
Operating expenses	$334	$355	$789	$788
Financing coordination fees	$170	$970	$170	$1,081

Liquidation/Listing

If Cole Advisors II or its affiliates provides a substantial amount of services, as determined by the Company's independent directors, in connection with the sale of one or more properties, including those held indirectly through joint ventures, the Company will pay Cole Advisors II up to one-half of the brokerage commission paid, but in no event to exceed an amount equal to 2% of the sales price of each property sold. In no event will the combined real estate commission paid to Cole Advisors II, its affiliates and unaffiliated third parties exceed 6% of the contract sales price.

If the Company's portfolio is liquidated, after investors have received a return of their net capital contributions and an 8% annual cumulative, non-compounded return, then Cole Advisors II is entitled to receive 10% of the remaining net sale proceeds.

If the Company's common stock is listed on a national securities exchange, a fee equal to 10% of the amount by which the market value of the Company's outstanding stock plus all distributions paid by the Company prior to listing, exceeds the sum of the total amount of capital raised from investors and the amount of cash flow necessary to generate an 8% annual cumulative, non-compounded return to investors will be paid to Cole Advisors II.

If the advisory agreement with Cole Advisors II is terminated, other than termination by the Company because of a material breach of the advisory agreement by Cole Advisors II, a performance fee of 10% of the amount, if any, by which (1) the appraised asset value at the time of such termination plus total distributions paid to stockholders through the termination date exceeds (2) the aggregate capital contribution contributed by investors less distributions from sale proceeds plus payment to investors of an 8% annual, cumulative, non-compounded return on capital. No subordinated performance fee will be paid to the extent that the Company has already paid or become obligated to pay Cole Advisors II a subordinated participation in net sale proceeds or the Subordinated Incentive Listing Fee.

During the six months ended June 30, 2012, and 2011, no commissions or fees were incurred for services provided by Cole Advisors II and its affiliates related to the services described above.

Due to Affiliates

As of June 30, 2012 and December 31, 2011, $1.3 million and $1.1 million, respectively, had been incurred, primarily for asset management fees and expenses, general and administrative expenses and finance coordination fees, by Cole Advisors II and its affiliates, but had not yet been reimbursed by the Company and were included in due to affiliates on the condensed consolidated unaudited balance sheets.

NOTE 13 — ECONOMIC DEPENDENCY

Under various agreements, the Company has engaged or will engage Cole Advisors II and its affiliates to provide certain services that are essential to the Company, including asset management services, supervision of the management and leasing of properties owned by the Company, asset acquisition and disposition decisions, the sale of shares of the Company's common stock available for issuance, as well as other administrative responsibilities for the Company, including accounting services and investor relations. As a result of these relationships, the Company is dependent upon Cole Advisors II and its affiliates. In the event that these companies are unable to provide the

Company with these services, the Company would be required to find alternative providers of these services.

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NOTE 14 — INDEPENDENT DIRECTORS' STOCK OPTION PLAN

The Company has a stock option plan, the Independent Director's Stock Option Plan (the "IDSOP"), which authorizes the grant of non-qualified stock options to the Company's independent directors, subject to the discretion of the board of directors and the applicable limitations of the IDSOP. The term of the IDSOP is ten years, at which time any outstanding options will be forfeited. The exercise price for the options granted under the IDSOP was $9.15 per share for 2005 and 2006, and $9.10 per share for 2007, 2008 and 2009. The Company does not intend to continue to grant options under the IDSOP; however, the exercise price for any future options granted under the IDSOP will be at least 100% of the fair market value of the Company's common stock as of the date the option is granted. As of June 30, 2012, the Company had granted options to purchase 50,000 shares under the IDISOP and options to purchase 45,000 shares at a weighted average exercise price of $9.12 per share remained outstanding with a weighted average contractual remaining life of five years. No shares were granted or exercised pursuant to the IDSOP for the three and six months ended June 30, 2012 and 2011. A total of 1,000,000 shares have been authorized and reserved for issuance under the IDSOP.

During the three and six months ended June 30, 2012 and 2011, the Company did not record any stock-based compensation charges, as all stock-based compensation charges related to unvested share-based compensation awards granted under the IDSOP had previously been recognized. Stock-based compensation expense is based on awards ultimately expected to vest and reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company's calculations assume no forfeitures.

NOTE 15 — SUBSEQUENT EVENTS

Issuance of Shares of Common Stock in the DRIP Offering

The Company continues to issue shares of common stock under the DRIP Offering. As of August 13, 2012, the Company had issued approximately 26.9 million shares pursuant to the DRIP Offering, resulting in gross proceeds to the Company of $242.6 million.

Redemption of Shares of Common Stock

Subsequent to June 30, 2012, the Company redeemed approximately 1.5 million shares for $14.3 million at an average price per share of $9.32.

Notes Payable and Line of Credit

Subsequent to June 30, 2012, the Company incurred fixed rate debt of $39.5 million, which bears interest at an annual rate of 3.90% and matures in July 2019. In addition, the Company repaid $12.6 million of fixed rate debt and $16.0 million of the amounts outstanding under the Credit Facility. As of August 13, 2012, the Company had $300.1 million outstanding under the Credit Facility and $49.4 million available for borrowing.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated unaudited financial statements, the notes thereto, and the other unaudited financial data included in this Quarterly Report on Form 10-Q. The following discussion should also be read in conjunction with our audited consolidated financial statements, and the notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2011. The terms “we,” “us,” “our” and the “Company” refer to Cole Credit Property Trust II, Inc. and unless otherwise defined herein, capitalized terms used herein shall have the same meanings as set forth in our condensed consolidated unaudited financial statements and the notes thereto.

Forward-Looking Statements

Except for historical information, this section contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including discussion and analysis of our financial condition and our subsidiaries, our anticipated capital expenditures, amounts of anticipated cash distributions to our stockholders in the future and other matters. These forward-looking statements are not historical facts but are the intent, belief or current expectations of our management based on their knowledge and understanding of our business and industry. Words such as “may,” “will,” “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “would,” “could,” “should words, variations and similar expressions are intended to identify forward-looking statements. All statements not based on historical fact are forward looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or implied in the forward-looking statements. A full discussion of our risk factors may be found under Part I Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. Investors are cautioned not to place undue reliance on forward-looking statements, which reflect our management's view only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. Factors that could cause actual results to differ materially from any forward-looking statements made in this Quarterly Report on Form 10-Q include, among others, changes in general economic conditions, changes in real estate conditions, construction costs that may exceed estimates, construction delays, increases in interest rates, lease-up risks, rent relief, inability to obtain new tenants upon the expiration or termination of existing leases, and the potential need to fund tenant improvements or other capital expenditures out of operating cash flows. The forward-looking statements should be read in light of the risk factors identified in the “Risk Factors” section of our Annual Report on Form 10-K for the year ended December 31, 2011.

Management's discussion and analysis of financial condition and results of operations are based upon our condensed consolidated unaudited financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate these estimates. These estimates are based on management's historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

Overview

We were formed on September 29, 2004 to acquire and operate commercial real estate primarily consisting of freestanding, single-tenant, retail properties net leased to investment grade and other creditworthy tenants located throughout the United States. We commenced our principal operations on September 23, 2005, when we issued the initial 486,000 shares of our common stock in our Initial Offering. We have no paid employees and are externally advised and managed by Cole Advisors II, our advisor. We currently qualify, and intend to continue to elect to qualify, as a REIT for federal income tax purposes.

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Our operating results and cash flows are primarily influenced by rental income from our commercial properties and interest expense on our property indebtedness. Rental and other property income accounted for 93% and 92% of our total revenue for the three and six months ended June 30, 2012, respectively, and accounted for 91% and 89% of our total revenue during the three and six months ended June 30, 2011, respectively. As 96% of our rentable square feet was under lease as of June 30, 2012, with a weighted average remaining lease term of 10.3 years, we believe our exposure to changes in commercial rental rates on our portfolio is substantially mitigated, except for vacancies caused by tenant bankruptcies or other factors. Our advisor regularly monitors the creditworthiness of our tenants by reviewing the tenant's financial results, credit rating agency reports (if any) on the tenant or guarantor, the operating history of the property with such tenant, the tenant's market share and track record within its industry segment, the general health and outlook of the tenant's industry segment, and other information for changes and possible trends. If our advisor identifies significant changes or trends that may adversely affect the creditworthiness of a tenant, it will gather a more in-depth knowledge of the tenant's financial condition and, if necessary, attempt to mitigate the tenant's credit risk by evaluating the possible sale of the property, or identifying a possible replacement tenant should the current tenant fail to perform on the lease.

As of June 30, 2012, the debt leverage ratio of our consolidated real estate assets, which is the ratio of debt to total gross real estate and related assets, net of gross intangible lease liabilities, was 50%, with 12% of the debt, or $209.3 million, including $205.0 million in Revolving Loans outstanding under the Credit Facility, subject to variable interest rates. Should we acquire additional commercial real estate, we will be subject to changes in real estate prices and changes in interest rates on any refinancings or new indebtedness used to acquire the properties. We may manage our risk of changes in real estate prices on future property acquisitions, if any, by entering into purchase agreements and loan commitments simultaneously so that our operating yield is determinable at the time we enter into a purchase agreement, by contracting with developers for future delivery of properties, or by entering into sale-leaseback transactions. We manage our interest rate risk by monitoring the interest rate environment in connection with our future property acquisitions, if any, or upcoming debt maturities to determine the appropriate financing or refinancing terms, which may include fixed rate loans, variable rate loans or interest rate hedges. If we are unable to acquire suitable properties or obtain suitable financing terms for future acquisitions or refinancing, our results of operations may be adversely affected.

Recent Market Conditions and Portfolio Strategies

Beginning in late 2007, domestic and international financial markets experienced significant disruptions that were brought about in large part by challenges in the world-wide banking system. These disruptions severely impacted the availability of credit and contributed to rising costs associated with obtaining credit. Since 2010, the volume of mortgage lending for commercial real estate has been increasing and lending terms have improved and they continue to improve; however, such lending activity continues to be significantly less than previous levels. Although lending market conditions have improved, certain factors continue to negatively affect the lending environment, including the sovereign credit issues of certain countries in the European Union. We have experienced, and may continue to experience, more stringent lending criteria, which may affect our ability to finance certain property acquisitions or refinance our debt at maturity. Additionally, for properties for which we are able to obtain financing, the interest rates and other terms on such loans may be unacceptable. Additionally, if we are able to refinance our existing debt as it matures, it may be at lower leverage levels or at rates and terms which are less favorable than our existing debt or, if we elect to extend the maturity dates of the mortgage notes in accordance with any hyper-amortization provisions, the interest rates charged to us will be higher, each of which may adversely affect our results of operations and the distribution rate we are able to pay to our investors. We have managed, and expect to continue to manage, the current mortgage lending environment by utilizing borrowings on our Credit Facility, and considering alternative lending sources, including the securitization of debt, utilizing fixed rate loans, short-term variable rate loans, assuming existing mortgage loans in connection with property acquisitions, or entering into interest rate lock or swap agreements, or any combination of the foregoing.

The economic downturn led to high unemployment rates and a decline in consumer spending. These economic trends have adversely impacted the retail and real estate markets by causing higher tenant vacancies, declining rental rates and declining property values. In 2011 and the first half of 2012, the economy improved and continues to show signs of recovery. Additionally, the real estate markets have experienced an improvement in property values, occupancy and rental rates; however, in many markets property values, occupancy and rental rates continue to be below those previously experienced before the economic downturn. As of June 30, 2012, 96% of our rentable square feet was under lease. During the three months ended June 30, 2012, our percentage of rentable square feet under lease remained stable. However, if the recent improvements in economic conditions do not continue, we may experience additional vacancies or be required to reduce rental rates on occupied space. Our advisor is actively seeking to lease all of our vacant space, however, as many retailers and other tenants have been delaying or eliminating their store expansion plans, the amount of time required to re-lease a property has increased.

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As a result of these improvements in market conditions, we have been actively evaluating potential strategies to exit our portfolio. Potential exit strategies we are evaluating include, but are not limited to, a sale of the Company or all or a portion of its portfolio, a merger or other business combination, or a listing of the Company's stock on a national securities exchange.

Results of Operations

Our results of operations are influenced by the timing of acquisitions and the operating performance of our real estate investments. The following table shows the property statistics of our consolidated real estate assets as of June 30, 2012 and 2011:

	June 30, 2012	2011
Number of commercial properties	753	749
Approximate rentable square feet [1]	21.2 million	21.0 million
Percentage of rentable square feet leased	96 %	95 %

(1) Including square feet of the buildings on land that are subject to ground leases.

The following table summarizes our consolidated real estate investment activity during the three and six months ended June 30, 2012 and 2011:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Commercial properties acquired	—	22	—	24
Approximate purchase price of acquired properties	$—	$ 68.2 million	$—	$ 76.9 million
Approximate rentable square feet [1]				